GAUHATI UNIVERSITY

COM-3076

Centre for Distance and Online Education

MASTER OF COMMERCE

M.Com. Third Semester

(Under CBCS)

Paper : COM 3076

ETHICS, CORPORATE GOVERNANCE & SUSTAINABILITY

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ISBN: 978-81-992787-5-2

July, 2025

Published on behalf of Gauhati University Centre for Distance and Online Education by the Director, and printed at Gauhati University Press, Guwahati-781014.

CONTENTS

Unit-1
Conceptual Framework of Corporate Governance

Unit Structure:

1.1 Introduction

This unit gives learners a basic understanding of the conceptual framework of corporate governance, focusing on its meaning, significance, and importance in today's business environment. It explains what corporate governance is, how it has evolved over time, and why it is now a critical area in the functioning of businesses and organizations. The unit covers key definitions, principles, models, and regulatory frameworks that shape corporate governance in India and globally. It also highlights the role of corporate governance in promoting transparency, accountability, fairness, and ethical conduct in business activities. By discussing both the benefits and challenges of corporate governance, this unit prepares learners to understand why good governance is essential for sustainable business success.

Corporate governance has become increasingly important in today's competitive and globalized world, where companies are under constant public and regulatory scrutiny. Strong governance practices help companies build trust with shareholders, customers, employees, and society. They reduce the risk of fraud, mismanagement, and corporate scandals, and help companies achieve long-term goals while staying compliant with laws and regulations. The purpose of this unit is to equip learners with the knowledge and skills to understand and apply the basic principles of corporate governance. By the end of the unit, learners will be able to explain the meaning and importance of corporate governance, describe its key elements and models, understand its regulatory framework, and appreciate its role in building ethical and sustainable organizations.

This unit gives an overview of the paper "*Conceptual Framework of Corporate Governance.*" This foundational knowledge will also prepare learners to explore more advanced topics related to corporate governance, ethics, and sustainability in later units.

1.2 Objectives

After going through this unit, you will be able to-

- *know* the meaning of corporate governance and corporate management.
- *understand* the historical background of corporate governance
- *discuss* the need for and principles of corporate governance

1.3 Meaning and Definition of Corporate Governance

In today's world, businesses are not only expected to make profits but also to follow ethical practices, be transparent, and safeguard the interests of all stakeholders. Corporate governance plays a crucial role in achieving this. It provides a framework for companies to conduct business in a fair, responsible, and accountable manner.

Corporate governance refers to the system of rules, practices, and processes by which a company is directed and controlled. It defines the relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance ensures that the company operates in a way that is responsible, ethical, and aligned with the interests of all its stakeholders. It covers areas such as decision-making, accountability, fairness, transparency, and responsibility. Good corporate governance helps companies build trust, improve performance, and maintain long-term sustainability.

Definitions:

- Organisation for Economic Co-operation and Development (OECD): The OECD defines corporate governance as "the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation—such as the board, managers, shareholders, and other stakeholders—and spells out the rules and procedures for making decisions on corporate affairs." This definition highlights the importance of balancing the interests of all parties involved.

- Cadbury Committee (UK, 1992): The Cadbury Committee defined corporate governance as "the system by which companies are directed and controlled." This simple yet powerful definition emphasizes the importance of having an effective framework for managing companies in a responsible manner.

- Securities and Exchange Board of India (SEBI): SEBI describes corporate governance as "the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders." SEBI's definition underlines the duties of management and the board to act as trustees, protecting the interests of shareholders and ensuring accountability.

In India, the meaning of corporate governance has evolved over the years, especially with the growth of the economy and the increasing participation of global investors. Corporate governance in India means following principles of fairness, transparency, accountability, and responsibility in the management of companies. It requires companies to disclose accurate financial information, follow ethical practices, and protect the interests of all stakeholders, including shareholders, employees, customers, suppliers, and society.

The Indian Companies Act, SEBI regulations, Clause 49 of the Listing Agreement (earlier), and now the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, have laid down clear guidelines for corporate governance. In the Indian context, corporate governance also focuses on improving investor confidence, attracting foreign investment, and enhancing the reputation of Indian companies in global markets.

Furthermore, the Indian approach to corporate governance goes beyond mere compliance. It is about promoting ethical conduct, respecting the rights of minority shareholders, ensuring board independence, preventing fraud, and aligning the interests of the company with those of society. In short, corporate governance in

India is seen as a key factor for long-term business success and sustainable development.

1.4: Difference between Corporate Governance and Corporate Management

The word “governance” comes from “govern,” which means to guide or control a group to benefit everyone involved. In a company, governance means setting rules or policies that guide how people should behave and make decisions. For example, a governance rule might say that board members cannot give contracts to their own companies or to companies owned by their family members. Another example is when a company requires two people to sign every cheque in the accounting department, which helps prevent fraud. In short, governance focuses on making sure the company runs fairly, honestly, and in the best interest of all stakeholders.

Whereas, Management refers to the work done by the people who run the company every day to help the business grow and succeed. This includes tasks like making budgets, giving instructions to employees, and planning marketing or product strategies. As a company grows larger, it usually forms a management team because one person (like the founder) can no longer handle everything alone. This team includes people with roles such as department head, director, manager, vice president, chief executive officer (CEO), chief operating officer (COO), and chief financial officer (CFO). In short, management is about running the company smoothly and working toward its goals.

1.5: Evolution and Historical Background of Corporate Governance

Corporate governance has become an important topic for companies, regulators, investors, and society across the world. It refers to the framework of rules, practices, and processes used to direct and control companies. The concept of corporate governance has evolved over time in response to corporate scandals, economic crises, and the need to protect the interests of shareholders and other stakeholders. In this section, we will look at how corporate governance has developed globally and in India, along with some key milestones.

Global Evolution of Corporate Governance: The concept of corporate governance is not new, but its importance has grown significantly over the last few decades. In the early days, companies were mostly family-run, and corporate governance was not a major concern. However, as companies became larger, raised money from the public, and expanded globally, the need for formal rules and accountability increased.

Some Key Phases in the Global Evolution of Corporate Governance

- 1970s–1980s: Focus on protecting shareholder rights: During the 1970s and 1980s, companies around the world started expanding in size and becoming more complex, with ownership often separated from management. Shareholders provided the capital, but managers were making the key decisions. This raised concerns about how well shareholder interests were being protected. As a result, the focus of corporate governance during this time was mainly on ensuring that shareholders' rights were safeguarded and that managers acted in the best interests of the owners. There was growing awareness that without proper governance, managers could misuse company resources or pursue their own interests at the cost of shareholders.

- 1990s: Rise of governance codes after corporate failures: In the 1990s, several high-profile corporate failures—such as the collapse of the Maxwell Group in the UK and the Barings Bank failure—brought governance issues into the spotlight. These failures exposed weaknesses in board oversight, lack of accountability, and poor risk management. In response, countries started introducing corporate governance codes to improve standards and prevent future failures. One of the most influential was the Cadbury Report (1992) in the UK, which laid down best practices for board structure, financial reporting, and internal controls. Other countries followed by developing their own codes, signaling the beginning of a formal governance framework across markets.
- 2000s: Major scandals like Enron, WorldCom, and Tyco shook investor confidence: The early 2000s were marked by some of the most serious corporate scandals in history, including the collapses of Enron, WorldCom, and Tyco in the United States. These companies were involved in massive frauds, accounting manipulation, and unethical practices, leading to huge financial losses for investors and employees. These scandals shattered public trust and exposed serious weaknesses in auditing, financial reporting, and board oversight. As a result, governments responded with strong legal reforms. In the US, the Sarbanes-Oxley Act (2002) introduced strict requirements for internal controls, financial disclosures, auditor independence, and personal accountability of top management. Similar reforms were adopted in other countries, strengthening the global governance framework.

- 2010s onwards: Shift to sustainability, environmental and social responsibility: From the 2010s onwards, the focus of corporate governance began to expand beyond just protecting shareholders. Stakeholders such as employees, customers, suppliers, communities, and the environment became central to the governance conversation. Issues like climate change, human rights, diversity, ethical supply chains, and corporate social responsibility gained importance. Investors and regulators began demanding that companies disclose their Environmental, Social, and Governance (ESG) performance and integrate sustainability into their strategy. Governance codes were updated to include topics like board diversity, stakeholder engagement, and long-term value creation, reflecting a more holistic approach to corporate governance.

Key International Milestones

1. Cadbury Report (UK, 1992): The Cadbury Report is one of the earliest and most influential reports on corporate governance. It focused on the financial aspects of governance, including the role of boards, separation of chairman and CEO roles, and the importance of independent directors. It introduced the principle of "comply or explain," which allows companies some flexibility in applying governance standards.

2. OECD Principles of Corporate Governance (1999, updated 2004, 2015, 2023): The OECD (Organisation for Economic Co-operation and Development) issued globally accepted principles to guide countries and companies on best practices. These principles emphasize the rights of shareholders, equitable treatment, disclosure, transparency, and the responsibilities of the board.

3. Sarbanes-Oxley Act (US, 2002): Following the Enron and WorldCom scandals, the US passed this law to strengthen corporate governance. It imposed strict regulations on financial reporting, internal controls, and the responsibilities of top management. It also increased the penalties for fraud and misconduct.
4. King Reports (South Africa, 1994 onwards): The King Reports on Corporate Governance are a series of influential reports from South Africa that have significantly shaped corporate governance thinking worldwide. The first King Report was released in 1994, and it was followed by updates in King II (2002), King III (2009), and King IV (2016). The reports introduced the concept of "apply and explain" (instead of "comply or explain"), meaning companies are expected to apply good governance principles thoughtfully and explain how they have done so, rather than just ticking boxes. The King Reports also promoted transparency, accountability, ethical leadership, board diversity, and stakeholder inclusiveness. As a result, they have been widely admired and have influenced governance thinking not just in South Africa but around the world.
5. G20/OECD Principles (2015, updated 2023): The G20/OECD Principles of Corporate Governance are considered one of the most important global benchmarks for good governance practices. These principles were first issued in 2015 and were updated in 2023 to reflect the changing global landscape, especially after the lessons learned from the 2008 global financial crisis. The 2008 crisis exposed major weaknesses in corporate governance, such as excessive risk-taking, lack of board oversight, poor disclosure, and short-term thinking by companies and investors. As a result, the G20 and OECD worked together to create guidelines that would help companies

build stronger, more resilient governance systems to avoid similar crises in the future. The principles focus on promoting sustainable economic growth, financial stability, and long-term value creation. They emphasize the importance of companies being accountable not only to shareholders but also to a wide range of stakeholders such as employees, customers, suppliers, creditors, regulators, and society at large.

Evolution of Corporate Governance in India: India's journey in corporate governance began mainly in the 1990s after the liberalization of the economy. As Indian companies accessed global markets, the need for transparency and accountability became critical. Several committees and regulations have shaped India's corporate governance framework:

1. Kumar Mangalam Birla Committee (1999): The Kumar Mangalam Birla Committee was set up by SEBI in 1999 to improve corporate governance in India, especially in listed companies. This committee laid the groundwork for many of the governance standards followed today. It recommended that companies should have independent directors on their boards to bring in impartial oversight. It also suggested setting up audit committees composed mainly of independent directors to oversee financial reporting and internal controls. The committee emphasized the responsibilities of the board of directors and called for improved disclosure practices so that shareholders and investors get timely and reliable information. Most of its recommendations were included in Clause 49 of the Listing Agreement, which became the cornerstone of governance rules for Indian listed companies.

2. Narayana Murthy Committee (2003): The Narayana Murthy Committee, also formed by SEBI, focused on strengthening and fine-tuning the governance framework. It looked particularly at

improving the functioning of audit committees, managing risks effectively, and clarifying the role and responsibilities of independent directors. The committee went a step further by emphasizing that companies should not just follow the rules on paper but should adopt governance practices in spirit. This meant focusing on the true purpose of governance: building trust, accountability, and fairness—not just ticking regulatory checkboxes.

3. J.J. Irani Committee (2005): The J.J. Irani Committee was set up to recommend changes for the upcoming new Companies Act. It focused on issues like defining the role of independent directors, protecting the interests of small shareholders, and improving board processes to make them more effective. The committee's work helped shape modern corporate governance provisions in India, ensuring that companies focus on fairness and transparency while balancing the interests of various stakeholders.

4. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015: These regulations, commonly called the SEBI LODR Regulations, were introduced to consolidate and strengthen the governance requirements for listed companies. They cover several critical areas, including board composition (such as the minimum number of independent directors and women directors), disclosure norms (ensuring timely and accurate information to investors), related party transactions (to avoid conflicts of interest), and the role of audit committees in ensuring financial discipline. The LODR Regulations have provided a uniform and clearer framework for companies to follow.

5. Companies Act, 2013: The Companies Act, 2013 brought a major shift in India's corporate governance landscape. It introduced several new provisions, such as:
    - Mandatory independent directors for certain classes of companies.
    - Formation of audit committees and nomination and remuneration committees to improve board oversight.
    - The introduction of corporate social responsibility (CSR), making it compulsory for large companies to spend a portion of their profits on social welfare activities. The Act aimed to improve accountability, transparency, and corporate responsibility, aligning India with international governance standards.

1.6 The Need for Corporate Governance

The importance of corporate governance has grown in recent times due to several key factors:

- Wide Spread of Shareholders: Today, companies have a large number of shareholders spread across the country and even around the world. Most of these shareholders are scattered and often show little interest in the day-to-day affairs of the company. Although the law and company rules (Articles of Association) talk about shareholder democracy, this idea needs to be put into practice through a proper system of corporate governance that protects their interests.
- Changing Ownership Structure: The ownership pattern of companies has changed a lot over the years. Today, institutional investors—both Indian and foreign—along with mutual funds, hold significant shares in large private sector companies. These

powerful investors have raised the standards and put pressure on company management to follow good governance practices. To maintain their reputation and trust in society, companies are now expected to follow proper corporate governance norms.

- Corporate Scams or Scandals : In recent years, various corporate scams and frauds have shaken public trust in companies. A well-known example is the Harshad Mehta scandal, which still serves as a reminder of the risks in the corporate world. Such events have made it even more necessary to have strong corporate governance systems to restore and maintain investor confidence, which is essential for economic growth and the overall development of society.
- Greater Expectations from Society: Today's society has much higher expectations from the corporate sector. People want companies to offer fair prices, provide better-quality products, control pollution, and use resources efficiently. To meet these social expectations, companies need to follow a clear code of corporate governance that ensures they are managed not just for profit but also in a responsible and sustainable manner.
- Hostile Takeovers: In many countries, we have seen examples of hostile takeovers, where companies are taken over against the wishes of their existing management. Such takeovers raise serious questions about how well the management of these companies was functioning. This situation shows the need for a strong system of corporate governance, with clear rules to ensure that management acts efficiently and responsibly.
- Huge Increase in Top Management Compensation: In both developed and developing countries, the salaries and compensation packages of top corporate executives have increased significantly. In many cases, these extremely high

payments are difficult to justify, especially since corporate funds ultimately belong to the shareholders and, in a way, to society as well. This situation underlines the need for corporate governance to keep management practices in check and prevent misuse of company resources.

- Globalisation: As more and more Indian companies aim to get listed on international stock exchanges, the importance of corporate governance has only grown. In today's world, corporate governance has become a key focus area in the business world. International investors and capital markets trust and support companies that are well-managed and follow globally accepted standards of governance.

1.7 Principles and Core Elements of Corporate Governance

- **Transparency**: Transparency means that a company shares relevant, accurate, and timely information with its stakeholders, including shareholders, employees, customers, and regulators. This includes financial reports, operational updates, and any major decisions or risks facing the business. When a company is transparent, it reduces uncertainty and builds trust, as stakeholders feel informed and confident in the company's actions. Transparency also helps prevent rumors, misinformation, and suspicion, which can harm the company's reputation and market value.
- **Accountability**: Accountability refers to the obligation of the board of directors, management, and employees to take responsibility for their actions and decisions. It means they are answerable to shareholders, regulators, and the public for how they manage the company's resources and fulfill their duties. Good corporate governance ensures that there are clear roles and

responsibilities, so when something goes wrong, it is easy to identify who is responsible and take corrective action. Accountability encourages ethical behavior, improves decision-making, and reduces the chances of mismanagement or fraud.

- **Fairness**: Fairness is about treating all stakeholders—especially shareholders, employees, customers, and suppliers—equally and justly. This means protecting the rights of minority shareholders, offering equal opportunities to employees, providing quality products to customers, and dealing fairly with suppliers and partners. Fair corporate governance ensures that no group is given unfair advantage over another and that everyone has a fair chance to participate in and benefit from the company's success.
- **Responsibility**: Responsibility means that companies should act in the best interest of all stakeholders, not just focus on short-term profits. This includes following laws and regulations, managing risks carefully, protecting the environment, and contributing positively to society. Boards and management have the responsibility to make decisions that ensure the long-term success and sustainability of the company. Responsible companies also establish clear policies for social responsibility, environmental care, and ethical behavior.
- **Ethical Conduct**: Ethical conduct is at the heart of good corporate governance. It means acting with integrity, honesty, and fairness in all business activities and decisions. Ethical companies follow not only the letter of the law but also its spirit, ensuring that their actions reflect high moral standards. This builds trust with stakeholders, strengthens the company's reputation, and reduces the risk of legal or financial penalties. Promoting an ethical culture within the organization encourages employees to do the right thing, even when no one is watching.

1.8 Models of Corporate Governance

The models of corporate governance are discussed below

- **Anglo-American Model**: The Anglo-American model is mainly followed in countries like the United States, the United Kingdom, Canada, and Australia. This model focuses on shareholder primacy, meaning the main goal of the company is to maximize shareholder value. The board of directors plays a central role, and there is usually a clear separation between the roles of the chairman (who leads the board) and the CEO (who leads the company). The market plays an important role in monitoring companies — for example, through share price movements and the threat of takeover if management underperforms. Shareholders have the power to vote on important matters, and disclosure requirements are strong, ensuring transparency.
- **German Model**: The German model is practiced mainly in Germany and some other European countries. It is known for its two-tier board structure:

The management board (Vorstand), which handles day-to-day operations.

The supervisory board (Aufsichtsrat), which oversees and monitors the management board.

Another key feature is co-determination, where employees have representation on the supervisory board. Banks and other financial institutions often hold significant stakes and play a major role in governance. This model balances the interests of shareholders, employees, and other stakeholders, focusing not only on profits but also on long-term stability.

- **Japanese Model**: The Japanese model emphasizes group-based governance, where companies are often part of a large business group called a keiretsu. In this system, companies hold shares in each other, and banks play a central role as both lenders and shareholders. Corporate governance focuses on building long-term relationships, stability, and mutual support rather than short-term profit. Employees also play an important role, as Japanese companies traditionally offer lifetime employment, creating a strong bond between management and workers. Boards often include insider managers, and external shareholder influence has historically been limited, though this has been changing over time.
- **Indian Model**: The Indian model is a hybrid system, influenced by both the Anglo-American and German/Japanese approaches. India has adopted several governance features from the Anglo-American system, such as independent directors, audit committees, and disclosure requirements, especially after the economic liberalization in the 1990s. However, family-owned businesses, promoter control, and group structures play a major role, similar to Japanese keiretsu or German cross-shareholding patterns. Regulatory bodies like SEBI and laws like the Companies Act, 2013 guide governance practices. Indian governance is evolving, with an increasing focus on transparency, accountability, and stakeholder interests.

Check Your Progress

1. What is corporate governance?
2. Give one key difference between corporate governance and corporate management.

3. Name one factor that influenced the evolution of corporate governance.
4. Why is corporate governance needed?
5. State one core principle of corporate governance.
6. Mention one model of corporate governance.

1.9 Regulatory Framework for Corporate Governance in India

Corporate governance in India has developed over time through a strong legal and regulatory framework that guides how companies should be managed and controlled. This framework ensures that companies work in a fair, transparent, and accountable manner, protecting the interests of shareholders, employees, customers, and the larger society. The main pillars of this framework include the Companies Act, 2013, SEBI (LODR) Regulations, and the roles played by the Ministry of Corporate Affairs (MCA), Securities and Exchange Board of India (SEBI), and stock exchanges. Various enactments and amendments in the said Acts, have significantly strengthened governance standards and increased accountability through disclosures. For example:

- The Companies Act, 2013 which has replaced the earlier Companies Act of 1956 covers laws relating to board composition, board meetings, independent directors, general meetings, related party transactions, financial statement disclosure obligations, and so on. The Act provides more opportunities for new entrepreneurs and enables wide application of Information Technology in the conduct of affairs by corporations.

- The Securities and Exchange Board of India (SEBI) is a regulatory body that oversees listed firms and publishes rules to guarantee that investors are protected.
- Companies whose shares are listed on stock exchanges are bound by the Standard Listing Agreement of Stock Exchanges. This agreement defines the rules, processes, and disclosures that companies must follow to remain as listed entities.
- The Institute of Chartered Accountants of India (ICAI) is an autonomous body, which issues accounting standards, provides guidelines for disclosures of financial information.
- The Institute of Company Secretaries of India (ICSI) is a self-governing group that establishes secretarial standards in accordance with the New Companies Act.

Let us discuss some of the important elements of the framework:

Companies Act, 2013: The Companies Act, 2013 is the foundation of corporate governance in India. It replaced the older Companies Act of 1956 and introduced many new provisions to improve governance standards. Some of the key features include the requirement for appointing independent directors on the board, setting up audit committees, and creating nomination and remuneration committees. The Act also introduced provisions on corporate social responsibility (CSR), making it mandatory for certain companies to spend a portion of their profits on social welfare activities. Additionally, it emphasizes timely disclosure of financial and operational information to ensure transparency. Overall, the Companies Act aims to make company boards more accountable and to protect the rights of all stakeholders.

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR)

SEBI is the main regulator of the securities market in India, and its **LODR Regulations, 2015** provide detailed governance guidelines for listed companies. These regulations cover important areas like board composition (including the presence of independent and women directors), disclosure of material events, related party transactions, quarterly financial reporting, and the functioning of the audit committee. The purpose of the LODR Regulations is to promote transparency, protect investor interests, and ensure that companies follow high governance standards. If companies fail to comply, they can face penalties, suspension from stock exchanges, or other regulatory actions.

Role of Ministry of Corporate Affairs, SEBI, and Stock Exchanges: The Ministry of Corporate Affairs (MCA) is responsible for the administration of corporate laws in India, including the Companies Act. It frames rules and guidelines, registers companies, and monitors compliance. The MCA also promotes good corporate practices through various notifications and amendments from time to time.

SEBI, as mentioned earlier, plays a crucial role in regulating the securities market. It ensures that listed companies follow fair practices, protect investor rights, and maintain market integrity. SEBI has the power to investigate, impose penalties, and issue guidelines to improve corporate governance in India.

Stock exchanges like the BSE (Bombay Stock Exchange) and NSE (National Stock Exchange) are also important players in the governance framework. They enforce compliance by monitoring whether listed companies are meeting SEBI's regulations and the listing agreement. Exchanges can issue notices, impose fines, or even delist companies that violate governance norms.

1.10 Benefits of Good Corporate Governance

Good corporate governance plays a crucial role in the success and long-term health of a company. It goes beyond just following rules — it helps build trust, ensures fairness, improves performance, and strengthens relationships with all stakeholders. Below are some key benefits of good corporate governance explained in simple language.

Improved Operational Performance: Good corporate governance improves how efficiently a company operates. When there are clear policies, proper checks and balances, and strong oversight by the board, the management can focus better on running the business smoothly. Good governance ensures that resources are used wisely, decisions are made in the company's best interest, and unnecessary costs are avoided. For example, well-run companies often have stronger internal controls, which reduces the chances of fraud or wastage. This leads to higher productivity and better financial results. Ultimately, when a company is well-governed, it is more likely to perform better in terms of profitability and growth.

Better Stakeholder Relationships: A company does not work in isolation — it has many stakeholders, including shareholders, employees, customers, suppliers, lenders, and the community. Good corporate governance ensures that the rights and interests of all these groups are respected. It promotes open communication and fair treatment, which helps build stronger and more positive relationships. For example, when a company regularly updates its shareholders about business performance or when it treats its employees fairly, it earns their trust and loyalty. This creates a positive work environment, improves customer satisfaction, and strengthens partnerships with suppliers. As a result, the company becomes more stable and resilient.

Risk Management and Compliance: Every business faces some level of risk — whether it's financial risk, market risk, legal risk, or reputational risk. Good governance plays a key role in identifying, managing, and minimizing these risks. It ensures that companies follow all legal and regulatory requirements, reducing the chances of facing penalties or legal actions. Well-governed companies often have risk management committees and systems in place to monitor potential issues before they become major problems. For example, strong governance can help a company avoid accounting scandals, environmental violations, or unethical practices. This protects the company's reputation and keeps it in good standing with regulators and the public.

Long-term Sustainability: One of the most important benefits of good corporate governance is that it helps ensure the long-term sustainability of the business. Rather than focusing only on short-term profits, good governance encourages companies to think about their future — how they can grow responsibly, take care of the environment, and contribute to society. This focus on sustainability helps companies attract long-term investors, retain top talent, and stay competitive in the market. For instance, companies that prioritize environmental, social, and governance (ESG) practices are often seen as more responsible and forward-looking, which benefits them in the long run.

1.11 Challenges and Issues in Corporate Governance

Corporate governance faces several challenges, both in India and across the world. While many countries have made progress by improving laws and regulations, practical problems still remain. Let's look at some key challenges that companies and regulators face today.

Board Independence: One of the most common challenges is ensuring the independence of the board of directors. A company's board is supposed to oversee the management and protect the interests of shareholders and other stakeholders. However, in many cases, boards include friends, family members, or loyal associates of the promoters or management. This weakens the board's ability to question decisions or hold management accountable. Independent directors, who are expected to bring an unbiased view, sometimes lack the authority, information, or willingness to challenge management. Ensuring true board independence is still a work in progress in many companies around the world, including in India.

Executive Compensation: Another big challenge is the issue of executive compensation, especially for top-level managers like CEOs and CFOs. In many companies, executive salaries, bonuses, and stock options have reached very high levels, sometimes without a clear connection to company performance. This creates a gap between the pay of top executives and that of ordinary employees, which can lead to dissatisfaction within the company and criticism from the public. There is also concern that excessive focus on short-term profits to boost bonuses can hurt long-term company goals. Balancing fair executive pay with company performance and shareholder expectations is a difficult but important challenge.

Shareholder Activism: Shareholder activism has become more common, where large shareholders, including institutional investors, demand changes in management decisions, strategy, or governance practices. While activism can push companies to improve, it can also create tensions between management and shareholders, especially when the demands are aggressive or short-term-focused.

In India, shareholder activism is still developing but growing rapidly, with investors pushing for better governance, higher returns, or changes in leadership. Managing activism effectively, without ignoring small shareholders or the long-term health of the company, is a delicate balancing act.

Other Common Challenges: Apart from these, companies also face challenges like improving transparency, managing related-party transactions (where companies do business with relatives or linked firms), ensuring timely disclosures, and dealing with regulatory complexities. Globally, issues like environmental, social, and governance (ESG) expectations are adding new pressures on companies to act responsibly beyond just financial performance. In India, governance issues sometimes also include promoter dominance, weak enforcement of rules, and a lack of awareness among small investors.

Check Your Progress

1. Name a key regulatory body for corporate governance in India.
2. State one benefit of good corporate governance.
3. Mention one challenge faced in corporate governance.
4. Name one emerging trend in corporate governance

1.12 Emerging Trends and Future of Corporate Governance: Corporate governance is evolving rapidly to keep up with the changes in technology, global business, and social expectations. Let’s explore some important trends shaping its future.

Digital Governance and Technology Impact: Technology is transforming how companies are governed. With the rise of digital tools, data analytics, artificial intelligence (AI), and cloud computing, boards and management now have better access to real-time information on company performance, risks, and operations. Digital governance means using technology to improve decision-making, transparency, and communication between the board, management, and stakeholders. For example, online board meetings, electronic voting, and automated compliance systems are making governance more efficient and inclusive. However, this also brings challenges, such as cyber security risks, data privacy concerns, and the need to train board members in digital skills.

ESG (Environmental, Social, and Governance) Integration: Another key trend is the growing importance of ESG factors in corporate governance. Investors, customers, and regulators now expect companies to not only focus on profits but also on their environmental and social responsibilities. Companies are being assessed on how they handle issues like climate change, diversity and inclusion, human rights, and ethical conduct. Good governance today means overseeing ESG risks and opportunities, setting clear ESG goals, and disclosing progress transparently. Boards are increasingly expected to integrate ESG into strategy and risk management, making it a central part of the company's long-term success.

Global Convergence of Governance Standards: As businesses become more global, there is a growing effort to align governance practices and standards across countries. International organizations like the OECD, G20, and World Bank are encouraging common governance principles that promote accountability, fairness, and transparency. Multinational companies and investors want clear, comparable governance practices worldwide, so they can assess risks and opportunities across different markets. This global convergence is helping improve governance in developing countries and creating a level playing field, but it also challenges companies to comply with multiple regulatory frameworks and cultural expectations.

1.13 Summing Up

Corporate governance refers to the system, principles, and processes by which a company is directed and controlled to achieve its objectives, ensure accountability, and protect the interests of stakeholders like shareholders, employees, customers, and society. It differs from corporate management, which focuses more on day-to-day operations, while governance deals with setting policies, ensuring ethical conduct, and overseeing performance. The concept of corporate governance has evolved over time, shaped by economic, legal, and social developments around the world. In India, its importance grew after several corporate scandals, making it clear that companies need to follow transparent and fair practices.

The need for corporate governance arises from the increasing separation between ownership and management, where shareholders depend on management to act in their best interests. Good governance builds trust, ensures compliance with laws, and improves a company's reputation. Principles like fairness, accountability, transparency, and responsibility form the foundation of corporate governance, while models like the Anglo-American and German/Japanese systems show how it operates in different countries. In India, the regulatory framework includes laws, guidelines, and bodies like SEBI, the Companies Act, and Clause 49. Good corporate governance offers many benefits, such as better access to capital, improved performance, and enhanced investor confidence. However, companies face challenges like balancing stakeholder interests, adapting to global standards, and addressing ethical issues. With changing business landscapes, emerging trends like ESG (Environmental, Social, Governance) reporting, digital governance, and stakeholder activism are shaping the future of corporate governance, making it even more important for companies to stay committed to responsible and sustainable practices.

1.14: Model Questions:

1. Define corporate governance and explain its meaning with examples.
2. Discuss the key differences between corporate governance and corporate management.
3. Trace the historical evolution and background of corporate governance in the global and Indian context.
4. Explain the need for corporate governance in today's business environment.
5. Describe the principles and core elements that form the foundation of corporate governance.
6. Discuss the major models of corporate governance practiced around the world.
7. Outline the regulatory framework for corporate governance in India, mentioning key laws and institutions.
8. What are the major benefits of implementing good corporate governance in an organization?
9. Discuss the main challenges and issues faced in ensuring good corporate governance.
10. Examine the emerging trends and predict the future direction of corporate governance.

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Unit-2

Principles of Corporate Governance, Management and Corporate Governance

Unit Structure:

2.1 Introduction

Corporate governance is related to practices as well as the processes and rules that the management has to follow. It has a critical role in ensuring that there is accountability, and fairness, and which is also known as transparency throughout the relations between the Company and its stakeholders such as shareholders, employees, customers, suppliers, the society as well as the entire economy. Corporate governance has to achieve a proper balance between social and economic goals and between individual and community concerns, or in other words, it has to provide a formal description of the top management's accountability.

The scope of corporate governance is shaped by external and internal factors like the legal and the regulatory systems, the market, value systems of society and the internal policies of an organization. All these factors individually or collectively influence the manner in which a corporation structures its governance processes and makes strategic decisions. Corporate governance norms of ethics and conduct compliance transparency accountability independence fairness and social responsibility are necessary for the business to be legal compliant based and ethical and socially sustainable in the long run.

In this case, management and corporate governance go together. Management is supposed to act within the parameters set out by the governing body of an organization. As such, corporate governance provides the structure for the organization with respect to direction, accountability, and strategic oversight, which relies upon the executive management to carry out on organizational strategies.

2.2 Objectives

After going through this unit, you shall be able to

- *explain* the concept of corporate governance,
- *describes* the core principles of corporate governance,
- *explains* the relationship between management and corporate governance.

2.3 Corporate Governance

Corporate governance is the system by which a company is directed and controlled. It is a combination of rules that guarantee accountability, transparency, and fairness between the shareholders and the rest of the stakeholders, such as management, customers, suppliers, regulators, and community at large.

Good corporate governance facilitates the making of logical and ethical choices, fosters compliance with laws and regulations, boosts investor confidence, and undertakes business risks. It also builds business credibility, manages risks, nurtures the stakeholder's rights, and encourages long-term prosperity of the business.

The broad principles of corporate governance rest on transparency, accountability, fairness, and overarching responsibility. These are achieved through an independent board of directors, adequate reporting, promotion of shareholders rights, and general compliance to good ethical business conduct.

In India, corporate governance is intensively improving its reputation after the liberalization of its economy in 1991. The establishment of regulatory frameworks like SEBI (Securities and Exchange Board of India) and the Companies Act 2013 enhanced the windows for better governance practices. The establishment of independent directors and audit committees, along with CSR governance, further improved governance. The context of Corporate Governance encompasses issues affecting the governance structure and practices of an organization, such as its efficiency. These issues are internal and external to the organization. They include legal and regulatory issues, cultural, economic, and institutional factors where a firm operates, and internal policies and procedures that control stakeholder interactions and decision making.

2.4 Elements of the Corporate Governance Environment:

1. External Environment:

- Legal and Regulatory Framework: Legislation, regulations and rules in business conduct such as company laws, securities laws, and stock exchange regulations.
- Market Conditions: Business cycles, competition, and expectations of the investing community.
- Social and Cultural Norms: Norm and ethics and values that impact governance policies of a corporation.
- Institutional Framework: The supply of and demand for compliance and transparent governance from regulators, stock exchanges, and rating agencies.

2. Internal Environment:

- Board Structure and Composition: The existence of independent directors and other board features that promote or hinder governance.
- Policies and Procedures: Internal controls and risk management systems and ethical conduct of business governing the corporation.
- Ownership structure: It details the composition of shares held by institutional investors, retail investors and family members.
- Corporate Culture: The values and practices of the organization that guides decisions and ethical behaviour.

The context of corporate governance affects the efficiency of governance practices, stakeholder confidence, and the company's sustainability.

2.5 Principles of Corporate Governance

1. Accountability: This principle of accountability is critical in corporate governance requiring the board of directors, general executive, and management to account for their decisions, activities taken, and overall performance of the company. This principle enables an organization to operate in a responsible and accountable manner while serving the interests of shareholders and stakeholders. In terms of corporate governance accountability refers to the obligation to explain decisions and actions taken to the shareholders of the company and to the employees, customers, suppliers, regulators, and the general public.
2. Transparency: In corporate governance, transparency is about the ability of a firm's stakeholders to receive timely and full disclosure regarding the operations, financial standing, strategic initiatives and key decisions of the firm. It guarantees that every concerned party is able to receive adequate information in order to make appropriate decisions. Transparency fosters trust, improves responsibility, and encourages ethical business conduct. Transparency is essential to achieve legal compliance and is equally important to the organization's culture of integrity and justice.
3. Independence: Effective corporate governance requires independence at the firm's top management level, specifically, the Board of Directors need to be members of a strong impartial non-partisan body, so that all corporate decisions are made with sound business judgement. In the absence of unilateral control at a company, good corporate governance is but a dream. Independence in corporate governance relates to the absence of control over the board of directors or other governing bodies by internal and external entities. This principle, designed to eliminate

personal, political, or other interests which conflict with optimal decision making, is aimed at the company and its stakeholders.

4. Fairness: Fairness in business management and set-up focuses on everyone getting an equal opportunity. This principle put across the concept of equity whereby the decisions made by the board of directors and management are fair and balanced. Fairness serves to ensure that no group of stakeholders is over favoured or discriminated against, and in an overall objective support participation, accountability, ethicality, and transparency in the organizational decision-making processes.

5. Social responsibility: Responsibilities that entail social dimensions of various management activities is one aspect of corporate governance that every company has to deal with. This concept believe that business should not just aim at getting maximum returns for shareholders but should also consider the employees, customers, suppliers, and other stakeholders like the community and the environment. This principle stands to advocate for the application of ethical, social, and environmentally sustainable practices in the governance of a corporation. By applying ethical, sustainable, and stakeholder centric approaches to corporate governance, the reputation of the business improves, potential risks are reduced, and the business makes positive contributions to the society at large.

Stop to Consider

Corporate governance principles guarantee that companies are run ethically, transparently, and responsibly. Accountability insists that the leaders give justifications for decisions and actions to the stakeholders. Transparency guarantees timely and truthful sharing of financials and strategies, thus creating confidence. Independence guarantees impartial decision-making by the board without coercion. Fairness guarantees equity by treating all stakeholders with justice and non-discrimination. Finally, social responsibility encourages businesses to exceed profits, relating to environmental, social, and community issues. Collectively, these standards promote good governance, ethical practice, and long-term sustainability, protecting and advancing the interests of shareholders and wider society.

Check Your Progress

1.Define corporate governance.

2.Explain the principles of corporate governance.

Self-Asking Questions

1.Do you think corporate governance is more important for large corporations than for small businesses? Give reasons.

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2. Do you think lack of transparency and accountability can lead to a corporate crisis? Provide reasons with examples.

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2.6 Management and Corporate Governance

The performance and sustainability of any organization greatly relies on the relationship between management and corporate governance.

Their relationship stems from the fact that corporate governance provides the scope within which management operates and ensures that there is accountability, transparency, and ethical conduct in the attainment of organizational goals. Together, they form a comprehensive structure that serves to balance the needs of all stakeholders, integrates strategic goals with operational activities, and ensures compliance with legal and ethical standards. Corporate governance encompasses the policies and procedures that control the decision-making processes within the business. It aims at protecting the interests of every stakeholder such as shareholders, employees, customers, and the community by ensuring that the business is operated in a socially responsible manner. It gives consequences to the issues of role allocation governance and defines the place of the board of directors and top management in the control and strategic direction of the organization to facilitate accountability. It stipulates the culture, values, and purposes for which the organization exists.

On the other hand, management is concerned with the implementation of the policies and the daily management functions. It entails planning, organizing, leading, and controlling resources to implement the objectives specified by the governance framework. Management makes certain that as decisions are made, they are implemented in the most effective and efficient way while ensuring that the outcome is in line with the organization's vision and ethics. It links the overarching purpose provided by the board of directors with the operational activities within the organization.

The relationship between management with corporate governance is defined through several critical dimensions. First, governance outlines the major strategic goals of the organization, and the management is tasked with devising ways to achieve these goals. The board of directors may determine sustainability to be a key organizational goal, and in turn, management would enact policies such as substantial investment in carbon emission minimalizing, extensive use of renewables, or sustainable supply chain management to achieve that goal.

Second, corporate governance ensures that stakeholders are able to assess the value created and the resources used by the Management was putting in. This is done by forwarding relevant information using regular reports and performance review audits. Management is accountable to the board of directors who makes sure the decisions undertaken are in line with the ethical and legal framework set for the organization. Let us consider the case of financial reports prepared by management. The board needs to review them to check if everything is in their proper place and meets the set regulations.

The third one is that the governance structures outline ethical principles and compliance obligations that constrain management action. It is management's responsibility to integrate these principles into the culture and practices of the organization. For example, if the governance framework includes a policy against corruption, it is the responsibility of management to facilitate compliance by enforcing training programs, internal controls, and reporting systems.

A further important consideration of this relationship is the risk management. Corporate governance describes the organization's strategy to comprehend and contain risks as well as the management responsibilities for execution. Such parameters as risk appetite may be set by the board which in turn may limit the scope of decisions made by management in regard to operational activities like investments or expansion.

Finally, stakeholder confidence and satisfaction are the last element that corporate governance and management need to work of hand in hand. Governance tries to reconcile and protect the objectives of different stakeholders while management deals with them on the operational level. For instance, if governance allocates a lot of attention to employees' welfare, management may be able to issue policies like flexible working hours.

To sum up, the interplay between management and corporate governance system is one of interdependence and joint effort. Governance has the overarching principles, monitoring, and responsibility functions, while management implements the plans and facilitates operational success. This collaboration guarantees that the organization behaves and functions ethically, realizes its goals, and remains adaptive within a transformational business landscape. In the absence of good governance, management becomes unaccountable and directionless. On the other hand, ineffective management renders governance incapable of accomplishing its aims. They work hand-in-hand to foster enduring sustainable growth of the organization while enhancing stakeholder confidence.

2.7 Challenges to Management and Corporate Governance

1. Globalization and Competition: Globalization is perhaps the biggest test of corporate management and governance. Organizations are global today, and there is a host of varying regulatory environments, cultural differences, and competitive forces from multinational companies. Management needs to keep changing plans to suit various international markets, and boards need to make governance mechanisms adaptable to fit cross-border complexities. It is a delicate balancing act of global standardization without local responsiveness that not all companies perform in a positive way.

2. Technological Disruption: Speeded-up technological revolutions have transformed business operations. Automation, artificial intelligence, big data, and blockchain have transformed decision-

making, operations, and customer relationships. The revolution, though, demands new capabilities, vision, and ethical leadership. From a governance perspective, maintaining data privacy, cybersecurity, and ethical use of AI is a key challenge. Boards are still predominantly short of board members with the technological acumen to perform these critical roles, altering the innovation-governance gap. New abilities, vision, and ethical leadership are needed to oversee this revolution.

3. Regulatory Compliance and Changing Laws: Corporate governance structures have to evolve continuously according to evolving legal and regulatory needs. Disclosures, board structure, corporate social responsibility, environmental footprint, and financial integrity remain subject to evolving legislation. Management can struggle to remain compliant while running an efficient firm. Governance institutions, however, have to effectively interpret and apply such laws to avoid fines, damage to reputation, and erosion of stakeholder confidence. Even accidental non-compliance can carry heavy costs in a global economy.

4. Ethical Leadership and Matters of Integrity: Integrity of leadership remains at the centre of governance and management effectiveness. Ethical issues like corruption, insider trading, conflict of interest, and accounting manipulations persist. Boards have the responsibility to uphold integrity but encounter obstacles in enforcing ethical requirements. Whistleblower procedures, transparency, and internal controls can help, but only when combined with a strong ethical culture in the organization. Governance failure in the majority of cases is not due to a lack of systems but due to a lack of moral courage and accountability.

5. Board Composition and Effectiveness: The quality of a company's board is crucial to sound governance. There are

challenges in achieving the right balance of skills, experience, independence, and diversity, though. Insiders or long-serving board members dominate boards in most organizations and are not objective enough in their examination. Gender, age, and experience diversity undermine the board's ability to appreciate issues of larger stakeholders. Additionally, passive or symbolic boards rubber-stamping management choices undermine the very purpose of corporate governance.

6. Stakeholder Expectations and Activism: Business today is not only accountable to shareholders but also to a wider group of stakeholders like employees, customers, communities, and the environment. Profit interests have to be balanced by management with social and environmental responsibilities. Stakeholder activism, especially by institutional investors, environment activists, and NGOs, is playing a growing role in shaping governance policies. Boards are being nudged to comply with Environmental, Social, and Governance (ESG) norms, and failure to succumb to these pressures may result in boycotts, lawsuits, or divestment campaigns.
7. Short-Termism vs Long-Term Value: One of the largest governance challenges is the tendency to prioritize short-term results over long-term sustainability. This is frequently prompted by pressure from investors, the media, and performance-driver incentives. Management groups will occasionally make choices that optimize quarter-by-quarter results but compromise innovation, employee well-being, or environmental sustainability. Boards need to resist these pressures and ensure the strategic plan aligns with the production of long-term value. Maintaining short-term financial performance with longer-term strategies requires strong leadership and vision.

8. Crisis Management and Risk Oversight: Uncertain crises such as pandemics, economic recession, cyberattacks, and geopolitical tensions test the resilience of management and governance structures. Many businesses are surprised when these crises occur. Crisis management not only needs operational responses but also strong governance structures for risk identification, risk mitigation, and recovery. Boards must actively engage in risk oversight, while management must adapt contingency planning and stress-testing structures for continuity.
9. Corporate Culture and Internal Controls: A company's culture is one way of expressing its values and assumptions, and can have a profound influence on both management behaviour and governance outcomes. Where the culture is closed, risk-taking, or fear-based, the best-designed systems of governance can be worthless. Developing an open, learning, and responsible culture is a formidable challenge. Internal controls, codes of conduct, and training programs must be embedded in day-to-day work and not pay lip-service. Culture audits and board-level discussions with employees can provide useful pointers to the organization's real ethical climate.
10. Absence of Training and Sensitization on Governance: There is a general deficiency of good governance principle awareness among the majority of managers and even a few board members. Governance is usually misperceived as a bureaucratic formality in small businesses and family businesses. Such ignorance generates resistance to change, poor board compositions, and suboptimal strategic direction. Enhancing governance learning, leadership development, and ongoing board training can fill this gap and improve decision-making at every level.

Stop to Consider

The interaction between corporate governance and management is essential for the success and longevity of an organization. Corporate governance lays down the policy framework of values and ethical codes of conduct, which directs management in decision-making and instils accountability and transparency. Management then executes these policies by planning, organizing, and controlling day-to-day activities. Governance specifies strategic objectives, whereas management operates them efficiently and responsibly. Their partnership ensures compliance, risk management, stakeholder satisfaction, and ethical behaviour. Together, they balance the shareholders', employees', customers', and community interests to maintain long-term growth and trust. In the absence of effective governance or management, success in an organization is not possible.

2.8 Best Practices for Effective Management and Corporate Governance

To improve the efficiency of management and corporate governance, organizations should:

i. Establish a Strong Ethical Culture: Encourage integrity, accountability, and transparency at all levels of the organization.

ii. Ensure Board Independence and Diversity: A balanced board with independent members can enhance decision-making and reduce conflicts of interest.

iii. Strengthen Internal Controls and Audits: Ensure that appropriate measures in the financial management framework and periodic audit assessment exist to contain the threat of fraud and mismanagement.

iv. Improve Stakeholder Communication: Keep lines of communication to shareholders, employees, and regulatory bodies open and transparent to build trust within those groups.

v. Adapt to Changes in the Business Regulatory Environment and Technology: Regularly monitor and adopt any industry regulations or technology changes if you want to remain in line.

vi. Implement Risk Management Strategies: Uncover risks and determine what actions will be taken through a risk management framework to minimize operational and financial risks.

vii. Encourage Corporate Social Responsibility (CSR): Embed CSR initiatives within business strategies in order to enhance brand perception and the extent of stakeholder engagement.

viii. Promote Leadership Development: Promote and administer training programs designed to develop leaders in making ethical decisions and good governance. Promote long-term sustainability: Embody the sustainable practices of business, which ushers' profitability, social, and environmental responsibility.

Check Your Progress

3. Explain the relationship of corporate Governance and management.
4. What are the different challenges in corporate governance and management.

Self-Asking Questions

3. Do you think good management guarantees good corporate governance all by itself? Why or why not?

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4. Do you think that aligning management incentives with governance goals can provide an improved ethical framework for firms?

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2.9 Summing Up

- Corporate governance is a set of rules, procedures, and processes that direct and manage a company's operations. It provides a framework for attaining a company's goals while balancing the interests of numerous stakeholders, such as shareholders, management, consumers, suppliers, financiers, the government, and the community.

- Accountability, openness, fairness, and responsibility are core elements of effective corporate governance. Accountability ensures that management is responsible to stakeholders. Transparency requires the transparent and accurate disclosure of financial and operational performance. Fairness ensures that all shareholders are treated equally, whereas accountability focuses on ethical corporate practices and regulatory compliance.

- Management plays an important role in corporate governance by enforcing policies and maintaining operational efficiency. The board of directors, CEOs, and other leaders collaborate to match business objectives with stakeholder interests. The board supervises management, ensuring that strategic decisions are consistent with legal and ethical norms.
- Good corporate governance boosts investor trust, improves financial stability, and reduces the dangers of fraud and mismanagement. Companies with excellent governance systems perform better, attract more investment, and achieve long-term viability. As business settings change, governance procedures must adapt to meet new problems, such as technological improvements and legal changes.

2.10 Model Questions

1. What is corporate governance and why is it necessary in modern businesses?
2. What techniques can organizations use to enhance their corporate governance frameworks?
3. Outline the fundamental principles of corporate governance and how they support ethical practices in business.
4. Describe why transparency is important for investor confidence.

2.11 Answers to Model Questions

1. Corporate governance is the term used to describe the guidelines, practices, and processes by which a company is directed and controlled. Corporate governance promotes transparency, accountability, and fairness in a company's relationships with its

various stakeholders, leading to a successful company advantageous to all stakeholders in the long term.

2. Technological independent boards, improved transparency, implementing ethical leaders or leadership and regulatory best practice.
3. The fundamental principles consist of accountability, transparency, fairness and responsibility. These principles help avoid fraud, safeguard stakeholders' interests, and promote long-term sustainability of the or
4. Transparency fosters trust through disclosure of financial statements, governance principles, and risk reviews timely based on circumstances. Transparency fosters sense of certainty to investors. Transparency is essential to achieve legal compliance and is equally important to the organization’s culture of integrity and justice.

2.12 Answers to Check Your Progress

1. Corporate governance is the system by which a company is directed and controlled. It is a combination of rules that guarantee accountability, transparency, and fairness between the shareholders and the rest of the stakeholders, such as management, customers, suppliers, regulators, and community at large.
2. The principles include accountability, transparency, fairness, and social responsibility.
3. The performance and sustainability of any organization greatly relies on the relationship between management and corporate governance. Their relationship stems from the fact that corporate governance provides the scope within which management

operates and ensures that there is accountability, transparency, and ethical conduct in the attainment of organizational goals. Together, they form a comprehensive structure that serves to balance the needs of all stakeholders, integrates strategic goals with operational activities, and ensures compliance with legal and ethical standards

4. Implementation of Management and Governance by the corporate management is faced with-these organizational matters such as Conflict of Interests, Fraud and Corruption, Scandals inside the corporation, Technological advancements, etc.

2.13 Answers to Self-Asking Questions

1. Although large businesses have a larger number of stakeholders, they are accountable to and have more governance scrutiny, small businesses can also benefit from better governance. Thinking about governance sooner rather than later can help build trust with stakeholders, find potential investors, and grow the business in a responsible manner, among other things. Better governance matters for businesses of all sizes, with the area of governance being a matter of scale and complexity.

2. A lack of transparency and accountability can lead to some of the most significant failures of governance, as we saw with the Enron example. Lack of independence within the organization, improper reporting of financial information, and processes that did not have sufficient transparency fostered a system that allowed for continued growth and deceptive practices regarding transparency and the real financial condition of the corporation. Ultimately this led to the bankruptcy of the corporation, the destruction of trust from investors, and the implementation of legislation such as the Sarbanes-Oxley Act.

3. Effective management is important, but good governance requires much more to make it effective, including the function of independent oversight, clear and enforceable policies, and stakeholder engagement including a commitment to legal compliance. Governance structures support management and other management functions by providing a framework for ethical behaviour, as well as accountability, thereby operating within ethical boundaries and appropriate accountability to stakeholders.
4. Yes, to the extent that when management performance rewards are linked to ethical behaviour, transparency, and long-term performance, management is more likely to act in the interests of the company and its stakeholders, as that improves governance as well.

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Unit-3

Theories of Corporate Governance

Unit Structure:

3.1 Introduction

The foundation of organisational management is corporate governance, which includes the values and procedures that direct choices, guarantee responsibility, and protect the interests of stakeholders. Corporate Governance is a set of rules and laws for how a company is governed. Fundamentally, corporate governance acts as a lighthouse for moral and sensible business practices. Businesses can cultivate a culture of honesty, trust, and moral behaviour among staff members at all levels by coordinating corporate governance with organisational culture and ethics. Furthermore, building mutual trust and long-term value creation requires acknowledging stakeholders' rights and involving them in decision-making processes. Organisations can adopt best practices and successfully adjust to their particular settings by using governance frameworks and models, which offer platforms for putting governance concepts into practice.

However, there are obstacles to applying governance principles to international operations, such as cultural disparities, complicated regulations, and differing stakeholder expectations. Businesses may improve their governance procedures and gain the confidence of stakeholders around the world by tackling these issues with diligence and flexibility.

3.2 Objectives

By going through this unit, you will be able to:

- *understand* the basic principles of governance,
- *identify* the challenges of implementing the governance principles,
- *know* the theories of corporate governance.

3.3 Key Governance Principles

A company's direction and control are shaped by its corporate governance. At every level, its tenets direct behaviour and decision-making. Effective governance is built on the foundations of accountability, responsibility, transparency, and fairness. Each is essential to maintaining stakeholder trust and business integrity. A framework for efficient corporate governance is provided by a set of rules and guidelines known as corporate governance principles. These guidelines are intended to encourage openness, responsibility, equity, and responsible decision-making in businesses. The following are widely accepted corporate governance principles, but specifics may differ based on the country and industry:

1. **Transparency:** A fundamental tenet of corporate governance is transparency. Businesses should disclose pertinent information to stakeholders and shareholders in a timely, accurate, and clear manner. It assists interested parties in making wise choices. Sharing accomplishments is only one aspect of transparency; another is being open about difficulties to enable genuine stakeholder participation. Financial reporting, executive pay, linked party transactions, and any other significant information that could influence stakeholders' choices are all included in this.
2. **Accountability:** Accountability links deeds to results. This implies that leaders have to respond to enquiries concerning their choices, actions, and results. This idea promotes a culture of trust by guaranteeing an open line of accountability within the business.
3. **Responsibility:** Being responsible entails recognising how the business affects both the internal and external environments. It's about making choices that benefit society as a whole as well as the business. The long-term effects of business decisions are taken into account by responsible governance.
4. **Fairness:** Equitable treatment is the essence of fairness. Regardless of their amount of interest or investment, all stakeholders should be given equal treatment. Within the business framework, this principle promotes a sense of equity and justice. All stakeholders, including shareholders, employees, clients, suppliers, and the local community, should be treated fairly and equally under corporate governance. This entails keeping stakeholders' rights safe, preventing conflicts of interest, and granting equal access to information.
5. **Board effectiveness:** In terms of corporate governance, the board of directors is essential. The significance of an efficient

and impartial board that oversees, establishes strategic direction, and protects shareholders' interests is emphasised by corporate governance principles. To make wise judgements, the board should be independent, diverse, and skilled.

6. **Safeguarding shareholder rights:** The goal of corporate governance is to safeguard the interests of shareholders while acknowledging their rights. This involves making certain that shareholders receive a just return on their investment, have the ability to vote, and take part in important decisions. Access to timely and accurate information about the company should also be available to shareholders.
7. **Risk management and Internal controls:** Principles of corporate governance emphasise the significance of efficient internal control and risk management. To protect stakeholders' interests, organisations should recognise, evaluate, and control risks. To guarantee the accuracy of financial reporting and adherence to legal requirements, internal control mechanisms had to be established.
8. **Stakeholder engagement:** One of the most important corporate governance principles is stakeholder engagement. Employers, consumers, suppliers, and the local community are just a few of the stakeholders that businesses should set up systems to communicate with and listen to. Decision-making procedures should take stakeholder viewpoints into account.
9. **Independence:** The board of directors must continue to operate independently of management in order to provide objective supervision for corporate governance to be effective. The interests of all parties involved, not just the CEOs or majority shareholders, can be taken into account thanks to independent directors.

10. **Prioritizing collective interests:** Priority should be given to the organization's overall objectives, and all staff members must cooperate to achieve this common objective. Disregarding personal interests, however, can be difficult, therefore leaders must resolve conflicts skilfully and openly when addressing staff issues.

11. **Integrity and ethical behaviour:** Companies ought to maintain the highest moral standards and encourage an honest culture across the board. This entails behaving honourably, openly, and in the stakeholders' best interests. Directors, executives, and staff members at all organisational levels should all exhibit ethical behaviour.

These guidelines serve as the cornerstone of efficient corporate governance procedures. Companies and countries may create unique rules, regulations, and practices that are suited to their unique needs and setting, even though they are only meant to be broad suggestions. Establishing a governance framework that encourages ethical, sustainable, and responsible business activities is the aim.

Check Your Progress

Q.1 Which principle of corporate governance emphasises the access of timely and accurate information about the company by the shareholders?

3.4 Challenges in Implementing Governance Principles across Global Operations

There are particular difficulties in applying governance concepts to international businesses. Multinational corporations function within a variety of regulatory, cultural, and legal contexts. It is difficult to establish uniform governance procedures across the globe because of these variances. The following discusses some of the difficulties that organisations encounter when attempting to uniformly apply governance concepts across their international operations:

1. Governance practices are impacted by cultural diversity. Corporate governance is influenced by local cultural norms and values. What one culture views as responsible or fair may not be the same in another. While adhering to fundamental governance principles, businesses must acknowledge these cultural variances. This calls for developing governance procedures with tact and adaptability.
2. Disparities in laws and regulations present a big obstacle. Every nation has its own corporate governance laws and rules. To maintain compliance, multinational corporations need to manage these complications. This necessitates a thorough comprehension of local laws and frequently modifying governing systems in accordance with them.
3. Coordination and communication on a global scale present additional difficulties. Effective communication is necessary to guarantee that governance policies are comprehended and applied uniformly throughout international operations. This endeavour may be hampered by time zone and language obstacles. Regular training and technology can be beneficial, but they come with a high cost.
4. Another level of complication is introduced by operational variety. The operating procedures and risk profiles of various business units may differ. It is difficult to apply consistent governance rules that work well for these various operations. While maintaining general consistency with corporate

principles, businesses must modify their governance procedures to meet the unique requirements of each operation.

5. It is also difficult to keep an eye on compliance across international operations. Businesses need to set up reliable systems to keep an eye on adherence to governance procedures. This frequently combines central monitoring with local supervision. The goal is to quickly detect and resolve non-compliance problems, which can require a lot of resources.
6. It might be difficult to adjust to change. Global operations need to be flexible enough to adjust to changes in business strategy, local legislation, and market conditions. This calls for a strong yet adaptable governing structure. To stay current and useful, businesses must constantly review and improve their governance procedures.

CASE

Context: A pioneer in the field of renewable energy, Greene Power took great satisfaction in its dedication to sustainability and corporate social responsibility. But, especially in its international activities, it had trouble bringing its governance procedures into line with its professed corporate culture and ideals.

Challenge: Due to the business's quick global expansion, disparities in the application of its governance principles in various geographical areas were discovered, which affected stakeholder involvement and would have compromised its standing as a responsible and equitable corporation.

Action taken: A thorough examination of the organization's governance structures and frameworks was started by the board of directors and the CEO. Transparency, accountability, fairness, and responsibility are the core governance principles that they aimed to incorporate into all facets of the business's operations and make sure were represented in the company's ethical standards and corporate culture.

Result: Greene Power reinforced its dedication to corporate sustainability and social responsibility by updating its governance frameworks to prioritise stakeholder rights and involvement. The company's performance and reputation in the international market were boosted by the increased trust and participation of stakeholders brought about by this convergence of corporate culture and governance.

Reflection: This situation demonstrates how important governance principles are in forming business ethics and culture. Greene Power created an industry standard by demonstrating the value of governance in accomplishing company sustainability and social responsibility objectives by coordinating its governance procedures with its ethical convictions.

Check Your Progress

Q2. Does language impact the implementation of corporate governance in an organisation?

3.5 Management and Corporate Governance

In the modern corporate milieu, governance and management indicates two critical concepts that play distinct yet interconnected roles. While governance refers to the act of creating and preserving the framework, procedures, rules, and structures that direct the strategic direction, accountability, and decision-making of an organisation, management comprises carrying out daily tasks, allocating resources, and putting plans into action in order to accomplish particular goals and provide value to stakeholders. In order to create and accomplish organisational goals, governance entails outlining the roles and duties of important stakeholders, including the board of directors, executive leadership, shareholders, and regulatory agencies. To guarantee effective and efficient performance, management on the other hand consists of duties like organising, planning, leading, and managing people, processes, and resources inside the company.

Do you think governance and management can be used interchangeably in an organisational set-up?

Example of Corporate Governance

Board of Directors: The board of directors plays a central role in governance, providing strategic guidance, oversight, and accountability to shareholders and other stakeholders. Boards establish governance policies, appoint executive leadership, and monitor organizational performance.

Corporate Governance Codes: Many organizations adhere to corporate governance codes, which provide guidelines and best practices for governance, including board composition, transparency, and shareholder rights.

The Coca-Cola Company adheres to robust governance practices, with a board of directors responsible for setting strategic direction, overseeing financial performance, and ensuring compliance with legal and regulatory requirements. The company's governance framework includes committees focused on audit, compensation, and corporate responsibility, ensuring comprehensive oversight and accountability.

3.5.1 Key differences between management and governance

Despite their close relationship, management and governance have different roles in organisations. Clarity, accountability, and efficacy in organisational decision-making and operations depend on an understanding of the distinctions between governance and management. Some of the key differences between governance and management can be understood as shown in Table 1 below:

Table 1: Difference between Governance and Management

Basis of difference	**Governance**	**Management**
Focal point	It emphasises on establishing the whole organization's strategic direction, framework, and supervision. It covers broad topics pertaining to stakeholder interests, vision, and values.	It lays emphasis on carrying out the strategic direction provided by governance, attending to particular tasks, initiatives, and operations in order to accomplish specific goals within predetermined bounds.
Duration	It usually takes a long-term view, anticipating the organization's long-term viability and future course.	It frequently works on shorter schedules, concentrating on urgent priorities, objectives, and operational tasks to satisfy needs and goals at the moment.

Decision making	It involves the board of directors, executive leadership, and other governance bodies having high-level decision-making authority.	It involves giving managers and supervisors who are in charge of daily operations and procedures the authority to make operational decisions.
Accountability and oversight	It places a strong emphasis on accountability for reaching predetermined performance objectives, targets, and results within predetermined timeframes and resource limitations.	It places a strong emphasis on taking responsibility for reaching predetermined performance objectives, targets, and results within predetermined timeframes and resource limitations.

Check Your Progress

Q3. How does the issue of long term viability of an organisation distinguish the concept of management from governance?

Example of Management

Project Management: Project management methodologies, enable organizations to plan, execute, and control projects effectively, ensuring timely delivery of products and services while managing risks and resources.

Performance Management: Performance management systems establish goals, measure progress, and provide feedback to employees, aligning individual and team performance with organizational objectives and facilitating professional development and growth.

Apple Inc. exemplifies effective management practices, with a leadership team responsible for executing the company's strategic vision, launching innovative products and services, and driving operational excellence. Apple's management emphasizes a customer-centric approach, product quality, and design innovation, leading to sustained growth and market leadership.

Thus to summarise, corporate governance is primarily about protecting a business, while management is more about growing it. Corporate governance establishes the framework for company policies and decision-making, while corporate management implements these decisions through daily operational activities. Both are integral elements to effectively run an organisation.

3.6 Theories of Corporate Governance

Theories of corporate governance describe who controls the company and how it has structured and managed itself to guarantee transparency and accountability. We can better understand how executives, board members, and stakeholders make decisions by using corporate governance theories. Corporate policy and strategy are impacted by various governance models, such as the stewardship theory, stakeholder theory, and agency theory of corporate governance. Sound governance encourages moral decision-making, sound financial management, and long-term company expansion.

Agency Theory: is one of the foundational concepts in corporate governance. It explains the relationship between the owners of a company (the principals, typically shareholders) and the managers (the agents) who are hired to run the company on their behalf.

Key Concepts:

- Principal-Agent Relationship:
- The principal delegates decision-making authority to the agent.
- In corporations, shareholders (principals) hire managers (agents) to operate the business.

Agency Theory plays a crucial role in shaping corporate governance practices by highlighting the potential conflicts between shareholders and managers. While it offers valuable insights into control and incentive mechanisms, it should be complemented with other theories (like stakeholder or stewardship theory) for a more balanced and ethical approach to governance.

According to agency theory, managers (agents) and shareholders (principals) have a direct relationship. It suggests that managers' agency issues are a factor in the fact that they may not always speak up for shareholders; instead, they may occasionally agree and occasionally disagree, which leads us to their other interests. Businesses use audits and performance-based incentives to ensure that managers work toward the objectives of the company and shareholders. The goal of this theory is to lessen the disputes between ownership and management. It emphasizes financial transparency, management accountability, and executive compensation. However, it contains distinctions that could be harmful because it assumes that managers are always acting in their own best interests and fail to acknowledge the social and ethical responsibilities of organizations in governance. The distribution of power between executives and shareholders is a crucial component of this strategy.

Stewardship theory

Stewardship theory is a business model that positions company executives as responsible guardians of the organizations they lead, with a primary focus on acting in the best interests of shareholders. Unlike agency theory, which emphasizes the need for oversight to align the interests of executives (agents) and shareholders (principals), stewardship theory assumes that executives will prioritize the welfare of the company and its stakeholders without self-serving motives. This perspective fosters an environment where company leaders are viewed as stewards who manage resources diligently and ethically.

In practice, organizations adhering to stewardship theory often have a board of directors comprised of internal members, reflecting the belief that leadership will inherently act in shareholders' interests. Companies employing this model may also embrace purposes beyond mere profit, such as ethical labor practices, environmental sustainability, or social justice, making them attractive to stakeholders who share these values. This alignment can lead to greater loyalty among employees and customers, who may choose to support a company that aligns with their ethical beliefs. However, businesses must maintain transparency and consistency in their actions to bolster credibility, as any disconnect between stated values and practices can erode stakeholder trust.

The stewardship theory prioritizes the interests of shareholders, which is similar to the agency theory. Nevertheless, this theory also makes the assumption that the individuals in charge of the company's leadership will behave responsibly. Someone who looks after something for someone else is called a steward. This something could be a business, a home, or another kind of asset or property. Despite not actually owning the asset, the steward takes care of and protects it as though they did. When it comes to a business, this entails doing everything in your power to safeguard its assets and expand them as much as you can. Even if it goes against their own best interests, a good steward will also act in the best interests of others. A board of directors may also be present in a business that follows the stewardship theory. These directors, however, are typically internal to the company, in contrast to one that employs the agency theory. In the stewardship theory, the organization or company is assumed to be responsible.

Stakeholder Theory

The Stakeholder Theory states that companies need to take into consideration all parties involved, not just shareholders. Customers, suppliers, workers, and the environment are all included. According to this theory, in order to provide long-term value for all stakeholders, businesses prioritize CSR, moral decision-making, and sustainable business practices. It promotes a balance between financial equity and social responsibility. It makes companies profitable and holds them responsible to society. However, because of the varied interests of stakeholders, this can be challenging for many businesses. Sometimes, maximizing shareholder wealth may clash with business choices that have a direct positive impact on society. It is therefore impossible to equally satisfy every group.

According to Gilbert and Rasche (2008), stakeholder theory explains how organizations truly consider stakeholder interest. The theory explains the people who are impacted by a company's operations and how they affect the company's business goals. Across numerous disciplines, the stakeholder concept has a long history (Richter and Dow, 2017). The stakeholders were divided into three categories by Fassin (2009): real stakeholders, stakewatchers, and stakekeepers. In addition to having a legitimate claim, authority, and influence, the true stakeholders have a real stake in the business, and the company owes them obligation and morality. In order to safeguard the interests of actual stakeholders, the stakewatchers serve as proxies or middlemen rather than having a genuine stake themselves. They serve as a watchdog and are made up of various associations that defend the rights of shareholders, the environment, and consumers. Their power stems from their representation of actual stakeholders' interests.

Taking care of the interests of the people who control the company is not the corporation's duty, authority, or moral obligation. Governments, courts, regulatory bodies, the media, and the press are examples of independent regulators who are considered stakeholder. Despite not owning any shares in the company, they enforce certain external controls and regulations on it. Gatekeepers are what they do. Although they are completely independent of the company, they have the ability to impose obligations both externally and indirectly. Concerning stakeholders, the company bears no accountability. Regulatory bodies, governments, courts, and the media can all be regarded as stakeholders (Fassin, 2009). In stakeholder theory, stakeholder relations are crucial (Hatami and Firoozi, 2019). According to stakeholder theory, if a company provides value to society, especially in sustainability projects and activities, the public will support it. Therefore, the focal business's primary responsibility is to coordinate value creation for and with stakeholders.

Stop to Consider

Leadership as Stewardship

According to stewardship theory, effective leadership embodies the values of resource guardianship for the long-term prosperity of the company, going beyond simple authority. Executives are seen as stewards dedicated to sustainability, achieving organizational objectives, and adding value for stakeholders. Stewardship is positioned as a framework that emphasizes intrinsic motivation over extrinsic controls, which stands in stark contrast to agency theory's transactional model of incentivized leadership. 2 This concept has been further developed in recent studies, which emphasize how stewardship-oriented leadership promotes moral decision-making and sustained organizational resilience.

Resource Dependence Theory

Businesses require outside resources to expand and thrive in the market, according to the resource dependence theory. For their survival, businesses rely on investors, suppliers, and governmental regulations. In an increasingly competitive marketplace, they are in charge of securing the resources and forming alliances that will enable their companies to thrive. Organizations focus on connections and relationships with the experts who can help them, according to this theory. Alliances facilitate efficient resource access for businesses. This theory overlooks internal elements like leadership and company culture because it is overly preoccupied with external factors. Additionally, it assumes that companies are incapable of effectively managing external risks.

Resource Dependence Theory (RDT) looks at how an organization's strategy and behavior are affected by its reliance on outside resources. It implies that businesses are open systems that are always interacting with and relying on their surroundings for essential resources like capital, talent, and raw materials. As organizations work to manage these dependencies and ensure they have access to the resources they need, power dynamics are created.

Managerial hegemony theory

According to the managerial hegemony theory, management—especially senior executives—effectively controls and influences the board of directors and other governing bodies in many contemporary corporations, thereby controlling the decision-making process. Because of this dominance, the board may end up acting as a "rubber stamp" for managerial decisions even though it is supposed to be in charge of monitoring management.

The idea of managerial hegemony originated with the work of sociologists and economists who noticed that ownership and control in big businesses were becoming increasingly separated. John Kenneth Galbraith, for example, emphasized in his writings the influence of the managerial class, or "technostructure". Boards frequently rely heavily on information provided by management, which may result in a lack of independent oversight, according to additional research, such as that conducted by Miles Mace.

The theory of managerial hegemony has important ramifications for corporate governance, implying that conventional forms of board supervision might not be adequate to handle possible abuses of authority by management. Critics contend that it may result in decisions that put management's interests ahead of accountability and could be detrimental. Though some contend that boards are growing more active and effective in their oversight role, the theory is not widely accepted.

3.7 Models of Corporate Governance

There are many types of corporate governance that a company might follow. Some use a traditional hierarchical leadership structure, and others are more flexible. Different corporate governance models may be found throughout the world. Here are a few of them.

The Anglo-American Model

This model has several variations (the Political Model, Stewardship Model, and Shareholder Model), but the shareholder model is currently dominant. Under the Shareholder Model, management reports to both the board of directors and shareholders. Although acknowledged as stakeholders, employees and vendors are powerless; management is responsible for managing the business to maximize shareholder interest. The model recognizes that shareholders put money into the business and can withdraw it if they are unhappy, which will motivate management to be efficient. The typical board comprises a combination of inside and independent members. Although the CEO and the chairperson of the board can often be the same person, this model seeks to have two different people fill those positions.

The Continental Model

The Continental Model has two groups representing the governing authority: the management board and the supervisory board, with the latter consisting of outsiders such as union representatives and shareholders (representatives from banks that own stock in a company may also be on the supervisory board), whereas the first tier consists of executives and other company insiders. The size of the supervisory board is determined by national laws and cannot be changed by shareholders; corporations are therefore heavily influenced by national interests under this model, which assumes that businesses will support governmental goals. Stakeholder involvement is also highly valued in this model, as it can assist and even strengthen a business in its ongoing operations.

The Japanese Model

The key players in the Japanese Model of corporate governance are:

- Banks
- Affiliated entities
- Management
- The government
- Major shareholders, known as Keiretsu, who may be invested in common companies or have trading relationships

Smaller, independent, individual shareholders have no role or voice in this model. Together, these key players establish and control corporate governance.

The board of directors is usually made up of insiders, including company executives. Keiretsu may remove directors from the board if profits wane. The government affects the activities of corporate management via its regulations and policies.

In this model, corporate transparency is less likely because of the concentration of power and the focus on the interests of those with that power.

3.8 Summing Up

The guiding principles that govern how systems or organisations are run are referred to as governance. Transparency, accountability, equity, independence, fairness, efficiency and effectiveness, ethics, and responsibility are among the fundamental concepts. Both the public and private sectors make decisions based on these values, which promote sustainability and ethics.

Nevertheless, there are many obstacles to overcome when putting governance concepts into practice, including conflicting rules and regulations, limited resources, political and cultural hurdles, communication difficulties, change management problems, and the complexity of globalisation. Fair, efficient, and inclusive governance is frequently thwarted by these barriers.

Stakeholder interests, organisational objectives, and leadership tactics are all intertwined by management and corporate governance dynamics. In order to strike a balance between immediate efficiency and long-term sustainability, management concentrates on strategic planning, leadership philosophies, and performance evaluation. On the other hand, corporate governance uses tools like boards of directors, audits, and compliance systems to make sure businesses act morally and in the best interests of their shareholders. It increases organisational sustainability, reduces legal risks, and fosters trust.

Ultimately, upholding moral principles, encouraging diversity, and promoting long-term success in all organisations depend heavily on governance and management dynamics.

3.9 Model Questions

i. Discuss the key governance principles that guide effective decision making in organisations.

ii. Explain the challenges of implementing governance principles across a global platform for corporations.

iii. Discuss the dynamics of management and governance in the context of modern corporate milieu.

iv. Discuss the significant differences between governance and management with suitable examples.

v. Explain the concept of corporate governance and its relationship with management.

3.10 Answers to Check Your Progress:

Question 1:

Safeguarding shareholder rights.

Question 2:

Coordination and communication on global scale present governance with difficulties due to the diversity of languages spoken. Effective communication is necessary to guarantee that governance policies are comprehended and applied uniformly throughout international operations. Language obstacles and time zone differences complicate the purpose of governance.

Question 3:

The long-term viability of an organisation is indicative of its future concern which is the area of governance, thus distinguishing the concept of management from it which take a comparatively short run perspective concentrating on urgent priorities, objectives, and operational tasks to satisfy needs and goals at the moment.

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Note: Latest edition of text books may be used.

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Unit-4

Art of Governance as per Kautilya's Arthashastra

Unit Structure:

4.1 Introduction

Arthashastra is the popular Indian manual on the art of politics attributed to Kautilya, the prime minister to the emperor Chandragupta, founder of the Mauryan dynasty. Kautilya, also known as Chanakya, was an eminent scholar and a master statesman with a clear vision of the future. Considered as a treatise, it discusses the structure of the state economy, the selection of ministers, the conduct of war, and the distribution and arrangement of taxes. Arthashastra reflects the science of material prosperity, believed to be one of the primary goals of human life. The word Arthashastra is derived from Sanskrit where 'Artha' refers to wealth, prosperity, or material well-being, while 'Shastra' means treatise or science. Thus, Arthashastra can be translated as "the science of material well-being" or "treatise on economics and statecraft."

4.2 Objectives

After going through this unit on Kautilya's Arthashastra, you will be able to:

- *know* about the popular Indian treatise on economics and politics known as Arthashastra,
- *understand* the views of Kautilya in regard to polity, economy and society,
- *explain* the significant aspects of the Arthashastra in the context of governance today.

4.3 *Saptang* Model of Governance

The *Saptang* model of governance proposed by Kautilya in Arthashastra, has seven constituents such as, *Swami* - the King, *Amatya* - the minister, *Janapada* - the country, *Durg* - the fortified city (robust infrastructure), *Kosha* - the treasury, *Danda* - the army and *Mitra* - the ally. The diversity of institutions and players participating in the governing process is acknowledged by this model, which is also a fundamental aspect of the contemporary idea of governance. A detailed view on this model is presented as below:

a) *Swami:* The most significant player is the *Swami*, or contemporary leader. It is expected of the leader to take direct and indirect responsibility for all of his choices and actions. The first sign of successful administration is that the ruler must be held accountable to his people and should give up his own identity in the service of his duty. Max Weber's theory of rational authority, which is represented by a depersonalised bureaucracy, resonates with Kautilya's idea. For Kautilya's king, it is considered appropriate to employ the phrase "constitutional slave," similar to a concept in England in the late seventeenth century.

b) *Amatya*: The *Amatya*, or elected ministers or appointed bureaucrats, are the second significant actor in the *Saptang* paradigm. In order to fulfil the promises of good governance, these individuals who are in charge of carrying out the administrative duties must be extremely competent and efficient. This guarantees the administration's quality as well. They also represent government machinery and are given various tasks by Kautilya.

c) *Janapada*: *Janapada* is the model's third limb. The *Janapada*'s organisational structure is explained in detail in the Arthashastra. In order to guarantee public engagement in the government process, which starts at the grassroots level, the modern paradigm of governance envisions a participatory *Janapada* and supports increased localisation and decentralisation of powers. Actually, there is a sutra in the *Chanakya Sutrani* called "Mantrasampada Rajyam Vardhate," which states that interactions and participation strengthen the state. This facet of governance also highlights the civil society, another significant and up-and-coming *Janapada* actor. It now plays a very important function, mobilising people's actions and acting as a catalyst and actor in crystallising the interests of the people. The contemporary goal of citizen engagement through local actors, such as civil society organisations, volunteer organisations, or non-state actors, is particularly well embodied by the *Janapada* in *Saptang* paradigm.

d) *Durg*: As was previously said, the development of strong infrastructure—the fourth important player in the Kautilian Model—is a belief shared by both the Kautilya and contemporary conceptions of governance. We are aware that there is now no serious discussion regarding the vital significance of infrastructure and that all governments should prioritise its development. However, the state's distribution of it is dubious. Therefore, the ideals of equality and inclusivity must inform and guide the *Durg* (Infrastructure). Infrastructure is emphasised by both the Kautilian and modern models of government, but the latter also include the elements of equity and inclusivity.

e) *Kosha*: In the same model, finance is the fifth most significant actor. All state and developmental initiatives revolve around and rely on funding, which is produced by taxes and other funds gathered from the populace. Therefore, the *Kosha*, or money, must be the most open and transparent part of government, according to the modern governance paradigm. Any kind of opaqueness in financial concerns is inappropriate and incompatible with contemporary financial governance. The survival of the remaining elements likewise depends on this.

f) *Danda*: The sixth important limb in the *Saptang* model is *Danda*, or the rule of law. In order to advance governance, Kautilya's Arthashastra echoes the *Danda* & *Dharma* dualism. On the one hand, the leader must dedicate himself to the people's interests; on the other hand, the *Danda* must be used in a way that is consistent with codified laws to guarantee justice and advance government for the common good (*Dharma*). The Arthashastra lays out extremely precise guidelines and standards for the appointment of ministers and officials, taxation and public spending, and the upholding of law and order as the cornerstones of good government in order to guarantee the efficient application of *Danda* in accordance with *Dharma*. The text also outlines in great depth how to prevent corruption, which can otherwise destroy the foundations of good administration and spread like a cancer across the seven main components of the state (*Prakrits*). The concept of constitutional supremacy and the concept of dharma-based *Danda* supremacy are very similar. Today, the constitution is regarded as the highest law in the land. All men are equal before it, and no man is superior to it. Kautilya envisions a similar paradigm as well, basing the welfare state and good governance process on the solid tenet of "*Dharma* based Duties." This duty-based narrative guarantees that the welfare state is neither an entitlement or a luxury that could be abused, as is the case with the contemporary rights-based narrative. Instead, every citizen is granted the right to a welfare state and good administration, and the ruler's only goal is to serve his subjects; he is subject to the same duties and obligations as them. The ruler's duties are far more extensive and far more significant than those of citizens, which is the only distinction between the two. Naturally, the *Yogkshema* model's emphasis on individual responsibilities translates into a focus on ethics and values in governance. The concept of Dharma is not superior than even the Raja. No state, administration, or leader in the current day is above the constitution or law books, which are the contemporary manifestation of this *Dharma*. Therefore, the rule of law principle, which finds a place in the contemporary understanding of governance, directs and guides the *Danda* of the *Saptang* model.

g) *Mitra*: The *Mitra* or the ally is the final significant player. Relationships with donor nations and international financing organisations are just as important to modern governments as their neighbours and other nations. Therefore, reaching a consensus and cooperating to achieve peaceful coexistence should be the guiding principle when dealing with them.

Check Your Progress

Q1: What is the core idea of the Saptang model of governance given by Kautilya?

Ask Yourself

Q1: What does the term Arthashastra mean?

4.4 The Fifteen Chapters of the Arthashastra

The whole text of Arthashastra is divided into fifteen chapters referred to as books that cover the core areas of polity, economy and society. This work on politics and diplomacy emphasises the importance of fruitfully maintaining and using land for the subsistence of humanity. A summary of the mentioned chapters in the translated work of Shamasatry is presented as follows:

BOOK I. It concerns discipline and the understanding of other sciences in the context of the state.

BOOK II. It is about the duties of Government Superintendents towards the administration of the state.

BOOK III. This chapter deals with law and the administration of justice.

BOOK IV. This part considers the issue of protection of the people in the kingdom from any form of adverse situation and handling of crimes with a view to curb and punish accordingly.

BOOK V. It concerns the management of the officials for maintaining the government functions through salary and other duty specifications.

BOOK VI. It deals with the elements of sovereignty; concerning peace and exertion.

BOOK VII. This discusses the approaches to foreign policy if need be and the ways of dealing with friends and enemies.

BOOK VIII. It focuses on the aggregate of the calamities of the elements of sovereignty and the considerations about the troubles of the king and his kingdom.

BOOK IX. It focuses on war preparations and covers topics including the kind of troops that can be mobilised, the prerequisites for initiating an expedition, and the risks that should be avoided before beginning.

BOOK X. This chapter is devoted to combat and describes the main war camp, various battle arrays, and a variety of fighting techniques.

BOOK XI. This one-chapter Arthashastra by Kautilya describes how a conqueror should deal with oligarchies that are run by a group of chiefs rather than a single monarch.

BOOK XII. This chapter illustrates how a weak monarch should block the plans of a stronger king and defeat him in the end.

BOOK XIII. This is solely concerned with fighting or using deception to take over the enemy's fort. It also establishes the rules for the occupied areas.

BOOK XIV. It is concerned with secretive tactics.

BOOK XV. It describes the steps involved and the conceptual methods used in the endeavour.

Check Your Progress

Q2: Which chapter in Kautilya's Arthashastra emphasises on mobilising of troops and initiating expeditions?

4.5 Governance in Kautilya's Arthashastra

Kautilya claims that good governance has three main goals: In order to facilitate and promote commerce, the king should (a) ensure the provision of public infrastructure, such as roads, and national security; (b) formulate effective policies and ensure their effective implementation, remove any barriers to economic growth, and encourage capital formation; and (c) ensure a clean, fair, and compassionate administration. Some of the significant aspects depicting governance practices as stated in Arthashastra can be discussed as follows:

1. **The main duty of the King:** According to Kautilya, a monarch should be well-educated, disciplined in the sciences, dedicated to the proper government of his subjects, and intend to strive for the welfare of all. The king should be able to inspire and encourage his ministers and set the example for achieving the goals that have been agreed upon by everybody in a given amount of time. The goal of good governance is for the king to carry out his responsibilities in a way that serves the needs and interests of his subjects. According to Arthashastra, the king would be a servant of the state and would not have any personal preferences; instead, he would follow the preferences of his subjects. The king's four roles are to obtain what cannot be obtained, safeguard what can be obtained, expand what can be safeguarded, and distribute the excess to those who deserve it. What Kautilya advocated was an enlightened monarchical paternalism. This clear definition of the role of the king is an indicator of the current role of the board of directors in terms of serving the various stakeholders through genuine welfare motives.
2. **Appointment of Qualified Ministers:** Arthashastra, states that competent and qualified ministers appointed by the king along

with highly virtuous and administratively qualified kings can only provide good governance to the state. Thus, in appointing the qualified and adroit ministers Kautilya wanted to establish that there was the sense of good governance at every step of administration. Businesses today must be administered by qualified personnel with strong integrity appointed through fair means. They have to be capable of upholding righteousness while delivering the best for everyone.

3. **Welfare nature of the state:** Kautilya vouched for a welfare state where the prosperity and welfare of the people were given optimal priority. He was not only concerned about the material welfare of the people but also their moral welfare. Kautilya maintained that a welfare state was the supreme concern of the ruler. The ideal of his welfare centric state also had the provisions for the advancement of vulnerable and weaker sections of the society.

4. **Adaptation of preventive measures:** The basic principles of Kautilya"s good governance were supervision and vigilance. He also considered the carrying out of preventive and punitive measures to punish corrupt officials as an indicator of good governance. Kautilya laid down strict rules of conduct and control. He opined that a well-considered and just punishment makes the people devoted to righteousness, wealth and enjoyment. According to Kautilya, punishment if exercised impartially in proportion to the guilt is bound to protect the world and the next. Punishment corresponding to the gravity of the offence acts exemplary in terms of preventing future similar occurrences. Businesses must take measures to prevent erring officials or practices and take necessary actions if need be.

5. **Economic growth:** According to Kautilya, generosity and desire rely on wealth to be realised, and wealth alone is

significant. Even a state without a leader can be ruled if its citizens are rich. Intelligence is a prerequisite for prosperity. Education is a prerequisite for intelligence. According to Kautilya, a good government encourages economic growth, which in turn supports moral behaviour, national security, and the funding of public infrastructure through increased tax receipts. Kautilya's economic theories emphasise the fundamental ideas of supply and demand economics and how they work together to determine prices. Price cannot be set fairly if supply and demand are not adequately taken into account, which in turn preserves the welfare of both producers and consumers. He firmly thought that improving people's quality of life was the only way for a king to gain the allegiance of the populace. In order to promote economic growth, he developed a comprehensive set of economic policies. Economic activity is the foundation of prosperity, and its absence causes tangible hardship. Both present affluence and future growth are at risk of being destroyed in the absence of productive economic activity. A king who engages in productive economic activity can accomplish his goals and amass wealth.

6. **Foreign trade:** Kautilya believed that international trade may boost the trading nations' economic well-being. He thought that "creating and preserving" *artha* (material well-being) was the goal of economic understanding. As a result, Kautilya used his economic theory to manage governmental operations as well as to maintain the state's economic standing.

7. **Effective communication:** Leaders must realise that sending employees to a course on communication skills does not enhance communication within the company, claims Chanakya. Maintaining open lines of communication both horizontally and vertically enhances communication. People learn the importance

of effective communication and put it into practice when leaders are prepared to respond to their questions and take the time to explain the deliverables. Leaders in the majority of organisations fall victim to the traps posed by their positions and privileges. They are less approachable by those who are ultimately in charge of producing results the higher they are in the organisation.

8. **Timely decision making:** A good leader, according to Chanakya, understands that the organization's actual requirements and problems take precedence above his or her own whims and preferences. He should keep his staff satisfied and give their requirements careful thought. A company with contented workers might have satisfied clients. Delayed decision-making is the most dangerous business disease. Decision-making in many organisations is sluggish for a number of reasons such as lack of empowerment resulting in decision bottle neck, centralised decision making where the key personnel in the organization are always busy and inefficient leaders postponing decision making.

9. **Accountability and performance:** According to Kautilya, those who provide all forms of punishment are despised by the public, whereas those who administer smaller punishment are seen with disdain. However, anyone who administers punishment as it is due gains respect. Because when punishment is given properly, it inspires people to be devoted to righteousness and to work for wealth and enjoyment; when it is given poorly, out of ignorance or under the influence of greed and rage, it incites rage even among householders and hermits who live in forests.

Furthermore, one of a leader's most crucial tools is holding others accountable for their outcomes. Regretfully, we frequently witness in today's business world that performance turns into a punishment and non-performance into a reward. Those that perform well are given increasingly more responsibility, while those who perform poorly appear to get away with less effort—just because we don't trust them enough with the duty. However, the high performers get resentful because they see that they are being overworked while the underachievers appear to be taking it easy. Chankya advices to commend top performers and appropriately discipline underachievers.

Stop to Consider

Some interesting facts:

Arthashastra was composed between the 2nd century BCE and 3rd century CE and remained influential until the 12th century. The text was lost for centuries and rediscovered in 1905 by Sanskrit scholar R. Shamasastry. It consists of 15 books, 150 chapters, and 180 topics, covering governance, diplomacy, taxation, law enforcement, and more.

Environmental Awareness: It mentions designated forests for timber and wildlife conservation, showcasing early environmental consciousness.

Rainfall Data: The text provides precise annual rainfall figures for various regions, showcasing its attention to detail.

Village Administration: It uses the term gramakuta to describe a village official or chief, hinting at regional governance practices.

Economic Crimes: It suggests severe collective fines for conspiracies among traders or artisans, emphasizing the importance of economic stability.

Four Fields of Knowledge: The Arthashastra identifies the Vedas, Anvikshaki (philosophy), the science of government, and the science of economics as essential areas of study.

Social Welfare: It advises rulers to initiate public projects like irrigation waterways and fort construction during times of famine or epidemics.

Check Your Progress

Q3: What is Kautilya's opinion on foreign trade for a nation?

4.6 Summing Up

Kautilya was a trailblazer in government administration and diplomacy. A great strategist and economist in Indian history, his merit lay in his ability to arrange his views in a methodical and logical manner in addition to providing the administration with extremely valuable practical guidance. A summary of the key aspects of governance according to Kautilya's Arthashastra emphasises the following aspects:

1. Role of the King - welfare of his subjects.

2. Duties of the King - being knowledgeable in all areas.

3. Council of Ministers - appointment of learned and experienced council of ministers.

4. Law and Order - maintain law and order.

5. Economic Policies - economic prosperity for a stable state.

6. Foreign Policy - diplomatic strategies and international relations.

7. Ethical Governance - integrity and well-being of the state over personal interests.

Kautilya's emphasis on the development of human capital is becoming more and more supported in the modern era. The general tenet of economics is that without the accumulation of human capital, development is impossible. Social welfare is the main focus of Kautilya's economic ideas. In addition to actively advancing the welfare of its citizens, the State had an obligation to support the weak and defenceless. Kautilya placed a higher priority on the development of human capital because growth is impossible without it.

Ask Yourself

Q2: How does Kautilya define the ideal king or ruler?

Q3: Do you think Arthashastra is still relevant today?

Stop to Consider

Governance issues covered in Arthashatra:

Environmental Awareness: It mentions designated forests for timber and wildlife conservation, showcasing early environmental consciousness.

Rainfall Data: The text provides precise annual rainfall figures for various regions, showcasing its attention to detail.

Village Administration: It uses the term gramakuta to describe a village official or chief, hinting at regional governance practices.

Economic Crimes: It suggests severe collective fines for conspiracies among traders or artisans, emphasizing the importance of economic stability.

Four Fields of Knowledge: The Arthashastra identifies the Vedas, Anvikshaki (philosophy), the science of government, and the science of economics as essential areas of study.

Social Welfare: It advises rulers to initiate public projects like irrigation waterways and fort construction during times of famine or epidemics.

4.7 Model Questions

i. Explain the *Saptang* Model of governance forwarded by Kautilya in Arthashastra.

ii. Discuss the art of governance as described in Kautilya's Arthashastra.

iii. Explain the role of the King as defined by Kautilya.

iv. State the various chapters of Arthashastra that highlights the issue of governance in a nation

v. What is the significance of law in governance?

vi. Explain the role of public participation for achieving effective governance.

4.8 Answers to Check Your Progress

Question 1: The Saptang model acknowledges the diversity of institutions and players participating together for securing governance which is similar to the contemporary idea of governance.

Question 2: BOOK IX

Question 3: Kautilya believed that international trade may boost the trading nations' economic well-being. He thought that "creating and preserving" *artha* (material well-being) was the goal of economic understanding. As a result, Kautilya used his economic theory to manage governmental operations as well as to maintain the state's economic standing.

4.9 Answers to Ask Yourself Questions

Question 1: The word Arthashastra is derived from Sanskrit where ‘Artha’ refers to wealth, prosperity, or material well-being, while ‘Shastra’ means treatise or science. Thus, Arthashastra can be translated as “the science of material well-being” or “treatise on economics and statecraft.”

Question 2: According to Kautilya, an ideal king should be wise and educated, disciplined and self-controlled, just and protective of his people, surrounded by capable advisors and always prioritizing the prosperity and security of the state. He emphasizes that the ruler's happiness lies in the happiness of his subjects.

Question 3: Yes, many of Kautilya’s ideas remain relevant in modern politics, economics, and strategic studies. His focus on realpolitik, administrative efficiency, and national security continues to influence leaders, policy makers, and military strategists.

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Note: Latest edition of text books may be used.

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Unit-5
Recent Issues and Challenges of Corporate Governance

Unit Structure:

5.1 Introduction

Corporate governance is a crucial aspect of modern business management. It refers to the system of rules, practices, and processes by which companies are directed and controlled. Effective corporate governance ensures transparency, accountability, and fairness. These principles are essential for building investor confidence, protecting the interests of stakeholders, enhancing the reputation of the company, and supporting its long-term success.

In recent years, corporate governance has been confronted with a variety of new and emerging challenges. Rapid technological developments, increasing expectations of ethical business conduct, and a growing focus on environmental and social responsibilities have significantly influenced governance practices. As a result, companies are now expected to move beyond traditional legal compliance and adopt more inclusive, transparent, and responsible approaches to governance.

This unit is designed to provide learners with a comprehensive understanding of the current issues affecting corporate governance. It will explore the causes, nature, and consequences of these challenges, and examine the ways in which companies and regulatory authorities are responding to them.

5.2 Objectives

After going through this unit, you will be able to-

- *understand* the concept and importance of corporate governance,
- *identify* and explain the recent issues and emerging challenges in corporate governance,
- *examine* the role of regulatory bodies in addressing governance challenges,
- *evaluate* how companies are responding to recent issues and challenges.

5.3 Recent Issues in Corporate Governance

Corporate governance refers to the system by which companies are directed and controlled to ensure transparency, accountability, and fairness in their operations. In recent years, the business environment has become more complex due to rapid technological changes, global competition, and growing awareness of ethical and environmental responsibilities. As a result, new issues and challenges have emerged in the field of corporate governance. These include concerns such as ESG reporting, board diversity, cyber security risks, executive pay gaps, and the growing influence of activist shareholders. Understanding these recent issues is essential for building stronger and more responsible corporate structures in today's dynamic world.

i. Environmental, Social, and Governance (ESG) Reporting and Greenwashing:

Nowadays, many companies are sharing information about how they care for the environment, treat people, and follow good governance practices, this is called ESG reporting. However, some companies make false or exaggerated claims just to look good in front of the public or investors. This is known as greenwashing. One major problem is that there are no common rules for how companies should report their ESG activities, which makes it hard to check if their claims are true. To fix this, regulators like SEBI in India and the SEC in the USA have started asking companies to provide clearer and more honest ESG reports.

ii. Board Diversity and Inclusion:

Having people from different backgrounds on a company's board, such as different genders, cultures, or experiences, helps bring new ideas and leads to better decision-making. This is known as board diversity, and it can make companies more creative and effective. However, even though many countries are encouraging the inclusion of all groups, women and minorities are still underrepresented in boardrooms. To improve this situation, some regulators now require companies to share information about how diverse their boards are. This helps track progress and encourages companies to become more inclusive.

iii. Cyber security and Data Governance:

In today's digital world, companies store a lot of important information, and any data breach or cyber attack can harm their reputation, finances, and the trust of their stakeholders. This makes cyber security a major concern for corporate governance. However, many board members do not have enough technical knowledge to properly understand or manage these risks. As a result, companies may not be fully prepared to deal with cyber threats. Recent incidents in sectors like finance and healthcare have shown that weak data protection can lead to serious problems, highlighting the need for stronger governance in this area.

iv. Executive Compensation and Pay Gap:

In many companies, the salaries of top executives, especially CEOs, are much higher than what regular employees earn. This large difference often raises questions about fairness and ethics. One major concern is that the high pay is not always linked to the actual performance of the company. Because of this, investors and the public are asking for more transparency in how executives are paid. There is also a growing demand for pay structures that are based on performance, so that executives are rewarded only when the company does well.

v. Related Party Transactions (RPTs):

Related Party Transactions happen when a company does business with people or organizations closely connected to it, such as family members or group companies. If these transactions are not properly shared with stakeholders and approved, they can lead to misuse of the company's resources. This becomes a bigger issue in family-owned or promoter-led businesses, where personal interests may influence decisions. To reduce such risks, SEBI has introduced stricter rules. Companies must now clearly disclose important related party transactions and get approval from shareholders before going ahead with them.

vi. Succession Planning and Leadership Transition:

Succession planning means preparing in advance for future changes in leadership, which helps a company stay stable and run smoothly.

However, many companies are not ready for sudden changes in top positions, such as when a CEO unexpectedly leaves. Without a proper plan, there can be confusion and delays in decision-making. This can shake investor confidence and disturb the company's long-term goals. Good governance requires that companies plan ahead to ensure smooth leadership transitions when needed.

vii. Governance of Emerging Technologies:

New technologies like artificial intelligence (AI), block chain, and automation are changing the way businesses operate. While these technologies offer many benefits, they also bring new challenges related to ethics, privacy, and regulation. Companies must now figure out how to make sure these tools are used in a fair and responsible way. It is difficult to ensure accountability and protect data when using such advanced systems. To deal with these challenges, it is important for companies to include technology experts on their boards who can guide them in making smart and ethical decisions.

viii. Stakeholder vs. Shareholder Governance:

In the past, companies mainly focused on increasing profits for their shareholders. However, this idea is now being challenged by a new approach that considers the interests of all stakeholders—such as employees, customers, society, and the environment. This has created an ongoing debate: should companies only work to benefit their shareholders, or should they also take care of the wider community and natural resources? Many believe that focusing on all stakeholders leads to more responsible and sustainable business practices.

ix. Activist Shareholders and Proxy Battles:

Shareholder activism happens when investors try to influence a company's decisions, especially by demanding changes in strategy, management, or governance. This type of activism is becoming more common and is changing how boards make decisions. On the positive side, it encourages companies to be more accountable and responsive to investor concerns. However, it can also push companies to focus on short-term results instead of long-term growth, which may not always be in the best interest of the business.

Stop to Consider

Geopolitical risks are becoming a central concern for global corporations. Events like trade wars, sanctions, or sudden regulatory shifts (such as the Russia-Ukraine conflict or China's changing data laws) can drastically affect operations. Modern corporate governance must now include political risk management as part of its strategic oversight.

5.4 Challenges of Corporate Governance

Corporate governance aims to ensure transparency, accountability, fairness, and ethical business practices. However, in the real world, several challenges can affect its successful implementation. Some of the key challenges are explained below:

i. **Lack of Transparency:** One of the major challenges is the lack of clear and timely disclosure of financial and non-financial information. When companies hide important details or provide incomplete reports, it becomes difficult for shareholders and other stakeholders to make informed decisions.

ii. **Concentration of Ownership:** In many companies, especially in developing countries, ownership is concentrated in the hands of a few promoters or families. This can lead to decisions that favor the majority owners at the cost of minority shareholders, resulting in poor governance.

iii. **Ineffective Board of Directors:** Boards are expected to provide oversight and guide the company's management. However, in many cases, board members may lack independence, expertise, or the courage to challenge wrong decisions. This weakens their role in maintaining good governance.

iv. **Poor Regulatory Compliance:** Some companies do not fully follow corporate laws, listing regulations, or governance codes. Weak enforcement by regulatory bodies can further encourage non-compliance, leading to unethical practices and financial irregularities.

v. **Insider Trading and Unethical Practices:** The misuse of confidential information for personal gain and other unethical activities continue to be major concerns. These practices harm investor trust and go against the principles of good governance.

vi. **Weak Protection of Minority Shareholders:** Minority shareholders often face difficulties in having their voices heard. In many cases, they are unable to influence key decisions or stop unfair practices, which lead to an imbalance in power and weak governance.

vii. **Limited Accountability:** Sometimes, top management and directors are not held accountable for poor performance or unethical decisions. Without proper checks and balances, they may continue to act in their own interest rather than in the interest of the company or its stakeholders.

viii. **Lack of Awareness and Training:** Many board members or company officers may not be fully aware of modern governance practices. Without proper training and understanding, it becomes hard to implement strong governance systems.

While corporate governance plays a vital role in ensuring responsible management and long-term success, it faces various challenges in practice. Overcoming these challenges requires stronger regulations, greater transparency, independent boards, ethical leadership, and active participation from all stakeholders. Only then can companies truly achieve good governance in the real sense.

Stop to Consider

Social License to Operate (SLO) means gaining approval and trust from the public, not just following the law. Even if a company has all the legal permissions, it may face problems like protests or boycotts if people feel it is harming the environment, ignoring community needs, or acting unethically. In today's world, good corporate governance means listening to what society expects, being transparent, and acting responsibly. If a company loses its social license, it can affect its reputation, profits, and long-term success. That's why SLO is now seen as an important part of running a business responsibly.

Check Your Progress

1. What does ESG stand for?
2. What is greenwashing in the context of ESG reporting?
3. What is shareholder activism?
4. Why is transparency important in corporate governance?

5.5 Summing Up

- Corporate governance refers to the system through which companies are directed and controlled. It plays a vital role in promoting transparency, accountability, and ethical conduct in business operations.
- In the changing business environment, new and emerging issues have posed significant challenges to traditional governance models. These issues demand more inclusive, responsible, and forward-thinking practices.
- Corporate governance today faces several emerging issues such as ESG reporting, greenwashing, lack of board diversity, cyber security threats, and executive pay gaps. Other key concerns include related party transactions, poor succession planning, ethical use of technology, stakeholder-focused governance, and rising shareholder activism.
- Corporate governance faces key challenges such as lack of transparency, promoter dominance, weak regulation, and ineffective boards. Other issues include poor protection of minority shareholders, unethical practices, low awareness of standards, and difficulty adapting to global and technological changes.

5.6 Model Questions

1. What is ESG reporting? Why is it important in corporate governance?
2. What are related party transactions? Why are they considered a governance risk?
3. Discuss the recent issues in corporate governance with suitable examples.

4. Explain the role of regulatory bodies in addressing governance issues.
5. Discuss the ethical and regulatory challenges emerging from the use of artificial intelligence and digital technologies in corporate governance.

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Unit-6
Corporate Governance Forums
and the CII Code of Corporate Governance

Unit Structure:

6.1 Introduction

Corporate governance in India has undergone a dramatic change over time, owing to various regulatory reforms, legal requirements, and market forces. Corporate governance is a system of rules, practices, and procedures by which firms are controlled, governed, and held accountable before the stakeholders. The objective of corporate governance in India is to make firms transparent, accountable, and fair and provide a system where they are able to function in a manner favourable to sustainable growth and ethical business practices.

The idea of corporate governance reached the forefront of India's economic policy following India's opening of the economy in 1991. Various regulatory efforts have been made since then to enhance the practice of governance, including efforts by industry bodies, legislative reform, and regulatory orders. All these efforts are intended to put India's corporate governance standards at par with global best practices and ensure business sustainability while safeguarding the interests of the stakeholders.

Corporate governance forums have also been emerging as critical platforms, where stakeholders, experts, regulators, and industry captains come together and discuss, popularize, and advance governance practices. These forums facilitate cooperation, sharing of best practices, and development of governance standards globally.

6.2 Objectives

After going through this unit, you shall be able to-

- *explain* Corporate governance forums,
- *describes* the CII Code of Corporate Governance.

6.3 Corporate Governance Forums

Corporate governance forums are forums that convene stakeholders, experts, regulators, and industry leaders to share, promote, and improve governance practices. The forums leave space for cooperation, best practice sharing, and the development of corporate governance standards globally. The corporate governance forums influenced the governance standards on a global scale: in many ways such as:

i. Policy making: Such forums draft and revision governance policies to global best practice. Legal reforms: Whereby many national regulators incorporate the recommendations of the forums into their laws.

ii. Trust: Through their initiatives, these forums push for higher corporate disclosures, cutting down on financial frauds.

iii. Stakeholder confidence: Investors, employees, and customers are gaining confidence in companies abiding by the best practices of governance.

6.4 Major Corporate Governance Forums

1. International Corporate Governance Network (ICGN)

The International Corporate Governance Network (ICGN) is a global, well-known organization founded in 1995 to advance sound corporate governance standards and shareholder engagement. It is an investor-sponsored organization, with over 700 members from institutional investors, corporations, regulators, and other stakeholders in more than 50 countries. The ICGN is a corporate governance professional forum where professionals gather to promote improved governance practices, increase transparency, and safeguard shareholder rights.

The mission of the ICGN is to encourage good governance practices and corporate stewardship by facilitating cooperation between investors, corporations, and policymakers. It works to ensure that companies are being managed effectively, with integrity, accountability, and transparency, which in turn improves long-term shareholder value. The vision of ICGN is to encourage corporate governance structures that deliver sustainable benefits to investors and all stakeholders, ensuring businesses contribute to social and environmental advancement.

Key Areas of Focus:

1.Shareholder Rights: The ICGN advocates for the defence of shareholder interests, especially those of institutional investors and minority shareholders. It encourages companies to respect shareholder rights such as voting on important matters, including executive compensation and board appointments.

2.Investor Stewardship: The ICGN advocates for the practice of investor stewardship, urging institutional investors to take an active role in managing the companies in which they have interests. This involves engaging with companies to improve governance, advocating for board diversity, and ensuring ethical business practices.

3.Transparency and Disclosure: Transparency in corporate governance is one area of focus for the ICGN. The organization advocates for greater disclosure of financial and non-financial information, such as sustainability and ESG (Environmental, Social, and Governance) practices. It advocates for transparent communication of the firm's strategies, risk management, and performance, thus enhancing investor decision-making.

4.Sustainability and ESG: As global awareness of sustainability grows, the ICGN places significant emphasis on incorporating ESG considerations in corporate governance. The network advocates for corporate policy that considers environmental issues, social issues, and governance issues that are aligned with long-term financial success and stakeholder well-being.

2. Organisation for Economic Co-operation and Development (OECD) Corporate Governance Forum

The OECD is an international organization established to promote policies to improve the economic and social well-being of people. Corporate governance is one of the main areas of focus within the

OECD, highlighting the OECD Corporate Governance Forum as one of the most important platforms for supporting good governance practices around the world. The forum, in summary, was created to respond to evolving opportunities and challenges in corporate governance, bringing together policymakers, regulators, corporate leaders, institutional investors, and academics. It offers a space for sharing best practices, reviewing regulatory developments, and developing policies for fostering strong, transparent, and accountable governance.

The OECD Forum has great international outreach and hence a big influence on governance reforms ranging from the developed countries to emerging markets. The OECD's approach to corporate governance emphasizes the right of shareholders to expect sound governance, strategic management, long-term, and sustainable business practices with transparency in their operations.

Key Focus Areas:

1. Corporate Governance Standards: The OECD develops and diffuses the guidelines and standards for corporate governance that provide a way for companies and regulators. The OECD Principles of Corporate Governance, first issued in 1999 and, from time to time, revised, outline core principles of governance in relation to accountability and transparency, including board structure and responsibilities, shareholder rights, and protection of minority shareholders.

2. Shareholder Rights and Responsibilities: The OECD Corporate Governance Forum provides a forum for debate on shareholders' rights, with a particular emphasis on those of minority shareholders. The Forum emphasizes that shareholders must have a say in major decisions affecting the company, should have access to necessary information about the company's operations, and that shareholders'

participation in the governance process should be protected. Basically, the OECD encourages institutional investors to be responsible by exercising their shareholder rights with respect to governance in the companies they invest in.

3. Board Governance and Role of Directors: The forum also deliberates on while exploring the role of boards of directors in directorship. Best practices for board composition, director independence, and functions of key board committees (such as audit committees and remuneration committees) are encouraged by the OECD itself. Much emphasis is laid upon openness in board diversity so that the board is equipped with relevant skills and can perform its one crucial function-the oversight over the management.

4. Corporate Transparency and Disclosure: Transparency is a fundamental premise of efficient governance. The need for clear, timely, and accurate disclosure of financial and non-financial information is being emphasized by the OECD. Financial performance, risk management practices, executive remuneration, and sustainability initiatives have to be disclosed. Effective transparency will complement investor confidence, effective governance, better decision-making, and shareholder accountability.

5. ESG Issues: The OECD Corporate Governance Forum increasingly focuses on integrating ESG factors into corporate governance. The forum explores the growing importance of environmental sustainability, social responsibility, and governance practices in shaping long-term corporate performance. It encourages companies to adopt strategies that align their business models with sustainable development goals (SDGs), considering the wider societal impacts of corporate activities.

6. Corporate Governance in Emerging Markets: The Corporate Governance Forum also extends to the challenges faced by emerging

market economies-and addresses them-in their bid to put in place and enforce sound governance practices. The forum works in close cooperation with countries so as to have governance frameworks that enhance the integrity of markets, promote investor confidence and provide further impetus to the general business environment.

3. Asian Corporate Governance Association (ACGA)

A major non-governmental organization interested in upholding corporate governance standards all across Asia, the Asian Corporate Governance Association (ACGA) came into existence in 2001, mainly aiming at improving the governance practices of the region. The ACGA performs this through a path of advocacy, research, and teamwork with businesses, regulators, and investors. The Association aims at promoting transparency, accountability, and sustainability in corporate practices and aligning Asian markets to attain global governance standards.

Mission and objectives of ACGA: The mission is to promote strong, transparent, and accountable corporate governance throughout Asia, ideally when good governance is an unflagging determinant of a regional economy's solid growth, stability, and grasping investor confidence. The whole of the features and the framework is aligned toward making a flourishing ground for corporate governance practices. ACGA aims for sustainable business growth in which corporate governance should enable long-term value creation, social is now in demand.

Key Areas of Focus:

1. Spreading Governance Best Practices: ACGA educates in Asia about the importance of corporate governance, advocating adherence to international best practices. It promotes board independence, the role of shareholders, transparent financial reporting, and executive compensation. The association believes that, by enhancing

governance standards, Asia will attract more foreign investments, improve market efficiency, and reduce corporate risks.

2. Regional Advocacy and Policy Reform: The association plays an important role in shaping corporate governance policy in Asia, working with government agencies, regulators, and industry bodies to influence the development of stronger governance frameworks. ACGA has continuously called for such regulatory reforms in many Asian markets regarding minority shareholder rights, board composition, and corporate disclosure.

3. Research and Education: ACGA carries extensive research in corporate governance issues in Asia, providing analyses and commentary on governance trends, issues, and market practices. The organization issues reports and studies appraising the governance scene in different Asian countries, pointing toward areas for improvement. It also organizes events, conferences, and workshops that highlight the importance of good governance for stakeholders and knowledge-sharing among companies and investors.

4. Advocating Shareholder Rights: Upheld as the very main focus of ACGA, this concerns the strengthening of shareholder rights, most especially the merits of the minority shareholders. This, thus prompts the organization to stress for the safeguarding of minority interests by advocating enhanced shareholder participation in corporate decision-making, making the voting process more transparent, and providing better information access. The ACGA further encourages the development of legal frameworks that treat all shareholders equitably and fair.

5. Encouraging Corporate Social Responsibility (CSR): The association further supports the treatment of corporate governance by incorporating the principles of CSR and ESG (Environmental, Social, and Governance). The ACGA provides technical assistance to

companies in enhancing their take on sustainable business practices, so that the already existing governance frameworks will reflect not only on the financial performance but also social and environmental aspects. This wider sense enables better build-up of trust between business and stakeholders and promotes sustainability in development.

4. Global Corporate Governance Forum (GCGF)

The Global Corporate Governance Forum was created in Quite the while ago 1999-this is an international initiative with focus towards the worldwide propagation of the better corporate governance standards around the globe. It operates under the auspices of the World Bank Group and is meant to support the development of sound corporate governance practices in emerging and developing countries.

Among its key objectives is that of assisting countries to reform their corporate governance so as to increase the integrity and accountability of businesses. The forum closely collaborates with the public and private sectors to formulate an ethos or series of policies that foster economic growth and corporate sustainability.

The GCGF is known for its research work, and for issuing guidelines, reports, and toolkits that are grounded in best governance practices. These cover all aspects of board structures and processes, shareholders' rights, as well as transparency.

In addition to research work, the forum provides capacity development efforts such as training programs and conferences; that supports the enhancement of governance infrastructure in corporate and regulatory bodies. The focus there is the capacity empowerment of regulators and business leaders to adopt those international standards befitting global trends.

Through this, the GCGF plays a central role in its advocacy for global corporate governance reforms whereby businesses operate with enhanced transparency, accountability, and sustainability.

5. Global Corporate Governance Forum (GCGF)

The Governance Center is at the forefront of research, analysis, and advocacy for the advancement of best practices in corporate governance. Established in 2001, the Governance Center functions as a reliable resource for boards of directors, investors, and other stakeholders oriented toward improving corporate governance systems. The Conference Board is a non-profit think tank that strives for better governance across sectors through research, knowledge-sharing, and thought leadership.

The Governance Center is engaged in research in the areas of board composition, executive pay, risk management, shareholder rights, and corporate responsibility. These reports and publications reflect current governance trends, regulatory developments, and best practices. The purpose of these reports is to assist organizations in managing governance challenges and ensure their practices align with legal obligations and practical expectations of stakeholders.

The Governance Center's signature is engaging in dialog between corporate leaders, regulators, institutional investors, and academics. Special events, conferences, and webinars are organized, where experts discuss topics such as board diversity, sustainability, and corporate ethics. Such an engagement ensures that the standards in corporate governance remain dynamic and responsive to changes in the world.

The Governance Center focuses heavily on the board's role in creating sustainable value by holding management responsible for their decisions and actions. It recommends a strong governance framework that strikes the balance between shareholder, employee, and community interests and contributes to the organization's continued success.The Governance Center plays a huge role in shaping the corporate governance environment, acting as a resource, research body, and collaborator.

6. Corporate Secretaries International Association (CSIA)

Corporate Secretaries International Association has constituted in 2004 an active global organization whose purpose is to work to empower corporate secretaries and governance professionals to strengthen corporate governance practices across the globe. It strives to promote the vital role of corporate secretaries in relation to effective corporate governance, legal compliance, and stakeholder communication among the board, the shareholders, and other stakeholders.

CSIA strives to promote the improvement of corporate governance standards and the professional development of corporate secretaries through educating them, doing research, and providing opportunities for networking. Best practices, tools, and knowledge exchanges among its members increase these members' capacities to strengthen the governance structure in their organizations.

Perhaps, one major function of CSIA is to advocate recognition for and development of the corporate secretary role globally. It provides guidelines and the resources for corporate secretaries to enable them to effectively carry out this responsibility, which may encompass management of board meetings, compliance with the law or regulations, and maintenance of corporate records.

CSIA further promotes collaboration among diverse governance organizations, acting as a platform of global discussions on the standards and trends of corporate governance. It indirectly partakes in research and the exploration of thought leadership in governance areas impacting key policies and regulations that usher in new governance practices across various industries.

With its members from several countries, CSIA is to bridge the global governance practices, constitute a center for ethical standards, and help promote the corporate secretary profession as a key player in effective corporate governance.

6.5 Challenges Faced by Corporate Governance Forums

The challenges facing corporate governance forums, including some of the following:

i. Lack of uniformity of corporate governance: As each state has a different set of standards for corporate governance, thus leading to inconsistencies.

ii. Compliance versus Performance: The concept of compliance, rather, has shifted to utilitarianism, where a good corporate governance system calls for monitoring performance.

iii. Limited power in enforcing recommendations: Most of these provide advice and have no powers of enforcement in governing.

iv. Technological challenges: Since digital transformation is set in motion, they have to establish a new governance framework that, for some forums, is proving challenging to establish.

6.6 Future of Corporate Governance Forums

Corporate Governance will continue to play different roles into the future, with some key trends determining how such forums take shape:

i. Integration of the ESG (Environmental, Social, and Governance) Principles: Focus of forums widening to sustainability and ethics in governance.

ii. Implementation of Technology in Governance: The implementation of technology, including blockchain and artificial intelligence, into governance structures.

iii. Strengthened Global Cooperation: The presence of increased collaboration between global and regional governance forums will result to a more harmonized governance standard.

Check Your Progress

1. What do corporate governance forums do for today's business environment?
2. How do corporate governance forums influence ethical behaviour in a business?
3. How does the OECD advance universal frameworks for governance?
4. What is the main purpose of ICGN?

6.7 CII Code of Corporate Governance

The Confederation of Indian Industry (CII) Code of Corporate Governance was one of the pioneering attempts in India to create high standards in corporate governance. Given in 1998, it was an attempt to improve the transparency, accountability, and efficiency in Indian corporate houses. Before this, corporate governance was voluntary, with little legal enforcement. The close aims of the CII Code were: aligning Indian corporate governance with global best practices; strengthening the role of the boards of directors; enhancing financial disclosures and transparency and ensuring fair treatment of stakeholders. The CII Code laid the foundation for following reforms in governance, influencing regulations such as the SEBI Clause 49 and Companies Act, 2013.

Recommendations of the CII Code

The Confederation of Indian Industry provided key recommendations for improving corporate governance practices in India. In particular, an enumeration of the main recommendations is as follows:

1.1. Board Composition and Independence

- The board shall consist of at least 50% nonexecutive directors to ensure neutrality in decision-making.
- For large companies, a minimum of 30% of independent directors should be appointed to enhance oversight.
- Chairman and CEO shall be separate persons to curb conflicts of interest and to bring about accountability.

1.2. Strengthening the Role of Independent Directors

- Independent directors should be chosen upon expertise coupled with integrity and experience.
- Independent directors should have an active role in corporate strategy, risk management, and governance oversight.
- Companies must periodically evaluate the performance and effectiveness of independent directors.

1.3. Formation of Audit Committees

- The company should have an Audit Committee composed of not less than three directors, a majority of whom should be independent.

- They will supervise the financial statements, risk management, and internal audits.
- External auditors should be independent and rotated at regular intervals to ensure impartiality.

1.4. Transparency-and-Disclosure Norms

- Companies should increase their disclosures, both financial and non-financial, as a means to build greater confidence among investors.
- Annual reports should contain information on company strategy, risk management, and governance performance in detail.
- Related-party transactions should be disclosed lest a conflict of interest be created.

1.5. Valorising Shareholder Rights

Shareholders need to be granted access to authentic and timely financial information.

- Protection of minority shareholders from oppressive practices and unfair treatment.
- Fair distribution policies concerning dividends and full information on voting rights need to be adopted by companies.

1.6. Enhancing Corporate Social Responsibility (CSR)

- Businesses must seek to incorporate CSR aspects in their operational strategies.
- Companies need to be mindful about ethical business practices, environmental sustainability, and the development of communities.
- These recommendations have laid the groundwork for mandatory provisions for CSR in the companies.

1.7. Strengthening Risk Management Practices

- Companies should develop broad risk management frameworks so as to gain insight into corporate risks for purposes of their mitigation.
- The boards should put in place mechanisms internal to their organizations for the detection of fraud and operational risks.
- The Audit Committee should, in fact, even consider the most basic idea of risk assessment reviews and mitigation strategies.

1.8. Performance Evaluation of the Board

- The boards should assess an annual performance review of directors and executive committees.
- Evaluations should address matters such as board effectiveness, outstanding governance policies and leadership efficiency.
- Peer review assessments of independent directors should be executed to uphold high governance standards.

1.9. Adoption of Ethical Governance Practices

- Companies should create mechanisms for protecting whistle blowers in order to enhance transparency.
- Ethical governance should become a way of life at any corporation.
- Codes of conduct should be established to ensure legitimate enforcement of standards of governance by businesses.

Stop to consider

The CII Code of Corporate Governance, introduced by the Confederation of Indian Industry in 1998, was a landmark step toward improving governance practices in India. It aimed to promote transparency, accountability, and ethical business conduct in corporate entities. Key recommendations included ensuring board independence, strengthening the role of audit committees, enhancing financial disclosures, and protecting shareholder rights. The code also emphasized corporate social responsibility, risk management, and ethical conduct. Although initially voluntary, it significantly influenced later legal reforms such as SEBI's Clause 49 and the Companies Act, 2013, and helped align Indian practices with global governance standards.

6.8 Effect of CII Code on Indian Corporate Governance

1. Introduction to the CII Cod: In 1998, the Confederation of Indian Industry (CII) developed the Desirable Corporate Governance Code with a view towards addressing increasing concerns about transparency, accountability, and ethical conduct by Indian listed companies. It was a time of extensive Indian economic liberalization, and there was a pressing need to bring corporate practices in line with international norms. The publication of the CII Code was a landmark in the governance practices of Indian companies, thus paving the way for follow-up regulatory reforms

2. Objectives and Vision: The CII Code, which is not legally enforceable, was intended to be a voluntary code to promote better corporate behaviour. On the whole, it was intended to promote investor confidence, protect shareholder interests, and promote more effective boards. It was intended to place corporate governance on the strategic agenda of companies and not as a compliance exercise. It also encouraged ethical behavior, disclosure in decision-making, and better monitoring by boards of directors.

3. Key Recommendations: One of the strongest suggestions of the code was the induction of independent directors on company boards

to maintain objectivity in decision-making. It also suggested more powerful audit committees to monitor financial reporting and internal controls. It advocated separation of the Chairman and CEO roles to avoid concentration of power and promoted improved and more frequent board meetings. It placed greater focus on timely and transparent disclosure of the financial and operating performance of the company to safeguard investors' interest and enhance corporate accountability.

4. Impact on Regulatory Structure: The CII Code made an important contribution to the Indian regulatory landscape. Inspired by its success and ground-breaking recommendations, the Securities and Exchange Board of India (SEBI) established the Kumar Mangalam Birla Committee in 1999. A few of the recommendations of the CII Code were incorporated in Clause 49 of the Listing Agreement, launched in 2000, which made several governance practices obligatory for listed companies. Later reforms like the Companies Act of 2013 and SEBI (LODR) Regulations of 2015, in turn, built upon the platform provided by the CII initiative.

5. Evolution of Corporate Governance Paradigms: The CII Code had a profound effect not just on legal frameworks but also initiated a change in corporate mindsets. It encouraged organizations to adopt governance practices on a voluntary basis, regardless of legal requirements. Many leading firms like Infosys, Tata Group, and Wipro were pioneers and role models in this regard. The code helped create a culture of ethical conduct and strategic thinking in the long term among Indian corporations and created a link between good governance and good business practices, as opposed to considering it a burden.

6. Effect on Investor Confidence The CII Code went a long way in building investor trust by encouraging transparency, accountability, and enhanced board-level monitoring. Foreign institutional

investors positively responded to Indian companies that demonstrated good governance standards. Enhanced governance practices resulted in enhanced valuations, enhanced brand image, and enhanced access to the capital markets. Such companies that were viewed as being well-governed were seen as safer and more reliable by domestic investors and foreign investors alike.

7. Implementation Challenges: While beneficial, the voluntary status of the CII Code led to unequal usage across industries. While big firms embraced its principles, the vast majority of medium and small firms either ignored the code or embraced it in a lukewarm manner. The lack of enforcement mechanisms and the lack of incentives for compliance capped the overall effect of the initiative. Voluntary codes were discovered to be required to be supplemented by legal frameworks in order to be more impactful.

8. Enduring Legacy and Impact: Even though the majority of the CII Code recommendations have since found their way into formal rules and legislation, the code is also seen as a pioneering move that brought the concept of Corporate Governance into mainstream Indian business culture. It served as a benchmark for future committees and reforms, which facilitated the establishment of a strong and reliable system of governance. The code also underlined the benefits of self-regulation and the proactive role that can be played by industry associations in bringing about change.

9. Relevance in the Modern World: In today's business world, where environmental, social, and governance (ESG) considerations are being scrutinized more closely, the CII Code principles remain highly relevant. Its emphasis on ethical governance, independent boards, and protecting the interests of stakeholders is in line with today's global expectations of business conduct. The voluntary and principles-based approach, as proposed, still commits organizations

to going beyond compliance with regulators and committing oneself to ethical business practices.

Check Your Progress
5. What was the CII Code's suggestion on independent directors on boards of companies?
6. Why should the Chairman and CEO posts remain distinct, as per the CII Code?
7. What did the CII Code state about companies' financial disclosures?

Self-Asking Questions
1. Do you think independent directors can truly remain impartial in Indian companies
2. Do you think the CII Code’s emphasis on disclosure and transparency still holds relevance today?

6.9 Summing Up

- The International Corporate Governance Network (ICGN) promotes investor stewardship, transparency, and ESG integration, with global membership striving for improved long-term shareholder value.
- The OECD Corporate Governance Forum sets international governance standards, including the widely accepted OECD Principles, emphasizing transparency, board roles, and shareholder rights.

- The Asian Corporate Governance Association (ACGA) promotes in Asia international standards of governance through research, advocacy, and promotion of board independence and CSR.
- The Global Corporate Governance Forum (GCGF) supported by the World Bank assists developing countries to improve governance through capacity building, training, and policy assistance.
- The Governance Center (of the Conference Board) provides leadership in executive compensation, board composition, and sustainable governance practice, among others.
- The CSIA seeks to enable corporate secretaries globally to further enhance board processes, compliance with the law, and communication with stakeholders.
- They share themes: upholding shareholder rights, promoting transparency, supporting ESG standards, and encouraging good governance globally.
- Challenges are absence of global uniformity, poor enforcement power, and adapting to quickly evolving technologies.
- Forums are being compelled to change from compliance-based to performance-based systems of governance.
- The future is characterized by greater ESG integration, technology-driven governance structures, and greater global cooperation towards harmonized standards of governance
- The Confederation of Indian Industry (CII) worked on the initial Indian voluntary Corporate Governance Code in 1998.
- It was formed to ensure transparency, accountability, and bring Indian governance to a global standard.

- The main recommendations were board independence, the division of CEO and Chairman roles, and strong audit committees.
- It emphasized maintaining ethical practices, measuring board performance, and protecting shareholder rights.
- The Code encouraged prompt and complete disclosures to establish investor trust and confidence.
- It encouraged the incorporation of Corporate Social Responsibility (CSR) into business strategies.
- The movement impacted significant legal changes such as SEBI Clause 49 and Companies Act, 2013.

6.10 Model Questions

1. Describe how the CII Code has impacted the evolution of corporate governance norms in the Indian context.

2. What are the issues confronting corporate governance forums in India in raising governance levels?

3. Describe how the guidelines of the CII Code paved the way for India's formal governance reforms.

4. Describe the significance of independent directors as mandated by the CII Code. How do they contribute to good corporate governance in Indian companies?

5. Examine the suggestion to split the Chairman-CEO roles in the CII Code. Is there any effect of such a structural shift on power and business decision-making? Give reasons by way of example.

6. Critically examine how the disclosure and transparency directions of the CII Code assist in creating investor confidence and market

credibility. How applicable are the directions now in comparison to when they were initially launched? Why or why not?

7. How have corporate governance forums shaped global standards of ethical business conduct?

8. In what ways can companies benefit from engaging with international governance forums?

6.11 Answers to Model Questions

1. The CII Code was India's initial effort at codifying good corporate governance, officially. It was voluntary, yet it prompted companies to adopt international best practices. It influenced SEBI's mandatory Clause 49 in 2000, backed by the force of law. It brought investor confidence, improved board structures, and introduced principles like independent directors and audit committees.

2. Challenges are:

• Insufficiency of enforcement in unlisted companies

• Promoter and board resistance

• Limited awareness among small businesses.

• Difficulty reconciling business interests with ethical principles

In spite of all these, forums still drive reforms through education, regulations, and cooperation.

3. The CII Code, although voluntary, impacted SEBI and the Ministry of Corporate Affairs. Its suggestions regarding board independence, audit committees, and disclosure procedures were codified by Clause 49. It made the corporate world sensitive to self-governance, transparency, and accountability, a change from promoter-dominated boards to more participative and ethical governance norms

4. The CII Code identifies independent directors as central to objective monitoring to the extent that decisions are in the best interests of shareholders as opposed to those of the management. Independent directors introduce objectivity, minimize conflicts of interest, and enhance board accountability, thereby improving overall Indian corporate governance.

5. Dual roles of Chairman and CEO, as envisioned by the CII Code, prevent centralization of power and promote balanced decision-making. For example, keeping these roles separate in Infosys facilitated independent board oversight, improving governance and investor confidence.

6. The emphasis in the CII Code on timely and accurate disclosure encourages transparency, and transparency encourages investor confidence and enhances the market reputation of a business. While such standards were state-of-the-art within the 1990s, they remain important today, as transparency is one of the best predictors of sustainable and ethical business practice.

7. Corporate governance forums like the OECD and ICGN have played a pivotal role in setting international benchmarks on transparency, board structure, and stakeholder rights. They provide frameworks that help unify governance practices across borders and improve investor confidence.

8. By participating in forums, companies gain access to best practices, global investor networks, and regulatory insights. This enhances their credibility, prepares them for international expansion, and improves internal governance systems.

6.12Answers to Check Your Progress

1. Corporate governance forums provide platforms for dialogue, best practices exchange, and policy influence, helping firms get aligned with global governance best practices and become transparent.
2. They encourage ethical behaviour by instilling responsibility, transparency, and good judgment through codes, guides, and training.
3. The OECD works out globally accepted standards of governance that assist nations in creating systems that encourage equitable, transparent, and effective corporate conduct.
4. The ICGN's primary goal is to promote good corporate governance and stewardship by investors worldwide in an effort to increase long-term value creation and defend shareholder rights.
5. The CII Code suggested that at least 30% of the board must be occupied by independent directors in those companies where the chairmen are non-executive and at least 50% where the chairman is executive. This was to provide unbiased monitoring and balanced decision-making.
6. The CII Code suggested keeping the Chairman and CEO positions separate to prevent improper convergence of powers and to provide stronger checks and balances in the operation of the board.
7. The CII Code put greater emphasis on disclosure, stating that companies must make proper, timely, and accurate disclosures regarding operating and financial performance as a way to establish investor confidence and accountability.

6.13 Answers to Self-Asking Questions

1. Yes, if appointed transparently and empowered with adequate information and authority, independent directors can provide unbiased oversight. However, conflicts of interest and boardroom politics may sometimes dilute their effectiveness.
2. Absolutely. In a time when stakeholders demand accountability, transparent disclosures build investor confidence and market credibility. Though tech and market expectations have evolved, the principles remain highly relevant.

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Unit-7

Board Structure and Directors; Role of Board, Board Committees and Their Functions

Unit Structure:

7.1 Introduction

Any company's highest-performing decision-making body is the Board of Directors (BOD). It serves as a company's governing body, with members chosen by shareholders (for public companies) to establish the company's strategy, supervise management, and safeguard stakeholders' and shareholders' interests. Section 2(10) of the Companies Act, 2013 states that the term "Board of Directors" or "Board" refers to the collective body of the company's directors. Directors of the firm are the individuals that manage the business. According to Section 2(34) of the Companies Act of 2013, a director is a person who oversees the day-to-day operations of the business and is chosen by the board of directors.

7.2 Objectives

After going through this unit, you will be able to

- *know* about the Board of Directors in an organisation under the Companies Act, 2013,
- *understand* the structure of the Board and the Directors within recognise the role of the Board,
- *comprehend* the concept of Board Committees, different types of committees and their functions.

7.3 Appointment of Directors

According to Section 149 (1) of the **Companies Act, 2013,** every company shall have a Board of Directors consisting of individuals as directors and shall have—

a) a minimum number of three directors in the case of a public company.

b) two directors in the case of a private company, and one director in the case of a One Person Company.

c) a maximum of fifteen directors.

The board can increase the number of directors by passing a special resolution with the mandate of appointing at least one female director to the board of directors. Section 149(4) of the Act further mandates that every listed public company have at least one-third of the total number of directors as independent directors.

Sub-section 2 mandates compliance with the above directions and fulfilling criteria within one year from the commencement or inception of the company or business.

The act also mandates filling up the vacant position of director by the articles of the company. The vacancy or vacancies may arise due to resignation, removal of an independent director or retirement by rotation. Such vacancies are to be filled up within a period of not more than 180 days. From the date of such resignation or removal as mandated in the Act.

An individual who desires to apply for the Board of Directors post needs to meet certain criteria as laid down under Section 153 of the Companies Act, 2013. One such criterion is possession of Director Identification Number (DIN) which can be obtained from the Ministry of Corporate Affairs, the Government of India by applying for the allotment of DIN along with depositing the prescribed fee.

7.3.1 Disqualifications for Appointment of Director

Section 164 of the Companies Act of 2013 lists several conditions that preclude an individual from being appointed as a director of a business.

A person shall not be eligible for appointment as a director of a company, if

(a) he is of unsound mind and is so declared by a competent court

(b) he is an undischarged insolvent

(c) he has applied to be adjudicated as an insolvent and his application is pending

(d) he has been convicted by a court of any offence, whether involving moral turpitude or otherwise, and sentenced in respect thereof to imprisonment for not less than six months and a period of five years has not elapsed from the date of expiry of the sentence.

Further, if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be appointed as a director in any company

(e) an order disqualifying him for appointment as a director has been passed by a court or Tribunal and the order is in force

(f) he has not paid any calls in respect of any shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call

(g) he has been convicted of the offence dealing with related party transactions under section 188 at any time during the last preceding five years

7.4 Board Structure and Directors

The arrangement and makeup of a company's or organization's board of directors are referred to as the board structure. It includes the number of directors, their functions, tasks, and relationships with one another as well as how they work together to carry out their responsibilities. The size of the business, the industry, corporate governance procedures, and legal requirements are some of the variables that affect the committees and board structure. The size of the company and the industry are two examples of the variables that affect the board's size. A minimum of three directors must normally be appointed by publicly traded firms. However, with a mix of executive and non-executive directors, 8 to 10 is the ideal number of directors in both the internal and external director categories. Additionally, a larger board can provide a range of viewpoints, while a smaller board may be more flexible and effective. In addition, a board panel may consist of just one director in small businesses. The board of directors makes decisions that guide the business towards achieving particular objectives within a set time frame. Protecting the interests of its stakeholders and acting in accordance with the company's articles of incorporation are among the board of directors' primary duties. A board's organisational structure and work planning are essential components of good governance.

7.4.1 Types of Directors

Depending on their positions, duties, and connections to the business, board directors can be divided into a number of categories. Here are a few examples of typical director types:

- Managing Directors: They are in charge of making sure the business runs well on a daily basis.
- Executive Directors: As full-time directors of the business, the EDs are more responsible for carrying out board decisions and are actively involved in day-to-day operations.
- Non-executive directors: These directors do not have executive positions and are not involved in the day-to-day operations of the business. They offer impartial perspective, independent supervision, and occasionally question management's presumptions.
- Independent Directors: They have no substantial financial or personal ties to the corporation and are non-executive directors.

They are called in to ensure the board's legitimacy and neutrality by providing unbiased decision-making.

- Lead Director: In the absence of the CEO, an independent director leads board meetings, promoting the board's efficacy and encouraging communication.
- Residential Director: He lives in the same nation as the corporation and serves as a director.

Boards promote diversity in terms of gender, ethnicity, skills, and experience from different geographic zones to offer broader viewpoints and improved decision making in order to perform better in meeting stakeholders' expectations. Having committees established for the various objectives of the organisation or business is another crucial aspect of the board structure. They may be speciality committees or standing committees. The standing committees often address important issues facing the business and operate continuously. It comprises a variety of committees, including the audit, nomination, and governance, and compensation committees. On the other hand, specialised committees, like the mergers and acquisitions committee and the risk management committee, are established to carry out particular duties or address particular circumstances. Other committees, such as the Executive Committee, the Task Force Committee, the Advisory Committee, the Steering Committee, and the Corporate Social Responsibility Committee, may exist based on the requirements of the organisation.

7.5 Role of Board

The board of directors, which safeguards the interests of shareholders and makes ultimate decisions, is the focal point of the corporate governance system concept. The board plays a vital role in strategy development, management team supervision, legal compliance, and decision-making that impacts the company's success. The following is a summary of some of the important roles that the board plays in an organisation.

a) Strategic decision making: The creation of the organization's strategic plan is the Executive Committee's most important responsibility. These choices could involve anything from capital allocation and risk management to mergers and acquisitions and long-term corporate plans. For instance, the board often has a broad knowledge base because its members have a variety of experiences. This aids in developing well-informed strategies for the business's successful trajectory.

b) Setting company culture and values: The very board of an organisation shapes its culture and values. The board shares its judgements and actions regarding corporate social responsibility, accountability, and business ethics. Ethics, which can enhance stakeholder trustworthiness, can only be achieved if it is based on a strong ethical foundation.

c) Management: The board supervises the Companies leadership team, which is made of a number of top officers including the CEO. This supervision ascertains that management's actions benefit the organisation and its stakeholders. The board is responsible for selecting top executives and assessing their performance.

d) Risk management: Effective risk management is essential for any business. The Board of Directors is in charge of recognising, keeping an eye on, and reducing any risks or unfavourable circumstances that might arise within the company. These risks include those related to finances, operations, law, and reputation. Through this, any risk related with the safety of assets or reputation gets detected and addressed by the board.

e) Financial oversight: This board's primary function is to provide financial management. Examining accounts, creating budgets and statements, and giving financial advice are all part of a financial review. They make ensuring that the business's financial procedures are sound and compliant with the law. It is also in charge of approving significant financial decisions, such as capital spending plans and dividend payments.

f) Stakeholder relations. A board of directors maintains relationships with important stakeholders, including as shareholders, clients, suppliers, and regulatory bodies. To gain their trust and ensure that the company's operations live up to their expectations, these groups require good communication and interaction.

g) Succession planning: One of the board's main responsibilities is to ensure that the company has capable leadership in succession. Identifying potential leaders for the company and establishing plans for succession if necessary are both included in succession planning.

Stop to Consider

• Board Composition Matters: A balanced mix of executive, non-executive, and independent directors strengthens oversight and reduces bias.

• Independence is Key: Independent directors provide unbiased judgment, helping to protect shareholder and stakeholder interests.

• Diversity Drives Better Decisions: Gender, professional, and experiential diversity on boards leads to broader perspectives and more effective governance.

• Fiduciary Duties Are Fundamental: Directors must act in good faith, with due care and loyalty, always putting the company's interests first.

• Training and Development Aren't Optional: Ongoing education helps directors stay informed about industry trends, laws, and best practices.

• Transparency Builds Trust: A well-structured board improves disclosure and transparency, leading to stronger investor confidence.

• Committees Enhance Focus: Specialized board committees allow for deeper analysis of critical areas like audit, risk, and remuneration.

• Legal and Ethical Oversight is a Priority: Boards are not just strategic bodies—they are guardians of ethical conduct and regulatory compliance.

7.6 Board Committees and Their Functions

As stated by the Institute of Company Secretaries of India, a board committee is 'a small working group identified by the board, consisting of board members, for the purpose of supporting the board's work'. Committees are typically established to increase board efficacy and efficiency in areas that need for more specialised, technical, and concentrated discussions. These committees report at the next board meeting and lay the foundation for decision-making.

Board committees usually serve three core functions such as governance, coordination and research and recommendations. Committee formation has become essential for organisations of any size due to the growing complexity of business and the time commitment of board members. Committees maintain the quantity of a manageable number of participants; in bigger groups, either a lot of people are unable to talk or the conversation becomes quite drawn out.

Committees may be formed for a diverse range of organisational needs, such as:

1. To look after/administer/support Board members and committee members and other executive positions
2. To select Board members, to select a CEO, to select key managerial and senior management personnel
3. To manage investment related decisions
4. To identify, measure and handle risks
5. To look into safety, health and environment issues
6. To inquire into particular questions (disciplinary, technical, etc.)
7. To manage the business of the organization between Board meetings.
8. To be responsible for financial reporting, organising audits, etc.
9. To identify new markets, build relationships with the media and public, etc.

7.6.1 Committee Management

Committees operate in compliance with the board-established terms of reference. Board committees can be ad hoc, meaning they end when their work is done, or they can remain standing. Articles or legislation should make provisions for standing committees. Committees suggest policies for the board as a whole to approve. Committees guarantee a range of viewpoints on the board and fully utilise the experience, dedication, and time of board members. They function at the board level rather than the staff level, and they do not replace the accountability of each board member. All committee meetings should have minutes taken, and the final minutes must be presented to the board.

Check Your Progress

Q1: What is the purpose of forming board committees within an organization?

7.7 Different Types of Board Committees Under the Companies Act, 2013

The Companies Act, 2013 has mandated the constitution of the following four board committees for all listed companies.

7.7.1 Audit Committee

One of the key pillars of any company's corporate governance system is the audit committee. The Audit Committee, which is primarily responsible for monitoring financial reporting and disclosure, seeks to increase trust in the accuracy of the company's financial reporting, internal control procedures, and risk management systems. The Audit Committee's mandate under the Companies Act, 2013 (henceforth referred to as the Act) differs greatly from that established under Section 292A of the Companies Act 1956, and its constitution and scope have also been expanded. Every listed company and a certain class or classes of firms are required under the Act to establish an audit committee.

Applicability of Audit Committee

Under Section 177 of the Act, the Board of directors of every listed company and the following classes of companies is required to constitute a Audit Committee of the Board:

(i) all public companies with a paid up capital of ten crore rupees or more;

(ii) all public companies having turnover of one hundred crore rupees or more;

(iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

The paid up share capital or turnover or outstanding loans or borrowings or debentures or deposits, as the case may be , as existing on the date of last audited financial statements shall be taken into account for the purposes of this rule.

Composition of the Audit Committee

A minimum of three directors, with independent directors making up the majority, will make up the Audit Committee. The majority of the Audit Committee's members, including the chairperson, must be able to read and comprehend basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows. The Chairman of the Audit Committee shall be an independent director. The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries. The Company Secretary shall act as the secretary to the committee.

Meetings of the Committee

According to the amended section 49, the Audit Committee must convene at least four times annually, with a maximum of four months separating meetings. There should be a minimum of two independent members present, but the quorum might be as small as two members or as large as one-third of the audit committee's members. The Audit Committee, which is arguably the most powerful committee, may invite executives to attend its meetings if it deems it appropriate, especially the head of the finance function. However, it may also occasionally meet without any executives from the company present. The head of internal audit, the finance director, and a statutory auditor representative may be invited to attend audit committee meetings.

Functions of the Committee

Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board. Terms of reference as prescribed by the board shall include,

(a) the recommendation for appointment, remuneration and terms of appointment of auditors of the company;

(b) review and monitor the auditor's independence and performance, and effectiveness of audit process;

(c) examination of the financial statement and the auditors' report thereon;

(d) approval or any subsequent modification of transactions of the company with related parties;

(e) scrutiny of inter-corporate loans and investments;

(f) valuation of undertakings or assets of the company, wherever it is necessary;

(g) evaluation of internal financial controls and risk management systems;

(h) monitoring the end use of funds raised through public offers and related matters.

Role of Audit Committee

Role of the Audit committee is given in the revised clause 49, which includes:

1. Supervision of the business's financial reporting procedure and information disclosure to guarantee the accuracy, sufficiency, and reliability of the financial statement.
2. Suggestion for the hiring, compensation, and terms of appointment of the company's auditors.
3. Authorisation of payment to statutory auditors for any additional services they provide.
4. Reviewing, with the management, the annual financial statements and auditor's report thereon before submission to the board for approval, with particular reference to:
    a) matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause (c) of sub-section 3 of section 134 of the Companies Act, 2013
    b) changes, if any, in accounting policies and practices and reasons for the same (c) major accounting entries involving estimates based on the exercise of judgment by management
    c) significant adjustments made in the financial statements arising out of audit findings
    d) compliance with listing and other legal requirements relating to financial statements
    e) disclosure of any related party transactions
    f) qualifications in the draft audit report
5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval.
6. Reviewing, with the management, the statement of uses / application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for

purposes other than those stated in the offer document / prospectus / notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take up steps in this matter.

7. Review and monitor the auditor's independence and performance, and effectiveness of audit process.
8. Approval or any subsequent modification of transactions of the company with related parties.
9. Scrutiny of inter-corporate loans and investments.
10. Valuation of undertakings or assets of the company, wherever it is necessary.
11. Evaluation of internal financial controls and risk management systems.
12. Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems.
13. Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
14. Discussion with internal auditors of any significant findings and follow up there on.
15. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
16. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.

17. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non-payment of declared dividends) and creditors.
18. To review the functioning of the Whistle Blower mechanism.
19. Approval of appointment of CFO (i.e., the whole-time Finance Director or any other person heading the finance function or discharging that function) after assessing the qualifications, experience and background, etc. of the candidate.
20. Carrying out any other function as is mentioned in the terms of reference of the Audit Committee.

Powers of the Audit Committee

Under section 177 the Audit committee has the following powers:

1. The Audit Committee has the **power to call for the comments** of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.
2. The Audit Committee has **authority to investigate** into any matter in relation to the items specified in terms of reference or referred to it by the Board and for this purpose the Committee has power to obtain professional advice from external sources. The Committee for this purpose shall have full access to information contained in the records of the company.
3. The auditors of a company and the key managerial personnel have a **right to be heard** in the meetings of the Audit Committee when it considers the auditor's report but shall not have the right to vote.

As per revised clause 49 the Audit Committee shall have the powers to:

(i) Investigate any activity within its terms of reference;

(ii) Seek information from any employee;

(iii) Obtain outside legal or other professional advice;

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

Revised Clause 49 further provides that the Audit Committee shall mandatorily review the following information:

(a) Management discussion and analysis of financial condition and results of operations;

(b) Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;

(c) Management letters / letters of internal control weaknesses issued by the statutory auditors;

(d) Internal audit reports relating to internal control weaknesses; and

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

Audit Committee and Vigil Mechanism

Subsections (9), (10) of section 177 of the Act with rule 7 of the Companies (Meetings of Board and its Powers) Rules, 2014 provide that every listed company and the companies belonging to the following class or classes shall establish a vigil mechanism for their directors and employees to report their genuine concerns or grievances:

a) the Companies which accept deposits from the public.

b) the Companies which have borrowed money from banks and public financial institutions in excess of fifty crore rupees.

The vigil system will be supervised by the audit committee, which must be formed by the required companies. The vigil mechanism must offer sufficient protections against abuse of those who utilise it, as well as direct access to the Audit Committee chairperson in suitable or extraordinary circumstances. The details of establishment of vigil mechanism are required to be disclosed by the company on its website, if any, and in the Board's report.

Disclosure in Board's Report: The Board's report is required to disclose the composition of audit committee and where the Board had not accepted any recommendation of the Audit Committee, the same is also required to be disclosed in the Board's report along with the reasons therefore.

Check Your Progress

Q2: Why is the function of the Audit Committee critical?

Risk Management Committee

In addition, the revised Clause 49 of the Listing Agreement also requires that the company through its Board of Directors shall constitute a **Risk Management Committee**. The majority of the Risk Management Committee shall consist of members of the Board of Directors. Senior executives of the company may be members of the said committee but the chairman of the committee shall be a member of the Board of Directors. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company. Further, the Board shall define the roles and responsibilities of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit.

Ask Yourself
Question 1:
How does the Risk Management Committee contribute to proactive decision-making?

7.7.2 Nomination and Remuneration Committee

Applicability of the Nomination and Remuneration Committee

According to Section 178 of the Companies Act 2013, the Board of Directors of every listed company and the following classes of companies are required to constitute a Nomination and Remuneration Committee of the Board:

i. all public companies with a paid up capital of ten crore rupees or more;

ii. all public companies having turnover of one hundred crore rupees or more;

iii. all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Composition of the Nomination and Remuneration Committee

The Committee so constituted by the Board shall consist of:

i. Atleast three non-executive directors out of which two shall be independent directors.

ii. The chairperson of the company (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but he shall not chair such Committee.

iii. In case of a listed company as per revised clause 49, Chairman of the committee shall be an independent director.

Functions of the Nomination and Remuneration Committee

The functions of the Committee as mentioned in sub- sections (2), (3) and (4) of section 178 shall include:

1. **identify persons** who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal.
2. **carry out evaluation** of every director's performance.
3. **formulate the criteria** for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees. While formulating the policy, the Committee shall consider the following:
    a. the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;
    b. relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and
    c. remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals.

The remuneration policy formulated by the Committee is required under the Act to be disclosed in the Board's report.

Role of the Nomination and Remuneration Committee

The role of the Committee constituted by a listed company includes:

1. formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration of the directors, key managerial personnel and other employees;
2. formulation of criteria for evaluation of Independent Directors and the Board;
3. devising a policy on Board diversity;
4. identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board their appointment and removal. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report.

Check Your Progress

Q3: How does the Nomination and Remuneration Committee ensure transparency and fairness?

7.7.3 Stakeholder Relationship Committee

Applicability of the Stakeholder Relationship Committee

According to Subsection (5) of Section 178, the Board of Directors of a firm with more than 1,000 shareholders, debenture holders, deposit holders, and any other security holders at any point during a financial year shall constitute a Stakeholders Relationship Committee.

Composition of the Stakeholder Relationship Committee

Stakeholders Relationship Committee shall consist of a chairperson who shall be a non-executive director and such other members as may be decided by the Board. The chairperson of the committees or, in his absence, any other member of the committee authorised by him in this behalf is required under the section to attend the general meetings of the company.

Functions of the Stakeholder Relationship Committee

The main function of the committee is to consider and resolve the grievances of security holders of the company. On similar terms revised clause 49 of the listing agreement provides that a committee under the Chairmanship of a non-executive director and such other members as may be decided by the Board of the company shall be formed to specifically look into the redressal of grievances of shareholders, debenture holders and other security holders. The grievances of the security holders of the company may include complaints related to transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends, which shall be handled by this committee.

7.7.4 Corporate Social Responsibility Committee

Applicability of the Corporate Social Responsibility Committee

Section 135 (1) read with rule 3 of Companies (Corporate Social Responsibility Policy) Rules, 2014, mandates the constitution of a Corporate Social Responsibility (CSR) Committee of the Board by every company (which may include a holding company or a subsidiary company) having:

(a) net worth of rupees five hundred crore or more, or;

(b) turnover of rupees one thousand crore or more or;

(c) a net profit of rupees five crore or more during any financial year.

Any financial year has been clarified as to imply any of the three preceding financial years.

Composition of the Corporate Social Responsibility Committee

Section 135 provides that the CSR committee shall be constituted with three or more directors, out of which at least one director shall be an independent director. Companies (Meetings of Board and Powers) Rules, 2014, however, relax this requirement as below:

1. an unlisted public company or a private company covered under sub-section (1) of section 135 which is not required to appoint an independent director, shall have its CSR Committee without such director.

2. a private company having only two directors on its Board shall constitute its CSR Committee with two such directors:

3. with respect to a foreign company covered under these rules, the CSR Committee shall comprise of at least two persons of which one person shall be as specified under clause (d) of sub section (1) of section 380 of the Act, i.e. the person resident in India authorized to accept on behalf of the company, service of process and any notices or other documents and another person shall be nominated by the foreign company.

The composition of the Corporate Social Responsibility Committee is required to be disclosed in the Board's report prepared under the Act.

Functions of the Corporate Social Responsibility Committee

In accordance with section 135 the functions of the CSR committee include:

a) **formulating** and recommending to the Board, a CSR Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII.

b) **recommending the amount of expenditure** to be incurred on the CSR activities.

c) **monitoring the Corporate Social Responsibility Policy** of the company from time to time.

d) Further the rules provide that the CSR Committee shall **institute a transparent monitoring mechanism** for implementation of the CSR projects or programs or activities undertaken by the company.

7.8 Summing Up

In summary, a well-structured board plays a crucial role in ensuring effective corporate governance and strategic decision-making. The board of directors serves as the governing body responsible for overseeing management, safeguarding shareholder interests, and driving long-term business success. Within the board, committees are established to enhance efficiency, focus on key governance areas, and provide specialized guidance on financial, risk, audit, and other critical functions.

Board committees, such as the Audit Committee, Nomination and Remuneration Committee, and Risk Management Committee, play pivotal roles in maintaining transparency, accountability, and compliance. Their functions range from financial oversight and executive appointments to risk assessment and ethical decision-making. A well-balanced board structure fosters strong leadership, effective delegation, and sound corporate governance practices, ensuring the organization's resilience and sustainability in a dynamic business environment.

7.9 Model Questions

1. Define the term "Board of Directors." State any two functions of the Board of Directors.
2. Define a board committee and explain its significance in corporate governance.
3. List any three board committees and mention one function of each.
4. Explain the role of Board of Directors in an organisation.
5. Describe the different types of directors in a company.
6. Discuss the appointment and disqualifications of Directors under the Companies Act 2013.
7. Describe the ideal structure of a corporate board and its significance in an organisation.
8. Discuss the roles and responsibilities of the Board of Directors in ensuring ethical and strategic governance.
9. Discuss the structure, composition, and key functions of the Audit Committee.
10. Who typically chairs the Nomination and Remuneration Committee?
11. Explain the role of the Nomination and Remuneration Committee in promoting ethical and transparent governance.

12. How does the Risk Management Committee help protect the company's long-term interests?
13. Discuss the composition and functions of the CSR Committee.
14. "Board committees enable deeper scrutiny and faster decision-making." Do you agree? Justify your answer with reference to at least two committees.

7.10 Answers to Check Your Progress

Question 1: What is the purpose of forming board committees within an organization?

The purpose of forming board committees within an organization is to enhance efficiency, focus, and accountability in corporate governance by delegating specific responsibilities to smaller groups of directors. It can be explained as below:

- Specialization and Focus: Committees allow directors to focus on specific areas like audit, risk, remuneration, or nomination, enabling deeper scrutiny and expertise-based decisions.
- Improved Efficiency: By handling detailed work in smaller groups, committees make the board's overall functioning more streamlined and time-efficient.
- Enhance Transparency and Accountability: Committees like the Audit Committee ensure transparent financial reporting, while the Nomination and Remuneration Committee ensures fair executive appointments and pay.
- Regulatory Compliance: Many committees are mandatory under law (e.g., Companies Act, 2013 and SEBI regulations), helping the organization stay compliant.

- Informed and Independent Oversight: Committees, especially those composed of independent directors, provide unbiased oversight, reducing conflicts of interest.
- Supports Board Decision-Making: Committees prepare detailed reports and recommendations, helping the full board make more informed and strategic decisions.

Question 2: Why is the function of the Audit Committee critical?

- **Prevents Fraud & Misstatements:** By verifying the accuracy of financial reports, it helps prevent manipulation or fraud.
- **Protects Stakeholder Interests:** It builds trust among shareholders, investors, regulators, and the public.
- **Promotes Corporate Governance:** Ensures that financial decisions are made ethically and in compliance with the law.
- **Enables Informed Decision-Making:** Gives the board reliable financial insights for strategic decisions.

Question 3: How does the Nomination and Remuneration Committee ensure transparency and fairness?

The Nomination and Remuneration Committee (NRC) ensures transparency and fairness in a company's governance practices by following structured, objective, and regulatory-guided processes in its functioning. This can be explained as below:

• Merit-Based Selection of Directors & Key Executives: The NRC formulates clear criteria for identifying and nominating directors and senior management based on qualifications, experience, integrity, and diversity. This reduces favouritism or bias and promotes objectivity in appointments.

• Transparent Remuneration Policy: The committee designs a well-documented remuneration policy that aligns with market standards, company performance and individual performance and is disclosed in the company's annual report and/or on the website, ensuring public visibility.

• Performance-Linked Evaluation: It ensures that remuneration is linked to measurable performance metrics, not arbitrary decisions. This applies to executive compensation, incentives, bonuses, and board evaluation processes.

• Independent Oversight: The NRC is usually composed majorly of independent directors, minimizing conflicts of interest and ensuring fair and unbiased decisions.

• Regulatory Compliance: It ensures the company complies with Section 178 of the Companies Act, 2013 and SEBI (LODR) Regulations, for listed companies. These laws require fair and transparent policies regarding director appointments and pay.

• Board Evaluation and Succession Planning: The NRC conducts annual evaluations of the board's performance and develops succession plans for key roles, preventing power concentration or abrupt transitions.

In essence, the NRC acts as a gatekeeper for ethical leadership by standardizing selection and remuneration, improving stakeholder confidence, and enhancing corporate governance.

7.11 Possible Answer to Ask Yourself Questions

Question: How does the Risk Management Committee contribute to proactive decision-making?

The Risk Management Committee (RMC) plays a vital role in helping companies make proactive, informed decisions by identifying, assessing, and mitigating risks before they become critical issues. It can be explained as below:

- Early Identification of Risks: The RMC systematically identifies potential risks such as financial, operational, strategic, regulatory, or reputational in advance. This enables the board and management to anticipate challenges rather than react to crises.

- Risk Assessment and Prioritization: The committee evaluates the likelihood and impact of each risk. By prioritizing high-risk areas, it guides leadership on where to focus attention and resources.
- Policy and Framework Development: It helps develop a formal risk management framework, ensuring that all departments follow a consistent approach. This structured process allows for more confident and data-backed decisions.
- Integration with Strategic Planning: The RMC ensures that risk insights are integrated into the company's strategic and investment decisions, allowing for balanced risk-taking aligned with long-term goals.
- Continuous Monitoring and Reporting: Constant risk monitoring allows the company to respond swiftly to changes in the internal or external environment. Regular reporting to the board keeps decision-makers well-informed and alert.
- Building a Risk-Aware Culture: By promoting awareness and accountability at all levels, the RMC helps embed risk-thinking into everyday decision-making, not just during crises.

In short, the RMC acts as a strategic advisor, helping the company navigate uncertainty with confidence, agility, and foresight.

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Unit-8
Corporate Governance and Shareholder Rights: Activism, Institutional Investors, and Class Action Suits

Unit Structure:

8.1 Introduction

Corporate governance ensures transparency and accountability in the management of companies. The company is operated for the benefit of all stakeholders, especially the shareholders. Owners or shareholders have fundamental rights regarding influencing the managerial decision processes and ensuring that the direction taken by the leadership is in their interest. Shareholder activism is one of the powerful forces to have emerged recently, where investors, especially institutional investors, play an active role in corporate decision-making to enforce change, good governance, and other issues, such as sustainability and executive compensation. Institutional investors, with huge financial stakes, can influence the policies and practices of corporations by exercising voting rights, dialogue with management, and public campaigns. In addition, class action suits provide shareholders with a common mechanism for addressing corporate malfeasance on their own. This, therefore, creates a high demand for governance structures that protect the rights of shareholders and enhance long-term value creation.

8.2 Objectives

After going through this unit, you shall be able to-

- *explain* corporate governance and shareholders rights,
- *understands* Shareholders activism,
- *describes* the role of Institutional Behaviour,
- *explains* the concept of Class action suits.

8.3. Corporate Governance and Shareholders Rights

Corporate governance refers to the system of managing and administering companies. It is concerned with the rules, practices, and processes governing the management of the corporation as well as the operation in a transparent, accountable, and equitable manner. Above all, corporate governance is usually concerned with the balance of interests of the stakeholders of the company, including shareholders, management, customers, suppliers, financiers, government, and the community. Fostering trust through a strong corporate governance framework; achieving long-term economic goals of the company with sustainable growth.

8.3.1 Shareholders' Rights in Corporate Governance

Shareholders are the owners of a corporation, and protecting their rights is a cornerstone of corporate governance. Effective governance frameworks ensure that shareholders have the ability to exercise their rights and that their interests are safeguarded. Key shareholders' rights include:

1. **Right to Ownership:** Shareholders have the fundamental right to own a portion of the company. This ownership is represented by shares, and shareholders benefit from the company's profits in the form of dividends and capital appreciation.
2. **Right to Participate in Decision-Making:** Shareholders are entitled to participate in major corporate decisions, such as electing members of the board of directors, approving mergers and acquisitions, and deciding on changes to the company's constitution. This is primarily achieved through voting rights at annual general meetings (AGMs).
3. **Right to Information**: Shareholders have the right to receive timely and accurate information about the company's financial performance, operations, and strategic initiatives. This includes access to annual reports, quarterly financial statements, and other disclosures.
4. **Right to Dividends:** Shareholders are entitled to a share of the company's profits, distributed as dividends. The declaration and payment of dividends are determined by the board of directors based on the company's profitability and financial health.
5. **Right to Transfer Shares:** Shareholders have the right to sell or transfer their shares to other parties without undue restrictions. This right ensures liquidity and allows investors to exit their investments when desired.
6. **Right to Redress:** In cases where shareholders believe that their rights have been violated, they have the right to seek legal remedies. This may include filing lawsuits against the company

or its management for misconduct, fraud, or breaches of fiduciary duty.

7. **Right to Convene Meetings:** Shareholders holding a minimum percentage of the company's shares (as stipulated by law) can request the convening of an extraordinary general meeting (EGM) to discuss specific issues of concern.
8. **Right to Approve Changes in Capital Structure:** Shareholders must approve significant changes in the company's capital structure, such as the issuance of new shares, stock splits, or share buybacks.

8.3.2 Corporate Governance Mechanisms to Protect Shareholders' Rights

To ensure that shareholders' rights are respected and upheld, companies implement various corporate governance mechanisms. These include:

1. **Board of Directors** The board of directors plays a critical role in overseeing the management of the company and ensuring that shareholder interests are protected. Independent directors, in particular, provide unbiased oversight and mitigate conflicts of interest.
2. **Audit Committees** Audit committees, comprising independent directors, oversee the company's financial reporting processes, internal controls, and risk management systems. They ensure the integrity of financial disclosures and compliance with legal and regulatory requirements.
3. **General Meetings** Annual general meetings (AGMs) and extraordinary general meetings (EGMs) provide a platform for

shareholders to voice their concerns, vote on key matters, and engage with the company's management.

4. **Regulatory Compliance** Companies must adhere to legal and regulatory requirements related to corporate governance. Regulatory bodies, such as the Securities and Exchange Board of India (SEBI) in India, establish guidelines to protect shareholders and promote transparency.
5. **Shareholder Activism** Shareholder activism involves shareholders taking an active role in influencing the company's decisions. This may include advocating for changes in corporate policies, management practices, or environmental and social initiatives.
6. **Proxy Voting** Shareholders who are unable to attend general meetings in person can exercise their voting rights through proxy voting. This ensures that their voices are heard in critical decisions.

8.3.3 Challenges in Protecting Shareholders' Rights

Despite the implementation of corporate governance frameworks, shareholders' rights can still face challenges, including:

1. **Minority Shareholder Oppression:** Majority shareholders may misuse their influence to marginalize minority shareholders and make decisions that are not in the latter's best interests.
2. **Lack of Transparency:** Insufficient disclosure of financial and operational information can hinder shareholders' ability to make informed decisions.
3. **Insider Trading:** The misuse of confidential information for personal gain undermines shareholder trust and violates their rights.

4. **Ineffective Board Oversight:** Boards of directors that fail to act independently or exercise adequate oversight can compromise shareholder interests.
5. **Regulatory Weaknesses:** Inadequate enforcement of corporate governance laws and regulations can leave shareholders vulnerable to exploitation.

8.3.4 Enhancing Corporate Governance and Shareholder Rights

To address these challenges, companies and regulators can take the following steps:

1. **Strengthening Regulatory Frameworks:** Governments and regulatory bodies must establish and enforce robust corporate governance laws to protect shareholders and ensure transparency.
2. **Promoting Shareholder Engagement:** Companies should actively engage with shareholders, encourage participation in decision-making, and address their concerns.
3. **Enhancing Board Independence:** Ensuring that boards of directors include a majority of independent members can improve oversight and accountability.
4. **Increasing Transparency:** Companies should adopt best practices for financial and operational disclosures, providing shareholders with comprehensive and timely information.
5. **Educating Shareholders:** Educating shareholders about their rights and the importance of corporate governance can empower them to take an active role in the company's affairs.
6. **Addressing Minority Shareholder Concerns:** Mechanisms such as cumulative voting and class action lawsuits can help protect the interests of minority shareholders.

8.4. Shareholder Activism

Shareholder activism refers to the actions taken by shareholders to influence a company's behaviour, policies, and decision-making. This activism can take many forms, from pushing for changes in corporate governance, environmental policies, executive compensation, to advocating for social or political issues. It plays a significant role in ensuring that companies remain accountable not only to their shareholders but also to other stakeholders, including employees, customers, and society at large. In the context of ethics, corporate governance, and sustainability, shareholder activism serves as a critical tool for aligning the interests of companies with broader societal values.

8.4.1. The Evolution of Shareholder Activism

Historically, shareholders were passive investors, with little power to influence company decisions. However, the rise of institutional investors, such as mutual funds, pension funds, and hedge funds, transformed this dynamic. These large investors began using their voting power to push for changes in corporate practices. The 1980s and 1990s saw a surge in activist campaigns, especially in the United States, as institutional investors became more assertive. Shareholder activism gained further prominence with the rise of socially responsible investing (SRI) and environmental, social, and governance (ESG) criteria.

Today, shareholder activism has become a global phenomenon, with both individual and institutional investors leveraging their influence to push for changes in areas such as environmental sustainability, social justice, and corporate governance. The increased use of technology and social media has also amplified the reach and effectiveness of activist campaigns, enabling activists to mobilize support and rally for causes faster and more efficiently than ever before.

8.4.2. Types of Shareholder Activism

1. **Proxy Fights**: One of the most common forms of shareholder activism is a proxy fight, where activist shareholders attempt to gain control of a company's board of directors by convincing other shareholders to vote in favour of their proposed candidates or changes. Proxy fights can be contentious and often lead to significant changes in leadership and strategy.
2. **Shareholder Proposals**: Shareholders can submit proposals to be voted on at annual general meetings (AGMs). These proposals can cover a wide range of issues, from changes in corporate governance practices to advocating for more sustainable practices, such as reducing carbon emissions. If the proposal garners enough support from other shareholders, the company may be forced to adopt the changes.
3. **Public Campaigns**: Activists can launch public campaigns to pressure a company into making changes. These campaigns may include media outreach, social media activism, and mobilizing consumer support. Public campaigns are particularly effective when the issue at hand aligns with public interest, such as environmental protection or social justice.
4. **Engagement and Dialogue**: Shareholder activists often prefer direct engagement with the company's management before resorting to more aggressive tactics. This can involve private meetings, letters, or collaborative discussions to address concerns. Engagement is often used when activists seek incremental changes rather than drastic shifts in company operations.

5. **Litigation**: In some cases, shareholder activists may resort to legal action to force companies to adhere to their fiduciary duties or comply with regulations. This can involve suing the company for breaches of corporate governance or failure to disclose material information to shareholders.

8.4.3 The Role of Shareholder Activism in Corporate Governance

Corporate governance refers to the system of rules, practices, and processes by which a company is directed and controlled. Effective corporate governance ensures that companies are managed in a way that is transparent, accountable, and aligned with the interests of shareholders and other stakeholders. Shareholder activism plays a critical role in improving corporate governance by holding management accountable and pushing for changes that benefit all stakeholders.

1. **Board Composition and Leadership**: Activist shareholders often target a company's board of directors, advocating for changes in leadership or the appointment of new members with specific skills, such as expertise in sustainability, technology, or diversity. This can lead to improved decision-making and a more diverse and competent board.
2. **Executive Compensation**: Shareholder activists frequently challenge excessive executive compensation, especially when it is not aligned with company performance. Activists may push for the introduction of performance-based incentives and greater transparency in executive pay structures.
3. **Transparency and Disclosure**: Shareholder activists often demand greater transparency in financial reporting, executive compensation, and company practices. This can include pushing for more detailed disclosures on ESG matters, such as carbon

emissions, employee treatment, and supply chain practices. Transparent reporting helps investors make more informed decisions and ensures that companies are accountable for their actions.

8.4.4. Shareholder Activism and Sustainability

In the context of sustainability, shareholder activism has become a powerful tool for pushing companies to adopt more environmentally and socially responsible practices. The growing importance of ESG factors has prompted many investors to use their influence to advocate for greater attention to sustainability issues.

1. **Environmental Impact**: Shareholders have been instrumental in pushing companies to reduce their environmental footprint. This includes advocating for lower carbon emissions, transitioning to renewable energy sources, and improving waste management. Activists may also push for companies to adopt climate change policies and disclose their environmental impact in line with global standards.

2. **Social Responsibility**: Shareholder activists often address social issues, such as fair labour practices, human rights, diversity, and inclusion. They may push for companies to adopt policies that promote diversity on boards and in leadership positions, as well as improve working conditions for employees and ensure ethical sourcing of materials.

3. **Governance and Ethics**: Activists may also focus on governance issues that have ethical implications, such as anti-corruption measures, fair business practices, and stakeholder rights. By pushing companies to adhere to high ethical standards, shareholder activism can help ensure that corporate actions align with broader societal values.

8.4.5. The Challenges and Criticism of Shareholder Activism

While shareholder activism has had positive outcomes in many cases, it is not without its challenges and criticisms. Some critics argue that activist shareholders are primarily motivated by short-term profit maximization, rather than long-term sustainability or social responsibility. These critics suggest that activists may pressure companies to adopt changes that are not in the best interest of the company or its stakeholders, such as pushing for cost-cutting measures that harm employees or reduce product quality.

Furthermore, shareholder activism can be disruptive, especially when it leads to boardroom battles, changes in management, or public controversies. This can create uncertainty, which may negatively impact a company's stock price or reputation.

Additionally, there is the issue of the unequal influence of large institutional investors over smaller shareholders, raising concerns about the democratic nature of shareholder activism. In some cases, the interests of large institutional investors may not align with the interests of smaller shareholders, leading to a concentration of power that undermines the broader goals of corporate governance.

Check Your Progress

1. What are the changes in the role of institutional investors in shareholder activism, and how has this impacted the practice of corporate governance?

2. What are activist shareholder strategies, and how do these impact company policy on corporate governance and sustainability?

3. How is shareholder activism playing a role in environmental sustainability and social responsibility in firms?

Self-Asking Questions

1. Do you think activism can be both friendly and hostile?

2. Do you think all shareholder activism is beneficial?

8.5. Role of Institutional Behaviour

Institutional behaviour plays a pivotal role in shaping the ethical, governance, and sustainability frameworks within organizations and societies. It encompasses the collective actions, decisions, and practices of institutions that influence their stakeholders, the broader economic environment, and the socio-political landscape. Understanding this role is essential for fostering trust, ensuring accountability, and achieving long-term sustainability

8.5.1. Defining Institutional Behaviour

Institutional behaviour refers to the patterns of conduct exhibited by institutions, including corporations, governments, non-profits, and other organized entities. These behaviours are guided by their values, policies, regulatory frameworks, and the expectations of their stakeholders. Ethical decision-making, adherence to governance principles, and a commitment to sustainability are all outcomes of positive institutional behaviour.

8.5.2. Ethics in Institutional Behaviour

Ethics forms the foundation of institutional behaviour. It refers to the moral principles that guide an institution's actions and decisions. Institutions with strong ethical values prioritize integrity, transparency, and fairness in their dealings. Key aspects of ethics in institutional behaviour include:

- **Code of Conduct:** Institutions often establish codes of ethics or conduct to outline expected behaviours and decision-making principles. These codes promote accountability and consistency across the organization.
- **Leadership Integrity:** Ethical institutional behaviour starts at the top. Leaders who model ethical behaviour set a precedent for employees and stakeholders, fostering a culture of trust and accountability.
- **Stakeholder Consideration:** Ethical institutions balance the interests of various stakeholders, including shareholders, employees, customers, and the community. This ensures decisions are not solely profit-driven but also socially responsible.

8.5.3. Corporate Governance and Institutional Behaviour

Corporate governance refers to the system by which organizations are directed and controlled. Institutional behaviour directly impacts governance practices, influencing accountability, fairness, and transparency. The interplay between governance and institutional behaviour can be analysed through the following dimensions:

- **Board Oversight:** Effective governance requires a competent and independent board of directors. The board's behaviour, including its commitment to ethical practices and oversight, sets the tone for the entire organization.
- **Risk Management:** Institutions with strong governance structures proactively manage risks. This includes identifying ethical risks, such as conflicts of interest or fraudulent practices, and implementing measures to mitigate them.
- **Transparency and Reporting:** Transparent communication with stakeholders is a hallmark of good governance. Institutions that

engage in open reporting of financial performance, sustainability efforts, and governance practices build stakeholder confidence.

8.5.4. Institutional Behaviour and Sustainability

Sustainability refers to meeting the needs of the present without compromising the ability of future generations to meet their own needs. Institutional behaviour is critical in driving sustainable practices. This involves:

- **Environmental Responsibility:** Institutions adopting sustainable behaviour focus on reducing their carbon footprint, conserving resources, and minimizing waste. Initiatives like adopting renewable energy sources and promoting circular economies are examples of positive institutional behaviour.
- **Social Equity:** Institutions play a role in promoting social equity by addressing issues such as diversity, inclusion, and fair labour practices. Behaviour that prioritizes social justice strengthens societal trust.
- **Long-term Vision:** Sustainability requires institutions to think beyond short-term profits. Ethical investments, corporate social responsibility (CSR) initiatives, and sustainable supply chain management are examples of long-term-focused behaviours.

8.5.5. Drivers of Institutional Behaviour

Several factors influence institutional behaviour, including:

- **Regulatory Frameworks:** Laws and regulations set the minimum standards for ethical, governance, and sustainability practices. Institutions adhering to these frameworks demonstrate lawful and responsible behaviour.

- **Cultural Values:** Institutional behaviour often reflects the cultural values of the society in which it operates. For example, institutions in cultures emphasizing collectivism may prioritize community welfare over individual gains.
- **Stakeholder Pressure:** Stakeholders, including investors, customers, and advocacy groups, influence institutional behaviour by demanding ethical practices and accountability.
- **Market Dynamics:** Competition and market trends also shape behaviour. Institutions that align their strategies with emerging sustainability and governance trends gain a competitive edge.

8.5.6. Challenges in Institutional Behaviour

Despite its importance, fostering positive institutional behaviour is not without challenges. Some of the common barriers include:

- **Conflicts of Interest:** Institutions may face situations where profit motives conflict with ethical or sustainable practices.
- **Short-termism:** Pressure to deliver immediate results can undermine long-term sustainability and ethical commitments.
- **Cultural Resistance:** Instituting changes in behaviour often faces resistance, particularly in institutions with entrenched practices.
- **Weak Enforcement:** Inadequate regulatory oversight or enforcement mechanisms can lead to non-compliance with ethical and governance standards.

8.5.7. Enhancing Institutional Behaviour

To overcome these challenges and foster positive institutional behaviour, organizations can adopt the following strategies:

- **Training and Education:** Regular training on ethics, governance, and sustainability equips employees and leaders to make informed decisions.
- **Stakeholder Engagement:** Actively involving stakeholders in decision-making processes ensures that diverse perspectives are considered.
- **Monitoring and Evaluation:** Institutions should establish mechanisms to monitor their behaviour and evaluate their impact on stakeholders and the environment.
- **Incentivizing Positive Behaviour:** Reward systems that recognize ethical and sustainable practices encourage their adoption across the institution.
- **Leadership Commitment:** Leadership commitment to ethical, governance, and sustainability goals is essential. This can be demonstrated through actions such as setting ambitious sustainability targets or championing diversity initiatives.

8.5.8. Case Studies of Institutional Behaviour

Studying real-world examples helps illustrate the role of institutional behaviour:

- **Tata Group (India):** Known for its ethical practices, the Tata Group has consistently prioritized corporate governance and sustainability. Initiatives such as the Tata Sustainability Group highlight its commitment to responsible behaviour.
- **Patagonia (USA):** This apparel company exemplifies sustainable institutional behaviour by focusing on environmental conservation, ethical sourcing, and transparency in its operations.
- **Norway’s Sovereign Wealth Fund:** As one of the world’s largest investors, the fund emphasizes ethical investing, excluding

companies that violate human rights or contribute to environmental harm.

8.5.9. Future Trends in Institutional Behaviour

The role of institutional behaviour will continue to evolve as global priorities shift. Emerging trends include:

- **Integration of ESG (Environmental, Social, Governance) Metrics:** Institutions are increasingly using ESG metrics to evaluate their performance and decision-making.
- **Technological Advancements:** Digital tools like blockchain and AI are enhancing transparency and accountability in institutional behaviour.
- **Global Collaboration:** Institutions are collaborating across borders to address global challenges like climate change and inequality.

Check Your Progress

6. What does ethical decision-making contribute to organizational behaviour in building trust and accountability within organizations and stakeholders?

7. What impact do regulatory systems have on the sustainability and governance practices of institutions?

8. How do institutions balance short-term pressure to maximize profits with longer-term goals of sustainability, and on what challenges does this present them?

9. What are some of the strategies which organizations can use in order to establish beneficial institutional behaviour, specifically in ethics, governance, and sustainability?

8.6. Class Action Suits: The Power of Collective Accountability

In the fast-paced world of corporations and businesses, it's easy to lose sight of one simple truth: companies exist within communities. They are woven into the fabric of society, impacting lives through their decisions, products, and practices. But what happens when a company fails its community—through dishonesty, negligence, or unethical behaviour? This is where class action suits step in, offering a powerful way for people to stand together and demand accountability.

8.6.1. What Are Class Action Suits?

Imagine you've bought a product, only to find it's defective. Alone, you might not have the time or money to take legal action against the company responsible. But what if thousands of others are in the same boat? A class action suit allows people with similar grievances to come together as one, pooling their claims into a single case.

These lawsuits are typically launched by consumers, shareholders, or employees who have been wronged—whether through deceptive practices, environmental harm, or financial mismanagement. By grouping their claims, individuals can take on powerful corporations in a way that's efficient, effective, and fair.

Why Class Actions Matter**:**

- Strength in Numbers**:** They amplify individual voices by uniting them into one powerful force.
- Levelling the Playing Field: Even small claims gain significance when combined, ensuring justice for everyone involved.
- Promoting Change**:** The financial and reputational stakes of a class action encourage companies to rethink their behaviour.

8.6.2 The Ethical Heart of Class Actions

At their core, class action suits are about ethics—those invisible guidelines that shape how businesses interact with their stakeholders. When companies stray from these principles, it’s not just profits or reputations at stake; real lives are affected.

Take, for instance, cases of financial fraud. Misleading investors about a company’s performance isn’t just a breach of trust—it’s an ethical failure that can shatter livelihoods. Similarly, environmental disasters caused by negligence harm ecosystems and entire communities. Class action suits aim to address these wrongs, giving people a chance to hold corporations accountable for their choices.

Ethical Breaches That Spark Class Actions:

1. Deceptive Practices**:** Whether it’s fudging financial statements or hiding product defects, dishonesty always catches up.
2. Environmental Neglect**:** Ignoring environmental safeguards often leads to lawsuits that demand reparations for affected communities.
3. Workplace Discrimination**:** Unfair treatment of employees—whether through wage theft or unsafe conditions—remains a common trigger for legal action.

8.6.3. Corporate Governance: Keeping Companies in Check

Corporate governance is all about how companies make decisions and stay accountable. Think of it as the rulebook for running a responsible business. When governance fails—when boards look the other way, or transparency is thrown out the window—class action suits often reveal these cracks.

How Class Actions Improve Governance**:**

- They shine a light on weak spots, like poor oversight or lack of communication with shareholders.
- They hold directors and executives accountable for breaches of trust, ensuring the people at the top take responsibility.

For example, when shareholders discover that a company's leaders acted against their interests—by engaging in insider trading or withholding crucial information—a class action can bring justice and force much-needed reforms.

8.6.4. The Sustainability Connection

Sustainability has become a buzzword in recent years, but at its core, it's about responsibility: to the planet, to people, and to future generations. Companies are expected to minimize harm, whether it's reducing their carbon footprint or ensuring ethical labour practices in their supply chains.

Class action suits are a growing tool for driving sustainability. They hold companies accountable when their actions contradict their promises—like when they claim to be environmentally friendly while polluting rivers or exploiting workers.

Class Actions in Action:

- Environmental Justice**:** Lawsuits following oil spills or toxic waste dumping demand accountability and often lead to stricter safeguards.
- Labor Rights**:** Cases against companies using child labour or unsafe factory conditions remind corporations that profits should never come at the expense of human dignity.

- Transparent ESG Reporting**:** As investors increasingly look at environmental, social, and governance (ESG) factors, misleading disclosures about sustainability efforts can spark legal action.

8.6.5. Stories of Change: When Class Actions Made a Difference

Sometimes, the best way to understand the power of class action suits is through real-life examples:

1. The BP Oil Spill (2010): The Deepwater Horizon disaster wasn't just an environmental tragedy; it was a governance failure. Communities impacted by the spill came together, leading to one of the largest settlements in history. BP was forced to rethink its approach to risk management and environmental responsibility.
2. Volkswagen's Emissions Scandal (2015)**:** When VW was caught manipulating emissions tests, lawsuits poured in from around the globe. The financial and reputational fallout pushed the company to invest heavily in cleaner technologies.
3. Wells Fargo Account Fraud (2016): By creating unauthorized customer accounts, Wells Fargo betrayed its customers' trust. The class action suit that followed spurred significant changes in leadership and a renewed focus on ethical practices.

These stories remind us that class actions aren't just about penalties—they're about transformation

Check Your Progress
10. How do class action suits help amplify individual voices and ensure justice when dealing with corporate wrongdoing?

11. In what ways do class action suits address ethical breaches in corporate behaviour, such as deceptive practices, environmental neglect, and workplace discrimination?

12. How do class action suits contribute to improving corporate governance by holding directors and executives accountable for their actions?

13. What role do class action suits play in promoting sustainability, especially when companies fail to meet their environmental or labour promises?

Self-Asking Questions

3. Do you think class action suits are effective in ensuring corporate accountability?

4. Do you believe class action suits strengthen minority shareholder rights?

8.7 Summing Up

- Shareholders are key stakeholders whose rights must be protected under effective corporate governance frameworks.
- Shareholders have rights to ownership, participation in decision-making, and receiving accurate company information.
- They are entitled to dividends, can transfer shares freely, and may seek legal redress if their rights are violated.
- They can call meetings and approve major changes such as share issuances or capital restructuring.
- Mechanisms like independent boards, audit committees, and regulatory compliance protect shareholder interests.

- General meetings and proxy voting enable shareholders to engage with and influence company decisions.
- Challenges include minority shareholder oppression, insider trading, lack of transparency, and weak oversight.
- Strengthening enforcement, board independence, and disclosure practices is essential to uphold shareholders' rights.
- Institutional behaviour shapes governance and ethics through leadership integrity, stakeholder focus, and long-term vision.
- Institutions must align with regulatory frameworks, cultural values, and stakeholder expectations for sustainability.
- Class action suits allow individuals to unite against corporate misconduct, promoting fairness and systemic change.

8.8 Model Questions

1. What is corporate governance? Why is it so important to the interests of shareholders' protection?

2. Describe the rights of the shareholders in a company. How do the rights of the shareholders balance the managers and shareholders?

3. What is shareholder activism? And how can it affect corporate decision-making? Provide some examples of how it has affected corporate governance.

4. Explain the role of institutional investors in firm governance. How do they influence company policies and practices with their actions and voting rights?

5. What are the best reasons that a firm should become involved in shareholder activism? How do companies respond to activist shareholders?

6. Define class action suits in corporate governance. How do they play a critical role in making corporations responsible for complaining shareholders?

7. Describe the connection between good governance practice and value creation for shareholders over the long term. How does good governance practice help the stability and success of a firm?

8. What are the criticisms and challenges of shareholder activists, such as the risk of short-termism and the breathtaking concentration of power in the hands of large institutional investors?

9. In what ways does shareholder activism enhance transparency and accountability in board leadership and executive compensation?

10. How do class action suits serve as a tool for corporate accountability, and what impact do they have on ethical practices within businesses?

11. In what ways do class action suits contribute to promoting sustainability, and how have they influenced corporate behaviours regarding environmental and labour rights?

8.9 Answers to Model Questions

1. Corporate governance is the process of rules, practices, and procedures under which a company is directed and controlled. It promotes transparency, accountability, and fairness in the relationship between a company and stakeholders, particularly shareholders. Good governance reduces conflict of interest and abuse by managers. It safeguards shareholders' investments and creates trust in the firm.

2. Shareholders are entitled to inherent rights like voting on matters of significance, getting dividends, attending meetings, and getting financial reports. Such rights enable shareholders to contribute to

significant decisions, for instance, the election of the directors. By exercising their rights, shareholders are able to hold the management accountable. The balance guarantees that the management will act in the best interest of the owners.

3. Shareholder activism is the efforts of shareholders, especially institutional shareholders, to force change in a company's strategy, governance, or policy. Activists may call for board shakeups, enhanced ESG conduct, or restructuring. Apple, for example, increased supply chain transparency due to activist pressure. Shareholder activism can lead to enhanced governance and strategic alteration in firms.
4. Institutional investors, with large holdings, have enormous power over corporate strategy. They use proxy voting, board engagement, and policy advocacy to encourage transparency, ethical behaviour, and shareholder value. They usually initiate leadership transitions, improved ESG disclosure, and improved risk management. They decide long-term corporate strategy.
5. Issues such as poor finances, poor governance, transparency issues, or neglected ESG issues result in shareholder activism. Firms can counteract this by being open, enhancing governance practices, and being receptive to shareholder input. Active communication generally is able to eschew acrimonious confrontations and foster long-term investor confidence.
6. A class action suit allows a group of shareholders to sue a company as a whole for breach of fiduciary duty, fraud, or misrepresentation. It is a legal tool that holds corporations accountable for governance failure. The suits allow small shareholders to recover, promote corporate accountability, and deter future abuse.

7. Good corporate governance establishes investor confidence, reduces risk, and encourages ethical and strategic decision-making. It supports transparency, protects shareholder interests, and encourages thinking in the long term. Stability attracts investment, enhances reputation, and creates sustainable growth. Properly governed companies will surpass their poorly governed peers in the long term.

8. Critics point out that short-termism is a possible risk as activists also sometimes demand short-term returns. The centralization of power is also problematic as the decisions are taken by a small group of large investors and not necessarily by smaller investors. Issues of equity, proportion, and long-term stability of the company come up.

9. Activists tend to demand direct connections between executive compensation and performance, demanding compensation reforms based on long-term outcomes. They also demand diversified, independent boards and periodic assessment of the directors. This pressure results in greater oversight, equity, and transparency in leadership decisions

10. Class action suits hold corporations accountable by addressing collective grievances of shareholders or stakeholders. They deter unethical practices, as companies face legal and financial consequences for fraud, negligence, or misconduct, promoting adherence to ethical standards.

11. Class action suits encourage sustainability by penalizing companies for environmental damage or labour rights violations. These lawsuits push corporations to adopt eco-friendly practices, improve working conditions, and ensure compliance with regulations to avoid reputational and financial harm.

8.10. Answers to Check Your Progress

1. Institutional investors have become active participants rather than passive shareholders, using their voting rights and ability to influence company decisions. Their activism led to greater board accountability and forced companies to seek long-term, sustainable strategies. This transformation has made corporate governance more transparent, accountable, and responsive to investor expectations.
2. Some of the key strategies used are proxy voting, shareholder proposals, direct dialogue with management, and public campaigns. These mechanisms compel companies to enhance governance frameworks, embrace ESG practices, and address shareholder issues better. Thus, companies are now altering their businesses according to sustainability and ethical business practices.
3. Shareholder activists demand environmentally responsible actions, forcing companies to report on climate risk and reduce emissions. They demand ethical human resources policies, diversity, and community engagement. Shareholder activism demands sustainable business and makes companies socially more responsible.
4. Ethical decision-making introduces equity, transparency, and honesty in organizational behaviour. Ethical behaviour from institutions earns the trust of stakeholders, such as investors, employees, and clients. Trust leads to accountability and improves the reputation of the organization, leading to long-term success and stakeholder loyalty.
5. Regulatory frameworks impose transparency standards, risk management, board accountability, and environmental responsibility. The codes and laws promote institutions to follow

best practices in governance and sustainability. Non-adherence to the regulations can lead to sanctions and loss of reputation, while strong compliance instils public trust.

6. Institutions can achieve both by integrating sustainability into the core strategy of the institution while maintaining financial return. The dangers are short-term-oriented shareholders, scarce resources, and competition in the marketplace. Effective balance demands good leadership, long-term perspective, and organizational mindset shift.
7. Companies can adopt clear ethical codes, promote transparency, improve board governance, and invest in ESG projects. Ongoing training, stakeholder involvement, and performance measurement also promote sustainable and ethical behaviour. These measures promote a culture of accountability and institutional reputation
8. Class action lawsuits enable people who share the same complaints to gather and bring a joint lawsuit against a business. This magnifies their voice, making it economically and legally possible to go up against powerful corporations. It provides access to justice for victims and holds businesses accountable for systemic harm.
9. Such lawsuits reveal and combat unethical corporate conduct through legal remedies for abuse on a large scale. They raise public scrutiny over practices such as misleading advertising, pollution, or discriminatory policies. Winning lawsuits typically results in compensation, policy reform, and discouragement of future unethical conduct.
10. Class action lawsuits may bring action against mismanagement, fraud, or fiduciary duty violations by directors or executives. Judicial scrutiny and possible sanctions compel leadership to implement improved monitoring, risk management, and

disclosure. This strengthens governance arrangements and deters unethical or irresponsible behaviour at the top.

11. Class action suits are used to hold businesses responsible when they don't live up to environmental or social standards. They can result in compensation, regulatory responses, and increased compliance with sustainability objectives. Through challenging greenwashing or labour abuses, the suits enforce responsible business and social justice.

8.11Answers to SAQ

1. Yes, shareholder activism can be cooperative (engaging privately with management) or confrontational (public campaigns, legal action, or proxy battles). The approach depends on the company's responsiveness and the activist's goals.
2. Not necessarily. While activism often uncovers inefficiencies or governance gaps, some activist investors may pursue personal financial gains over collective stakeholder welfare. The impact depends on the intent and method of activism.
3. Yes, they are effective in increasing pressure on corporations to act ethically. They bring public scrutiny, financial risk, and legal consequences to companies that indulge in fraud, misrepresentation, or negligence. However, their effectiveness depends on robust legal enforcement.
4. Definitely. In systems dominated by majority stakeholders or promoters, minority shareholders often have limited power. Class action suits provide them a legal avenue to challenge oppression, ensuring their rights are recognized and protected collectively.

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Unit-9
Business Ethics

Unit Structure:

9.1 Introduction

Every business decision, big or small, carries with it a moral weight. From how a company treats its employees to how it markets its products or impacts the environment, ethics quietly shapes the reputation, success, and sustainability of modern enterprises. Yet, ethics in business isn’t just about compliance or image- it’s about building a culture rooted in trust and responsibility.

This unit opens with the concept of ethics, helping learners understand the underlying values that guide human behavior. It then connects these ideas to the concept of business ethics, focusing on how moral principles apply in organizational settings. As businesses grow and interact with diverse stakeholders, ethical behavior becomes not just desirable, but essential. Further, the unit outlines the key characteristics of ethics, such as fairness, accountability, and respect for others, which serve as cornerstones of ethical practice. It also explores the principles of business ethics, offering a framework for making thoughtful, responsible choices in the business world.

Through this unit, learners will develop not just an understanding of what ethics means in theory, but also why it matters in the real world- where values and profits must often walk hand in hand.

9.2 Objectives

After going through this unit, you will be able to-

- *understand* the basic concept of ethics,
- *explain* the meaning and role of business ethics,
- *identify* key characteristics of ethical business conduct,
- *discuss* fundamental principles of business ethics,
- *apply* ethical thinking to business situations.

9.3 Concept of Ethics

Ethics can be described as the foundational framework that helps individuals and societies distinguish between what is morally right and wrong. Derived from the Greek term "ethos", which refers to habits or character, ethics explores the moral principles that shape human behavior and decision-making. It is essentially a branch of philosophy concerned with evaluating how people ought to act in various situations, both personal and professional.

In the broader context of society, ethics predates the formal establishment of laws. Before the existence of legal systems, communities relied on shared moral values to guide behavior. These ethical norms evolved naturally as people began living in groups and interacting with one another, establishing an early sense of acceptable and unacceptable conduct. Over time, these moral expectations were codified into laws, but ethical reasoning continues to function independently, often serving as the conscience behind legal frameworks.

In the world of business, ethics holds a critical place. As organizations grow in size and influence, the ethical implications of their actions become increasingly significant. Ethics in business is not merely about compliance with rules; it is about creating a culture of integrity, fairness, and social responsibility. It defines how companies interact with stakeholders—employees, customers, suppliers, and the wider community.

In today's interconnected and transparent world, ethical conduct in business is more relevant than ever. With increased public scrutiny and higher expectations from consumers and regulators, businesses must not only ask whether a decision is legal but also whether it is just and fair. Ethical considerations prompt important questions such as: What is a reasonable level of profit? Are we harming society or the environment in the process? Are our practices inclusive and equitable?

9.4 Concept and Meaning of Business Ethics

Business ethics refers to the practice of applying ethical principles to the realm of business. It deals with determining what is right or wrong in the conduct of business operations and guides how organizations should behave in their pursuit of success. It involves aligning business decisions, actions, and policies with accepted standards of morality and integrity.

At its core, business ethics is about incorporating moral values into corporate decision-making. This includes not only following laws and regulations but also going beyond them to ensure that a company's activities contribute positively to society. It encourages businesses to act responsibly toward all their stakeholders—

consumers, employees, suppliers, investors, and the wider community.

Ethical business conduct goes beyond profit generation. It demands that enterprises operate with honesty, fairness, and transparency. This includes treating employees with dignity, offering safe working conditions, delivering quality goods and services at fair prices, and avoiding practices that deceive or exploit consumers. It also involves fulfilling responsibilities such as timely tax payments, environmental protection, and contributing to the well-being of society at large.

Business ethics has gained growing relevance in modern times as companies face increasing public scrutiny. Stakeholders today expect businesses to be accountable not just for financial outcomes, but also for the ethical implications of their decisions. In this context, ethical business behavior builds long-term trust, strengthens brand reputation, and fosters sustainable growth.

Stop to Consider

In business, ethics often goes unnoticed when everything is running smoothly. It quietly guides decisions and behavior behind the scenes- much like oxygen that keeps life going. But the moment a company makes an unethical choice, even a small one, it grabs public attention. Trust erodes quickly, and damage control becomes urgent. Ethics may not always be visible, but when it's missing, the impact is loud and far-reaching. That's why maintaining ethical standards is not optional- it's essential for long-term survival.

9.5 The Three Pillars of Business Ethics

Business ethics can be better understood through three essential dimensions, often referred to as the "Three C's": Compliance, Contribution, and Consequences. These pillars provide a comprehensive approach to ensuring ethical conduct in business operations and decision-making.

1. Compliance: Adhering to Rules and Standards

The first dimension involves aligning business practices with established rules, both internal and external. Ethical businesses operate within the framework of:

- Moral norms and values that reflect integrity and fairness.
- Legal requirements set by regulatory bodies to ensure lawful conduct.
- Organizational policies and procedures that promote accountability and consistency.

Compliance ensures that a company's actions are not only lawful but also morally sound and aligned with its internal code of conduct.

2. Contribution: Adding Value to Society

Ethics in business is not limited to following rules; it also involves actively contributing to the well-being of society. A responsible business should focus on:

- Delivering high-quality products and services that meet customer needs.
- Generating employment opportunities and contributing to economic development.
- Upholding core values such as honesty, respect, and responsibility.
- Ensuring that its offerings are useful and beneficial to the consumers and the community.

Contribution reflects a company's commitment to being a positive force in society, not just a profit-making entity.

3. **Consequences: Understanding the Impact of Business Activities**

Every business action has outcomes, and ethical responsibility includes evaluating those outcomes. This involves:

- Recognizing obligations to various stakeholders, including shareholders, employees, financial institutions, and customers.
- Maintaining a positive public image through ethical behavior and social engagement.

By being mindful of the broader consequences of their actions, businesses can foster trust, loyalty, and long-term success.

Check Your Progress

1. What is the meaning of ethics?
2. Define business ethics in simple terms.
3. What are the three main components or "C's" of business ethics?
4. Give one example of an ethical business practice.

9.6 Characteristics of Business Ethics

Business ethics encompasses a set of guiding principles that shape the conduct of enterprises in a responsible and value-driven manner. The following are the defining features or characteristics that characterize ethical practices in the business world:

i. **Standards for Business Conduct**: Business ethics sets out moral guidelines to determine what acceptable and unacceptable behavior in business activities is.

ii. **Structured Framework**: It offers a foundation that helps integrate social, legal, cultural, and economic considerations into business decisions.

iii. **Based on Social and Moral Values**: Principles like honesty, fairness, self-control, and responsibility form the basis of ethical business behavior.

iv. **Protection of Stakeholders**: Ethical practices safeguard the interests of all stakeholders- customers, employees, shareholders, suppliers, and society.

v. **Requires Education and Awareness**: Businesses and individuals need training and awareness to understand how to apply ethics effectively in real-world situations.

vi. **Voluntary in Nature**: Ethical conduct should come from within, not be forced by external regulations. Voluntary adoption reflects true commitment.

vii. **Varies Across Contexts**: Ethical standards are not fixed, they may change based on the industry, country, or specific business environment.

viii. **Driven by Integrity**: Integrity ensures consistency between words and actions, building credibility and trust within and outside the organization.

ix. **Commitment to Public Good**: Ethical businesses aim to contribute to the betterment of society while pursuing profits, promoting overall welfare.

9.7 Principles of Business Ethics

Business ethics refers to the values and moral rules that guide how businesses behave. While the idea of ethics in business continues to grow and change with time, there are some basic principles that most responsible businesses try to follow. These principles help organizations build trust, make fair decisions, and contribute positively to society.

i. **Honesty:** Telling the truth and being sincere in all business dealings is at the heart of ethical behavior. Whether it’s advertising a product, handling financial records, or communicating with employees, honesty helps build strong and lasting relationships.

ii. **Fairness:** Fair treatment means giving equal opportunities to everyone, avoiding discrimination, and being just in every action- whether it's hiring, promotions, pricing, or partnerships. Ethical businesses make sure no one is taken advantage of.

iii. **Responsibility:** Being responsible means accepting the consequences of your actions. Ethical companies take ownership when things go wrong and work toward making it right instead of blaming others or covering up mistakes.

iv. **Transparency:** An ethical business doesn't hide important information. Being open about policies, prices, decisions, and performance builds confidence among customers, employees, and investors. Transparency helps people make informed choices.

v. **Respect for the Law:** Following the law is the minimum standard for ethical conduct. Businesses must operate within legal boundaries and respect both local and international regulations. Ethical companies never use illegal shortcuts to gain profit.

vi. **Respect for People:** This includes treating employees, customers, and all other stakeholders with dignity and consideration. Listening to opinions, ensuring safe working conditions, and valuing contributions all reflect ethical respect.

vii. **Leadership with Values:** Ethical leaders guide by example. When managers and executives act with integrity and fairness, they set the tone for the entire organization. Ethical leadership encourages others to follow the same values.

viii. **Environmental Responsibility:** Ethical businesses recognize that they share a duty to protect the environment. They try to reduce pollution, waste, and overuse of natural resources. Sustainable practices are a sign of long-term ethical thinking.

ix. **Loyalty:** Loyalty means staying committed to your company, team, and values without compromising what's right. Ethical loyalty involves honesty and trust, not blind obedience or ignoring wrong behavior.

x. **Integrity:** Acting with integrity means staying true to your principles- even when no one is watching. It's about doing the right thing consistently, not just when it's easy or convenient.

xi. **Compassion and Empathy:** Caring about others- especially those affected by business decisions is a key part of ethics. Businesses must think beyond profits and consider how their actions impact people's lives.

xii. **Accountability:** Ethical businesses are open to being questioned. They keep clear records, welcome feedback, and allow others to review their practices. Being accountable ensures that actions align with the organization's stated values.

Check Your Progress

1. Name any two characteristics of business ethics.
2. List any three principles of business ethics.
3. Is business ethics the same in every country? Why or why not?

9.8 Summing Up

- Ethics can be described as the foundational framework that helps individuals and societies distinguish between what is morally right and wrong.
- Business ethics refers to the practice of applying ethical principles to the realm of business. It deals with determining what is right or wrong in the conduct of business operations and guides how organizations should behave in their pursuit of success.
- Business ethics can be understood through three essential dimensions, often referred to as the "Three C's"- Compliance, Contribution, and Consequences.
- Business ethics involves moral values and responsible practices that guide how companies interact with stakeholders, make decisions, and contribute to society- emphasizing honesty, fairness, integrity, and respect.
- Business ethics provides a flexible yet structured framework for ethical conduct across diverse contexts, encouraging voluntary commitment, legal compliance, environmental care, and leadership rooted in values and accountability.

9.9 Model Questions

1. "Ethics provides the foundation for responsible behavior." Discuss this statement with reference to business decision-making.
2. How can the three pillars (Compliance, Contribution, and Consequences) serve as a guide for ethical business conduct? Illustrate with examples.

3. Do you think it is possible to balance profit-making with ethical principles in today's business environment? Justify your answer with suitable arguments.
4. Discuss how the principle of accountability and transparency contributes to corporate governance and public trust.
5. Why is it necessary for businesses to adopt ethical practices voluntarily rather than being legally enforced?

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Unit-10

Theories of Business Ethics

Unit Structure:

10.1 Introduction

Ethics plays a vital role in the way businesses operate and make decisions. With increasing attention on responsible business practices, understanding ethical theories has become essential for managers, leaders, and professionals. This unit explores the key theories of business ethics that explain how businesses can determine what is right or wrong.

These theories are broadly classified into traditional and normative approaches. Traditional theories like utilitarianism, deontology, and virtue ethics offer philosophical insights rooted in moral thinking. On the other hand, normative theories such as stakeholder theory and social contract theory are more modern and practical, helping organizations make ethical decisions in real-world situations.

In addition to understanding these theories, the unit also discusses the importance of ethical theories in business. These theories help businesses develop values, guide their behavior, improve their reputation, and build trust among stakeholders. They serve as a foundation for creating ethical policies and making responsible choices in complex situations.

By the end of this unit, learners will have a clear understanding of how ethical theories shape business behavior and why they are crucial for sustainable and socially responsible business practices.

10.2 Objectives

After going through this unit, you will be able to-

- *understand* key traditional and normative ethical theories,
- Explain how these theories apply to business decision-making,
- *recognize* the importance of ethics in shaping responsible business practices,
- *identify* how ethical theories influence values, policies, and organizational culture.

10.3 Theories of Business Ethics

Ethical decision-making in business is influenced by several theoretical perspectives. These theories provide different frameworks for evaluating whether a business action is morally right or wrong. Broadly, these can be classified into Traditional Theories and Normative Theories.

A. Traditional Theories of Business Ethics

Traditional business ethics theories are based on classical moral philosophy, focusing on right and wrong through principles like consequences, duties, rights, fairness, and character. Although these theories predate modern business practices, they continue to guide ethical decision-making today, helping organizations act responsibly and maintain public trust.

1. **Utilitarianism (Consequentialism):** Utilitarianism, rooted in the philosophical works of Jeremy Bentham and later expanded by John Stuart Mill, is a major ethical theory that falls under consequentialism, which means it evaluates actions based on their outcomes. At its core, utilitarianism holds that the most ethical decision is the one that brings about the greatest happiness or benefit to the greatest number of people. Rather than focusing on intentions or fixed rules, this theory emphasizes results- if the outcome leads to more overall good than harm, the action is considered morally right. In the business world, utilitarianism is often applied when companies weigh the costs and benefits of their decisions. For example, a firm might choose to adopt automation technologies that reduce operational costs and lower prices for millions of customers, even if it leads to job losses for a few employees. While such decisions may seem harsh, utilitarianism justifies them by focusing on the overall gain to society or the business.
   - **Focus:** Maximizing benefits and minimizing harm for the greatest number.
   - **Criticism:** May ignore the rights or needs of minorities and can justify unethical actions if they bring overall benefit.
2. **Deontology (Duty-Based Ethics):** Deontology, often referred to as duty-based ethics, was primarily developed by the German philosopher Immanuel Kant in the 18th century. This ethical theory emphasizes that actions are morally right or wrong based on adherence to rules or duties, rather than the consequences they produce. According to deontology, individuals and organizations must follow universal moral principles- such as honesty, fairness, and respect for others- regardless of outcomes. In a business context, deontology implies that companies should act ethically not just to gain profits or good reputation, but

because it's their moral obligation to do so. For example, a company should not deceive customers or exploit workers, even if doing so could increase revenue, because these actions violate ethical duties.

- **Focus:** Doing what is right, regardless of the outcome.
- **Criticism:** Can be rigid and may not consider the consequences of actions.

3. **Rights-Based Ethics:** Rights-based ethics is grounded in the belief that every individual possesses certain fundamental rights that must be respected and protected, regardless of the outcomes. This approach gained prominence through the works of philosophers like John Locke and later thinkers who emphasized human dignity and personal freedom. In the context of business, rights-based ethics means that companies have a moral responsibility to uphold the rights of all stakeholders- including employees, customers, and communities. This includes ensuring fair wages, privacy, safe working conditions, and freedom from discrimination. Even if violating these rights could bring business benefits, such actions are considered unethical because they disregard the inherent value and dignity of individuals.
   - **Focus:** Respecting and protecting the fundamental rights of individuals.
   - **Criticism:** May not provide clear guidance on balancing competing rights or other stakeholders' interests.
4. **Justice and Fairness:** The theory of Justice and Fairness is based on the idea that everyone should be treated equally and justly. It was strongly influenced by philosopher John Rawls, who believed that fairness should guide how resources, opportunities, and responsibilities are shared in society. In simple terms, this theory says that businesses should act in a fair

way when dealing with employees, customers, and other stakeholders. For example, they should pay fair wages, avoid discrimination, offer equal chances for promotions, and make decisions based on merit- not favoritism. The goal is to create a workplace and business environment where people feel respected and treated fairly.

- **Focus:** Ensuring fair distribution of resources, opportunities, and rewards.
- **Criticism:** Different views exist on what is "fair," which can cause confusion in applying this theory.

5. **Virtue Ethics:** Virtue Ethics is a moral theory that focuses on a person's character rather than specific actions. Its roots go back to ancient Greek philosophy, especially the work of Aristotle. He believed that being a good person involves developing positive traits like honesty, courage, kindness, and fairness- called virtues. In the context of business, Virtue Ethics suggests that ethical behavior comes naturally when business leaders and employees build good character. Instead of just following rules or thinking about outcomes, businesses should aim to create a culture where values like integrity, trustworthiness, and respect are encouraged. This helps the organization act ethically in all situations, even when there are no clear rules.

   - **Focus:** Developing good moral character and values like honesty, integrity, and trust.
   - **Criticism:** Vague guidance on specific actions and difficulty in applying to organizations rather than individuals.

Stop to Consider

The Self-Driving Car Dilemma – A Test of Utilitarianism When companies like Tesla and Google design self-driving cars, they face moral dilemmas that directly use Utilitarian principles. For example, if a car must "choose" between hitting one person or five, how should it decide? Engineers use ethical algorithms that weigh harm versus benefit- making this a real-world example of ***consequentialist ethics*** in modern technology.

B. Normative Theories of Business Ethics

Normative theories of business ethics are more modern in nature and are designed specifically to address ethical responsibilities within organizations. These theories look at what businesses ought to do in their role as a part of society. Unlike traditional theories that rely on abstract moral reasoning, normative theories provide a practical framework for making ethical choices by considering all affected parties and the broader impact on society. These theories bridge the gap between moral ideals and everyday business practices.

1. **Stakeholder Theory:** Stakeholder Theory is an approach to business ethics that emphasizes the importance of considering all the people or groups affected by a company's actions- not just shareholders or owners. This theory was developed more formally in the 1980s by R. Edward Freeman, though the idea itself has earlier roots. The core concept is that businesses have moral responsibilities to a wide range of stakeholders, including employees, customers, suppliers, communities, and the environment, not just those who invest capital. In practical terms, this means that companies should make decisions by

balancing the interests of all stakeholders, aiming for fairness and long-term value rather than focusing only on profit.

- **Focus:** Serving the interests of all stakeholders- not just shareholders.
- **Criticism:** Offers no clear prioritization when stakeholder interests conflict, making practical decision-making challenging.

2. **Social Contract Theory:** Social Contract Theory has its roots in political philosophy, particularly from thinkers like Thomas Hobbes, John Locke, and Jean-Jacques Rousseau. In the context of business ethics, it suggests that companies exist because society allows them to- under an implicit contract. In return for the freedom to operate and earn profits, businesses are expected to act in ways that benefit society. This includes adhering to laws, ethical norms, and contributing to societal welfare. The core idea is that businesses should not act solely in their own interest but align their operations with the values and expectations of the society that supports them.

   - **Focus:** Businesses operate with society's approval, and in return, must act in society's best interest.
   - **Criticism:** The idea of an "implicit contract" is abstract and hard to define, making obligations unclear.

3. **Universal Principles:** Universal Principles theory in business ethics is based on the idea that ethical decisions should follow rules or values that can be applied consistently across all situations and to all people. Inspired by philosophers like Immanuel Kant, this approach asks businesses to act according to principles they would want every organization to follow- such as honesty, justice, respect for human dignity, and human rights. It promotes fairness and moral consistency, encouraging

businesses to go beyond self-interest and consider what is right universally.

- **Focus:** Following ethical rules that can apply to everyone, everywhere.
- **Criticism:** Not all cultures or societies may agree on what is "universal," leading to conflict in global business settings.

4. **Common Good Theory:** Common Good Theory in business ethics is centered around the belief that businesses should work not just for profits, but for the well-being of society as a whole. Rooted in classical philosophy, especially Aristotle and later developed by thinkers like John Rawls, this theory emphasizes human dignity, social welfare, and shared values. It holds that businesses have a moral obligation to support the common good- such as education, healthcare, clean environments, and safe communities- through ethical practices, fair policies, and responsible decision-making.
   - **Focus:** Promoting the overall well-being of society.
   - **Criticism:** Defining the "common good" can be difficult, as different groups may have conflicting ideas about what benefits society.

10.4 Importance of Ethical Theories in Business

Ethical theories play a key role in guiding how businesses behave and make decisions. They help companies stay responsible, fair, and trustworthy in a competitive environment. Here's why they matter:

1. **Helps in Making Right Choices**: Ethical theories act like a map for businesses when facing tricky situations. They help managers figure out what is right or wrong and make better decisions for everyone involved.

2. **Builds Strong Values**: Theories of ethics shape the core beliefs and principles of a business. These values become the foundation for how a company treats its people, customers, and society.

3. **Supports Ethical Rules and Guidelines**: When a company makes a code of conduct or a set of ethical policies, these are often based on well-known ethical theories. They give meaning and support to the rules a company follows.

4. **Used to Check Business Practices**: Businesses can use ethical theories to judge if their actions and policies are fair, responsible, and respectful. This helps them improve and do better in the long run.

5. **Improves Public Image**: Ethical businesses are trusted by customers and society. When companies follow sound ethical thinking, they build a positive reputation that attracts support and loyalty.

6. **Avoids Legal and Financial Problems**: By following ethical principles, companies reduce the risk of breaking laws or ending up in scandals. This protects them from losses and damage to their brand.

7. **Creates a Positive Workplace Culture**: Ethical thinking helps build a company culture where honesty, respect, and fairness are a part of daily work. It encourages employees to act with integrity and feel proud of where they work.

Check Your Progress

1. Name any two traditional theories of business ethics.
2. What is the main aim of the Stakeholder Theory?
3. Which ethical theory emphasizes duties and moral rules?
4. Why are ethical theories important for businesses?

10.5 Summing Up

- Ethical theories guide business decisions by offering different frameworks- based on consequences, duties, rights, fairness, or virtues- for evaluating right and wrong actions.
- Traditional theories, like Utilitarianism, Deontology, and Virtue Ethics, draw from classical moral philosophy and help businesses maintain integrity and public trust.
- Normative theories, such as Stakeholder Theory and Social Contract Theory, focus on what businesses ought to do in society, promoting fairness, responsibility, and shared benefits.
- Applying ethical theories helps businesses build strong values, develop fair policies, and maintain positive relationships with stakeholders.
- Ethical behavior guided by theory enhances a company's reputation, minimizes risks, and fosters a culture of trust and responsibility.

10.6 Model Questions

1. Discuss how the Utilitarian and Deontological theories can lead to different decisions in the same business scenario.
2. How does the Stakeholder Theory help businesses maintain ethical balance among different interest groups?
3. "Ethical theories not only guide actions but also shape a firm's values." Discuss this statement with reference to the importance of ethical theories in business.
4. Explain how the Justice and Fairness theory can be applied in employee promotion policies in a company.

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Unit-11
Ethical Organizations, Code of Ethics, Ethics Committee

Unit Structure:

11.1 Introduction

Any organization's profitability and long-term viability depend heavily on ethical behavior. This highlights the significance of moral behavior, emphasizing how businesses can have a solid ethical base by enacting codes of ethics and setting up efficient ethics committees. In particular, this subject looks at how businesses can create and preserve an integrity-based culture, use it to inform choices, and deal with moral dilemmas in an accountable and open way. Being ethical is more than just following the rules; it's a core value that supports long-term success, reputation, and trust. Businesses that place a high value on moral behavior improve their reputation, forge closer bonds with stakeholders, and are better equipped to handle opportunities and obstacles.

A written statement outlining an organization's ideals, tenets, and required conduct is called a code of ethics. It gives workers a foundation for comprehending and putting ethical norms into practice on a daily basis. To guarantee that every employee understands their duties and obligations, a well-written code of ethics should be understandable, succinct, and easy to access.

A group of people in charge of monitoring the moral implications of an organization's activities is known as an ethics committee. In addition to addressing ethical quandaries, they might create and evaluate ethical policies, offer training, and look into possible infractions. Employees can benefit greatly from the advice and assistance that an efficient ethics committee can provide when facing moral dilemmas.

Prioritizing ethical behavior has several advantages for businesses, such as higher employee morale, a lower chance of legal and reputational harm, increased stakeholder trust, and improved long-term sustainability.

11.2 Objectives

After going through the units you will be able to-

- *know* the concept of ethical organizations and its characteristics & benefits,
- *code* of ethics, types, how do they serve & significance,
- *ethics* committee and its functions.

11.3 Ethical Organizations

11.3.1 An organization is considered ethical if it puts a high priority on moral principles and values in all aspects of its operations, treats stakeholders, customers, and employees fairly, and maintains high standards of behavior. Establishing a culture of integrity and accountability, encouraging moral leadership, and maintaining a clear code of ethics are all part of this.

Stop to Consider

An organization that prioritizes justice, honesty, respect, and accountability in all of its interactions—with staff, clients, and the community at large—is considered ethical. This idea goes beyond following the law and emphasizes preserving principles that promote honesty, trust, and constructive societal impact.

Check Your Progress

What do you understand by ethical organizations?

11.3.2 Characteristics of Ethical Organizations

i. Respectful and Equitable Treatment: Moral businesses treat everyone equally, irrespective of their position or role.

ii. Honesty & Transparency: They build trust with staff, clients, and stakeholders by being open and honest in their business practices.

iii. Accountability: They demand accountability from both themselves and their members for their choices and actions.

iv. Integrity: In all of their dealings, they uphold moral norms and ideals with a great sense of integrity.

v. Corporate Social Responsibility: They actively promote societal well-being and go above and beyond the call of duty.

vi. Ethical Leadership: Leaders at all levels set an example of moral conduct and foster an ethical culture.

vii. Strong beliefs and Code of Conduct: They create a code of conduct that directs employee behavior and clearly articulate and convey their key beliefs.

viii. Focus on Ethical Education: They offer instruction and training on moral values and conduct.

ix. Incentives for Moral Conduct: They give credit and rewards to workers who act morally.

x. Open Communication: They promote an environment where moral dilemmas can be brought up and resolved.

Stop to Consider

Strong emphasis on integrity, equity, and responsibility, as well as a dedication to moral decision-making and a respectful workplace atmosphere, are characteristics of ethical firms. By placing a high value on corporate social responsibility, openness, and moral leadership, they create an atmosphere that encourages moral behavior from staff members.

Check Your Progress

What are the characteristics of Ethical Organizations?

11.3.3 Benefits of Ethical Orgainizations

i. Better Reputation: Companies that uphold ethics establish a solid reputation for honesty and reliability, which can draw clients and investors.

ii. Enhanced Productivity and Employee Morale: In an ethical workplace, workers are more likely to be involved and productive.

iii. Decreased Risk and Liability: Legal and reputational concerns can be lessened with the aid of ethical behavior.

iv. Improved Stakeholder Relationships: Long-term success depends on establishing trust with stakeholders, such as staff, clients, and the community.

v. Long-Term Sustainability: Organizations with a strong ethical foundation are more likely to succeed and persist over the long run.

Stop to Consider

Stronger consumer loyalty, superior reputation, more trust, and better employee engagement and retention are all advantages of ethical businesses. Moreover, they enjoy a competitive edge, lower legal risks, and improved long-term viability. Businesses create a more robust and beneficial business foundation by upholding ethical standards.

Check Your Progress

Discuss about the benefits of Ethical Organizations.

11.4 Code of ethics

A code of ethics is a set of tenets that specify moral requirements and standards for people or organizations. It provides a framework for upholding integrity in both personal and professional interactions and for making moral decisions.

11.4.1 Types of Codes of Ethics

A code of ethics can be in many different forms. Nonetheless, its overarching objective is to guarantee that a company and its workers abide by local, state, and federal laws, behave honorably, and benefit all parties involved. These two categories of codes of ethics are frequently observed in the corporate world.

i. Code of Ethics Based on Compliance:

Laws govern matters like recruiting practices and safety requirements for all firms. Compliance-based codes of ethics establish standards for behavior and provide sanctions for transgressions. In order to enforce regulations, businesses such as banking have adopted compliance-based codes of ethics, which are based on specific laws that govern business conduct. In order to comprehend these regulations, employees usually need formal training. Individual employees may be penalized for not adhering to policies, and noncompliance may cause legal problems for the business.

To make sure that the code of ethics is followed, several businesses designate a compliance officer. This person keeps abreast of changes to regulations and keeps an eye on staff behavior to promote compliance.

Rather than focusing on tracking individual conduct, this kind of code of ethics is founded on precise regulations and well-defined penalties. Although it guarantees adherence to the law, it might not always foster an ethically conscious workplace.

ii. A Code of Ethics Based on Values:

A company's basic values are addressed by a value-based code of ethics, which establishes guidelines for moral behavior that benefits the environment and the general public. Compared to compliance-based codes, these ethical standards frequently call for greater self-regulation.

Both compliance and values are addressed in some standards of conduct. For instance, a chain of supermarkets may establish a code that puts health and safety requirements ahead of profits. The code may also contain a pledge to steer clear of vendors who use hormones on cattle or keep animals in cruel circumstances.

Stop to Consider

A code of ethics is a formal, frequently written document that outlines the ethical conduct standards of a profession or organization. It acts as a manual for choosing actions and decisions that support the standards and values of the company. There are several sorts of codes of ethics, including integrity-based, compliance-based, and industry-specific codes.

Check Your Progress

What is Code of Ethics? What are the types of Codes of Ethics?

11.4.2 What Does a Code of Ethics Serve to Do?

The term "business ethics" describes how moral standards direct an organization's activities. Business ethics frequently covers topics including social responsibility, bribery, insider trading, environmental concerns, discrimination, and employer-employee relations.

Even while many laws set down fundamental moral principles for companies, creating a thorough code of ethics is largely the responsibility of company executives.

In the long run, ethical behavior has been demonstrated to be advantageous to both a business and society. In addition to satisfying the rising demands of socially conscious investors, workers, and consumers, it is consistent with the triple bottom line philosophy of profit, people, and planet.

Employees and members are typically required to abide by a code of ethics established by businesses and trade associations. A violation of this code may result in dismissal or termination. A code of ethics is essential because it provides a foundation for preventative warnings and explicitly outlines the standards for behavior.

Stop to Consider
In order to guarantee moral behavior and decision-making, a code of ethics provides guidelines for both individuals and organizations. It facilitates establishing expectations for professional conduct, encouraging justice and honesty, and bringing behavior into line with accepted norms.

11.4.3 Significance of Code of Ethics

For corporate houses, a code of ethics is essential because it creates a foundation for moral behavior, fosters an integrity-based culture, and protects a company's reputation. It guarantees adherence to rules and laws, supports employees in making wise decisions, and reaffirms corporate values. In the end, a robust code of ethics promotes confidence among interested parties and helps ensure long-term, sustainable success.

1. **Establishing Integrity and Ethical Standards:**

a) **Explicit Rules**: A code of ethics ensures consistent implementation of ethical concepts by giving employees explicit rules on how to behave in different scenarios.

b) **Reinforcement of principles:** It helps staff members align with the organization's ethical position by reminding them of the company's basic principles and expected behaviors.

c) **Better Decision-Making:** Employees can better navigate complex situations and make judgments that are consistent with the company's goals by using the code, which offers a framework for ethical concerns.

d) **An Integrity Culture:** Integrity and moral conduct are respected in the workplace when there is a strong code of ethics in place, which promotes accountability and responsibility.

2. **Improving Credibility and Trust**:

a) **Stakeholder Trust:** Businesses gain the trust of staff members, clients, investors, and the general public by exhibiting a dedication to moral behavior.

b) **Management of Reputation:** Moral conduct improves a business's standing by setting it apart from rivals and drawing favorable attention.

c) **Long-Term Success:** Establishing and upholding trust is essential for long-term success since moral businesses are more likely to draw in and keep clients, investors, and staff.

3. **Encouraging Risk Reduction and Legal Compliance:**

a) **Respect for the Law and Regulations:** By ensuring adherence to pertinent rules and regulations, a code of ethics reduces the possibility of fines and harm to one's reputation.

b) **Risk management:** Businesses can reduce the dangers of unethical activity, including fraud, corruption, and discrimination, by proactively addressing ethical concerns.

4. **Creating a Positive Workplace Culture:**

a) **Employee Contentment and Involvement:** Employees who work in ethical environments are more likely to be content and involved because they feel appreciated and respected.

b) **Higher Productivity and Morale:** When workers believe they can act morally without worrying about the consequences, their morale and output may rise.

c) **Decreased Misconduct at Work:** By preventing workplace misconduct, a clear code of ethics might lessen the need for expensive investigations and corrective actions.

5. **Encouragement of Corporate Social Responsibility (CSR):**

a) **Complementing the CSR Objectives:** A code of ethics can assist a business in coordinating its activities with its corporate social responsibility (CSR) objectives, which include community involvement, fair labor standards, and environmental sustainability.

b) **Creating a Positive Social Impact:** Businesses may help create a more sustainable and just world by conducting themselves ethically.

In summary, a code of ethics is an essential instrument for creating a profitable, moral, and long-lasting company in addition to being a legal necessity. It supports a positive work atmosphere, protects reputation, guides employee behavior, and defines the company's ideals.

It guarantees that businesses behave honorably, fairly, openly, and accountable toward all parties involved, including investors, consumers, and employees. Businesses that operate with moral values like justice and honesty establish solid reputations and gain the confidence of their clients.

Stop to Consider

It offers a structure and a benchmark for moral decision-making inside the company. Apart from its significance within the company, the code of ethics may also communicate to clients, suppliers, and other external stakeholders what the company, its leadership, and its staff value. A code of ethics is not only required by law, but it is also a crucial tool for building a successful, moral, and long-lasting business. It upholds a positive work environment, safeguards the company's brand, directs employee conduct, and establishes its values.

Companies that conduct their operations with moral principles such as fairness and integrity build strong reputations and win over customers.

Check Your Progress

What is the significance of Code of Ethics?

11.5 Ethics Committee

In corporate ethics, an ethics committee is a team of individuals in charge of monitoring and encouraging moral behavior inside a company. To make sure moral principles are upheld, they create and implement ethical policies, offer training, and look into complaints.

An ethical committee results from the organization's core principles, vision, and aim. Regardless of what the Companies Act of 2013 and other pertinent rules say, a corporation should have an ethics committee to determine its principles and morals. The company's value system is a unique and susceptible aspect that the ethics committee addresses with a traditional design. It can provide valid guidance on how to balance conflicts of interest and adopt a value-oriented business decision-making process.

The responsibility for adhering to the value framework should be shared with a specially created ethics committee because the Board of Directors cannot embrace all aspects of administration. It will outline the general norms that the organization must go by and be responsible for the proper implementation of moral strategy. The committee's accountability will be to the organization's Board of Directors. It will provide top management with the proper guidance to align with the organization's values. In addition to senior management, the council will also advise employees on how to behave morally.

11.5.1 Functions of Ethics Committee

a) **Specifying the organization's values:** For an organization to grow sustainably, having a clear ethics policy is especially important. Consistency with the organization's ethical process is ensured via a sound methodology. It is necessary for the organization to first describe its moral principles and ideals. In order to create the organization's moral strategy, the ethics committee will dissect every aspect of the moral way of acting consistently with the organization's stakeholders.

b) **Review of previous ethics policy:** Sociology is the most extensive and intricate field of study. It mostly focuses on how people behave. It is well known that the developed ethics strategy is up to date. One organization's morality approach might not be suitable for another. Everything is based on the organization's concept. For example, there is a noticeable difference between the marketing strategies of the industrial and service industries.

c) **Ensure uniformity:** The ethics committee bears responsibility for ensuring adherence to the norms of behavior it has established. The agreement should not, in a sense, be confined to documents. It should guarantee that all individuals connected to the firm adhere to ethical standards of conduct. The employees should interpret moral behavior in their own way. It is the ethics committee's responsibility to resolve any conflicts of understanding. The ethics committee is the highest authority for ensuring that codes of ethics are followed.

d) **Providing employees with guidelines**: The ethics committee's established norms and regulations should be well understood by the staff. It will ensure that the business abides by particular regulations that the staff must follow. They should be given access to a few archives or publications, and frequent training sessions should be provided to keep them informed about the codes' consistency.

e) **Maintaining Consistency:** When employees adhere to the ethical norms established by the ethics committee, the committee has succeeded. To ensure that the morals are being upheld, it is necessary to continuously observe.

f) **Implementing disciplinary measures:** When an employee engages in unethical behavior, disciplinary action should be taken, and it should be taken regularly. This suggests that disciplinary measures should be planned and that the severity of them should be based on the type of misconduct.

g) **Consistent auditing and monitoring:** It should be the ethics committee's duty to regularly evaluate the set of rules. As the situation changes, the ethics plan should incorporate new requirements.

Stop to Consider

A group of individuals charged with upholding moral behavior in a variety of contexts, particularly in research and inside organizations, is known as an ethics committee. Reviewing study proposals, keeping an eye on ongoing studies, and offering advice on ethical matters are their main responsibilities. They essentially serve as a conscience for institutions and academics, encouraging accountability and maintaining moral principles.

Check Your Progress

What is ethics committee? What are the functions or responsibilities of ethics committee?

11.6 Summing Up

The moral norms and guidelines that direct the behavior of people and organizations in the business sector are collectively referred to as business ethics. It entails making moral choices and deeds that promote trust between companies and their stakeholders, such as clients, staff, and the general public, and goes beyond simple legal compliance.

An organization is considered ethical if it functions according to a set of moral standards and values, giving fairness, integrity, and accountability first priority when interacting with its stakeholders, customers, workers, and the general public. It actively fosters an environment of integrity and moral decision-making, going beyond merely following the law.

The mission statement, values, and ways by which employees will tackle problems are all outlined in a code of ethics document. It also outlines the ethical principles that employees must adhere to based on the organization's values and the fundamental standards that they commit to uphold.

An ethics committee is a group that examines research ideas in order to guarantee moral behavior and safeguard the rights and welfare of participants. They ensure adherence to ethical norms and rules by supervising the moral aspects of an organization's internal and external operations. When it comes to research, they evaluate scientific validity, risks, benefits, and regulatory compliance in addition to offering advice on ethical issues.

11.7 Model Questions

1. What defines an ethical organization?
2. Why is a code of ethics important for an organization?
3. What are different types of code of ethics?
4. Who is responsible for creating a code of ethics in an organization?
5. What is the role of an ethics committee?
6. Why are ethics committees important in organizations?

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Unit-12
Understanding and Managing Ethical Issues in Business

Unit Structure:

12.1 Introduction

Ethics in business goes beyond just following laws- it's about doing the right thing, even when it's not easy. As future professionals and decision-makers, it's important for learners to understand what ethical behavior looks like in a business setting, why some organizations deviate from it, and how to handle difficult situations where the right choice isn't always obvious. This unit covers ethical and unethical business practices, highlighting how businesses interact with stakeholders like employees, customers, investors, and society. It also helps learners explore ethical dilemmas- complex situations where values may conflict- and provides practical ways to address them responsibly. By the end of this unit, learners will be better equipped to recognize ethical challenges and respond with integrity and confidence.

12.2 Objectives

After going through this unit, you will be able to-

- *understand* the concept and importance of ethical practices in business,
- *identify* various types of ethical and unethical business practices,
- *analyze* the consequences of unethical behavior on organizations,
- *recognize* ethical dilemmas commonly faced in the business environment,
- *apply* suitable strategies to effectively address and resolve ethical dilemmas.

12.3 Ethical Business Practices

Ethical business practices refer to the conduct of organizational activities in a morally responsible and transparent manner. These practices aim not only to comply with legal requirements but also to uphold values such as honesty, fairness, and respect toward all stakeholders. By engaging in ethical conduct, businesses strengthen their reputation, foster long-term sustainability, and contribute positively to society.

Some essential areas of ethical business conduct include:

- **Towards Investors**: Investors provide essential financial backing for business operations and growth. Businesses have a duty to ensure the safety of these investments by managing funds prudently and avoiding fraudulent or misleading practices. Regular and accurate financial reporting, transparency in risk disclosures, and timely dividend payments help maintain investor confidence and trust. Ethical behavior also includes protecting shareholder rights and encouraging informed participation in corporate governance.

- **Towards Employees**: Employees are vital assets of any organization, and treating them ethically is not only a moral responsibility but also a driver of productivity and loyalty. Ethical treatment involves providing equal opportunities in recruitment, fair evaluation for promotions, access to skill development and training, and timely and appropriate remuneration. In addition, businesses must ensure a safe, inclusive, and healthy working environment, respect labor rights, and uphold dignity at the workplace.
- **Towards Customers**: Customers expect honesty, quality, and safety in the products and services they use. Businesses must ensure that they provide accurate and clear information about their offerings, maintain high standards of quality, and avoid deceptive advertising or exaggerated claims. Furthermore, businesses should respect consumer privacy and handle customer data responsibly, ensuring it is not misused for personal or commercial gain.
- **Towards Competitors**: Fair and ethical competition is a hallmark of a healthy market. Organizations should compete on the basis of quality, service, innovation, and value rather than resorting to unethical practices such as spreading false information, price fixing, sabotage, or stealing trade secrets. Ethical companies acknowledge and respect the existence of competition and strive to outperform rivals through legitimate means.
- **Towards the Government**: Businesses function within a legal and regulatory framework and are obligated to adhere to all laws, including those related to taxes, labor, corporate

governance, and trade. Ethical companies fulfill these obligations diligently, avoid corrupt practices such as bribery or lobbying for unfair advantages, and support government efforts to maintain market integrity and protect public interest.

- **Towards the Environment**: In an era of growing environmental consciousness, ethical businesses recognize their responsibility toward nature. They take proactive measures to reduce their environmental footprint by minimizing emissions, managing waste responsibly, conserving energy and natural resources, and ensuring compliance with environmental regulations. Some companies also invest in green technologies and sustainability initiatives that contribute to long-term ecological balance.

12.4 Benefits of Ethical Business Practices

The implementation of ethical practices leads to several strategic and social advantages, including:

a. **Increased Consumer Trust and Revenue**: Ethical behavior builds brand loyalty and consumer goodwill, resulting in higher demand and repeat business.

b. **Enhanced Brand Recognition**: A reputation for integrity and social responsibility improves public image and distinguishes a firm from competitors.

c. **Attraction and Retention of Talent**: Ethical workplaces foster motivation, job satisfaction, and loyalty among employees, leading to better recruitment and retention.

d. **Access to Ethical Investment**: Businesses following ethical principles may attract funding from socially conscious investors and financial institutions.

e. **Societal and Economic Contribution**: Ethical companies help raise living standards and support overall economic development by operating responsibly and inclusively.

12.5 Unethical Business Practices

Unethical business practices refer to actions and decisions by organizations that violate established moral principles, legal regulations, or societal expectations in pursuit of personal or corporate gain. These practices not only damage the reputation of businesses but also harm consumers, employees, society, and the environment. In many cases, such actions are driven by the desire to accumulate excessive profits, avoid accountability, or gain unfair competitive advantages.

Below are some common forms of unethical behavior observed in the business world:

- **Dishonesty and Deception**: Some businesses engage in dishonest practices such as lying to customers, stakeholders, or authorities. This may include making false claims about products or services, hiding flaws, or delivering substandard goods intentionally.
- **Distortion of Facts**: Misrepresenting or withholding critical information to manipulate perceptions or outcomes is a frequent unethical tactic. This can mislead investors, consumers, or regulatory authorities.
- **Emotional Manipulation**: Exploiting people's fears, desires, or vulnerabilities for profit- such as using misleading emotional advertising- undermines the principle of respect and integrity in business dealings.

- **Excessive Profit Motive (Greed)**: Businesses that prioritize profit over all else often ignore ethical concerns. This may result in exploitative pricing, cost-cutting at the expense of safety, or ignoring social and environmental responsibilities.
- **Falsification of Records**: Creating or altering documents, such as financial statements, to present a false image of profitability or growth is a serious offense. It deceives investors, regulators, and the public, and may lead to corporate fraud.
- **Evasion of Accountability**: Avoiding penalties, fines, or compensation for illegal or unethical acts- often through loopholes, legal delays, or bribery- demonstrates a blatant disregard for justice and fair treatment.
- **Lack of Transparency**: Withholding information, resisting audits, or concealing internal practices prevents proper scrutiny and contributes to unethical conduct going unchecked within the organization.
- **Environmental Negligence**: Ignoring government regulations regarding air, water, and noise pollution- especially by industrial units- results in harm to ecosystems and public health. Deliberate environmental degradation for profit is a grave unethical act.
- **Sexual Discrimination**: Unequal treatment based on gender, including bias in hiring, promotions, pay, and workplace behavior, undermines workplace ethics and legal mandates for equality.
- **Unethical Competition**: Resorting to methods such as spreading false rumors, sabotage, or intellectual property theft to damage or eliminate competitors is unethical and unlawful.

These unethical practices can have far-reaching consequences, including legal action, loss of customer trust, employee dissatisfaction, reputational damage, and long-term financial decline. It is therefore critical for businesses to establish robust ethical frameworks and promote a culture of integrity.

Stop to Consider
While ethical business practices may sometimes seem like an added responsibility or cost, the long-term consequences of ignoring ethics can be far more damaging. Scandals such as those involving Enron, Satyam, and Volkswagen are examples of how unethical decisions- once exposed- can lead to loss of credibility, legal penalties, massive financial losses, and even the collapse of entire organizations. These cases underline the fact that ethics is not just about "doing the right thing"- it is about building sustainable, trust-based business foundations that can withstand scrutiny and change.

12.6 Strategies to Prevent Unethical Practices

Unethical practices can harm a company's image, trust, and long-term success. To avoid this, businesses should follow some simple yet important strategies:

a. **Be Honest in All Dealings**: Always tell the truth- whether it's about company earnings, product information, or dealings with employees and vendors. Honesty builds trust and helps in creating a good reputation.

b. **Handle Complaints Quickly**: When customers, vendors, or employees raise complaints, address them immediately. Ignoring them can damage the company's image. Listening and solving issues shows responsibility.

c. **Admit and Fix Mistakes**: Instead of hiding problems or covering them up, companies should accept their mistakes and take steps to fix them. Apologizing and correcting issues earns respect and trust.

d. **Ensure Product Safety**: If a product is harmful or has issues, ethical companies take it off the market and inform customers. They fix the problem before selling it again. Consumer safety should always come first.

e. **Take Responsibility as a Company**: If an employee makes a mistake, the company should also take responsibility- not just blame the individual. This shows fairness and strong ethical values.

Check Your Progress

1. List any three responsibilities of businesses towards customers.
2. Mention two benefits of ethical behavior in business.
3. What is meant by unethical business practices? Give two examples.
4. State any two common strategies to prevent unethical practices.

12.7 Ethical Dilemmas

An ethical dilemma occurs when a person or organization faces a situation where they must choose between two or more conflicting moral principles or values. In such cases, doing the “right” thing is not always clear or easy, and every available option may have both positive and negative consequences.

In the context of business, ethical dilemmas are common because companies often need to balance profit-making goals with responsibility toward employees, customers, society, and the environment. Understanding the key features of such dilemmas can help businesses recognize and respond to them more effectively:

- **Conflict of Values**: There is a clash between what is legally right, professionally acceptable, and morally appropriate.
- **No Clear Right or Wrong**: The choices are not simply "good" or "bad" but often involve trade-offs.
- **Need for Judgment**: One has to make a thoughtful decision, considering the impact on all stakeholders.
- **High Stakes**: The decision may affect the company's reputation, financial outcomes, and public trust.

12.8 Strategies to Address Ethical Dilemmas

Addressing ethical dilemmas in a business environment requires a proactive, structured approach. Organizations must establish systems that guide employees toward ethical decision-making and ensure that ethical principles are embedded into the corporate culture. The following strategies are commonly adopted to address and mitigate ethical challenges effectively:

a. **Establish Clear Policies**: Organizations should begin by formulating a comprehensive Code of Ethics that outlines acceptable and unacceptable behaviors. This document serves as a formal guide to help employees identify and resolve ethical issues. It should clearly define the organization's values, principles, and expected standards of conduct in various business scenarios. A well-communicated ethical policy ensures consistency in behavior and decision-making across all levels of the organization.

b. **Provide Ethics Trainin**g: Regular training programs are essential to equip employees with the knowledge and skills necessary to handle ethical dilemmas. These sessions should include real-life case studies, role-playing activities, and discussion of complex ethical scenarios. Training helps employees understand the application of ethical principles in day-to-day business decisions and reinforces the importance of integrity and accountability.

c. **Encourage Open Communication**: Creating a culture of openness and trust is crucial. Employees should feel safe to raise ethical concerns or seek advice when facing moral uncertainty. This can be promoted by:

  - Ensuring that employees who report wrongdoing are not punished or treated unfairly.
  - Conducting regular team discussions on ethical challenges.
  - Encouraging feedback on ethical practices within the organization.

  Open dialogue helps prevent the escalation of unethical behavior and fosters a shared sense of responsibility.

d. **Implement Reporting Mechanisms**: Effective ethics management includes establishing secure and anonymous channels- such as whistleblower hotlines, suggestion boxes, or digital portals- for employees to report unethical conduct. These systems should be managed independently and ensure confidentiality to protect the identity of the reporter.

e. **Lead by Example (Ethical Leadership)**: Leadership plays a critical role in shaping organizational ethics. When managers and senior executives demonstrate integrity, fairness, and transparency in their actions, it sets a standard for others to follow. Ethical leadership not only builds trust within the organization but also strengthens its reputation externally.

By incorporating these strategies, businesses can create a robust ethical culture that empowers individuals to make principled decisions, thereby reducing the occurrence of ethical dilemmas and strengthening long-term sustainability.

Check Your Progress

1. Define an ethical dilemma in the context of business.
2. Name any two features of ethical dilemmas.
3. Why is transparency important in business operations?

12.9 Summing Up

- Ethical business practices promote fairness, transparency, and responsibility toward all stakeholders including investors, employees, customers, competitors, government, and the environment.
- Businesses benefit from ethical conduct through increased consumer trust, improved brand image, employee loyalty, ethical investment, and positive societal impact.
- Unethical practices- such as dishonesty, manipulation, lack of transparency, and environmental harm- can damage reputation, reduce trust, and lead to legal consequences.
- Preventing unethical behavior involves honest dealings, prompt resolution of complaints, admitting mistakes, prioritizing safety, and taking corporate responsibility.

- Ethical dilemmas arise when businesses face conflicting values or moral uncertainties, often with no clear right or wrong answer.
- To address ethical dilemmas, organizations should establish clear policies, provide ethics training, promote open communication, set up reporting systems, and demonstrate ethical leadership.

12.10 Model Questions

1. Define ethical business practices. Discuss the ethical responsibilities of a business toward different stakeholders.
2. Explain the concept of unethical business practices. Highlight the consequences of such practices with examples.
3. "Ethical business practices are not just about compliance but about culture." - Discuss this statement in the context of today's corporate environment with relevant examples.
4. What are ethical dilemmas? Describe their key features and provide a few real-life examples faced by businesses.
5. "Whistleblowing is both an ethical duty and a professional risk." - Critically examine this statement in light of the mechanisms needed to protect whistleblowers.
6. Suppose you are a manager and are instructed to manipulate financial data to attract investors. What ethical considerations would guide your response and what course of action would you take?

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Unit-13

Business Ethics and Practices in India

Unit Structure:

13.1 Introduction

Ethics are the foundation of any successful business, particularly in India, where the intersection of tradition, culture, and global business practices creates distinct challenges and opportunities. As Indian companies navigate this landscape, embedding ethical practices into operations is more crucial than ever.

This unit focuses on the importance of business ethics in India, highlighting their role in fostering trust, reputation, and long-term success. It examines the major ethical issues that businesses face, such as corruption, workplace discrimination, and environmental neglect, while also offering insights into ways these issues can be addressed. The unit also delves into the regulatory framework supporting ethical conduct, including laws and initiatives that promote transparency and fairness. Emerging trends like sustainability and CSR are explored, alongside the challenges businesses encounter when striving to implement these ethical standards. Finally, the role of ethical training programs in shaping the behavior of employees and leaders is emphasized.

By the end of this unit, learners will have gained a deeper understanding of how ethical conduct shapes the future of businesses in India.

13.2 Objectives

After going through this unit, you will be able to-

- *understand* business ethics in the Indian context,
- *identify* key ethical issues in Indian businesses,
- *analyze* the regulatory framework for business ethics in India,
- *explore* emerging trends in ethical practices,
- *recognize* challenges in implementing ethics in business,
- *highlight* the role of ethical training programs.

13.3 Business Ethics in India

Business ethics in India refers to the moral values and principles that govern the conduct of individuals and organizations in the business sphere. It reflects a blend of ancient wisdom and modern governance, shaped by India's cultural heritage, socio-economic transitions, and increasing global integration.

Rooted in timeless philosophies like Dharma (duty), Ahimsa (non-violence), and Satya (truth), ethical thinking has long been a cornerstone of Indian society. These values, drawn from sacred texts such as the Bhagavad Gita and principles of Dharma, promote righteousness, justice, and compassion- not just in personal life, but in economic dealings as well. Leaders like Mahatma Gandhi further enriched this ethical tradition by advocating for trusteeship- a philosophy that encourages business leaders to serve as caretakers of societal well-being, rather than mere profit-makers.

In today's dynamic economic environment, Indian businesses face the dual challenge of staying rooted in these ethical traditions while adapting to global corporate standards. With growing awareness among consumers, investors, and regulators, companies are increasingly expected to be transparent, socially responsible, and ethically accountable. As such, Indian business ethics today is not merely about compliance- it is about aligning organizational goals with the broader values of justice, equity, and sustainability.

13.4 Importance of Business Ethics in the Indian Context

Business ethics play a vital role in shaping the integrity, performance, and long-term sustainability of enterprises, especially in a diverse and developing country like India. With a rapidly expanding economy, a large consumer base, and increasing global participation, Indian businesses face the dual challenge of ensuring profitability while upholding values and responsibilities toward society and the environment. Ethical practices are crucial for Indian businesses for the following reasons:

a. **Trust and Reputation Building:** In a competitive market like India, where consumers are becoming more aware and value-driven, ethical behavior helps build trust and brand loyalty.

b. **Compliance with Laws and Governance:** Ethical practices help businesses comply with India's legal framework, including taxation laws, labor codes, environmental regulations, and corporate governance standards.

c. **Stakeholder Relationships:** In India, where stakeholder expectations vary widely, fairness and inclusiveness help maintain harmony and productivity.

d. **Global Integration:** As Indian companies expand into international markets, ethical conduct aligns them with global standards and expectations, improving their reputation abroad and opening doors to partnerships and investments.

e. **Differentiation in the Marketplace:** Companies that prioritize ethics often stand out as role models. Ethical branding distinguishes businesses from competitors and appeals to socially conscious consumers.

f. **Talent Attraction and Retention:** Ethical workplaces attract skilled professionals who seek respectful, fair, and inclusive environments.

g. **Investor Confidence:** Socially responsible investing is on the rise in India, with funds increasingly preferring companies with strong ESG (Environmental, Social, and Governance) performance.

h. **Operational Efficiency:** Transparent operations reduce internal fraud, corruption, and inefficiencies. Ethical companies are more resilient, especially during crises, as they have established trust and credibility.

i. **Addressing Inequality:** Ethical businesses create inclusive workplaces and support community development initiatives, helping reduce disparities in education, employment, and health-key goals in India's development agenda.

j. **Environmental Responsibility:** With India facing serious environmental challenges, ethical businesses adopt green practices, reduce their ecological footprint, and contribute to climate action goals.

k. **Rural and Social Upliftment:** Through Corporate Social Responsibility (CSR), many Indian firms invest in rural education, health, sanitation, and livelihood programs, aligning business success with national development goals.

l. **Long-term Value Creation:** Ethical businesses contribute to a stable and fair economy, enabling long-term growth and sustainability. They create value not just for shareholders, but for society at large.

13.5 Major Ethical Issues in Indian Business

Despite regulatory progress, Indian businesses continue to face several ethical challenges that impact trust, sustainability, and fairness in operations. Some of the most common ethical problems faced by businesses in India include:

a. **Workplace Discrimination and Harassment:** Bias based on gender, caste, or socio-economic status remains prevalent. Unequal opportunities in hiring, promotions, and pay, along with cases of harassment, contribute to a toxic work environment and lower employee morale.

b. **Corruption and Bribery:** Unethical dealings such as bribery in licensing, procurement, and inspections are still common. Such practices erode trust, distort fair competition, and slow down ethical business growth.

c. **Corporate Misgovernance:** Irregularities like financial fraud, insider trading, and covering up internal issues damage stakeholder confidence. Weak governance often leads to legal issues and reputational loss.

d. **Environmental Violations:** Ignoring pollution norms and overexploiting natural resources are widespread in industrial zones. Such actions harm ecosystems and public health, reflecting poor environmental responsibility.

e. **Labor Exploitation:** Workers, especially in informal sectors, often face low wages, poor safety, and excessive work hours. In some cases, child labor persists, showing a clear disregard for labor rights.

f. **Data Privacy Violations:** With digital growth, misuse of customer data is rising. Many firms collect and share personal information without consent, risking user privacy and legal non-compliance.

g. **Misleading Advertisements:** False or exaggerated claims in ads mislead customers and violate principles of honest communication, damaging consumer trust and market fairness.

Check Your Progress

1. List two ethical values rooted in Indian tradition that influences business ethics.
2. Identify one major ethical issue businesses in India face and explain why it is significant.
3. Why is trust important for businesses in India?

13.6 Regulatory Framework Supporting Business Ethics in India

India has developed a robust regulatory ecosystem aimed at promoting ethical conduct and responsible business practices. These frameworks help ensure that businesses operate transparently, fairly, and sustainably while safeguarding the interests of various stakeholders.

1. **Companies Act, 2013:** A landmark legislation that mandates Corporate Social Responsibility (CSR) for companies meeting specific financial criteria. It requires eligible firms to spend a portion of their profits on social development initiatives, promoting ethical accountability and corporate citizenship.
2. **SEBI Regulations:** The Securities and Exchange Board of India (SEBI) enforces strict disclosure norms and corporate governance standards to ensure transparency, fairness, and investor protection in the capital markets. Regulations like the Listing Obligations and Disclosure Requirements (LODR) emphasize ethical financial reporting and board accountability.
3. **Whistleblower Protection Act, 2014:** This Act provides protection to individuals who report corruption or unethical behavior in government or corporate setups. It encourages transparency and helps uncover wrongdoing by shielding whistleblowers from victimization or retaliation.
4. **Labour Laws and Environmental Acts:** Various laws such as the Factories Act, Minimum Wages Act, and the Environmental Protection Act ensure ethical treatment of workers and environmental responsibility. They regulate working conditions, safeguard workers' rights, and impose penalties for pollution and environmental damage.
5. **National Guidelines on Responsible Business Conduct (NGRBC):** Issued by the Ministry of Corporate Affairs, these guidelines urge businesses to integrate principles of ethics, human rights, and sustainability into their operations. They serve as a voluntary code encouraging responsible decision-making and inclusive growth.

13.7 Emerging Trends Promoting Ethical Practices in India

In recent years, India has witnessed a positive shift toward ethical business conduct, driven by evolving consumer expectations, government regulations, and global sustainability goals. These emerging trends are gradually reshaping the corporate landscape toward more responsible and transparent operations.

1. **CSR Becoming a Norm:** With the Companies Act, 2013 making Corporate Social Responsibility (CSR) mandatory for eligible firms, CSR is no longer just a voluntary effort but a legal and moral obligation. Companies are increasingly investing in education, health, rural development, and environmental sustainability, thereby aligning business goals with societal needs.

2. **Emphasis on Sustainability Reporting:** Indian businesses are increasingly adopting ESG (Environmental, Social, and Governance) reporting frameworks. By disclosing their environmental impact, social contributions, and governance standards, companies are enhancing their accountability to stakeholders and boosting investor confidence.

3. **Rise of Ethical Startups:** The startup ecosystem in India is seeing a rise in ventures built on ethical foundations. Entrepreneurs are launching clean-tech solutions, social impact platforms, and fair-trade businesses that prioritize purpose alongside profit. These startups reflect a generational shift toward value-driven enterprise.

4. **Digital Governance and Transparency:** The integration of technology in governance and compliance- such as e-filing of returns, digital payment systems, and block chain for auditing- has enhanced transparency. Digital platforms help reduce human

intervention, curb corruption, and ensure traceability in operations and public dealings.

5. **Rise of Conscious Consumers:** Indian consumers today are more informed and socially aware. They increasingly prefer to engage with brands that are environmentally friendly, socially responsible, and transparent. This shift is compelling companies to adopt ethical practices not just as a legal requirement but as a competitive differentiator.

6. **Integration of Ethics in Education and Training:** Business schools and corporate training programs are integrating ethics and corporate governance into their curricula. This is helping build a future workforce that is not only skilled but also ethically aware and socially responsible.

7. **Public-Private Partnerships for Ethical Initiatives:** Governments and private companies are increasingly collaborating on projects focused on ethical goals, such as digital literacy, environmental conservation, and women's empowerment. These partnerships foster collective responsibility and sustainable impact.

Stop to Consider

In recent years, the role of technology in shaping business ethics has become more significant. The digital age has introduced both new opportunities and challenges for ethical behavior in business. For example: A large Indian retail company is rapidly expanding its online presence. To meet growing consumer demand, the company collects vast amounts of personal data from its customers. However, questions arise- how secure is this data? How transparent is the company in explaining its data collection practices to customers?

Are consumers aware of how their personal data is being used? In the rush to scale, could the company be compromising its ethical obligations?

This example highlights how businesses today must not only address traditional ethical issues such as corruption or discrimination but also navigate complex digital ethics, including data privacy, cyber security, and the transparency of algorithms.

13.8 Challenges in Implementing Ethics in Indian Business

Despite growing awareness, several obstacles hinder the consistent adoption of ethical practices in India:

a. **Lack of Awareness and Training**: Many businesses, especially in the unorganized sector, lack structured training on ethics, resulting in limited understanding of ethical responsibilities and standards.

b. **Weak Enforcement of Laws**: While India has strong legal frameworks, inconsistent implementation and delayed justice often weaken the deterrent effect, allowing unethical practices to persist.

c. **Short-term Profit Pressures**: The drive to meet financial targets or satisfy shareholders sometimes leads businesses to compromise on ethical standards, prioritizing immediate gains over long-term integrity.

d. **Cultural Tolerance of Minor Ethical Breaches**: Certain unethical behaviors, like giving small bribes or overlooking compliance gaps, are often socially accepted or overlooked, making systemic change difficult.

e. **Influence of Political and Economic Power**: Powerful business entities may use their influence to bypass regulations, secure favorable treatment, or suppress whistleblowers, undermining ethical governance.

Check Your Progress

1. What is the purpose of the Whistleblower Protection Act, 2014?
2. What challenges do Indian businesses face when implementing ethical practices?
3. Mention one law that helps in promoting ethical business practices in India.

13.9 Ethical Training Programs that Foster Ethical Behavior

To strengthen ethical standards within organizations, several training programs have been developed globally and are increasingly adopted in India. These programs focus on real-life applications, legal compliance, and values-based decision-making:

a. **Anti-Bribery and Anti-Corruption Training (by EdApp)**: Educates employees on recognizing and preventing bribery, corruption, and unethical dealings, especially important in procurement and public sector interactions.
b. **Ethics Training for the Workplace (by SkillPath)**: Helps employees assess workplace dilemmas and align their behavior with organizational codes of conduct and ethical expectations.
c. **Leadership Professional in Ethics & Compliance (LPEC, by ECI)**: Certification program designed for managers and compliance officers, emphasizing ethical leadership, cultural change, and governance.
d. **Global Anti-Bribery & Corruption Training (by EVERFI)**: Offers interactive, scenario-based modules that train employees

to identify and report unethical practices in international and domestic business.

e. **Sexual Harassment Prevention Training (by Traliant)**: Ensures understanding of workplace behavior standards, employee rights, and the legal framework for preventing harassment.

f. **Compliance and Code of Conduct Training (by NAVEX Global)**: Covers organizational ethics policies, whistleblowing processes, conflict of interest management, and responsible reporting.

g. **Diversity, Equity, and Inclusion Training (by Coursera/edX)**: Promotes ethical treatment of individuals regardless of gender, caste, religion, or socioeconomic background- relevant in the Indian context.

h. **Data Privacy and Cyber Ethics Training (by Infosec Institute)**: Focuses on ethical handling of personal and consumer data- critical in the digital era of Indian business.

i. **Corporate Social Responsibility (CSR) Training (by Udemy/LinkedIn Learning)**: Introduces employees to ethical obligations beyond profit- such as sustainability, community impact, and long-term societal welfare.

j. **Whistleblower Protection and Ethical Reporting (by SAI Global)**: Encourages internal reporting of unethical practices without fear, building a transparent and accountable workplace culture.

13.10 Summing Up

- A blend of ancient values (Dharma, Ahimsa, Satya) and modern governance, guiding ethical conduct in businesses, rooted in India’s cultural and spiritual heritage.

- Business ethics is essential for trust-building, compliance, stakeholder relationships, and long-term success. Ethical practices support social responsibility, sustainability, and enhance reputation in both domestic and global markets.
- Common ethical issues include workplace discrimination, corruption, corporate misgovernance, environmental violations, labor exploitation, and data privacy concerns.
- India's legal frameworks, like the Companies Act (2013), SEBI regulations, and Whistleblower Protection Act, promote ethical business conduct and safeguard stakeholder interests.
- Emerging trends like CSR has become mandatory, sustainability reporting is growing, and ethical startups are on the rise. Digital governance also ensures greater transparency in business practices.
- Lack of awareness, weak enforcement of laws, pressure for short-term profits, and cultural tolerance of minor ethical breaches hinder the adoption of ethical practices.
- Programs like Anti-Bribery Training, Ethics Training, and Diversity & Inclusion Training are essential in shaping ethical behavior among employees and leaders.

13.11 Model Questions

1. Given the rising corruption issues in India, propose a strategy that Indian businesses could adopt to reduce bribery and promote transparency in their operations.
2. Consider a company facing pressures to meet quarterly profit targets at the expense of ethical considerations. How would you advise them to align their short-term financial goals with long-term ethical practices?

3. Critically analyze the effectiveness of the current legal framework in ensuring ethical business practices. Are there any gaps or challenges in enforcement that need addressing?
4. In light of India's rapid digital transformation, how can companies ensure that data privacy and cyber ethics are maintained while expanding their digital operations?
5. Explore the emerging trend of ethical startups in India. What makes these businesses successful, and how can traditional businesses adopt similar ethical practices?
6. Analyze the challenges of workplace discrimination and harassment in Indian businesses. How can organizational leaders create a more inclusive and equitable work environment?

13.12 References and Suggested Readings

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Unit-14
Ethical Decision-Making Process in Business

Unit Structure:

14.1 Introduction

In today's competitive business environment, organizations are often confronted with situations where the line between right and wrong is unclear. Decisions made by managers not only affect profits but also have far-reaching implications for employees, customers, shareholders, and society at large. Ethical decision-making provides a structured approach to resolving such dilemmas in a manner that upholds fairness, honesty, responsibility, and social accountability. By following systematic steps and applying ethical frameworks, businesses can ensure that their choices are both legally sound and morally justified, thereby strengthening trust, reputation, and long-term sustainability.

14.2 Objectives

After completing this unit, learners will be able to:

- *understand* the meaning and importance of ethical decision-making in business,
- *identify* and analyze ethical dilemmas faced by organizations,
- *explain* the steps involved in the ethical decision-making process,
- *recognize* the role of stakeholders and evaluate the consequences of business decisions,
- *apply* ethical frameworks such as the Ethical Navigation Wheel and Lynn Paine's Moral Compass,
- *appreciate* how ethical decision-making builds trust, reduces risks, and promotes sustainable business practices.

14.3 Meaning of Ethical Decision-Making

Ethical decision-making in business refers to the process of evaluating and choosing among different alternatives in a way that aligns with the principles of fairness, honesty, and responsibility. It ensures that the decision taken is not only legally acceptable but also morally sound and socially responsible.

In business, ethical decision-making becomes essential because managerial choices affect a wide range of stakeholders, including employees, customers, investors, suppliers, and the community at large. When managers face ethical dilemmas—situations where the correct choice is not clear or when both alternatives have moral consequences—they rely on structured ethical decision-making processes.

Definition

Different scholars have defined ethical decision-making as follows:

1. General Definition: *"Ethical decision-making is the process of identifying, evaluating, and selecting the best alternative that is consistent with ethical principles and minimizes harm to stakeholders."*
2. As per Business Ethics Perspective: *"It is the process of eliminating unethical options and choosing the alternative that upholds moral values, organizational integrity, and societal well-being."*

14.4 Ethical Decision-Making Process in Business

Ethical decision-making is the method of resolving business dilemmas in a way that respects moral principles, upholds fairness, and takes into account the welfare of all parties involved. Managers often face situations where the line between right and wrong is not obvious, and where any choice they make may have serious consequences for employees, customers, shareholders, and society. A structured process helps them move from identifying the ethical problem to selecting and implementing the most responsible solution. The following are the key stages of this process, explained in detail.

1. Recognize the Ethical Dilemma

The first stage is to understand whether the situation you are facing has moral implications. An ethical dilemma arises when the decision-maker must choose between options that all carry some moral weight or when the correct course of action is not immediately clear. Recognizing this dilemma requires moral sensitivity—the ability to see that a situation involves questions of right and wrong. For instance, if a colleague is involved in academic cheating or if a company is engaged in illegal practices, you are immediately placed in a moral conflict: do you protect the individual or the organization, or do you uphold honesty and fairness? Recognizing the dilemma is the foundation of the entire process because you cannot make an ethical choice without first acknowledging that one exists.

2. Gather All Relevant Facts

Once the dilemma is recognized, the next step is to collect all the information that might affect your decision. Acting without understanding the full context can lead to poor or biased choices. At this stage, you try to answer all the basic questions: who is involved, what exactly has happened, where and when the events took place, why the situation arose, and how it impacts different parties. Gathering facts ensures that your decision is grounded in reality rather than assumptions or incomplete knowledge. For example, in a whistleblowing situation, you would need to understand precisely what illegal activity the organization is conducting, who is responsible, and what the consequences would be if the issue were reported or ignored.

3. Define the Ethical Issues Clearly

After collecting the facts, it becomes important to define the ethical issues with clarity. Many business dilemmas are essentially conflicts of values. They may involve a choice between loyalty and honesty, profit and social responsibility, or short-term gains and long-term sustainability. By defining the core moral issue, the decision-maker focuses on what is truly at stake instead of being distracted by peripheral concerns. For instance, in the case of whistleblowing, the central ethical question may be whether it is more important to protect the organization from immediate harm or to fulfill a responsibility to society by exposing wrongdoing.

4. Identify the Stakeholders

The next stage is to understand who will be affected by the decision. Stakeholders can be both internal, such as employees, managers, and shareholders, and external, such as customers, suppliers, regulators, and the local community. Each of these groups may experience different benefits or harms depending on what choice you make. Considering stakeholders ensures that the decision is not narrowly focused on the interests of a single party. For example, when deciding whether to report a safety issue in a product, you must recognize that the customers, the company, and even the broader public may be affected in very different ways.

5. Evaluate the Consequences

Having identified the stakeholders, you now evaluate the consequences of the possible actions. This involves weighing both short-term and long-term outcomes and thinking carefully about who might benefit and who might be harmed. Ethical decision-making requires looking beyond immediate results to consider the broader impact of your choice. Reporting a friend for cheating may damage your personal relationship in the short term, but it upholds fairness in the academic or organizational system in the long run. Similarly, exposing unethical corporate behavior may temporarily harm the company's reputation, but it prevents greater legal and social harm in the future.

6. Refer to Ethical Principles and Community Standards

A sound ethical decision is not just about calculating outcomes; it must also align with accepted moral principles and community standards. This stage involves reflecting on principles of rights, justice, and fairness, as well as the organization's own code of conduct. It also requires considering what society or your professional community would view as a responsible action. A decision may be legal but still unethical if it violates the spirit of fairness or honesty. Referring to these standards ensures that your decision is morally defensible and consistent with both professional and societal expectations.

7. Generate and Evaluate Alternatives

Often, people see dilemmas in black-and-white terms, but ethical decision-making encourages you to look for additional possibilities. Instead of assuming there are only two options, you should brainstorm alternative solutions that might balance the interests of multiple stakeholders. Creative thinking can reveal a “third option” that resolves the dilemma more effectively. For example, rather than immediately reporting a friend for cheating or ignoring the act completely, you might first counsel the friend to correct their behavior, preserving fairness without immediately resorting to punishment.

8. Select the Best Ethical Alternative

After considering the facts, the stakeholders, the consequences, the ethical principles, and the possible alternatives, the decision-maker must choose the option that represents the most ethical path. This is the course of action that is fair, reasonable, and capable of being defended publicly if questioned. Selecting the best alternative often requires moral courage, as it may involve confronting peers, superiors, or even risking personal loss. The chosen option should be one that you can confidently justify to yourself, to your organization, and to the wider community.

9. Prepare for Opposition and Implement the Decision

Even the most carefully considered ethical decision may face resistance. Some stakeholders may disagree with your action, especially if they stand to lose from it. Preparing for opposition involves anticipating the likely objections and having clear, well-reasoned responses ready. Once prepared, you can implement the decision with confidence and transparency. For instance, if you decide to expose a corporate wrongdoing, management or colleagues may challenge your choice, and you must be able to explain why your action was necessary and justifiable.

10. Review and Reflect on the Outcome

The final stage of the process is to look back at the decision and assess its outcomes. Reflection allows you to see whether the action produced the intended ethical results and what lessons can be drawn for the future. This stage strengthens moral awareness and helps improve decision-making in later situations. If the decision succeeded in protecting stakeholders and upholding fairness, it confirms the value of the process. If there were unintended consequences, reflection provides insight into how they might be managed better next time.

By moving through these ten stages, managers and decision-makers can handle complex business dilemmas responsibly. This process encourages careful thought, adherence to moral principles, and accountability for the outcomes. It strengthens both individual integrity and organizational trust, which are essential for sustainable and ethical business practice.

14.5 Steps in Ethical Decision-Making

Ethical decision-making in business is a structured process that guides managers and individuals in resolving dilemmas responsibly. While the complete process can have many stages, it is often summarized into six essential steps: recognizing the ethical issue, gathering facts, identifying stakeholders, evaluating alternatives and consequences, selecting the most ethical option, and finally implementing and reflecting on the decision. Each step plays a critical role in ensuring that the choice made is fair, defensible, and socially responsible.

1. Recognize the Ethical Issue

The first step is to realize that the situation you are dealing with involves an ethical dimension. An ethical issue arises when a decision affects the rights, welfare, or fairness of others, or when there is a clear conflict between values such as honesty and loyalty. Recognizing the issue requires awareness and sensitivity, as not all ethical problems are immediately obvious. For example, imagine a manager who discovers that a supplier is cutting corners on safety. At first, it may seem like a simple business problem, but in reality, it raises moral concerns about customer safety and corporate responsibility. Without recognizing the ethical aspect of the situation, it is impossible to make a responsible choice.

2. Gather Facts

Once the ethical issue is recognized, the next step is to collect all the facts related to the situation. Decisions made on incomplete or inaccurate information often lead to poor outcomes. Gathering facts means understanding who is involved, what events have occurred, why they happened, and how different choices will impact others. It is important to separate assumptions from verified details. For instance, in a whistleblowing scenario, before reporting wrongdoing, an employee should carefully confirm what actions are actually taking place, when and where they occur, and whether they are indeed illegal or harmful. A well-informed decision is always more likely to be fair and defensible.

3. Identify Stakeholders

Every ethical decision affect people or groups, known as stakeholders, and it is crucial to identify them early in the process. Stakeholders can be internal, such as employees, managers, and shareholders, or external, such as customers, suppliers, regulators, and the local community. Understanding who is impacted allows the decision-maker to weigh the benefits and harms more thoughtfully. For example, when deciding whether to recall a defective product, a company must consider not only the financial interests of shareholders but also the safety of consumers and the trust of the public. Identifying stakeholders ensures that the decision does not focus narrowly on one group while neglecting others.

4. Evaluate Alternatives and Consequences

After identifying the stakeholders, the next step is to explore the possible courses of action and evaluate their consequences. This involves looking at both short-term and long-term effects, as well as considering who benefits and who may be harmed by each option. A responsible evaluation requires asking difficult questions: Will this decision protect fairness and rights? Will it damage relationships or the company's reputation? For instance, if a manager finds a friend cheating in a workplace test, the alternatives might include reporting the misconduct, ignoring it, or counselling the friend privately. Each choice carries potential consequences for the friend, the organization, and the manager's own integrity. Thinking through these consequences helps in identifying the path that aligns best with ethical principles.

5. Select the Most Ethical Option

After considering the facts, the stakeholders, and the consequences of each alternative, it is time to choose the most ethical option. This is the decision that upholds fairness, minimizes harm, and can be openly defended if questioned. The chosen option should reflect honesty, responsibility, and respect for the rights of others. Making this choice often requires moral courage, as it may involve going against personal convenience or the expectations of peers. For example, choosing to report wrongdoing in your company may feel risky, but if it protects customers, upholds the law, and maintains your integrity, it represents the most ethical course of action.

6. Implement and Reflect

The final step is to act on the decision and then reflect on its outcome. Implementation should be carried out with confidence and transparency, ensuring that the action is consistent with the ethical reasoning used to select it. Reflection comes after the decision has been implemented, and it involves assessing whether the results achieved were ethical and effective. Reflecting also helps the decision-maker learn from the experience, so future ethical dilemmas can be handled with greater awareness and confidence. For example, after reporting a safety violation, a manager might reflect on whether the action prevented harm, protected stakeholders, and reinforced the organization's values.

These six steps form a clear, practical framework for ethical decision-making in business. By following them, managers and individuals can handle dilemmas thoughtfully, protect the interests of stakeholders, and strengthen both personal integrity and organizational trust.

14.6 Ethical Decision-Making Frameworks

Several frameworks and models can guide managers in ethical decision-making. The major ones include:

a) Ethical Navigation Wheel (Kvalnes & Overenget, 2012)

A six-step framework that evaluates decisions from different angles:

1. Law – Is it legal?
2. Identity – Does it reflect my professional and personal values?
3. Morality – Is it morally right?
4. Reputation – Will it protect the company's image?
5. Economy – Does it support sustainable profitability?
6. Ethics – Can I justify this decision publicly?

The Ethical Navigation Wheel, developed by Oyvind Kvalnes and Einar Overenget (2012), is a practical framework for making ethical decisions in business by examining a situation from six different angles. It is particularly useful when managers or employees face moral dilemmas where both options seem right or equally wrong. Here is a detailed explanation of each component, written in a clear and student-friendly manner:

1. Law – Is it Legal?

The first consideration is whether the action complies with the law. Any business decision must respect the legal framework of the country and industry in which it operates. A decision might seem profitable or convenient, but if it violates laws—such as labor regulations, environmental rules, or anti-bribery laws—it can lead to serious consequences for the organization and its managers. It is important to remember that just because something is legal does not always make it ethical. For example, selling a product that meets minimum legal safety standards but is harmful in the long term may still be questioned morally.

2. Identity – Does it Reflect My Professional and Personal Values?

The second step asks whether the decision aligns with the core values of both the individual and the organization. Identity here refers to the principles and professional codes that guide conduct. For instance, doctors value patient welfare, accountants value transparency, and teachers value fairness. A manager should ask, "Does this decision match who I am as a professional, and does it represent my company's stated values?" If an action conflicts with the organization's identity or the manager's professional standards, it may damage long-term trust and self-respect.

3. Morality – Is it Morally Right?

Morality involves one's inner sense of right and wrong, shaped by culture, upbringing, and socialization. Even when an action is legal, it might still feel morally wrong. For example, in some cultures, giving expensive gifts to clients may feel acceptable, while in others, it is considered a bribe. A decision-maker should consider personal moral intuition as well as shared societal norms before acting. If your conscience feels uneasy about a decision, that is a strong signal to pause and rethink.

4. Reputation – How Will This Affect My and My Company's Image?

This stage evaluates how the decision would be viewed if it became public. In today's world of instant communication and social media, a company's reputation can collapse overnight. Even if an action is legal and might not seem immediately harmful, it could cause lasting damage if stakeholders—such as customers, employees, or the community—see it as unethical. For instance, a company that hides a product defect might save money in the short term, but once the issue is exposed, its reputation could suffer irreparable harm.

5. Economy – Does it Support Sustainable Profitability?

Business decisions also require considering financial implications. A solution that is ethical but leads to severe financial loss may not be viable in the long run. However, this does not mean profit should override all other concerns. Instead, the idea is to seek a balance where the decision supports the organization's sustainability while respecting its moral and legal responsibilities. For example, temporarily halting the launch of a new product to fix a safety issue may cause a short-term loss but protect the company from long-term financial and reputational damage.

6. Ethics – Can I Justify This Decision Publicly?

Finally, the ethical test asks whether the decision can be openly defended using established ethical principles. Kvalnes and Øverengetemphasize the principle of equality (treating similar cases equally) and the principle of publicity (being able to explain your decision publicly without shame). This step ensures the action is not only legally and financially sound but also morally defensible in the eyes of society. If you would be uncomfortable explaining your choice to a public audience, it likely fails the ethical test.

How the Navigation Wheel Works

The six steps do not have to be followed in a strict sequence. Decision-makers can start at any point and move around the wheel, weighing each aspect according to the situation. The purpose is to encourage a 360-degree evaluation of choices, preventing decisions based solely on profit or convenience. Managers can use it both for proactive decision-making and for reflecting on past decisions to learn from their outcomes.

b) Lynn Paine’s Moral Compass

Harvard Professor Lynn Paine suggests evaluating decisions based on four guiding questions:

1. Does the action serve a worthwhile purpose?
2. Is it consistent with principles, laws, and governance norms?
3. Does it respect the legitimate claims of stakeholders?
4. Do I/we have the authority and courage to act?

Lynn Paine’s Moral Compass

Harvard Business School professor Lynn Paine developed the idea of a moral compass as a practical tool to guide ethical decision-making in business. It acts as an internal navigation system, helping managers and organizations make choices that uphold integrity, respect stakeholder interests, and comply with the expectations of society. According to Paine, every significant decision in business can be evaluated using four guiding questions that form the core of the moral compass. These questions ensure that decisions are not just legal or profitable but also ethically sound and socially responsible.

1. Does the action serve a worthwhile purpose?

The first question prompts decision-makers to reflect on the purpose behind their action. In business, it is easy to get caught up in short-term profits or personal gains. This step reminds managers to consider whether the decision contributes to the organization’s larger mission or to the well-being of society. A worthwhile purpose goes beyond financial benefit; it includes promoting safety, fairness, innovation, or sustainability.

Example: Before launching a new product, a company should ask if the product genuinely meets customer needs and improves their lives, rather than simply increasing sales.

2. Is it consistent with principles, laws, and governance norms?

The second question examines whether the decision aligns with ethical principles, legal requirements, and organizational standards of governance. Ethical principles include honesty, fairness, respect for others, and responsibility. Compliance with laws and codes of conduct ensures that the organization avoids illegal or corrupt practices, while good governance reflects accountability and transparency.

Example: A manager considering a cost-cutting strategy must ensure that the approach does not involve violating labor laws or misleading customers about product quality.

3. Does it respect the legitimate claims of stakeholders?

The third question brings stakeholders into focus. Businesses affect many groups—employees, customers, suppliers, investors, regulators, communities, and the environment. A decision is ethical only if it considers and respects the legitimate interests of these groups. Ignoring stakeholders can lead to unfair treatment, reputational damage, or even legal consequences.

Example: When a company decides to automate certain processes, it should consider how this change will affect employees, provide fair notice, and explore measures to support displaced workers.

4. Do I/we have the authority and courage to act?

The final question asks whether the decision-makers have the right and the moral courage to implement the chosen action. Authority ensures that the action is within the decision-maker's role or the organization's power, while courage is needed to act ethically even when the decision is difficult, unpopular, or risky. Ethical decisions often require standing firm against pressure, criticism, or temptation to compromise.

Example: A compliance officer might have the authority to report financial irregularities but also needs the courage to confront senior management or external auditors.

Significance of the Moral Compass

By answering these four questions, individuals and organizations can navigate complex dilemmas with greater confidence and clarity. Lynn Paine's Moral Compass integrates purpose, principles, stakeholders, and personal courage, creating a balanced approach that promotes integrity, responsible leadership, and long-term trust. When consistently applied, it strengthens an organization's ethical culture and ensures decisions serve both the company and society.

c) Kidder's Nine Ethical Checkpoints

A stepwise method to navigate complex dilemmas:

1. Recognize the moral issue
2. Determine responsibility
3. Gather facts
4. Test right vs wrong (legal, smell, front-page, mom test)
5. Test right vs right (truth vs loyalty, justice vs mercy, short vs long-term)
6. Apply the tests
7. Consider creative "trilemma" solutions
8. Decide and act
9. Reflect and learn

14.7 Importance of Ethical Decision-Making in Business

Ethical decision-making is not only a moral responsibility but also a strategic necessity for organizations. In today's competitive and socially aware environment, businesses are constantly evaluated by how their choices affect people, society, and the environment. The importance of ethical decision-making in business can be understood through the following points:

1. Enhances Stakeholder Trust and Corporate Reputation

Ethical decision-making builds trust among stakeholders, including employees, customers, investors, suppliers, and the community. When a company consistently makes fair and responsible choices, stakeholders develop confidence in its integrity and reliability. This trust strengthens customer loyalty, employee commitment, and investor confidence, ultimately improving the organization's reputation. A strong corporate reputation serves as a competitive advantage and helps the business sustain long-term growth.

Example: A company that recalls a defective product immediately, even at a financial cost, earns the trust of customers and enhances its brand image.

2. Reduces Legal and Compliance Risks

Decisions guided by ethical principles are more likely to comply with laws and regulations. Organizations that consider the legal and moral implications of their actions avoid the risk of lawsuits, regulatory fines, and penalties. Ethical decision-making ensures that policies and operations align with both formal legal requirements and broader governance standards, reducing the chances of conflicts with regulatory authorities.

Example: Following labor laws, environmental norms, and anti-bribery rules prevents legal complications and reinforces the company's commitment to responsible practices.

3. Promotes Long-Term Sustainability and Social Accountability

Ethical decision-making encourages businesses to look beyond short-term profits and consider the broader social and environmental impacts of their actions. Companies that prioritize social responsibility create sustainable operations that contribute to long-term success. Ethical practices such as responsible sourcing, reducing environmental impact, and supporting community welfare ensure that the business maintains its social license to operate.

Example: A company investing in eco-friendly production methods may face higher costs initially but benefits from long-term sustainability and public support.

4. Builds a Culture of Fairness and Transparency within Organizations

When ethical decision-making is consistently practiced, it creates a workplace culture where honesty, fairness, and accountability are valued. Employees in such organizations feel respected and motivated because decisions are made openly and justly. A culture of transparency also reduces internal conflicts, promotes teamwork, and ensures that problems are addressed proactively rather than hidden.

Example: Companies that communicate openly about financial performance, organizational changes, or employee evaluations foster a sense of trust and reduce workplace tension.

Ethical decision-making in business is essential for protecting the interests of stakeholders, maintaining legal compliance, and ensuring the long-term success of the organization. By fostering trust, supporting sustainable practices, and promoting a transparent culture, it strengthens both the organization's performance and its contribution to society.

Ethical decision-making is the foundation of responsible and sustainable business practice. Managers today face dilemmas where the correct choice is not always obvious, and decisions can affect employees, customers, shareholders, and society at large.

Frameworks such as the Ethical Navigation Wheel and Lynn Paine's Moral Compass provide structured guidance to evaluate actions from legal, moral, and stakeholder perspectives. By following the steps of recognizing ethical issues, gathering facts, considering stakeholders, evaluating alternatives, and acting with courage and integrity, organizations can make choices that are both fair and sustainable.

A strong commitment to ethical decision-making not only prevents misconduct but also builds trust, credibility, and long-term success. Ultimately, the true test of any business decision is whether it upholds core values, serves a worthwhile purpose, and can be confidently justified to both the organization and society. This alignment of profit with principle ensures that businesses remain respected contributors to the communities they serve.

14.8 Summing Up

1. Ethical decision-making is essential for sustainable business. Every major business choice has a moral dimension that can impact employees, customers, shareholders, and society.
2. A structured process leads to better decisions. Recognizing the ethical issue, gathering facts, identifying stakeholders, evaluating alternatives, selecting the best option, and reflecting on the outcome help ensure fairness and responsibility.
3. Frameworks guide moral clarity. Tools like the Ethical Navigation Wheel and Lynn Paine's Moral Compass offer practical ways to examine decisions from legal, moral, and stakeholder perspectives.

4. Stakeholders must always be considered. Respecting the legitimate interests of employees, customers, suppliers, communities, and the environment builds long-term trust and credibility.
5. Courage and integrity are central to ethical leadership. Making the right decision often requires moral courage to act, even when it is difficult or unpopular.

Ethical choices strengthen reputation and success. Aligning profit with principle ensures that organizations maintain credibility, avoid harm, and create lasting positive

Check Your Progress

1. Ethical decision-making in business primarily involves:
a) Maximizing profits only
b) Following government orders blindly
c) Choosing alternatives aligned with fairness, honesty, and responsibility
d) Avoiding any decision that impacts stakeholders negatively

Answer: c) Choosing alternatives aligned with fairness, honesty, and responsibility

2. Which of the following is NOT one of the steps in the six-step ethical decision-making process?
a) Recognize the ethical issue
b) Identify stakeholders
c) Ignore consequences and focus on short-term results
d) Evaluate alternatives and consequences

Answer: c) Ignore consequences and focus on short-term results

3. According to the Ethical Navigation Wheel, which step focuses on financial sustainability?

a) Morality

b) Economy

c) Reputation

d) Ethics

Answer: b) Economy

4. Which question is part of Lynn Paine's Moral Compass?

a) Does this decision ensure immediate profit?

b) Is this decision popular with all employees?

c) Does the action serve a worthwhile purpose?

d) Can I avoid stakeholder consideration?

Answer: c) Does the action serve a worthwhile purpose?

5. Reflecting on the outcome of a decision primarily helps in:

a) Avoiding accountability

b) Learning lessons for future ethical decisions

c) Focusing only on organizational profit

d) Reducing employee involvement

Answer: b) Learning lessons for future ethical decisions

14.9 Model Questions

Short Answer Type Questions

1. Define ethical decision-making in business in your own words.
2. List any three stakeholders that may be affected by business ethical decisions.
3. Why is gathering facts important before making an ethical decision?

4. Mention two benefits of applying Lynn Paine's Moral Compass.
5. State the importance of reflecting on the outcome after implementing an ethical decision.

Long Answer Type Questions

1. Explain the six steps of the ethical decision-making process with suitable examples.
2. Discuss the Ethical Navigation Wheel by Kvalnes & Overenget. How can it help managers make better decisions?
3. Describe Lynn Paine's Moral Compass and explain the significance of each of its four guiding questions.
4. Ethical decision-making is vital for long-term organizational sustainability. Discuss with examples how aligning profit with principles builds trust and credibility.
5. Compare and contrast the Ethical Navigation Wheel and Moral Compass frameworks. Explain how both can be applied together to solve complex business dilemmas.

14.10 References and Suggested Readings

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Unit-15

Corporate Social Responsibility and Corporate Sustainability

Unit Structure:

15.1 Introduction

Corporate Social Responsibility (CSR) and Corporate Sustainability have become integral aspects of modern business practices. CSR emphasizes a company's responsibility toward society and the environment, beyond profit-making, while corporate sustainability focuses on balancing economic growth with long-term social and environmental well-being. Together, they ensure that businesses operate ethically, create value for stakeholders, and contribute to sustainable development.

15.2 Objectives

After completing this unit, learners will be able to:

- *explain* the meaning, concept, and importance of CSR and sustainability,
- *identify* the components and approaches of CSR, including philanthropy, community development, and creating shared value,
- *understand* the legal framework of CSR in India under the Companies Act, 2013,
- *analyze* the three pillars of corporate sustainability—people, planet, and profit,
- *evaluate* the role of CSR and sustainability in enhancing corporate reputation, stakeholder trust, and long-term growth.

15.3 Corporate Social Responsibility (CSR)

15.3.1 Meaning and Concept of CSR

Corporate Social Responsibility (CSR) is the philosophy and practice of conducting business in a way that integrates social, environmental, and ethical responsibilities alongside economic goals. It reflects the belief that corporations are not only accountable to their shareholders but also to society at large. CSR requires businesses to operate responsibly and contribute positively to the communities and environments in which they function.

In simple terms, **CSR means that companies should "give back" to society** by supporting sustainable development, protecting the environment, and improving the quality of life for stakeholders. Modern CSR aligns with the **triple-bottom-line approach**, which balances **Profit (economic growth), People (social well-being), and Planet (environmental protection)**.

Over time, CSR has evolved from voluntary philanthropic activities to strategic and legally mandated responsibilities. The enactment of **Section 135 of the Companies Act, 2013** in India made it mandatory for eligible companies to spend 2% of their average net profits on CSR initiatives, further embedding social responsibility as a core aspect of business operations.

Key Features of CSR:

1. Integration of social and environmental concerns with business operations.
2. Responsibility towards stakeholders beyond profit-making.
3. Commitment to ethical, transparent, and sustainable practices.
4. Support for long-term societal development through community initiatives.

Example:

A company investing in renewable energy, contributing to education programs in rural areas, and improving local healthcare facilities demonstrates CSR by combining profitability with social good.

15.3.2 Components of Corporate Social Responsibility (CSR)

Corporate Social Responsibility is expressed in several ways, reflecting how a business chooses to engage with society and the environment. While companies may adopt different approaches depending on their resources and priorities, three major components of CSR are widely recognized: **philanthropy**, **community development**, and **creating shared value**. Each of these components represents a unique way for businesses to contribute to social progress while maintaining their role in the economy.

1. Philanthropy

Philanthropy is the oldest and most familiar form of CSR. It involves a company voluntarily contributing resources—such as money, goods, or services—to causes that improve the well-being of society. These efforts are often charitable in nature and are motivated by a sense of social responsibility rather than a direct expectation of financial returns. Common philanthropic activities include funding educational scholarships, supporting hospitals, donating to disaster relief programs, or sponsoring cultural and sports events.

Philanthropy helps businesses build goodwill and positive public perception, but it generally operates outside of the company's core operations. For example, a technology firm donating computers to schools or an industrial company funding the construction of a local playground are philanthropic gestures that enhance the community without necessarily generating immediate business benefits.

2. Community Development

Community development reflects a deeper, long-term commitment to improving the social and economic conditions of the regions where a company operates. Instead of one-time donations, this approach involves **direct engagement with local communities** to create sustainable improvements. Companies may initiate projects in areas like healthcare, education, skill development, sanitation, rural infrastructure, or environmental protection.

The purpose of community development is to build stronger relationships with local stakeholders while addressing critical social needs. For instance, a manufacturing company might partner with NGOs to run health awareness programs, improve access to clean water, or establish training centres for youth to enhance their employability. Such initiatives create mutual benefits: communities become healthier and more self-reliant, while the company gains a stable and supportive operating environment.

3. Creating Shared Value (CSV)

Creating Shared Value is a modern and strategic approach to CSR that integrates social responsibility directly with business objectives. Instead of viewing CSR as separate from profit-making, this approach identifies ways to **generate economic value while solving social or environmental problems**. The core idea is that companies can achieve long-term growth by aligning business success with societal progress.

An example of CSV is a food processing company working with local farmers by providing training, technology, and fair pricing. This initiative improves the farmers' income and living standards while ensuring the company has a reliable, high-quality supply chain. Similarly, investing in renewable energy solutions can help meet environmental goals and reduce operating costs for the company. Creating Shared Value demonstrates how businesses can thrive by making a positive difference to society.

Conclusion

These three components—philanthropy, community development, and creating shared value—illustrate the different levels of corporate engagement with society. Philanthropy reflects voluntary giving, community development builds lasting local impact, and shared value integrates social objectives into core business strategies. Together, they form a comprehensive approach to CSR, enabling companies to fulfill their social responsibilities while supporting sustainable business growth.

15.4 Ethics in the Context of CSR

Ethics in the context of CSR is the moral foundation upon which social responsibility initiatives are built. While CSR deals with the actions a company takes to benefit society, **ethics concerns whether those actions are morally right, fair, and justifiable**. Ethical considerations ensure that CSR is not merely a marketing tool but a genuine commitment to sustainable and responsible business practices.

15.4.1 Meaning of Ethics in CSR

Ethics in CSR refers to the application of moral principles and reasoning to corporate actions that impact society, the environment, and stakeholders. It involves asking **"What is the right thing to do?"** in situations where business objectives may conflict with social or environmental responsibilities.

An ethical approach to CSR requires companies to:

- Respect the rights and welfare of all stakeholders.

- Avoid harm to the environment and community.
- Make decisions that are fair, transparent, and socially accountable.

15.4.2 Types of Ethics Relevant to CSR

1. **Personal Ethics**
   - ❖ The individual beliefs and moral values of employees or managers about right and wrong.
   - ❖ Example: A manager who personally values environmental protection will support eco-friendly CSR initiatives.
2. **Professional Ethics**
   - ❖ The accepted codes of conduct or moral standards associated with a profession.
   - ❖ Example: Accountants and auditors must ensure that CSR spending is accurately reported, upholding professional integrity.
3. **Organizational Ethics**
   - ❖ The ethical culture, policies, and value systems of the organization.
   - ❖ Example: Companies like Tata Motors define CSR missions with a focus on inclusive growth, expecting all employees to align with these values.

15.4.3 Importance of Ethics in CSR

1. **Ensures Genuine Social Contribution** – Ethics prevents CSR from being treated as a publicity stunt and ensures it genuinely benefits society.

2. **Supports Rational Decision-Making** – Ethical reasoning helps companies select CSR initiatives that align with moral responsibilities and stakeholder needs.
3. **Resolves Conflicts of Interest** – Ethics helps balance profit motives with the obligation to protect the environment and support communities.
4. **Strengthens Reputation and Trust** – Organizations perceived as ethical enjoy long-term stakeholder loyalty and public confidence.

15.4.4 Ethical Theories Applied to CSR

1. **Contractarian View**
   - ❖ Morality is based on agreements and mutual benefit.
   - ❖ Companies engage in CSR because maintaining social contracts with communities is in their own interest.
2. **Utilitarian or Consequentialist View**
   - ❖ The right action is the one that produces the greatest overall good.
   - ❖ CSR is justified if it maximizes benefits for the most stakeholders, even if it involves some cost to the company.
3. **Deontology (Duty-Based View)**
   - ❖ Certain actions are morally obligatory, regardless of consequences.
   - ❖ Companies have a duty to engage in CSR simply because it is the right thing to do.

Ethics in CSR ensures that corporate actions are not limited to profit-driven motives but are rooted in fairness, responsibility, and long-term social impact. When businesses integrate ethical reasoning into their CSR policies, they create lasting value for stakeholders, protect the environment, and build a positive corporate legacy.

15.5 Importance of Corporate Social Responsibility (CSR)

Corporate Social Responsibility plays a vital role in modern business as it aligns corporate success with social and environmental responsibilities. It is no longer sufficient for companies to focus solely on profitability; they are also expected to contribute positively to the communities and environments in which they operate. The importance of CSR can be understood through several key aspects that highlight its influence on organizational growth, reputation, and long-term sustainability.

Enhances Stakeholder Trust and Corporate Reputation

CSR initiatives strengthen the trust of all stakeholders, including employees, customers, investors, suppliers, and the local community. When a company consistently engages in activities that benefit society, such as promoting education, protecting the environment, or supporting healthcare initiatives, stakeholders perceive it as a responsible and reliable organization. This trust builds loyalty among customers and employees and fosters confidence among investors. Over time, a strong commitment to CSR translates into an enhanced corporate reputation, which serves as a powerful differentiator in competitive markets and helps attract new opportunities for growth and collaboration.

Reduces Legal and Compliance Risks

By adhering to ethical practices and integrating social responsibility into business operations, companies can significantly reduce their exposure to legal and regulatory risks. CSR requires organizations to consider the legal framework within which they operate and ensure that their actions are compliant with labor laws, environmental regulations, and other governance standards. Engaging in responsible practices minimizes the likelihood of penalties, lawsuits, and regulatory investigations. Moreover, companies that proactively implement CSR initiatives often stay ahead of evolving legal requirements, which provides an additional layer of security and stability in business operations.

Promotes Long-Term Sustainability and Social Accountability

CSR encourages organizations to look beyond immediate profits and focus on long-term sustainability. Companies that actively invest in environmental protection, community development, and responsible resource management contribute to the creation of a stable and supportive social environment in which they can thrive. By being socially accountable, businesses not only help address pressing societal challenges but also secure their own future by fostering goodwill and reducing resistance from local communities. For instance, companies that implement eco-friendly production methods or support skill-building programs for underprivileged communities ensure that their growth is sustainable and aligned with broader societal needs.

Builds a Culture of Fairness and Transparency within Organizations

The adoption of CSR principles promotes a culture where fairness, integrity, and transparency become the foundation of organizational behavior. Employees working in such environments feel respected and valued, which increases their motivation and commitment. Transparent communication about CSR policies and activities also creates a sense of pride and ownership among employees, encouraging them to contribute actively to social initiatives. This culture of fairness reduces internal conflicts, strengthens teamwork, and ensures that ethical considerations are embedded in every level of decision-making. Over time, this internal ethical culture becomes an asset, helping organizations maintain credibility with external stakeholders as well.

In conclusion, the importance of CSR lies in its ability to connect business success with ethical responsibility. By enhancing trust, reducing risks, promoting sustainability, and building a transparent workplace culture, CSR not only benefits society but also secures long-term organizational growth and reputation. Companies that integrate CSR into their core strategy are better positioned to thrive in today's competitive and socially conscious business environment.

15.6 CSR under the Companies Act, 2013 in India

The **Companies Act, 2013** marked a major milestone in the evolution of Corporate Social Responsibility (CSR) in India by making it a **statutory obligation** for certain companies. Prior to the enactment of this law, CSR activities in India were mostly voluntary, with companies engaging in philanthropy or community initiatives based on their values and resources. The 2013 Act introduced a **mandatory framework** that integrates CSR into corporate governance, ensuring that businesses contribute directly to social and environmental development alongside their economic goals.

Under **Section 135** of the Companies Act, 2013, CSR provisions apply to companies that meet any one of the following financial thresholds in the preceding financial year:

- A **net worth** of ₹500 crore or more,
- A **turnover** of ₹1,000 crore or more, or
- A **net profit** of ₹5 crore or more.

Companies falling under these criteria are required to **spend at least 2% of the average net profits** made during the **three immediately preceding financial years** on CSR activities. This provision ensures that profitable companies actively contribute to social and environmental causes, promoting inclusive growth.

The Act also requires companies to form a **CSR Committee** of the Board consisting of **three or more directors**, with at least one independent director in the case of public companies. This committee is responsible for formulating and recommending a CSR policy, specifying the activities to be undertaken, and monitoring their implementation. The company's Board of Directors must ensure that the CSR policy is disclosed in the annual report and that the prescribed expenditure is made in accordance with the policy.

The **CSR Rules (2014)** provide clear guidelines on the types of activities that qualify as CSR. These include:

- Eradicating hunger, poverty, and malnutrition, and promoting healthcare and sanitation,
- Promoting education and vocational skills,
- Ensuring environmental sustainability and ecological balance,
- Promoting gender equality and women empowerment,

- Rural development projects and contributions to government-approved social funds, such as the PM National Relief Fund or PM CARES Fund.

It is important to note that CSR activities **must be carried out in India** and should **not be part of the company's routine business operations**, except in specific cases like R&D for COVID-19-related projects under temporary amendments.

The Act also introduced a **comply or explain** approach. If a company fails to spend the prescribed 2% of profits on CSR activities, it must **disclose the reasons** in its annual Board Report. Amendments introduced in 2021 have made CSR compliance even stricter by requiring unspent CSR amounts for ongoing projects to be transferred to a **special account** and spent within three years, failing which the amount must be remitted to a government-specified fund.

15.7 Significance of CSR under the Companies Act, 2013

The statutory CSR framework in India has several far-reaching impacts. It ensures that large and profitable corporations participate in addressing social and environmental challenges, fostering sustainable development. The law promotes **transparency and accountability** by requiring formal CSR committees, policies, and reporting. It also encourages businesses to integrate social responsibility into their long-term strategies, aligning corporate success with societal well-being. By legally mandating CSR, India became one of the first countries in the world to formally link corporate governance with social accountability.

15.8 Corporate Sustainability

In recent years, the way we define business success has undergone a significant transformation. No longer is financial profit the sole indicator of a company's performance. Today, corporations are increasingly expected to create value not just for shareholders, but also for employees, consumers, communities, and the environment. This shift has given rise to the concept of **corporate sustainability**, which now forms a core part of modern business strategy.

15.8.1 Meaning and Concept

Corporate sustainability refers to a business approach that ensures long-term growth and profitability while being mindful of the environmental, social, and economic impacts of its operations. At its core, it is about running a business in a way that supports the well-being of present and future generations.

This concept stems from the broader idea of **sustainable development**, which was popularized in the 1987 Brundtland Report, defined as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs." However, while sustainable development is often discussed at the macro level—addressing governments, global institutions, and international frameworks—corporate sustainability brings the focus to the micro level of individual businesses and firms.

Corporations, being powerful economic entities, play a crucial role in shaping environmental and societal outcomes. From climate change and pollution to social inequality and ethical governance, the actions of businesses have widespread consequences. Thus, adopting sustainability is no longer optional—it is a necessity for survival in an interconnected and risk-prone global economy.

15.8.2 The Triple Bottom Line Approach

A key feature of corporate sustainability is the **triple bottom line** framework, which expands the traditional financial bottom line to include **three pillars**:

1. **Environmental Sustainability**

This focuses on reducing the company's ecological footprint. It includes minimizing waste, cutting greenhouse gas emissions, adopting renewable energy, conserving water, and using sustainable raw materials. Environmental stewardship is about ensuring that natural resources are not depleted or damaged by corporate activity.

2. **Social Sustainability**

Social sustainability emphasizes a business's responsibility toward people—employees, customers, suppliers, and the wider community. This means ensuring safe and fair workplaces, promoting diversity and inclusion, respecting human rights, and contributing to community development. It also involves building strong relationships with stakeholders and maintaining the company's social license to operate.

3. **Economic (or Governance) Sustainability**

While profitability remains essential, the economic pillar of sustainability is more than just making money. It includes ethical business conduct, compliance with laws and regulations, transparency in reporting, risk management, and long-term strategic thinking. Good governance ensures that a company's growth does not come at the cost of integrity or societal harm.

These three pillars—environmental, social, and economic—are often summed up by the phrase **"people, planet, and profit."** They are interdependent and must be balanced to achieve true sustainability.

15.8.3 Evolution and Global Response

The journey toward corporate sustainability has been shaped by a number of key global events and policy shifts. The **Rio Earth Summit (1992)** and the **Johannesburg Summit (2002)** brought sustainability into the spotlight, urging corporations to recognize their environmental and social responsibilities. Following these summits, many developed nations institutionalized sustainability practices through agencies like the U.S. Environmental Protection Agency (EPA) and the European Environment Agency. Protocols such as the **Kyoto Protocol**, **Basel Convention**, and the **Convention on Biological Diversity** further emphasized the need for corporate action.

International organizations like the **World Business Council for Sustainable Development (WBCSD)** have also played a role in promoting sustainability by bringing together hundreds of global corporations committed to responsible practices. In India, companies like **Tata Group** and **Infosys** have integrated sustainability into their vision and mission statements, focusing on clean technologies, energy efficiency, and eco-friendly innovations.

The adoption of international standards such as **ISO 14000** (for environmental management) has helped formalize these practices across industries.

15.9 Corporate Sustainability vs. Corporate Social Responsibility (CSR)

While closely related, **corporate sustainability** and **corporate social responsibility (CSR)** are not identical. CSR is generally understood as a company's voluntary efforts to improve social and environmental conditions. It often takes the form of charitable donations, employee volunteer programs, or one-off community projects.

In contrast, corporate sustainability is **not an add-on or a separate initiative**. It is a **strategic, integrated approach** that influences the way the entire business operates—from supply chains and production to marketing and reporting. Where CSR asks "What good can we do?", corporate sustainability asks "How can we do business better—for everyone and the planet?"

To put it simply, CSR is about what a business **does**, while sustainability is about **how** a business **works**.

15.10 Why Corporate Sustainability Matters

In today's world, businesses face complex and evolving risks—climate change, resource scarcity, social unrest, and changing stakeholder expectations. According to the **World Economic Forum's Global Risks Report (2020)**, environmental threats like climate action failure are now considered the most likely and most impactful global risks. Ignoring such risks can affect a company's operations, reputation, and long-term viability.

On the other hand, embracing sustainability can bring real business benefits:

- Cost savings through energy efficiency and waste reduction
- Enhanced brand reputation and customer loyalty
- Easier access to capital from ESG-conscious investors
- Improved employee engagement and retention
- Innovation through sustainable product and service design

Companies that integrate sustainability into their core operations are more resilient, more adaptive, and better positioned to succeed in the long run.

Corporate sustainability is no longer a fringe idea or a matter of public relations. It has become a mainstream business imperative. Companies that fail to align with environmental, social, and economic expectations risk being left behind—not just by regulators and investors, but by consumers and employees as well.

Understanding corporate sustainability means recognizing that businesses are not separate from society and nature. They are embedded within them—and their success depends on the health and well-being of the world around them. The future of business, therefore, lies in building models that are **profitable, responsible, and sustainable.**

15.11 The Three Pillars of Corporate Sustainability

To understand how a business can function sustainably, we must look at what supports the very idea of sustainability in a corporate context. This is where the concept of the **three pillars of corporate sustainability** becomes essential. These pillars—**environmental, social, and economic (or governance)**—serve as the foundation for sustainable decision-making and long-term value creation.

Each pillar represents a key area of responsibility that businesses must address in order to contribute positively to society and ensure their own future survival.

1. The Environmental Pillar: Safeguarding the Planet

The environmental pillar focuses on how businesses interact with the natural world. This includes efforts to reduce pollution, lower greenhouse gas emissions, minimize waste, conserve natural resources, and adopt energy-efficient technologies. The aim is to operate in a way that protects and preserves the environment, not just for current business needs but for future generations.

Key practices include:

- Reducing carbon footprint across operations and supply chains
- Switching to renewable sources of energy
- Using recyclable, biodegradable, or minimal packaging
- Managing water use and industrial discharge
- Eliminating toxic substances and hazardous waste

For example, companies like **Walmart** have implemented zero-waste programs, cutting down on packaging and encouraging suppliers to adopt recycled materials. These initiatives not only benefit the environment but often lead to cost savings and improved operational efficiency.

The environmental pillar is often seen as the most urgent and visible due to rising concerns about climate change, biodiversity loss, and resource depletion. However, for environmental efforts to be effective, they must be embedded into the core business model—not treated as external projects.

2. The Social Pillar: Focusing on People and Communities

The social pillar refers to a business's responsibility towards people—its employees, consumers, suppliers, and the broader community. This pillar rests on the idea that companies should contribute to social well-being and maintain ethical practices in human relationships, both internally and externally.

Key focus areas include:

- Ensuring safe and inclusive working conditions
- Fair wages, employee benefits, and work-life balance
- Supporting diversity, equity, and inclusion (DEI)
- Respecting human rights across the supply chain
- Building strong relationships with local communities

Companies are expected to go beyond legal compliance and demonstrate respect, fairness, and care in their dealings. For example, offering parental leave, supporting continuing education for staff, or investing in local school infrastructure are seen as socially responsible actions.

A company's **"social license to operate"**—meaning public trust and approval—largely depends on this pillar. If a business mistreats its workers, ignores safety standards, or is involved in exploitative practices (such as child labor), it risks damaging its brand, losing customers, and facing regulatory backlash.

3. The Economic (or Governance) Pillar: Ensuring Long-Term Viability

The third pillar, often referred to as the economic or governance pillar, relates to a company's ability to remain financially stable while being ethically and legally sound. Unlike traditional profit-maximization approaches, this pillar emphasizes **responsible profitability**—earning profits without compromising ethics or social and environmental standards.

Key elements of this pillar include:

- Transparent financial reporting and accounting
- Risk management and regulatory compliance
- Ethical leadership and decision-making
- Stakeholder accountability
- Long-term value creation over short-term gains

This pillar is sometimes called the **"governance pillar"** because it addresses internal systems of control—such as board independence, avoidance of conflicts of interest, and shareholder rights. It ensures that the business is not only profitable but also governed in a way that promotes fairness, trust, and sustainability.

Importantly, the economic pillar makes it practical for businesses to commit to sustainability. By aligning profit with ethical and sustainable practices, companies are more likely to adopt responsible models voluntarily rather than through regulation alone.

Integration and Balance of the Three Pillars

The three pillars are interconnected. A business cannot claim to be sustainable by focusing only on one or two of them. For example, a company may be environmentally conscious but exploit workers—this is not sustainability. Likewise, a profitable business that pollutes local water bodies or hides financial risks from investors fails the test of true sustainability.

Effective corporate sustainability depends on balancing these pillars, recognizing their trade-offs, and making decisions that serve people, the planet, and profits all at once. This approach is often referred to as the **"triple bottom line"**—an alternative to the traditional bottom line of profit alone.

The phrase **"people, planet, and profit"** has become a widely accepted way of expressing this balance.

The three pillars of corporate sustainability provide a framework for businesses to evaluate and improve their impact on the world. They encourage companies to think beyond short-term gains and take a long-term, holistic view of success.

By building strategies that support environmental responsibility, social equity, and sound governance, companies can create resilient operations, earn public trust, and remain competitive in a changing world. These pillars are not abstract ideals—they are practical guides for shaping sustainable, responsible, and future-ready business practices.

15.12 How to Implement Corporate Sustainability

Understanding the concept of corporate sustainability is only the first step. The real challenge lies in putting the principles into action. Implementing sustainability in a business requires more than scattered environmental initiatives or social outreach programs. It needs a strategic, long-term commitment that is integrated into every aspect of how the company operates.

Whether a business is large or small, public or private, local or global—sustainability must be treated as a core business function, not an optional add-on.

1. Start with Leadership Commitment

The journey toward sustainability starts at the top. Senior leadership, including the board of directors and executive management, must commit to sustainability as a business priority. Without their support, sustainability efforts may lack direction, resources, and accountability.

To begin:

- Leadership must clearly define what sustainability means for the business.
- Sustainability should be embedded in the company's **vision, mission, and values**.
- Clear expectations and goals must be communicated across all departments.

2. Assess Current Practices and Identify Gaps

Before setting sustainability goals, businesses need to understand where they currently stand. This involves conducting a **sustainability audit** to review existing practices related to environmental impact, employee welfare, community relations, and governance systems.

Important questions to consider:

- How much waste and energy does the company generate?
- Are employees satisfied, safe, and treated fairly?
- Are suppliers following ethical labor and environmental standards?
- Are there transparency and compliance mechanisms in place?

This assessment helps in identifying **gaps and opportunities** for improvement.

3. Set Clear, Measurable Sustainability Goals

Vague ambitions such as "going green" or "being socially responsible" are not enough. Businesses must define specific goals tied to each pillar of sustainability.

For example:

- **Environmental goal**: Reduce carbon emissions by 30% over five years.
- **Social goal**: Achieve gender diversity of at least 40% in leadership roles.
- **Governance goal**: Publish an audited sustainability report annually.

These goals should be **SMART**—Specific, Measurable, Achievable, Relevant, and Time-bound.

4. Align Sustainability with Core Business Strategy

Sustainability should not be a separate department or side project. Instead, it must align with the company's overall business strategy. That means integrating sustainability into:

- Product design and innovation
- Procurement and supply chain management

- Marketing and branding
- Human resource policies
- Risk assessment and compliance systems

For example, a food company might reduce plastic in packaging while also investing in local farming initiatives to support sustainable agriculture.

5. Engage Stakeholders

Sustainability isn't achieved in isolation. Companies must actively involve key stakeholders—employees, customers, investors, suppliers, and community members—in both planning and execution.

Ways to engage stakeholders include:

- Hosting workshops or focus group discussions
- Sharing sustainability reports and updates
- Inviting feedback and suggestions from employees and customers
- Partnering with NGOs, government agencies, and academic institutions

Stakeholder engagement builds **trust, transparency, and long-term support** for sustainability efforts.

6. Establish Systems to Track and Monitor Progress

What gets measured, gets managed. To ensure progress, companies need to develop **monitoring systems** and assign responsibility for tracking key sustainability metrics.

Common tools include:

- Key Performance Indicators (KPIs) for sustainability
- Carbon accounting software
- Employee satisfaction surveys

- ESG (Environmental, Social, Governance) reporting frameworks

International frameworks such as the **Global Reporting Initiative (GRI)**, **Sustainability Accounting Standards Board (SASB)**, and **ISO 14001** help guide reporting and ensure consistency.

7. Communicate Achievements and Challenges

Transparency is crucial. Companies should regularly share their sustainability performance through:

- **Annual sustainability reports**
- Updates on websites and social media
- Internal newsletters and employee bulletins
- Press releases and investor briefings

It's equally important to be honest about challenges, setbacks, and areas needing improvement. This builds credibility and prevents **greenwashing**—the practice of exaggerating or misrepresenting environmental performance.

8. Reward Sustainability Efforts Internally

Recognizing and rewarding sustainable behavior motivates employees to participate actively. Companies can:

- Include sustainability targets in performance appraisals
- Offer bonuses or recognition for achieving sustainability milestones
- Create employee-led "green teams" or sustainability task forces

When staff feel part of the mission, implementation becomes a shared responsibility—not a top-down order.

9. Continuously Improve and Innovate

Sustainability is not a one-time project; it's a continuous process. Businesses must remain alert to new technologies, changing regulations, stakeholder expectations, and global sustainability trends.

Regular reviews, benchmarking, and learning from best practices can help businesses stay on track and push for greater impact.

Implementing corporate sustainability is both a strategic and moral responsibility. It requires businesses to act intentionally and consistently across all levels—from leadership to day-to-day operations. When done well, sustainability not only reduces risks and enhances reputation but also opens new pathways for innovation, efficiency, and growth.

In a world where environmental and social challenges are growing more urgent, sustainable businesses are better equipped to adapt, compete, and contribute to a more just and resilient future.

15.13 Corporate Sustainability Reporting

In today's world, stakeholders—ranging from customers and employees to investors and governments—expect businesses to operate with transparency, accountability, and a long-term commitment to people and the planet. One of the most effective ways to meet these expectations is through **corporate sustainability reporting**.

Corporate sustainability reporting is the structured process by which a company discloses its environmental, social, and economic goals, activities, and impacts. It allows organizations to communicate how they are addressing sustainability-related risks and opportunities, while also demonstrating their contribution to a sustainable global economy.

Corporate Sustainability Reporting (CSR) is the practice of publicly disclosing a company's performance and progress in areas related to environmental protection, social responsibility, and economic or governance practices. It is a structured process through which a business communicates how it is contributing to sustainable development—beyond just generating profit.

In simple terms, sustainability reporting answers three key questions:

- **What goals has the company set to be more sustainable?**
- **What actions has it taken toward those goals?**
- **What measurable outcomes have been achieved so far?**

Purpose and Relevance

The main purpose of sustainability reporting is to promote **transparency** and **accountability**. By sharing non-financial data along with traditional financial information, businesses allow stakeholders—such as investors, employees, regulators, consumers, and communities—to better understand their overall impact on society and the environment.

Sustainability reporting involves **publicly sharing information** about a company's use of resources, its positive and negative effects on the environment and society, and its strategies for becoming more sustainable. It may cover a wide range of topics, such as:

- Energy consumption and carbon emissions
- Waste management and recycling initiatives
- Water usage and conservation efforts
- Employee welfare and human rights compliance

- Community engagement and stakeholder participation
- Economic performance with ethical governance

The primary purpose is to enhance **transparency** and **accountability** in how the business operates across all three pillars of sustainability—environmental, social, and economic. Such reports help stakeholders make informed decisions, improve a company's reputation, and build long-term trust.

15.13.1 What Does It Include?

A typical sustainability report may include information on:

- Environmental impacts (e.g., carbon emissions, water use, waste management)
- Social initiatives (e.g., employee welfare, community development, diversity and inclusion)
- Governance practices (e.g., ethics, compliance, transparency)
- Alignment with global goals such as the **UN Sustainable Development Goals (SDGs)**

Many companies also use recognized frameworks such as the **Global Reporting Initiative (GRI)**, **Sustainability Accounting Standards Board (SASB)**, or **Integrated Reporting Framework (IR)** to guide their reporting process.

Regulatory Framework in India

India is among the few countries where Corporate Social Responsibility (CSR) and sustainability reporting have legal backing. The **Companies Act, 2013**, under **Section 135** and the accompanying **CSR Rules, 2014**, mandates qualifying companies to spend a specific portion of their profits on CSR and to report on these activities annually.

In addition to CSR provisions, the **Business Responsibility Reporting (BRR)** framework was introduced by the **Securities and Exchange Board of India (SEBI)** in 2011 for top-listed companies. It emphasizes the need to disclose information on social, environmental, and governance issues, promoting a culture of responsibility and sustainability in the corporate sector.

15.13.2 What Should a Sustainability Report Include?

An ideal sustainability report is comprehensive and covers the following areas:

- **Vision and goals** related to sustainability
- **Sustainability strategy and action plans**
- **Performance indicators** such as carbon footprint, waste reduction, employee diversity, etc.
- **Progress and targets achieved** with year-on-year comparisons
- **Challenges faced** and future improvement plans
- **Stakeholder engagement efforts**
- **Independent audits or third-party verifications**, if any

Companies may choose to align their reports with international frameworks such as:

- Global Reporting Initiative (GRI) Standards
- UN Sustainable Development Goals (SDGs)
- ISO 26000 on Social Responsibility
- Integrated Reporting (<IR>) Framework

15.13.3 Benefits of Sustainability Reporting

A well-prepared sustainability report delivers multiple benefits:

- Improves stakeholder confidence through transparency
- Enhances brand reputation and public goodwill
- Helps identify operational inefficiencies and risks
- Attracts ESG (Environmental, Social, Governance)-oriented investors
- Enables benchmarking against industry standards
- Demonstrates regulatory compliance and responsible citizenship

From a broader perspective, it allows companies to align themselves with global efforts to combat climate change, reduce inequality, and ensure ethical economic growth.

15.13.4 Challenges in Reporting

Despite the growing popularity of sustainability reporting, many businesses—especially small and medium enterprises (SMEs)—face challenges such as:

- Lack of technical expertise to measure sustainability metrics
- Absence of standardized data collection systems
- Perceived high cost of reporting and verification
- Fear of exposing weaknesses or underperformance
- Limited stakeholder awareness or interest in non-financial disclosures

Overcoming these challenges requires capacity-building, leadership support, and adoption of suitable reporting tools tailored to the company's size and sector.

Corporate sustainability reporting is more than just a compliance exercise—it is a tool for **building trust**, **measuring impact**, and **driving long-term improvement**. As sustainability becomes central to business survival and competitiveness, reporting will continue to evolve in both scope and sophistication.

By embracing transparent reporting practices, companies not only meet the expectations of regulators and stakeholders but also reaffirm their commitment to a future that values environmental responsibility, social equity, and ethical governance.

15.14 Difference Between CSR and Sustainability Reporting

Although often used interchangeably, Corporate Social Responsibility (CSR) reporting and sustainability reporting are not the same. Both aim to make businesses more transparent and accountable for their non-financial performance, but they differ in scope, focus, and approach.

Understanding the distinction helps clarify how companies plan, implement, and communicate their social and environmental responsibilities.

1. Scope and Coverage

- CSR Reporting typically focuses on social development activities carried out by the company, such as education, healthcare, livelihood support, and community welfare projects. It mainly captures the company's spending and initiatives under CSR obligations, especially in compliance with laws like Section 135 of the Indian Companies Act, 2013.
- Sustainability Reporting has a broader scope. It includes not only social initiatives but also the company's environmental

impact, governance practices, economic performance, and how its operations align with global sustainability goals.

2. Legal vs. Voluntary Nature

- In India, CSR reporting is mandatory for companies that meet certain financial thresholds. These companies are required to form a CSR Committee, allocate a specific percentage of their net profit, and report their activities in the Annual Report.
- Sustainability reporting, though gaining ground, is often voluntary—especially for unlisted companies. However, SEBI has mandated Business Responsibility and Sustainability Reporting (BRSR) for the top 1000 listed entities, signaling a move toward broader disclosure expectations.

3. Time Frame and Intent

- CSR reports are often retrospective, focusing on what the company has already done (e.g., how much money was spent, what projects were completed).
- Sustainability reports are more strategic and forward-looking. They describe goals, strategies, risks, performance metrics, and long-term sustainability plans.

4. Focus Areas

Aspect	**CSR Reporting**	**Sustainability Reporting**
Primary Focus	Community development, philanthropy	Environmental, Social, and Governance (ESG) factors
Main Driver	Legal compliance	Business strategy and stakeholder expectations
Reporting Base	Section 135 and CSR Rules (India)	Global frameworks (GRI, SDGs, SASB, IR)

Aspect	CSR Reporting	Sustainability Reporting
Target Audience	Regulators and local communities	Investors, analysts, employees, and wider public
Alignment	Schedule VII of Companies Act, 2013	Triple bottom line: people, planet, and profit

Integration with Business Strategy

- CSR activities may or may not be aligned with core business strategy. Sometimes they are run as standalone projects, separate from business operations.
- Sustainability efforts are typically embedded into the company's business model, influencing decision-making across departments like supply chain, product design, risk management, and finance.

In summary, CSR reporting shows what a company gives back, while sustainability reporting explains how a company operates responsibly across all dimensions of its business. Both are important, but they serve different purposes. Together, they help build a company's credibility, trust, and long-term value in the eyes of stakeholders.

Check Your Progress 1

1. Which of the following is *not* one of the three pillars of corporate sustainability?

a) Social

b) Economic

c) Cultural

d) Environmental

Answer: c) Cultural

2. **Which business practice aligns with the environmental pillar of sustainability?**

   a) Offering employee stock options

   b) Shifting to renewable energy sources

   c) Sponsoring local sports teams

   d) Publishing financial reports

   Answer: b) Shifting to renewable energy sources

3. **The term “triple bottom line” refers to:**

   a) Profit, productivity, and price

   b) People, planet, and profit

   c) Risk, return, and responsibility

   d) Compliance, control, and cost

   Answer: b) People, planet, and profit

4. **Which reporting framework is most commonly used for sustainability disclosures?**

   a) GAAP

   b) ISO 9001

   c) GRI

   d) BIS

   Answer: c) GRI

5. **Which of the following is a benefit of adopting corporate sustainability?**

   a) Reduced compliance burden

   b) Isolation from global trends

   c) Improved brand reputation

   d) Increased use of non-renewable resources

   Answer: c) Improved brand reputation

Check Your Progress 2

1. In India, CSR provisions are governed under which section of the Companies Act, 2013?

a) Section 123

b) Section 135

c) Section 145

d) Section 101

Answer: b) Section 135

2. CSR reporting is mainly focused on:

a) Predicting future environmental impacts

b) Auditing financial performance

c) Social development and philanthropic activities

d) Product pricing strategies

Answer: c) Social development and philanthropic activities

3. Which of the following would be a typical CSR initiative?

a) Reducing carbon emissions

b) Publishing ESG reports

c) Building a school in a rural area

d) Introducing new packaging designs

Answer: c) Building a school in a rural area

4. Which is *not* a primary driver of CSR in India?

a) Legal obligation

b) Shareholder demand

c) Community pressure

d) Global reporting standards

Answer: d) Global reporting standards

5. Which schedule in the Companies Act provides a list of activities for CSR?

a) Schedule V

b) Schedule VII

c) Schedule X

d) Schedule IV

Answer: b) Schedule VII

15.15 Model Questions

Short Answer Questions

Corporate Sustainability:

1. What are the three pillars of corporate sustainability?
2. Why is the “triple bottom line” important for businesses today?
3. How does sustainability reporting benefit a business?
4. Define corporate sustainability in one or two sentences.
5. What does “stakeholder engagement” mean in the context of corporate sustainability?

Corporate Social Responsibility:

1. What is the legal threshold for mandatory CSR in India?
2. Mention two differences between CSR reporting and sustainability reporting.
3. Give two examples of CSR activities under Schedule VII of the Companies Act.
4. What is the role of a CSR Committee in a company?
5. Why is CSR important for corporate image?

Long Answer Questions

Corporate Sustainability:

1. Explain in detail the three pillars of corporate sustainability and their interdependence.
2. Describe the key steps a business can take to implement corporate sustainability across its operations.
3. What is corporate sustainability reporting? Discuss its purpose, components, and benefits.
4. How does sustainability contribute to long-term business viability? Use examples to support your answer.

5. Compare and contrast the roles of leadership and stakeholder engagement in driving corporate sustainability.

Corporate Social Responsibility:

1. Discuss the legal framework for CSR in India, including Section 135 and Schedule VII.
2. How is CSR reporting different from sustainability reporting? Provide examples.
3. Examine the role of CSR in improving community relationships and social equity.
4. What challenges do companies face in implementing effective CSR initiatives?
5. Explain the evolution of CSR in India and its transition from philanthropy to a strategic business function.

15.16 References and Suggested Readings

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Unit-16

CSR and Corporate Governance

Unit Structure:

16.1. Introduction

In today's business world, companies are not just profit-making entities; they are also expected to act responsibly towards society and the environment. This expectation has given rise to important concepts like Corporate Social Responsibility (CSR), Corporate Governance, and the Gandhian concept of Trusteeship. CSR refers to the responsibility of companies to contribute positively to society beyond their legal obligations. Corporate Governance refers to the system of rules, practices, and processes by which a company is directed and controlled, ensuring accountability and fairness to all stakeholders. Gandhian Trusteeship is a moral and ethical approach that suggests businesses should act as trustees or caretakers of wealth, using their resources for the benefit of society. Together, these ideas shape the ethical and responsible functioning of modern businesses.

These three concepts are closely connected and reinforce one another. CSR focuses on what companies do for society, while corporate governance focuses on how companies make decisions and ensure accountability. Good corporate governance ensures that CSR efforts are not just superficial acts but are genuinely integrated into the company's strategy and culture. Gandhian Trusteeship provides the moral foundation for both CSR and governance by emphasizing the ethical duty of businesses to use their wealth and power for the common good. When a company combines strong governance, meaningful CSR, and the ethical values of trusteeship, it builds trust with stakeholders, strengthens its reputation, and contributes to sustainable development. Together, these concepts guide businesses towards being responsible, transparent, and committed to the well-being of all sections of society.

16.2: Objectives

After going through this unit you will be able to:

- *understand* the concept and importance of Corporate Social Responsibility (CSR) and its relevance in the Indian context,

- *examine* the principles of good corporate governance and the link between CSR and corporate governance,
- *explore* the concept, types, and significance of corporate social reporting for various stakeholders,
- *study* Mahatma Gandhi's idea of Trusteeship and its application in modern corporate and ethical business practices.

16.3: Corporate Social Responsibility (CSR)

Corporate Social Responsibility (CSR) refers to the responsibility of businesses to act in ways that benefit society, beyond just making profits. It means that companies should think about the social, environmental, and economic impacts of their actions and work towards creating positive effects for their employees, customers, communities, and the planet. CSR is based on the idea that businesses are not separate from society but are a part of it, and they should contribute to solving social problems like poverty, education, health, environmental protection, and human rights. Simply put, CSR is about doing business in a way that is fair, ethical, and beneficial to all stakeholders, not just the shareholders.

16.3.1: Importance of CSR

The following points highlight the importance of CSR

- **Builds a Positive Image**: When companies engage in CSR activities, they create a good reputation, which helps attract customers, investors, and talented employees.
- **Strengthens Stakeholder Relationships**: CSR helps companies build trust and stronger relationships with stakeholders like customers, employees, communities, and governments.

- **Supports Sustainable Development**: By addressing social and environmental issues, companies help promote long-term sustainability and protect resources for future generations.
- **Improves Employee Satisfaction**: Employees feel proud and motivated to work for companies that care about social causes, leading to better morale and productivity.
- **Gains Competitive Advantage**: Companies with strong CSR practices often stand out from competitors and can win customer loyalty.
- **Reduces Regulatory Pressure**: Companies that take voluntary action on social issues may face less government intervention or regulation.
- **Contributes to Social Good**: Ultimately, CSR helps improve the quality of life in society by supporting causes like education, health, poverty reduction, and environmental conservation.

16.3.2: CSR in Indian Context

(Companies Act, 2013, Section 135)

In India, CSR became a legal requirement under the Companies Act, 2013. Section 135 of the Act makes it mandatory for certain companies to spend at least 2% of their average net profits (from the past three years) on CSR activities. The key points are:

- Companies with a net worth of ₹500 crore or more, or turnover of ₹1,000 crore or more, or net profit of ₹5 crore or more during any financial year must follow the CSR rules.
- These companies must form a CSR Committee with at least three directors, including at least one independent director, to plan and oversee CSR activities.

- Companies must prepare a CSR policy that outlines the activities they will undertake, focusing on areas listed in Schedule VII of the Act, such as education, healthcare, environment, poverty reduction, rural development, and gender equality.
- Companies must spend the required amount each year and report their CSR activities in the Board's Report. If they fail to spend the required amount, they must explain the reasons.

This legal framework makes India one of the first countries to make CSR spending mandatory, reflecting the government's commitment to social development.

16.3.3: Benefits and Challenges of CSR Implementation

a) Benefits: The following points highlight the key benefits of CSR Implementation :

- Enhanced Brand Reputation: CSR initiatives improve a company's image, making it more attractive to customers, investors, and employees.
- Customer Loyalty: Customers prefer to buy from companies that show social and environmental responsibility.
- Attracts and Retains Talent: Employees are more likely to work for and stay with companies that align with their values and care for society.
- Risk Management: CSR helps companies manage social and environmental risks and avoid scandals or controversies.
- Community Support: CSR activities strengthen the company's relationship with the local community, creating goodwill and support.

- Innovation Opportunities: Working on social or environmental challenges can lead to innovative products and services.

b) Challenges: The following points highlight the challenges of CSR Implementation.

- Lack of Awareness: Some companies, especially small and medium enterprises, may not fully understand CSR or its benefits.
- Resource Constraints: Smaller companies may lack the financial or human resources to plan and implement CSR programs effectively.
- Measuring Impact: It is often difficult to measure the real impact of CSR activities on society, making it hard to assess success.
- Compliance Burden: Companies may find it challenging to comply with all legal requirements, documentation, and reporting under CSR laws.
- Risk of Tokenism: Some companies may treat CSR as just a checkbox activity or public relations exercise, without real commitment to social change.
- Stakeholder Expectations: Balancing the expectations of different stakeholders (shareholders, customers, communities) can be complex.

Check Your Progress

1. What is the full form of CSR?
2. Name any two key areas where companies invest under CSR in India.
3. State one major benefit of CSR for a business.
4. Mention one challenge companies face while implementing CSR.

16.4: Corporate Governance

Corporate governance refers to the system of rules, practices, and processes by which a company is directed and controlled. It defines how decisions are made in the company, how the interests of various stakeholders (such as shareholders, employees, customers, suppliers, and the community) are balanced, and how the company ensures accountability and fairness in its operations. Good corporate governance ensures that a company operates ethically, efficiently, and in the best interest of all stakeholders. It is mainly carried out by the board of directors, who oversee management and ensure that the company follows legal, ethical, and strategic guidelines. In short, corporate governance is about creating a framework that promotes trust, transparency, and integrity in business.

16.4.1: Principles of Good Corporate Governance

The principles of good corporate governance are:

- Accountability: Company management and the board of directors are accountable to the shareholders and stakeholders. They must take responsibility for the company's actions and outcomes.
- Transparency: Companies must provide clear, accurate, and timely information about their financial position, performance, and governance practices, helping build trust with stakeholders.
- Fairness: All shareholders, including minority and foreign shareholders, should be treated fairly and equally. The rights of stakeholders must be respected.
- Responsibility: Companies must comply with legal requirements and ethical standards, ensuring responsible behavior towards the environment, society, and all stakeholders.

- Independent Oversight: The presence of independent directors on the board helps ensure that decisions are made objectively without conflicts of interest.
- Stakeholder Engagement: Good corporate governance considers the interests of various stakeholders, not just shareholders, fostering long-term sustainability.

16.4.2: Relationship between CSR and Corporate Governance

- **Shared Ethical Foundation**: Both CSR and corporate governance are rooted in ethics, fairness, and responsibility. Good governance ensures that CSR is not just for show but is genuinely part of company values.
- **Accountability in CSR**: Corporate governance mechanisms hold management accountable for implementing CSR activities effectively and aligning them with company strategy.
- **Transparency of CSR Activities**: Governance ensures that CSR initiatives are reported clearly and accurately, helping build stakeholder trust and avoiding greenwashing (false claims of sustainability).
- **Board's Role in CSR**: The board of directors oversees not only financial performance but also social and environmental responsibilities, ensuring CSR is part of long-term business goals.
- **Sustainability and Risk Management**: Strong governance links CSR with sustainability strategies, helping companies manage risks related to environmental, social, and governance (ESG) issues.

- **Stakeholder Inclusion**: Corporate governance ensures that CSR efforts consider the needs and expectations of all stakeholders, not just shareholders, promoting balanced decision-making.

Check Your Progress
1. What is meant by corporate governance?
2. List any two principles of good corporate governance.
3. How is CSR linked to corporate governance?

16.5: Corporate Social Reporting

Corporate Social Reporting (CSR) refers to the process by which companies communicate their social, environmental, and sustainability activities to stakeholders. It is a way for companies to disclose how they are addressing social issues, protecting the environment, ensuring good governance, and contributing to the welfare of society beyond financial profits. Corporate social reporting allows businesses to be transparent about their non-financial performance and show that they are committed to ethical, responsible, and sustainable business practices. This type of reporting helps build trust with stakeholders, including shareholders, customers, employees, regulators, and the community, by providing them with meaningful information about the company's broader impacts.

16.5.1: Types of Social Reports

The following are the different types of social reports:

- **Environmental Reports**: These reports provide information on a company's environmental policies, practices, and performance. They cover areas such as energy use, carbon emissions, waste management, water conservation, and pollution control. Environmental reports show how a company is working to reduce its negative environmental impact and promote sustainability.

- **Sustainability Reports**: Sustainability reports present a company's overall approach to sustainable development by covering three key areas: environmental, social, and governance (ESG) performance. These reports often follow international frameworks like the Global Reporting Initiative (GRI) and provide details on how the company balances economic goals with environmental protection and social responsibility.
- **Social Audits**: Social audits are systematic reviews of a company's social performance, including working conditions, labor rights, health and safety, community involvement, and ethical practices. Unlike financial audits, social audits focus on the social impacts of the company's operations and assess how well it meets its social responsibilities. Social audits can be conducted internally or by independent third parties to ensure fairness and accuracy.

16.5.2: Importance of Social Reporting for Stakeholders

The following points highlights the importance of Social Reporting.

- **For Shareholders and Investors**:

  Social reporting provides investors with valuable information about the company's sustainability practices, helping them assess long-term risks and opportunities beyond financial performance.

- **For Customers**:

  Customers are increasingly choosing to buy from companies that act responsibly. Social reporting helps customers understand a company's values and ethical commitments, influencing their purchasing decisions.

- **For Employees**:

  Employees feel more engaged and motivated when they know their company is making a positive contribution to society. Social reporting keeps employees informed and proud of their organization's efforts.

- **For Regulators and Governments**:

  Governments and regulatory bodies use social reports to ensure that companies comply with environmental and social regulations and contribute to national development goals.

- **For Communities and NGOs**:

  Local communities and non-governmental organizations (NGOs) use social reporting to monitor how companies affect local environments, economies, and social well-being, enabling them to hold businesses accountable.

16.5.3: Recent Trends and Practices in India and Globally

- **Integrated Reporting**:

  Globally, there is a growing trend towards integrated reporting, which combines financial and non-financial (social, environmental, governance) performance into a single report. This gives stakeholders a complete picture of the company's overall impact and sustainability.

- **Adoption of Global Frameworks**:

  Many companies now align their reports with international standards such as the Global Reporting Initiative (GRI), United Nations Sustainable Development Goals (SDGs), and the International Integrated Reporting Council (IIRC) framework, making their reports globally comparable.

- **Increased Use of Digital Platforms**:

  Companies are increasingly using digital platforms, websites, and social media to publish and share their social reports, making them more accessible and engaging for a wider audience.

- **Mandatory CSR Disclosures in India**:

  In India, under the Companies Act, 2013, eligible companies must disclose their CSR policies, projects, and spending in the annual Board's Report and on their websites, increasing transparency and accountability.

- **Focus on Climate Change and ESG Factors**:

  Both in India and globally, there is rising emphasis on reporting climate-related risks, carbon footprints, and other environmental, social, and governance (ESG) factors, as investors and stakeholders demand more detailed sustainability disclosures.

16.6: Concept of Gandhian Trusteeship

The concept of Gandhian Trusteeship is a unique socio-economic philosophy introduced by Mahatma Gandhi. It is based on the idea that wealth and resources, though legally owned by individuals or businesses, are ultimately held in trust for the benefit of society. Gandhi believed that the wealthy are not the absolute owners of their riches but should act as trustees, managing their wealth responsibly and using it to serve the common good. This philosophy promotes the voluntary sharing of wealth, fair treatment of workers, ethical conduct, and concern for the welfare of all — not through force or government control, but through moral duty and self-discipline. Trusteeship rejects both extreme capitalism and socialism, offering a middle path where wealth is generated but also fairly distributed for the well-being of society.

16.6.1: Mahatma Gandhi's Views on Wealth and Responsibility

Gandhi believed that wealth creation was not inherently wrong — but hoarding wealth for personal luxury while others suffer in poverty was unethical. He argued that businessmen and industrialists have a **moral responsibility** to use their resources for the benefit of their workers, communities, and the nation. In Gandhi's words, "I desire to end capitalism almost, if not quite, as much as the most advanced socialist. But our methods differ. My theory of 'trusteeship' is no makeshift, certainly no camouflage." He envisioned a system where wealth holders would voluntarily limit their consumption and channel surplus wealth into social causes, such as education, healthcare, rural development, and poverty alleviation. For Gandhi, this was the ideal approach to social justice — one that relied on ethical awakening, not coercive redistribution.

16.6.2: Relevance of Trusteeship in Modern Corporate Practices

Though developed in the early 20th century, the Gandhian concept of trusteeship remains highly relevant today, especially in the corporate world. Modern businesses operate in complex environments where they are expected to balance profits with social responsibility. Gandhi's idea reminds companies that profit-making should not be the sole aim; rather, businesses should view themselves as custodians of resources, including human, natural, and financial capital. In the age of rising inequality, environmental crises, and social unrest, trusteeship provides a moral framework for companies to engage in fair labor practices, reduce environmental harm, and contribute meaningfully to societal development. Many principles underlying trusteeship — fairness, social responsibility, ethical leadership — align closely with modern concepts like stakeholder capitalism, business ethics, and sustainable development.

16.6.3: Application of Trusteeship in CSR and Ethical Business Practices

Gandhian trusteeship plays a powerful role in shaping Corporate Social Responsibility (CSR) and ethical business practices today. Companies that follow the spirit of trusteeship:

- Design CSR initiatives that address real community needs — such as education, health, rural livelihoods, and environmental conservation — rather than treating CSR as mere publicity or compliance.
- Invest in fair wages, employee welfare, and safe working conditions, recognizing workers as key stakeholders who deserve respect and dignity.
- Practice ethical supply chain management, ensuring that the company's operations, as well as those of its partners and suppliers, do not exploit people or harm the environment.
- Adopt long-term thinking, focusing on sustainable growth and responsible innovation rather than short-term profit maximization.

- Engage openly with stakeholders, including communities, NGOs, governments, and customers, reflecting the trustee's responsibility to act transparently and fairly.

In essence, Gandhian trusteeship provides the moral foundation for businesses to go beyond legal compliance in CSR, embedding ethical values deeply into corporate culture and operations. It encourages companies to act not just as economic entities but as agents of positive social change, using their wealth and influence for the greater good.

Check Your Progress

1. What is a social report?
2. Name one global trend in corporate social reporting.
3. Who proposed the concept of Trusteeship in business ethics?

16.7: Summing Up

This unit helps us understand the concept of Corporate Social Responsibility (CSR), which means the responsibility of companies towards society, beyond making profits. It explains why CSR is important, especially in India, where many companies are now required by law to spend on social welfare. It also discusses the benefits of CSR, like building a good image and trust among people, and challenges, such as lack of proper planning and limited resources. The unit also talks about corporate governance, which means following good rules and practices in managing a company. Good governance ensures transparency, fairness, and accountability. The link between CSR and governance is highlighted—when companies follow good governance, they are more likely to be socially responsible.

The unit also covers corporate social reporting, which is the process of sharing information about a company's social and environmental activities. Different types of social reports are explained, and it shows how these reports help stakeholders like investors, employees, and the public to know what a company is doing for society. The unit then discusses recent trends in India and the world in social reporting and CSR activities. Lastly, the unit introduces Gandhian Trusteeship, a concept by Mahatma Gandhi. He believed that wealthy people should act as caretakers (trustees) of their wealth for the benefit of society. The idea of trusteeship is still useful today in promoting ethical business and responsible behaviour. The unit explains how modern companies can follow Gandhi's ideas by including ethical values and social responsibility in their business practices.

16.8: Model Questions

1. Define Corporate Social Responsibility (CSR). Discuss its importance in today's business environment.
2. Explain the concept of CSR in the Indian context. How has CSR evolved in India over the years?
3. Discuss the major benefits and challenges involved in implementing CSR initiatives.
4. What do you understand by Corporate Governance? Explain its significance in corporate functioning.
5. Explain the key principles of good corporate governance. How do they ensure ethical business practices?
6. Discuss the relationship between CSR and corporate governance. How do they support each other?
7. What is Corporate Social Reporting? Describe its types with examples.

8. Explain the importance of social reporting for stakeholders. How does it enhance transparency?
9. Describe the recent trends and practices in social reporting in India and globally.
10. What is Gandhian Trusteeship? Discuss its relevance and application in today's CSR and ethical business practices.

16.9: Reference and Suggested Readings

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Unit-17
Global Reporting Initiative and ESG Index

Unit Structure:

17.1: Introduction

In today's world, businesses are expected to do more than just earn profits. People now want companies to act responsibly—by protecting the environment, treating employees fairly, and being honest in their actions. As a result, the need for transparency (being open) and accountability (taking responsibility) in how businesses operate has become very important. This is especially true when it comes to issues like pollution, climate change, worker rights, and ethical governance.

There is now a growing trend of responsible business practices, where companies try to balance profit-making with doing good for society and the planet. Customers, investors, governments, and other stakeholders want to know how businesses are performing not only financially, but also socially and environmentally.

To help companies report this kind of information in a clear and structured way, several global tools and standards have been developed. Two of the most widely used are the Global Reporting Initiative (GRI) and the ESG Index. The GRI provides guidelines for companies to report on their environmental, social, and governance (ESG) activities. On the other hand, the ESG Index is used to measure and compare companies based on how well they perform in these areas.

17.2: Objectives

By the end of this unit, learners will be able to:

- *understand* the concept and significance of sustainability reporting,
- *explain* the origin, purpose, and structure of the Global Reporting Initiative (GRI),
- *identify* the major environmental, social, and governance (ESG) parameters,
- *comprehend* the concept and methodology of ESG Index,
- *evaluate* the importance of ESG metrics for investors, corporations, and policymakers,
- *discuss* the relevance of GRI and ESG reporting in the Indian and global context.

17.3: Global Reporting Initiative (GRI)

In today's world, companies are expected not just to make profits, but also to act responsibly towards people and the planet. The Global Reporting Initiative (GRI) is an international organization that helps businesses and other organizations report their impact on the economy, environment, and society. Its main aim is to promote transparency and encourage sustainable development. GRI provides a set of guidelines and standards that companies can use to create sustainability reports. These reports show how a company is performing not just financially, but also in areas like environmental protection, fair treatment of workers, and community involvement. This is also known as the Triple Bottom Line – focusing on People, Planet, and Profit.GRI was created after environmental disasters like the Exxon Valdez oil spill showed the need for better corporate responsibility. Today, GRI is used by thousands of companies across the world to share clear and comparable information with stakeholders like customers, investors, and the public.

17.3.1: Objectives of GRI

The main objectives of Global Reporting Initiative are as follows:

1. Promote Transparency: Encourage organizations to openly share information about their environmental, social, and economic performance.
2. Support Sustainable Development: Help companies understand their impact and take steps toward becoming more sustainable and responsible.
3. Improve Comparability: Create common standards so stakeholders can easily compare sustainability reports from different companies.

4. Strengthen Accountability: Make organizations more accountable to stakeholders by reporting on important sustainability issues.
5. Encourage Stakeholder Engagement: Promote communication between companies and their stakeholders for better understanding and decision-making.
6. Build Trust: Increase public trust in organizations by showing that they are committed to ethical and sustainable practices.

17.3.2: Principles of GRI

The principles of GRI are classified as: A) Principles to define content and B) Principles to define report quality. Let us try to understand the principles of GRI.

A. Principles to Define Report Content

1. Materiality: Report only the issues that are most important to the company and its stakeholders.
2. Stakeholder Inclusiveness: Identify and consider the views of all stakeholders (employees, customers, investors, etc.) in the reporting process.
3. Sustainability Context: Present the company's performance in the broader context of environmental and social conditions.
4. Completeness: Include all relevant information needed to understand the company's significant impacts.

B) Principles to Define Report Quality

1. Balance: Present both positive and negative aspects of performance for an honest report.
2. Comparability: Use consistent methods so data can be compared over time and with other organizations.

3. Accuracy: Provide precise and reliable data to ensure credibility.
4. Timeliness: Share information regularly so stakeholders have up-to-date knowledge.
5. Reliability: Ensure the data and information are trustworthy and can be checked.
6. Clarity: Make the report easy to read and understand for all users.

17.3.3: Structure of GRI Standards

The GRI Standards is designed to help organizations prepare high-quality sustainability reports. They are **modular**, which means organizations can use different parts depending on their needs. The structure is divided into *three main categories*:

1. Universal Standards (Foundation for Reporting): These are the core standards that every organization must use when reporting with GRI. They provide the basic structure and common framework for all sustainability reports. The Universal Standards include:

- GRI 1: Foundation 2021: Explains how to use the GRI Standards and introduces the core concepts of sustainability reporting.
- GRI 2: General Disclosures 2021: Covers background information about the organization, such as its size, operations, values, governance, and stakeholders.
- GRI 3: Material Topics 2021: Helps organizations identify, prioritize, and report on the sustainability issues that matter most (called "material topics").

These standards apply to all organizations, regardless of size, sector, or location. They lay the groundwork for using topic-specific and sector standards.

2. Topic-specific Standards (Environmental, Social, Governance Topics): These standards allow organizations to report in detail on specific areas of sustainability. They are grouped into three categories:

A. Environmental Topics: Focus on how a company interacts with the natural environment. Examples include:

- GRI 302: Energy
- GRI 303: Water and Effluents
- GRI 305: Emissions
- GRI 306: Waste

B. Social Topics: Cover the impact of the company on people. Examples include:

- GRI 401: Employment
- GRI 403: Occupational Health and Safety
- GRI 404: Training and Education
- GRI 408: Child Labor
- GRI 413: Local Communities

C. Governance (Economic) Topics: Related to economic performance, anti-corruption, tax, and responsible business practices. Examples include:

- GRI 201: Economic Performance
- GRI 205: Anti-corruption
- GRI 207: Tax

Organizations select and report only on the topics that are relevant (material) to their operations and stakeholders.

3. Sector Standards (Industry-Specific Guidance): Different industries face different sustainability challenges. Sector Standards provide tailored reporting guidance based on the specific risks and impacts of a particular sector. Each Sector Standard helps organizations:

- Identify likely material topics relevant to their industry
- Report in a way that meets stakeholder expectations for that sector
- Improve consistency and comparability among companies in the same field

Examples of sectors with GRI Sector Standards:

- GRI 11: Oil and Gas Sector 2021
- GRI 12: Coal Sector 2022
- GRI 13: Agriculture, Aquaculture, and Fishing Sector 2022

More sector standards are being developed to cover other industries like banking, textile, mining, and telecommunications.

17.3.4: Benefits and Challenges of Adopting GRI

The following points highlight the benefits of Adopting GRI Reporting :

1. Enhances Transparency: GRI reporting helps organizations openly share their environmental, social, and governance (ESG) performance with stakeholders.
2. Builds Trust with Stakeholders: Regular and reliable reporting builds confidence among investors, customers, employees, and the community.

3. Improves Risk Management: By identifying and disclosing risks, companies can take timely action to avoid or reduce negative impacts.
4. Supports Decision-Making: GRI data helps management make informed strategic and operational decisions.
5. Improves Brand Image and Reputation: Transparent sustainability practices enhance a company’s public image and attract responsible customers and partners.
6. Attracts Responsible Investment: ESG-focused investors often prefer companies that follow globally recognized frameworks like GRI.
7. Ensures Compliance with Regulations: GRI standards help companies meet national and international sustainability disclosure requirements.
8. Promotes Continuous Improvement: Organizations can monitor their progress and set future goals to improve performance over time.

The following points highlight the challenges of Adopting GRI Reporting:

1. High Cost of Implementation: Collecting data, training staff, and obtaining assurance can be expensive, especially for small organizations.
2. Complexity in Data Collection: Gathering accurate and consistent data from different departments or locations can be challenging.
3. Need for Skilled Personnel: Organizations require trained staff to understand GRI standards and prepare the report properly.

4. Time-Consuming Process: The reporting process involves detailed planning, stakeholder engagement, and analysis, which can take considerable time.
5. Difficulty in Engaging Stakeholders: It may not be easy to identify and consult all relevant stakeholders during the materiality assessment.
6. Lack of Standardization Across Industries: Some GRI topics may not fit every industry equally, making comparison difficult.
7. Possibility of Green washing: If not done sincerely, GRI reports may be used to show a false positive image of a company's sustainability efforts.
8. Keeping Up with Updates: GRI Standards are updated regularly, and organizations need to stay informed and adapt to changes.

17.4: ESG Index: Meaning and Concept

ESG stands for Environmental, Social, and Governance – three key factors used to evaluate the sustainability and ethical practices of a company.

- **Environmental (E):** Looks at how a company affects and manages the environment. This includes energy use, pollution, waste, and climate change policies.
- **Social (S):** Focuses on how a company treats people—employees, customers, and the wider community. It includes labor practices, workplace safety, diversity, and human rights.
- **Governance (G):** Examines how a company is governed. It includes board structure, transparency, ethics, executive pay, and shareholder rights.

17.4.1: Components of ESG

ESG stands for Environmental, Social, and Governance – three broad categories used to evaluate how responsibly and sustainably a company operates. Each component focuses on different areas of impact and helps investors and stakeholders assess a company's overall commitment to ethical and sustainable practices.

Environmental Component: The Environmental aspect focuses on how a company interacts with the natural environment. It reflects the company's efforts to reduce its negative environmental impact and promote sustainability.

Key Elements of the Environmental Component:

- Emissions: Greenhouse gas (GHG) emissions, air pollution, carbon footprint.
- Energy Use: Use of renewable vs. non-renewable energy, energy efficiency measures.
- Climate Strategy: Policies and actions taken to mitigate climate change risks.
- Water and Waste Management: Efficient use of water, reduction and recycling of waste, pollution control.

Companies that manage these areas well are often considered more resilient to environmental risks and better prepared for future regulations.

Social Component: The Social component relates to how a company manages relationships with its employees, customers, suppliers, and the broader community. It indicates how the company respects human rights and contributes to social welfare.

Key Elements of the Social Component:

- Labor Practices: Fair wages, safe working conditions, health benefits.
- Human Rights: Protection of human rights in operations and supply chains.
- Diversity and Inclusion: Equal opportunities across gender, race, and other social factors.
- Community Relations: Involvement in community development, philanthropy, and social welfare programs.

A strong social score shows that the company values people and society, which enhances brand loyalty and employee satisfaction.

Governance Component: The Governance component evaluates how a company is directed and controlled. It focuses on the structure and behavior of the board of directors and top management, and how ethical and transparent the company is in its operations.

Key Elements of the Governance Component:

- Board Composition: Diversity, independence, and expertise of board members.
- Transparency: Openness in financial and operational disclosures.
- Ethics: Presence of anti-corruption policies and a code of conduct.
- Shareholder Rights: Fair treatment of shareholders, voting rights, and access to information.

Good governance practices increase investor confidence and reduce the risk of fraud or mis-management.

Check Your Progress

1. What is the main purpose of the Global Reporting Initiative (GRI)?

2. Name any two core principles of GRI reporting.
3. What are the three main types of GRI Standards?
4. Mention one benefit and one challenge of adopting GRI standards.
5. Define ESG Index in simple terms.
6. List the three components of ESG.

17.4.2: ESG Ratings and Indices

● Concept of ESG Scores and Methodology: ESG scores are ratings given to companies based on how well they manage Environmental, Social, and Governance factors. These scores are calculated by analyzing various ESG-related data such as emissions, labor practices, board transparency, etc. The methodology typically involves assigning weights to each ESG factor, gathering data from company disclosures, news sources, and third-party data, and then producing a score or rating (usually on a scale like AAA to CCC or 0–100). The aim is to help investors evaluate the ESG risk and performance of companies.

● Major Global ESG Rating Agencies (MSCI, Sustainalytics, Bloomberg): There are several prominent agencies that assess and publish ESG ratings:

- MSCI ESG Ratings evaluate companies based on their exposure to industry-specific ESG risks and how well they manage them. It uses a scale from AAA (leader) to CCC (laggard).
- Sustainalytics provides ESG risk ratings by assessing how exposed a company is to ESG risks and how well those risks are managed. Scores range from negligible to severe risk.
- Bloomberg collects ESG data and scores companies based on their public disclosures. It is widely used by financial analysts and institutions for investment research.

● Examples of ESG Indices: ESG indices track the performance of companies that meet specific ESG criteria:

- Dow Jones Sustainability Index (DJSI): One of the first global indices to track sustainable leaders based on ESG performance.
- FTSE4Good Index Series: Measures the performance of companies that meet globally recognized ESG standards.
- MSCI ESG Indexes: These indexes include companies with high ESG ratings and help investors build ESG-focused portfolios.

17.4.3: ESG Index in India

● Nifty ESG Index and S&P BSE ESG Index: In India, two key ESG indices track the performance of top companies based on ESG criteria:

- Nifty ESG Index: It includes companies from the Nifty 100 index that meet ESG norms. Companies are ranked based on their ESG score.
- S&P BSE ESG Index: This index includes BSE-listed companies that demonstrate strong ESG practices. It reflects the sustainability performance of Indian firms.

● Criteria Used for Selection of Companies: Companies are selected for these indices based on:

- ESG disclosure quality and data availability.
- Assessment of environment-related risks (like emissions, energy use), social factors (like employee welfare), and governance factors (like board independence).
- Consistency in sustainability performance over time.

● Role of SEBI and Regulatory Push towards ESG Disclosure: SEBI (Securities and Exchange Board of India) has taken key steps to encourage ESG disclosures:

- It has made Business Responsibility and Sustainability Reporting (BRSR) mandatory for the top 1000 listed companies.
- SEBI is also working on standardizing ESG ratings and increasing transparency.
- These regulations are aimed at promoting responsible corporate behavior and helping investors make informed decisions.

17.4.4: ESG and Investment Decision-Making

● Impact on Risk Assessment and Financial Performance: Investors are increasingly recognizing that strong ESG performance is linked to lower risks and better long-term returns. Companies that manage ESG issues effectively are more likely to avoid scandals, legal fines, or reputational damage. As a result, ESG analysis has become a part of financial risk assessment.

● ESG Investing and Mutual Funds: ESG investing involves selecting companies for investment based on their ESG performance. In India and globally, several ESG mutual funds have emerged. These funds avoid companies involved in environmentally or socially harmful activities and invest in firms that promote sustainability. ESG funds appeal to investors who want both financial returns and positive social/environmental impact.

● Trends in Institutional Investor Preference: Institutional investors such as pension funds, insurance companies, and sovereign wealth funds are shifting towards ESG-aligned portfolios. They are:

- Demanding greater transparency in ESG reporting.
- Using ESG ratings to screen investment opportunities.
- Engaging with companies to improve ESG performance.

17.4.5: Relevance in Indian and Global Context

● GRI and ESG Adoption Trends Globally: Globally, the adoption of GRI standards and ESG frameworks has grown significantly over the past decade. Many multinational companies in Europe, North America, and parts of Asia have integrated GRI-based sustainability reporting into their annual disclosures. Investors and regulators around the world increasingly rely on ESG data to assess corporate performance beyond profits, focusing on long-term risks and social responsibility.

In fact, ESG investing has become mainstream in developed markets. Major stock exchanges and institutional investors now prefer companies with strong ESG performance, pushing more firms to adopt GRI reporting to stay competitive and transparent. International collaborations like the Task Force on Climate-related Financial Disclosures (TCFD) and ISSB (International Sustainability Standards Board) also encourage companies to adopt robust sustainability reporting frameworks like GRI. This global shift reflects the growing demand for responsible business practices and data-driven ESG performance assessments.

● Initiatives by Indian Regulators (SEBI BRSR Mandate): In India, the Securities and Exchange Board of India (SEBI) has taken proactive steps to align corporate reporting with global standards. Starting from FY 2022–23, SEBI has made it mandatory for the top 1000 listed companies (by market capitalization) to submit a Business Responsibility and Sustainability Report (BRSR).

The BRSR format is largely aligned with GRI principles, covering key ESG indicators such as energy use, diversity, governance structures, and community impact. This move marks a significant step towards formalizing ESG disclosure practices in India and integrating sustainability into the financial ecosystem.

● Role of GRI/ESG in Meeting UN SDGs and Climate Commitments: GRI and ESG frameworks play a crucial role in supporting the United Nations Sustainable Development Goals (SDGs) and climate change commitments such as the Paris Agreement. Companies that report through GRI standards provide measurable insights into how their operations contribute to social, environmental, and economic goals.

By promoting transparency and accountability, GRI and ESG practices help companies align their strategies with national and global sustainability targets. In India, this also supports the country's vision of achieving net-zero emissions by 2070, promoting green finance, and enhancing corporate responsibility.

Check Your Progress

1. Name two agencies that provide ESG ratings.
2. Which are two prominent ESG indices available in India?
3. How does ESG influence investment decision-making?
4. Why is ESG considered relevant in both the Indian and global context?

17.5: Summing Up

This unit introduces the Global Reporting Initiative (GRI) as a widely accepted framework for sustainability reporting. It explains the objectives of GRI, which include promoting transparency and accountability in corporate sustainability disclosures. The principles of GRI, such as stakeholder inclusiveness, sustainability context, and completeness, guide organizations in preparing their reports. The structure of GRI Standards is also discussed, comprising universal, sector, and topic-specific standards. The unit further outlines the benefits and challenges of adopting GRI, highlighting enhanced stakeholder trust, compliance readiness, and issues like complexity and resource constraints.

The unit also explores the concept and relevance of ESG (Environmental, Social, and Governance) in assessing corporate sustainability performance. It explains the components of ESG, ESG ratings and indices like MSCI and Dow Jones Sustainability Index, and the development of ESG indices in India (e.g., Nifty ESG Index and S&P BSE ESG Index). The unit emphasizes the impact of ESG on investment decision-making, with increasing interest from institutional investors. It concludes by explaining the inter-linkage between GRI and ESG, and their role in supporting the UN Sustainable Development Goals (SDGs) and national climate commitments in both global and Indian contexts.

17.6: Model Questions

1. What are the main objectives of the Global Reporting Initiative (GRI)?
2. Explain any three principles of GRI reporting.
3. Describe the structure of GRI Standards.
4. List two major benefits and two challenges of adopting GRI.
5. What is the meaning of ESG in corporate reporting?
6. Mention the key elements under each ESG component.
7. What are ESG ratings and how are they assessed?
8. Name two ESG indices and their features.
9. Discuss the role of SEBI in promoting ESG reporting in India.
10. How do GRI and ESG contribute to achieving the UN SDGs?

17.7: References and Suggested Reading

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- Institute of Company Secretaries of India (ICSI): https://www.icsi.edu
- GRI Standards (https://www.globalreporting.org)
- SEBI's Business Responsibility and Sustainability Report (BRSR) guidelines
- MSCI ESG Ratings Methodology
- KPMG Survey of Sustainability Reporting

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Unit-18

Sustainability Reporting by Corporate, Principles of Responsible Investment

Unit Structure:

18.1 Introduction

Sustainability reporting is the process of making a company's performance in environmental, social, and governance (ESG) sectors publicly available. It offers openness regarding the company's efforts, commitments, and effects on sustainable development. Businesses convey how they manage opportunities and risks associated with ESG aspects, including social equality, resource consumption, climate change, and ethical governance, through sustainability reports. Good sustainability reporting provides information on a company's long-term value and sustainability initiatives, assisting stakeholders—including investors, customers, regulators, and employees—in making well-informed decisions.

Businesses frequently organize their reports using internationally accepted frameworks and standards, like the European Sustainability Reporting Standards (ESRS) and the Global Reporting Initiative (GRI). These frameworks help companies provide information that is comparable, transparent, and consistent. Sustainability reporting has become crucial for businesses hoping to improve their reputation, satisfy legal requirements, and show leadership in corporate responsibility in an increasingly ESG-focused business climate.

Sustainability reporting is essential for assisting businesses in establishing credibility and proving their responsibility by openly disclosing their ESG policies and effects. It helps companies to drive continuous development, find innovative opportunities, and manage risks. In addition to ensuring adherence to changing requirements, effective reporting also helps lower financial and legal risk. By emphasizing ethical business practices, it improves a company's reputation beyond compliance and draws in partners, investors, and clients that respect sustainability.

Over time, effective sustainability reporting boosts competitive positioning, fosters business expansion, and advances more general global sustainability objectives.

18.2 Objectives

After going through the units you will be able to-

- *know* the concept of Sustainability Reporting by Corporate and its elements,
- *its* significance, standardized structure & guidelines, objective,
- *prerequisites* for a report on sustainability,
- *resolving* typical issues with sustainability reporting,
- *principles* of Responsible Investment concept,
- *reasons* for growth,
- *principles* of Responsible Investment.

18.3 Sustainability Reporting by Corporate

18.3.1 Corporate sustainability reporting entails informing external stakeholders, including investors, consumers, and regulators, on non-financial aspects of their environmental, social, and governance (ESG) performance. By being transparent about a business's sustainability initiatives, effects, and hazards, this reporting fosters stakeholder involvement and confidence.

Stop to Consider

The practice of making a company's environmental, social, and governance (ESG) performance publicly visible is known as sustainability reporting. It provides transparency about the business's endeavors, pledges, and impacts on sustainable development. Businesses use sustainability reports to communicate how they manage the risks and opportunities related to ESG factors, such as resource consumption, social equity, climate change, and ethical governance.

Check Your Progress

Explain the concept of Sustainability Reporting by Corporate

18.3.2 Important elements of Sustainability Reporting

i. **Transparency**: Businesses must report any information pertaining to their ESG performance, including the effects on the environment (such as carbon emissions and resource consumption), society (such as labor practices and community involvement), and governance (such as risk management and ethical behavior).

ii. **Engagement of stakeholders**: In order to inform different stakeholders on the company's sustainability initiatives and how they complement their interests, sustainability reports are created.

iii. **Responsibility**: Reports enable businesses take responsibility for their activities and effects and show their dedication to sustainable practices.

iv. **Regulations**: Sustainability reporting is required for specific organizations in a number of jurisdictions, including the EU with the Corporate Sustainability Reporting Directive (CSRD) and India with the Business Responsibility and Sustainability Reporting (BRSR).

Stop to Consider

• Businesses must report any information pertaining to their ESG performance.
• sustainability reports are created to inform different stakeholders on the company's sustainability initiatives
• effects show their dedication to sustainable practices
• Sustainability reporting is required for specific organizations in a number of jurisdictions

Check Your Progress

What are the significant elements of Sustainability Reporting?

18.3.3. Significance of Sustainability Reporting

i. **Reputation and trust-building**: Open reporting helps businesses improve their sustainable reputation and gain the trust of stakeholders.

ii. **Increasing the performance of finances:** Through effective risk management and opportunity identification, businesses can enhance their financial performance and draw in investors.

iii. **Fulfilling expectations of stakeholders:** Businesses can respond to stakeholders' increasing demand for information regarding ESG performance, including investors, consumers, and employees, by implementing sustainability reporting.

iv. **Encouraging efficiency and innovation:** Cost savings and competitive advantages can result from innovation and increased operational efficiency brought about by the sustainability reporting process.

18.3.4. Standardized structures and guidelines

i. **The Global Reporting Initiative (GRI**): It is a popular framework for sustainability reporting that offers recommendations for covering governance, social, and environmental issues.

ii. **The SASB or Sustainability Accounting Standards Board**: A system that offers sustainability disclosures tailored to a certain industry, emphasizing the data that matters most to investors.

iii. **The International Sustainability Standards Board (ISSB):** It creates guidelines to provide a global standard for sustainability disclosures with an emphasis on financial markets and investors.

iv. **Task Force on Climate-related Financial Disclosures (TCFD):** A structure for disclosing possibilities and risks associated with climate change

Stop to Consider

Significance: Reputation and trust-building, increasing the performance of finances, fulfilling expectations of stakeholders

Standardized structures and guidelines: GRI, SASB, ISSB, TCFD

Check Your Progress

- Discuss about the significance of Sustainability Reporting
- Discuss about the standardized structures and guidelines

18.3.5. Sustainability Reporting's Objective

In addition to helping a company discover possibilities and dangers that could affect its long-term performance, sustainability reporting can also help increase brand image and transparency. Businesses may lessen the effects of possible ESG risks, save waste and save more money, make sure they are in compliance with regulations, and make better strategic decisions by reporting on sustainability.

18.3.6. Prerequisites for a report on sustainability

The sustainability report of a business must show that it complies with any mandatory reporting laws that may be in effect. For example, the UK requires businesses to report their annual greenhouse gas emissions, while the EU requires some large businesses to report information on social and environmental issues. To guarantee that statistics are accurate and consistent and to prevent greenwashing, sustainability reports should be in line with a reliable set of standards, such SASB or GRI, in addition to regulatory compliance.

18.3.7. Resolving Typical Issues with Sustainability Reporting

Key challenges that businesses frequently encounter when creating sustainability reports include complicated data collecting, changing rules, and varying stakeholder expectations. These issues can be resolved by organizations by:

i. To precisely track ESG performance across operations and supply chains, put in place extensive data management tools.
ii. Maintain compliance and lower risk by keeping abreast of regulatory developments through ongoing training and monitoring.
iii. Take the initiative to communicate with stakeholders in order to learn their expectations and provide pertinent and significant disclosures.
iv. Utilize specialist platforms and tools for sustainability reporting to expedite the procedure and generate reports that are transparent, high-quality, and compliant.

Stop to Consider

- Sustainability reporting can also help increase brand image and transparency.
- The sustainability report of a business must show that it complies with any mandatory reporting laws that may be in effect
- Key challenges that businesses frequently encounter when creating sustainability reports include complicated data collecting, changing rules, and varying stakeholder expectations

Check Your Progress

What is the Sustainability Reporting's Objective?

How can the typical Issues with Sustainability Reporting be resolved?

18.4 Principles of Responsible Investment

18.4.1 Concept of PRI

The United Nations' framework for assisting investors in understanding the investment implications of environmental, social, and governance (ESG) factors, and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions is known as the Principles for Responsible Investment or PRI.

We live at a time of fast global change and a pivotal moment in terms of the economy, society, and environment. As the primary mechanism for distributing limited financial resources, market-based economies are also creating an increasing number of social and environmental externalities.

Investors must evaluate the entire range of risks and opportunities that could affect their portfolios' performance in order to allocate capital in a way that serves their customers' and beneficiaries' long-term interests.

18.4.2 Reasons for Growth

Investors are becoming more conscious of ESG considerations and attempting to incorporate them both before making an investment and as continuing, active owners of shares, bonds, and other securities and assets, as seen by the PRI Initiative's robust growth.

The following factors are propelling the expansion of responsible investing:

i. Understanding that ESG issues are financially significant for individuals

ii. Recognizing that an investor's fiduciary duty to its customers and beneficiaries includes incorporating these issues

iii. Competitors' pressure to set themselves apart by their approach to responsible investment

iv. Long-term factors of risk and return that should be addressed more comprehensively in the ownership and management of businesses.

v. Growing legislative actions mandating that investors execute their ownership rights and obligations, especially those related to participation and voting.

18.4.3 Principles of Responsible Investment

A multinational group of institutional investors created the Principles for Responsible Investment in response to the growing importance of corporate governance, social concerns, and environmental concerns in investment practices. The Secretary-General of the United Nations called the meeting.

The Principles are inspirational and optional. They provide a range of options for addressing ESG concerns. There are several ways to integrate ESG concerns into investment practice, which can be found in the ***Six Principles for Responsible Investment***.

Principle 1	We will incorporate ESG issues into investment analysis and decision-making processes
Principle 2	We will be active owners and incorporate ESG issues into our ownership policies and practices
Principle 3	We will seek appropriate disclosure on ESG issues by the entities in which we invest

Principle 4	We will promote acceptance and implementation of the Principles within the investment industry
Principle 5	We will work together to enhance our effectiveness in implementing the Principles
Principle 6	We will each report on our activities and progress towards implementing the Principles

- **Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.**

<u>Possible actions</u>:

- Address ESG issues in investment policy statements.
- Support development of ESG-related tools, metrics, and analyses.
- Assess the capabilities of internal investment managers to incorporate ESG issues.
- Assess the capabilities of external investment managers to incorporate ESG issues.
- Ask investment service providers (such as financial analysts, consultants, brokers, research firms, or rating companies) to integrate ESG factors into evolving research and analysis.
- Encourage academic and other research on this theme.
- Advocate ESG training for investment professionals.

- **Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.**

Possible actions:

- Develop and disclose an active ownership policy consistent with the Principles.
- Exercise voting rights or monitor compliance with voting policy (if outsourced).
- Develop an engagement capability (either directly or through outsourcing).
- Participate in the development of policy, regulation, and standard setting (such as promoting and protecting shareholder rights).
- File shareholder resolutions consistent with long-term ESG considerations.
- Engage with companies on ESG issues.
- Participate in collaborative engagement initiatives.
- Ask investment managers to undertake and report on ESG-related engagement

- **Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.**

Possible actions:

- Ask for standardized reporting on ESG issues (using tools such as the Global Reporting Initiative).
- Ask for ESG issues to be integrated within annual financial reports.
- Ask for information from companies regarding adoption of/adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact).
- Support shareholder initiatives and resolutions promoting ESG disclosure.

- **Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.**

<u>Possible actions:</u>

- Include Principles-related requirements in requests for proposals (RFPs).
- Align investment mandates, monitoring procedures, performance indicators and incentive structures accordingly (for example, ensure investment management processes reflect long-term time horizons when appropriate).
- Communicate ESG expectations to investment service providers.
- Revisit relationships with service providers that fail to meet ESG expectations.
- Support the development of tools for benchmarking ESG integration.
- Support regulatory or policy developments that enable implementation of the Principles.

- **Principle 5: We will work together to enhance our effectiveness in implementing the Principles**

<u>Possible actions:</u>

- Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning.
- Collectively address relevant emerging issues.
- Develop or support appropriate collaborative initiatives

- **Principle 6: We will each report on our activities and progress towards implementing the Principles**

Possible actions:

- Disclose how ESG issues are integrated within investment practices.
- Disclose active ownership activities (voting, engagement, and/or policy dialogue).
- Disclose what is required from service providers in relation to the Principles.
- Communicate with beneficiaries about ESG issues and the Principles.
- Report on progress and/or achievements relating to the Principles using a comply-or-explain approach.
- Seek to determine the impact of the Principles.
- Make use of reporting to raise awareness among a broader group of stakeholders

Stop to Consider

- The United Nations' framework for assisting investors in understanding the investment implications of environmental, social, and governance (ESG) factors, and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions is known as the Principles for Responsible Investment or PRI.
- Investors are becoming more conscious of ESG considerations and attempting to incorporate them both before making an investment and as continuing, active owners of shares, bonds, and other securities and assets, as seen by the PRI Initiative's robust growth.

- The Principles are inspirational and optional. They provide a range of options for addressing ESG concerns. There are several ways to integrate ESG concerns into investment practice, which can be found in the Six Principles for Responsible Investment.

Check Your Progress

What is the concept of PRI?

Explain the factors are propelling the expansion of responsible investing?

Explain the principles of Responsible Investment?

18.5 Summing Up

Sustainability reporting is becoming an essential part of contemporary corporate strategy and is no longer optional. Businesses may increase trust, efficiently manage risks, and take advantage of sustainability-driven opportunities by openly sharing ESG impacts and performance. Businesses can strengthen their commitment to sustainability and establish themselves as leaders in a quickly changing global marketplace by streamlining and improving their reporting procedures with the use of well-established frameworks.

In response to a complex and highly dynamic social, environmental, and economic environment, sustainability reporting expands on current company management tools and concepts and uses them in a wider context. It uses traditional business management methods, like key performance indicators, with an emphasis on life cycle management and the triple bottom line. Integrating sustainable, non-financial success metrics into an organization's conventional reporting calls for a sophisticated strategy. Extracting value from sustainability data to positively direct and transform business operations is the challenge of sustainability for business organizations. Without a strategic goal, sustainability reporting could produce information that is good to know, expensive to acquire, and not very helpful to the business, the environment, or society.

When implemented by a proactive organization that learns, adapts, and continuously improves, sustainability reporting can provide a competitive edge in navigating the complex business environment. In addition to alerting management to business opportunities pertaining to new markets, goods, and services, sustainability reporting enables organizations to pinpoint previously unidentified business dangers. Although sustainability reporting is still in its infancy, management may benefit greatly from the wealth of knowledge and advice available to them as they integrate sustainable practices into their businesses.

A substantial amount of resources may be required to put sustainability reporting into practice. Any company, regardless of size, stage of development, or maturity, can incorporate elements of sustainability reporting into their operations to enhance operational outcomes while reducing adverse social effects and highlighting beneficial ones.

The world's foremost advocate for responsible investment is the PRI. Its goals are to: comprehend the effects of environmental, social and governance (ESG) factors on investments; and assist its global network of investor signatories in taking these elements into account when making ownership and investment decisions.

ESG issues can be incorporated into investment practice using the menu of potential actions provided by the six Principles for Responsible Investment. For investors, by investors, the Principles were created. By putting them into practice, signatories help create a more resilient global financial system.

18.6 Model Questions

1. Describe sustainability reporting and explain its significance for businesses.
2. What are the elements of Sustainability Reporting?
3. Explain about the standardized structure and guidelines of Sustainability Reporting.
4. Explain the concept of PRI
5. Provide a list of the six UN Principles for Responsible Investment (PRI) and a brief explanation of each.

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Unit-19
Corporate Governance Regulatory Framework in India

Unit Structure:

19.1 Introduction

Corporate Governance refers to those rules and processes which are followed in managing and overseeing a company. The objective of corporate governance is to ensure that businesses are run in a responsible and transparent manner, thus securing the interests of its different stakeholders. It acts as a safety net against misconduct, through the enforcement of high ethical standards and establishment of accountability.

The Institute of Company Secretaries of India has defined 'Corporate Governance' as follows:

"Corporate Governance is the application of best management practices, compliance of laws in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders".

The Cadbury Committee, United Kingdom, defined it as follows:

"It is a system by which companies are directed and controlled".

19.2 Objectives

This unit is an attempt to make students understand the key aspects of corporate governance, and familiarize them with some of the revolutionary developments in the corporate governance scenario of India. After going through this unit, you will be able to:

- *gather* a clear understanding about the concept, core principles, importance, and key participants of corporate governance,
- *gain* knowledge on some of the prominent developments in the corporate governance framework of India.

19.3 Core Principles of Corporate Governance

The core principles of corporate governance are stated as under:

- **Fairness:** The principle of fairness promotes fair treatment and equal consideration to all shareholders, vendors, employees and the community at large by the Board of Directors.
- **Transparency:** This principle advocates that the Board must ensure clarity, accuracy and timeliness of information related to financial performance, risks, conflict of interests, etc., material for decision making by the shareholders and other stakeholders.
- **Accountability:** As per this principle, the Board of Directors must encourage accountability in the company. The stakeholders

must be explained the purpose behind the company's activities, as well as its results. The Board shall be accountable when the company's potential, capacity and performance are assessed.

- **Risk Management:** Determination of all the possible kinds of risks in the business environment and how to tackle them in the best way is what this principle prescribes. Acting on the recommendations on how to deal with these risks is another essential element for ensuring the well-being of the interested parties.
- **Responsibility:** The Board of Directors shall be responsible for overseeing the management and overall corporate affairs. Awareness about the ongoing activities of the company and extending the needed support for its success are vital for acting in the best interest of its stakeholders.

19.4 Importance of Corporate Governance

A myriad of reasons make corporate governance vital for the health of a company. These have been discussed below:

- **Promotes transparency and accountability:** Transparency is maintained in a company's decision making processes, operations and financial reporting, when corporate governance is in place. Fraud and corruption is prevented, management is held accountable and ethical conduct is promoted as a consequence of this transparency.
- **Protects shareholders' interests:** Corporate governance encourages greater participation and investment by shareholders by ensuring fair treatment to them. This holds particularly true for the minority shareholders as undue influence by any single group over the corporate decisions is prevented.
- **Fosters sustainable growth:** By focusing on long term strategies, governance practices balance short term gains with

long-term objectives and ensure sustainable growth. Through this approach, profitability is sustained and value is created for the different stakeholders.

- **Encourages ethical behaviour and Corporate Social Responsibility (CSR):** In the current scenario, regulators encourage corporates to adopt practices and policies that promote environmental and social sustainability. Corporate governance, by fostering social responsibility and ethical culture, ensures that companies make a positive contribution to the society besides complying with the legal standards.
- **Improves decision making:** By encouraging diverse viewpoints, providing a structured process, and focusing on value creation for the long term, informed decision making is facilitated by a strong corporate governance framework. As a result of this, strategies are more effective and outcomes are better for a company.
- **Increases shareholder confidence and trust:** When governance practices are transparent and ethical standards are adhered to, shareholders' trust is fostered. With increased confidence among investors, the organization can now have greater access to capital and higher potential for growth.
- **Reduces legal and reputational risks:** A robust corporate governance structure ensures accountability, ethical behavior and compliance with laws and regulations, thus leading to the minimization of legal and reputational risks. Reputation and stakeholder confidence can be maintained, and costly legal battles can be avoided as potential issues are proactively addressed by the company.

Keeping these benefits aside, what makes good corporate governance even more important is for what it averts- financial loss, loss of stakeholders' support and ultimately, collapse.

19.5 Key participants in Corporate Governance

The decisions taken by a corporate impacts people and entities like the directors, employees, shareholders, suppliers, creditors, government and the society at large, who are collectively known as stakeholders. Out of these, the directors, key managerial personnel and others officers of the company and the shareholders comprise the key stakeholders who actively participate in the corporate governance process.

- **Directors:** The Board of Directors comprises the key individuals responsible for the formulation and implementation of corporate governance practices. They make the key decisions for setting long term corporate strategies and shoulder the responsibility for a good governance structure, thus enabling effective leadership at all levels and performance monitoring in a transparent and fair manner.
- **Key managerial personnel and officers:** The Chief Executive Officer, Managing Director, Whole Time Director and Company Secretary are the ones who serve the top management level as Key Managerial Personnel (KMP) and officers of the company. They advise the Board of Directors on how to achieve the goals of the organization and adhere to good governance practices. In case of any non-compliance by the company, they should report the same to sectoral regulators. They must operate the company in a manner that adheres to the set laws in true letter and spirit, efficiently and effectively attaining the dual objectives of wealth maximization and profit maximization.
- **Shareholders:** They comprise of individuals and institutions that purchase the shares of the company and thus contribute to its capital, and receive dividend on the profits earned by the company. The individual shareholders exercise their voting

rights when key decisions of the company are taken and in this way participate in corporate governance. Institutional investors like trusts, insurance companies, investment banks, etc. who hold larger shares assess the market viability of the company and play a more prominent role in monitoring its governance activities.

Stop to consider

• Corporate Governance are the rules and processes meant for operating a company in a manner that secures the interest of all its stakeholders.

• Fairness, Transparency, Accountability, Risk Management, and Responsibility are the core principles of Corporate Governance.

• An efficient and effective Corporate Governance framework can ensure transparency and accountability in the organization, protect the interest of shareholders and enhance their trust and confidence in the business entity, foster sustainable growth and improved decision making, promote Corporate Social Responsibility, reduce legal risks, and increase reputation.

• Out of all the stakeholders of a company, its directors, key managerial personnel and officers, and shareholders are the key participants in the corporate governance process.

Check Your Progress

1. What is the key objective of corporate governance?

2. What does the principle of 'transparency' in corporate governance denote?

3. Who are primarily responsible for the overseeing of corporate affairs?

4. How does good corporate governance help in reducing legal and reputational risks?

5. Are shareholders a key participant in corporate governance?

19.6 Evolution of Corporate Governance in India

The corporate governance scenario of India underwent significant changes over the years. Traditionally, Indian businesses were largely family-owned and driven by the promoters' interests, often overlooking the interests of minority shareholders. Though the legal framework for corporate governance was provided by the Companies Act, 1956, its enforcement was weak with accountability and transparency not receiving much emphasis. The landscape went through a transformation in the early 1990s when the nation went through economic liberalization. As the economy had now opened up, there arrived the need to improve the governance practices of corporates in order to attract local and global investors. Key developments during 1991-2009 include- (a) In 1998, the **Confederation of Indian Industry (CII)**, an industry body, released the Desirable Corporate Governance Code for listed companies (b) In 1999, the **Kumar Mangalam Birla Committee** was appointed by the Securities and Exchange Board of India (SEBI), and it made recommendations that emphasized the role of audit committees, independent directors and disclosures (c) **Clause 49** of the Listing Agreement was introduced in 2000 (revised in 2004), mandated listed companies regarding the role of independent directors, composition of board and establishment of audit committees (d) In 2002, the **Naresh Chandra Committee** was formed by the government as a response to failures of global corporates like Enron. Enhanced disclosure requirements and stricter auditing norms were recommended by the committee (e) In 2003, the **Narayan Murthy Committee** was appointed by SEBI to review Clause 49. The recommendations of the committee were implemented in 2004 and they were focused on enhancement of shareholders' rights, improvement of the quality of financial disclosures and strengthened role of audit committees (g) In 2009, the **Satyam Scandal** revealed the loopholes in the corporate governance structure of India. Its chairman Ramalinga Raju had confessed that the company financials were inflated by $ 1.47 billion. This highlighted the need for overhaul of regulations and a more robust mechanism for corporate governance.

Post 2009, the corporate governance scenario in India continued to evolve, driven by market dynamics, global trends and regulatory changes. Some of the notable developments since 2010 are: (a) **The Companies Act, 2013,** replaced the Companies Act, 1956 and incorporated a number of provisions to improve the country's corporate governance standards (b) The **SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015** streamlined and consolidated the disclosure requirements and listing obligations for listed entities (c) In 2017, SEBI constituted the **Kotak Committee** to put forward recommendations to further strengthen corporate governance. The improvements proposed by the committee were implemented in 2018, which included stricter independence criteria for directors, enhanced board diversity, stronger whistleblower mechanisms and improved oversight of group entities.

Integrated reporting, Focus on ESG (Environmental, Social and Governance), and Technology and Digital Governance was some of the recent trends in corporate governance. Under integrated reporting, a holistic view of the company's financial, social and environmental aspects is provided which boosts transparency and help stakeholders make informed decisions. ESG factors are gaining increasing recognition in long-term value creation of a company. Regulators and investors wish for better ESG disclosures and sustainable business practices are being adopted by many companies. Companies are now adopting technology for compliance tracking, board meetings, and stakeholder engagement, thus increasing transparency and efficiency.

Though there have been significant milestones in the evolution of corporate governance in India, challenges like gaps in implementing regulations, lack of autonomy among independent directors, regulatory overlap and difficulties in embedding a good corporate culture remain. Hence, continuous efforts are needed to deal with these issues. In the following sections, some of the key developments in the corporate governance framework of India are discussed.

Stop to Consider

• Traditionally, Indian businesses were driven by promoters' interests and often overlooked the interest of minority shareholders.

• Though the Companies Act, 1956 provided the legal framework for corporate governance, actual transformation happened only after the economic liberalisation in the early 1990s.

• Key developments in corporate governance during 1991-2009 were brought in by the Confederation of Indian Industry (CII), Kumar Mangalam Birla Committee, Clause 49 of the Listing Agreement, Narayan Murthy Committee, and the Satyam Scandal.

• Post 2009, the Companies Act, 2013, the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, the Kotak Committee were responsible for notable developments in corporate governance.

• Integrated Reporting, ESG (Environmental, Social and Governance), and Technology and Digital Governance are some of the recent trends in corporate governance.

Check Your Progress

6. The legal framework for corporate governance was provided by the…………………….. (Fill in the blank)
7. Which industrial body had released the Desirable Corporate Governance Code for listed companies?
8. Who had appointed the Narayan Murthy Committee to review Clause 49 of the Listing Agreement?
9. Name the IT sector scandal that occurred in 2009 and called for a more robust mechanism for corporate governance.
10. What do you understand by Integrated Reporting?

19.7 Kumar Mangalam Birla Committee (1999)

In 1999, the Securities and Exchange Board of India (SEBI) set up the Kumar Mangalam Birla Committee under the chairmanship of Shri Kumar Mangalam Birla, who was a member of the SEBI Board at that time. The primary objective of the committee was to prepare a 'Code' that would raise the standards of corporate governance in India by considering the perspective of the investors and shareholders. The recommendations made by the committee were divided into two categories- mandatory and non-mandatory. **Mandatory recommendations** were those which were absolutely essential for corporate governance, could be precisely defined, and could be enforced by amending the listing agreement. **Non-mandatory recommendations** comprised of other such recommendations which were either desirable or required change of laws.

The mandatory recommendations made by the committee would be applicable to listed companies which had a paid up share capital of rupees 3 crores and above and were as follows:

- The Board of Directors should have an optimum combination of executive and non-executive directors.

- Audit Committee should comprise of three independent directors, and at least one among them should have accounting and financial knowledge.
- A remuneration committee should be formed.
- A minimum of four meetings should be held in a year by the Board, with a gap not more than four months between two meetings where capital budgets, operational plans, quarterly results and minutes of committee's meetings would be discussed.
- Director can act as a member of upto ten committees and as a chairman of upto five committees across all companies.
- Management discussion and analysis report that covers opportunities, risks, threats, outlook, internal control system and industry structure should be made available for external review.
- Any information relevant to shareholders to make their investment decisions should be shared with them.

Several non-mandatory recommendations were made by the committee with regard to role of chairman, shareholders' right to receive information related to half-yearly financial performance, further issue of capital, corporate restructuring, remuneration committee of board, postal ballots covering critical matters, sale of whole or substantial part of the undertaking, venturing into new businesses.

It was recognized by the committee that companies would require restructuring of their existing boards to comply with the recommendations and that it would be difficult for smaller companies to comply with these conditions immediately.

Stop to Consider

• The Kumar Mangalam Birla Committee was set up by the SEBI in 1999 under the chairmanship of Shri Kumar Mangalam Birla, with the objective of raising corporate governance standards by setting a 'Code' that would take investors and shareholders perspectives into consideration.

• The committee put forward two sets of recommendations – mandatory and non-mandatory recommendations.

• The mandatory recommendations comprised those absolutely essential for corporate governance and applicable to companies that were listed and had a paid up share capital of rupees 3 crores and above. These were related to the composition of Board of Directors and Audit Committee, formation of Remuneration Committee, number of board meeting to be held in a year, role of director, items of external review, and information to shareholders. The other desired or required change of laws fell under non-mandatory recommendations.

19.8 Narayan Murthy Committee (2003)

The Narayan Murthy Committee was constituted by the SEBI under the chairmanship of N.R. Narayan Murthy in 2003 for evaluation of the existing practices of corporate governance and improvement of the standards as per the evolving market dynamics. Some of the key mandatory recommendations made by the committee focused on the following:

- Among the members of the audit committee, at least one should be 'financially knowledgeable' and at least one should proficient in accounting or related financial management.
- The quality of financial disclosures should be improved, including those concerned with related party transactions.
- Companies that raise money though Initial Public Offering (IPO) should disclose the application of funds by major categories like sales and marketing, capital expenditure, working capital, etc. to the Audit Committee.

- Corporate executive boards shall be required to assess and disclose business risks in the companies' annual reports.
- It shall be obligatory on the part of the Board to lay down the code of conduct for the senior management of the company as well as all board members.
- In case of public sector companies, the nominee directors of the government shall go through a similar election process and have the same liabilities and responsibilities as other directors.
- There should be improved disclosures in matters of payment of compensation to non-executive directors.
- Personnel who observed an unethical or improper practice (not necessarily a violation of law) should be able to approach the audit committee without necessarily informing their superiors.

The non-mandatory recommendations made by the committee included moving to a regime where corporate financial statements are not qualified, evaluating the performance of board members, and instituting a system of training board members.

Stop to Consider

• The SEBI constituted the Narayan Murthy Committee in 2003, with N.R. Narayan Murthy as its chairman with the objective of improvement of corporate governance practices in line with the evolving market dynamics.

• The committee made mandatory recommendations regarding the proficiency of the members of the audit committees, quality of financial disclosures, code of conduct, nominee directors of the government in case of public sector companies, whistleblowing, etc. Besides these, certain non-mandatory recommendations were also made by the committee.

Check Your Progress

11. What was the primary objective of the Kumar Mangalam Birla Committee?
12. Who would the mandatory recommendations made by the Kumar Mangalam Birla Committee apply to?
13. As per the recommendation of the Kumar Mangalam Birla Committee, how many independent directors should be there in an audit committee? Also, how many committees across all companies could a director act as the chairman of?
14. What was the recommended number of member(s) in the audit committee who should have 'financial knowledge', as per the recommendation of the Narayan Murthy Committee?
15. What was the recommendation given by the Narayan Murthy Committee regarding personnel who observed an unethical or improper practice (not necessarily a violation of law)?

19.9 Relevant provisions of Companies Act, 2013

The Companies Act, 2013 has introduced several provisions which lays a greater emphasis on corporate governance. Some of these have been discussed below:

- **Board of Directors:**

Section 149 of the Companies Act, 2013 provides that a minimum of three directors should be appointed in a public company and a minimum of two directors should be appointed in a private company. A maximum of fifteen directors can be appointed in a board. However, even more number of directors can be appointed subject to special approval.

It shall be mandatory to appoint a woman director for- (1) a listed company (2) a public unlisted company whose paid up share capital is 100 crores rupees or more, or turnover is 300 crores or more.

Section 149(3) of the Act makes it mandatory for every company to have at least one director who has stayed in India for a period of not less than 182 days.

Section 149(6) provides for the qualifications for appointing an independent director in a public company. According to the Act, at least one third of the directors of a public listed company shall be independent directors, while a public unlisted company that meets the following criteria shall have two directors-

(1) The share capital is rupees 10 crores or more;

(2) The turnover is rupees 100 crores or more;

(3) The amount of outstanding loans, deposits and debentures is more than rupees 50 crores.

In order to make directors accountable for their actions, section 134 of the Act requires directors to provide a detailed financial report which includes the director's responsibility statement.

- **Stakeholder Relationship Committee:**

According to Section 178(6) of the Companies Act, 2013, it shall be mandatory to constitute a stakeholder relationship committee if a company has more than 1000 shareholders, debenture holders, deposit holders or any other security holder in a financial year. This committee shall be formed primarily to address the grievances of shareholders and resolve conflicts between them and the Board of Directors. A non-executive director shall act as the chairperson of the board.

- **Audit Committee:**

As per Section 177 of the Companies Act, 2013, an audit committee shall be constituted by the following class of companies-

(1) Listed company;

(2) Public company having a share capital of more than rupees 10 crores;

(3) Public company having a turnover of rupees 100 crores;

(4) Public companies having outstanding loans, debentures or deposit of more than rupees 50 crores.

The main task of the audit committee shall be to examine the financial reports and disclosures of the company. It shall consist of at least three directors, with independent directors forming the majority. The audit committee has to perform the duties provided under Section 177(4) of the Act.

- **Internal Audit:**

Under Section 138 of the Companies Act, 2013, internal audit has been mandated for certain classes of companies.

- **Serious Fraud Investigation Office (SFIO):**

The Serious Fraud Investigation office shall be established to investigate company related frauds as per Section 211(1) of the Companies Act, 2013. The Act grants power to the office to investigate into the affairs of the company or in public interest or on receipt of report of Registrar or Inspector or if requested by any Department of Central Government or State Government.

- **Nomination and Remuneration Committee:**

As per Section 178 of the Companies Act, 2013, the following class of companies shall constitute a nomination and remuneration committee:

(1) Listed company;

(2) Public company having a share capital of more than rupees 10 crores;

(3) Public company having a turnover of rupees 100 crores;

(4) Public company having outstanding loans, debentures or deposits of more than rupees 50 crores.

The committee shall consist of at least 3 directors, with independent directors forming the majority. The selection criteria for Key Managerial Personnel (KMP) and the remuneration for KMPs and directors shall be decided by the committee.

- **Corporate Social Responsibility (CSR):**

As corporates utilize the resources of the society, it is their responsibility to be good corporate citizens and contribute to societal growth. This is what the concept of CSR rests on.

As per Section 135 of the Companies Act, 2013, CSR shall be applicable to a company when-

(1) Net worth of the company is rupees 500 crores or more;

(2) Turnover of the company is rupees 1000 crores or more;

(3) Net profit of the company is rupees 5 crore or more.

The provisions related to CSR shall not only apply to Indian companies but also to branch offices of foreign companies in India. Companies that meet the threshold limits under Section 135 of the Act and Company (Corporate Responsibility) Rules, 2014, shall spend a minimum of 2% of its average net profit for the immediately preceding three financial years on CSR activities. A CSR committee shall be constituted by these companies consisting of three or more directors. The CSR committee shall be responsible for determining the CSR policy, recommending the amount of money to be spent on CSR activities and monitoring the CSR policy. The Board of Directors shall approve the CSR policy after taking into account the recommendations made by the CSR committee.

The companies required to contribute towards CSR shall ‘comply’, and if they fail to do so, they need to explain the reason behind their non-compliance. Hence, this CSR regime is said to follow the "comply or explain" approach.

Related Party Transactions:

Related party transactions are business transactions with the relatives of KMPs or Directors of a company. Such transactions, though not banned in India need to be scrutinized. As per section 188 of the Companies Act, 2013, such transactions can be entered into only after the fulfillment of certain conditions.

- **Class Action Suits:**

A collective suit can be filed against a company by a group of aggrieved people who have the same grievance. These suits are called class action suits. Minority shareholders, therefore, can file a suit against a company and its management in the National Company Law Tribunal (NCLT). For unlawful, fraudulent or wrongful act, Section 245 of the Companies Act, 2013 allows the filing of suits against directors, management, auditors and any other person responsible for the wrong doing.

The changes introduced by the Companies Act, 2013 are a step forward to strengthening the core corporate machinery through robust corporate governance norms to achieve the goals of maximization of stakeholders' benefit and excellent corporate repute.

Stop to Consider

Several provisions emphasizing on corporate governance were introduced by the Companies Act, 2013. These related to-

• Composition of Board of Directors in public and private companies in terms of number, gender diversity, residential status, appointment of independent directors, and the like.

• Constitution and tasks of the Stakeholder Relationship Committee.

• Constitution and tasks of the Audit Committee.

• Internal audit.

• Establishment and powers of the Serious Fraud Investigation office (SFIO).
• Constitution and tasks of the Nomination and Remuneration Committee.
• Applicability of Corporate Social Responsibility (CSR); constitution and responsibilities of the CSR committee.
• Scrutiny of Related Party Transactions.
• Filing of Class Actions Suits.

Check Your Progress

16. What is the minimum number of directors to be appointed in a public company as per the Companies Act, 2013?
17. Should a public unlisted company mandatorily appoint a woman director?
18. What shall be proportion of independent directors in a public listed company?
19. When should a stakeholder committee be mandatorily constituted by a company?
20. Which section of the Companies Act, 2013 provides the duties of an audit committee?
21. Why shall the Serious Fraud Investigation Office (SFIO) established?
22. Which committee shall decide the remuneration for Key Managerial Personnel (KMPs)?
23. The Corporate Social Responsibility (CSR) provisions under the Companies Act, 2013, shall apply to offices of foreign companies in India- True or False.
24. What is meant by ‘related party transactions’?
25. What are ‘class action suits’?

19.10 SEBI: Listing Obligations and Disclosure Requirements (LODR), 2015

With the object of streamlining and strengthening corporate governance practices across listed entities, the Listing Obligations and Disclosure Requirements (LODR) were introduced by SEBI. Before the LODR regulations were introduced, corporate governance rules and disclosure requirements for listed entities were fragmented across various regulations. With the expansion of India's capital markets and increase in the number of listed companies, the need for a unified framework was recognized by SEBI. The LODR are "a set of regulations to ensure that listed companies adhere to comprehensive corporate governance norms and provide timely, accurate, and transparent disclosures to shareholders and other stakeholders". The LODR mandate covers aspects like board composition, shareholders' rights, financial reporting and disclosure of material events. It serves to:

(1) Maintain transparency in business operations

(2) Promote better corporate governance

(3) Enforce timely disclosures and protect investors' interest

(4) Standardize disclosure requirements for listed companies.

These regulations are enforced by SEBI so that a level playing field is created in the capital markets, thus making evaluation of company's performance and managing risks easier for investors. The LODR regulations consolidated:

(1) Listing Agreement obligations

(2) SEBI guidelines on disclosure and transparency

(3) Corporate governance standards for listed companies.

The LODR mandate shall apply to all listed entities on recognized stock exchanges in India. They shall include Public Listed Companies, Debenture Issuers, Entities Listed on International Exchanges, and Entities Planning to go Public. Based on the market capitalization of companies, the specific provisions of the LODR regulations may differ, for example, the top 1000 companies by market capitalization may have to follow more stringent corporate governance norms.

The key obligations and requirements to be met under the SEBI LODR Mandate are discussed below:

Financial Disclosure and Reporting Obligations

Ensuring timely and accurate financial reporting is one of the central tenets of the SEBI LODR mandate. The following must be complied by the listed entities:

- **Quarterly Financial Results:** The financial performance of companies must be disclosed on a quarterly basis, including profit/loss figures, income statements, and balance sheets. The company must disclose these reports on their websites and stock exchanges.
- **Annual Financial Reports:** Along with the financial statements, the annual financial reports must include a Management Discussion and Analysis (MD&A) section where risk factors, business developments, and future outlooks are detailed.
- **Audit Reports:** An independent auditor must audit the financial statements of a listed company, and the audit reports must be submitted.

In order to ensure standardization in the submission of financial reports, the XBRL (eXtensible Business Reporting Language) format is used widely. This makes the financial reports easily accessible and comparable by investors and regulators.

Corporate Governance Standards

In order to improve corporate governance practices, strict guidelines have been laid out by the LODR mandate. They are as follows:

- **Board composition:** The Board of Directors of listed companies must have a specified proportion of independent directors for objective decision making.
- **Board diversity:** In order to ensure gender diversity, at least one woman director must be included in the board.
- **CEO and Director Compensation:** The compensation structure for CEOs, directors and key managerial personnel must be disclosed. A comparison of CEO pay ratios must also be provided.
- **Risk Management and Internal Controls:** To ensure the management of operational and financial risks effectively, a robust risk management and internal controls framework must be in place.

Disclosure of Material Events and Information

Any material events or information that shall affect investor decision-making must be disclosed by listed companies. Some of such events are:

- **Mergers and Acquisitions (M&A):** Any significant activity related to M&A must be immediately disclosed to stock exchanges.
- **Related Party Transactions (RPTs):** To maintain transparency in transactions between related entities and ensure that proper governance protocols are followed, RPTs must be disclosed in details.
- **Change in Capital Structure:** If a listed company goes through changes in debt structure, share capital, or issuance of securities, it must be disclosed.
- **Legal Proceedings:** There must be timely communication of potential and ongoing legal proceedings that may have an impact on the financial performance of a company.

ESG Reporting

There has been an increasing focus by SEBI on the Environmental, Social, and Governance (ESG) aspects of corporate reporting. For the top 1000 listed companies based on market capitalization, the Business Responsibility and Sustainability Report (BRSR) is a key requirement under the LODR mandate. The following needs to be disclosed in these reports:

- **Environmental Metrics:** Energy consumption, carbon footprint, and waste management.
- **Social Metrics:** Employee welfare, workforce diversity, and community engagement.

Stop to Consider

• The Listing Obligations and Disclosure Requirements (LODR) were enforced by SEBI with the aim of streamlining and strengthening corporate governance rules and disclosure requirements across listed entities. This shall offer a level playing field in the capital markets, enabling investors to evaluate companies' performance and manage risks more easily.

• The LODR mandate shall be applicable to all listed entities on recognized stock exchanges in India.

• Under the SEBI LODR mandate companies shall be required to disclose quarterly financial reports, annual financial report with a Management Discussion and Analysis section, audit reports by an independent auditor. They need to follow strict guidelines with regard to board composition, board diversity, CEO and Director compensation, and risk management and internal controls. Events or information material to investor decision-making must be disclosed such as those related to mergers and acquisitions, related party transactions, change in capital structure, and legal proceedings. Disclosure of environmental and social metrics in the Business Responsibility and Sustainability Report (BRSR) by the top 1000 listed companies (based on market capitalization) is also now a key requirement.

Check Your Progress

26. Why was the Listing Obligations and Disclosure Requirements (LODR) introduced by SEBI?
27. The LODR mandate shall apply to all listed entities on recognized stock exchanges of India- True or False.
28. The SEBI LODR mandate requires the disclosure of financial performance on a quarterly basis- True or False.
29. State two material events that must be disclosed under the LODR mandate?
30. Which companies are required to prepare the Business Responsibility and Sustainability Report (BRSR) under the LODR mandate?

19.11 Uday Kotak Committee (2017)

The Uday Kotak Committee was set up by SEBI in June, 2017, for enhancement of the governance standards of listed companies in India. It consisted of members from the industry, stock exchanges, government, professional bodies, academics, etc. Some of the important recommendations made by the committee are as follows:

- In the company's board, there should be an increase in the number of independent directors from 33% to 50%.
- The eligibility criteria for independent directors will be strict so that no kin of a promoter is named to the board.
- The Board of Directors shall have a minimum of six directors.
- There shall be an optimum combination of executive and non-executive directors on the board. Non-executive directors shall comprise not less than 50% of the Board of Directors.

- At least one woman shall act as an independent director on the board.
- No person who has attained 75 years of age shall be appointed or continue as a non-executive director for a listed company, unless a special resolution is passed to that effect.
- Holding a minimum of five board meetings a year shall be made mandatory for a company, in order to ensure that in at least one of the meetings corporate governance issues are discussed and not quarterly financial results. Each board member is prescribed to have a minimum level of attendance at such meetings.
- Listed entities that have a public shareholding of more than 40 percent shall separate the role of Chairperson and Managing Director/Chief Executive Officer, with effect from 1st April, 2020.
- The committee had observed that when there is no channel legitimizing information flow to certain promoters and significant shareholders, such information sharing occurs in the "shadows". Hence, in order to regulate their information rights, a transparent framework was recommended by the committee.
- The remuneration of executive promoter director was capped at Rs. 5 crore a year or 2.5 percent of net profit, whichever is higher. Overall the salary of all executive promoter director was capped at 5 per cent of net profit. Shareholders' approval taken through a special resolution would be needed for both these cases.
- To maintain more transparency in the usage of funds and keep an eye on any round tripping of funds, the audit committee shall review the usage of funds by a subsidiary in which any parent or holding company has invested or lent Rs. 100 crore or more.

The Uday Kotak Committee report aimed at strengthening of the role of independent directors and make the functioning of boards more transparent. However, a number of its recommendations conflicted with the provisions of the Companies Act, 2013 and dissented with regulatory bodies like the Ministry of Corporate Affairs (MCA) and Institute of Chartered Accountants of India (ICAI).

Stop to Consider

• Set up by the SEBI in June, 2017, the Uday Kotak Committee offered important recommendations for improving the corporate governance standards of listed companies in India.

• The recommendations by the committee were on aspects such as composition of the Board of Directors, number of board meetings to be held in a year, separation of the roles of chairperson and MD/CEO in certain scenarios, greater transparency while providing information, remuneration of executive promoter director, and review of the usage of funds.

Check Your Progress

31. When was the Uday Kotak Committee set up by SEBI?

32. What was the percentage of independent directors recommended by the Committee?

33. As per the recommendation of the Committee, could a person who had attained the age of 75 years be appointed or continue as a non-executive director for a listed company?

34. Why were five mandatory board meetings a year recommended by the Uday Kotak Committee?

35. The Committee had recommended the capping of the salary of all executive promoter director at ……… per cent of net profit. (Fill in the blanks)

Self-Assessment Questions

1. Read about the Satyam Scandal and highlight how the principles of corporate governance were violated by the company.
2. According to you, is the current corporate governance framework of India appropriate? If not, what suggestions would you give for further improvement?

19.12 Summing Up

1. Corporate Governance are the rules and processes meant for operating a company in a manner that secures the interest of all its stakeholders.
2. Fairness, Transparency, Accountability, Risk Management, and Responsibility are the core principles of Corporate Governance.
3. An efficient and effective Corporate Governance framework can ensure transparency and accountability in the organization, protect the interest of shareholders and enhance their trust and confidence in the business entity, foster sustainable growth and improved decision making, promote Corporate Social Responsibility, reduce legal risks, and increase reputation.
4. Out of all the stakeholders of a company, its directors, key managerial personnel and officers, and shareholders are the key participants in the corporate governance process.
5. Traditionally, Indian businesses were driven by promoters' interests and often overlooked the interest of minority shareholders.
6. Though the Companies Act, 1956 provided the legal framework for corporate governance, actual transformation happened only after the economic liberalisation in the early 1990s.
7. Key developments in corporate governance during 1991-2009 were brought in by the Confederation of Indian Industry (CII), Kumar Mangalam Birla Committee, Clause 49 of the Listing

Agreement, Narayan Murthy Committee, and the Satyam Scandal.

8. Post 2009, the Companies Act, 2013, the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, the Kotak Committee were responsible for notable developments in corporate governance.
9. Integrated Reporting, ESG (Environmental, Social and Governance), and Technology and Digital Governance are some of the recent trends in corporate governance.
10. The Kumar Mangalam Birla Committee was set up by the SEBI in 1999 under the chairmanship of Shri Kumar Mangalam Birla, with the objective of raising corporate governance standards by setting a 'Code' that would take investors and shareholders perspectives into consideration.
11. The committee put forward two sets of recommendations – mandatory and non-mandatory recommendations.
12. The mandatory recommendations comprised those absolutely essential for corporate governance and applicable to companies that were listed and had a paid up share capital of rupees 3 crores and above. These were related to the composition of Board of Directors and Audit Committee, formation of Remuneration Committee, number of board meeting to be held in a year, role of director, items of external review, and information to shareholders. The other desired or required change of laws fell under non-mandatory recommendations.
13. The SEBI constituted the Narayan Murthy Committee in 2003, with N.R. Narayan Murthy as its chairman with the objective of improvement of corporate governance practices in line with the evolving market dynamics.
14. The committee made mandatory recommendations regarding the proficiency of the members of the audit committees, quality of financial disclosures, code of conduct, nominee directors of the

government in case of public sector companies, whistleblowing, etc. Besides these, certain non-mandatory recommendations were also made by the committee.

15. Several provisions emphasizing on corporate governance were introduced by the Companies Act, 2013. These related to-

- Composition of Board of Directors in public and private companies in terms of number, gender diversity, residential status, appointment of independent directors, and the like.
- Constitution and tasks of the Stakeholder Relationship Committee.
- Constitution and tasks of the Audit Committee.
- Internal audit.
- Establishment and powers of the Serious Fraud Investigation office (SFIO).
- Constitution and tasks of the Nomination and Remuneration Committee.
- Applicability of Corporate Social Responsibility (CSR); constitution and responsibilities of the CSR committee.
- Scrutiny of Related Party Transactions.
- Filing of Class Actions Suits.

16. The Listing Obligations and Disclosure Requirements (LODR) were enforced by SEBI with the aim of streamlining and strengthening corporate governance rules and disclosure requirements across listed entities. This shall offer a level playing field in the capital markets, enabling investors to evaluate companies' performance and manage risks more easily.
17. The LODR mandate shall be applicable to all listed entities on recognized stock exchanges in India.
18. Under the SEBI LODR mandate companies shall be required to disclose quarterly financial reports, annual financial report with

a Management Discussion and Analysis section, audit reports by an independent auditor. They need to follow strict guidelines with regard to board composition, board diversity, CEO and Director compensation, and risk management and internal controls. Events or information material to investor decision-making must be disclosed such as those related to mergers and acquisitions, related party transactions, change in capital structure, and legal proceedings. Disclosure of environmental and social metrics in the Business Responsibility and Sustainability Report (BRSR) by the top 1000 listed companies (based on market capitalization) is also now a key requirement.

19. Set up by the SEBI in June, 2017, the Uday Kotak Committee offered important recommendations for improving the corporate governance standards of listed companies in India.
20. The recommendations by the committee were on aspects such as composition of the Board of Directors, number of board meetings to be held in a year, separation of the roles of chairperson and MD/CEO in certain scenarios, greater transparency while providing information, remuneration of executive promoter director, and review of the usage of funds.

19.13 Key Terms:

- Board of Directors: The board of directors is a governing body of the company that is typically elected or appointed by its shareholders to oversee the company's activities and management, set strategy, and protect shareholders' and stakeholders' interests.
- Corporate Governance: Corporate governance refers to the system of rules, practices, and processes by which a company is directed and controlled.

- Corporate Social Responsibility: Corporate Social Responsibility is the overall ethos that drives a company to adopt policies and practices that support sustainability, societal and other ethical ends.
- Stakeholders: Stakeholders are the groups, units, individuals, or organizations, internal or external to an organization, which are impacted by, or can impact the outcomes of the organization.
- Key Managerial Personnel (KMP): According to Section 2(51) of the Companies Act, 2013, in relation to a company, Key Managerial Personnel (KMP) shall include "the chief executive officer, manager or managing director; the company secretary; the whole-time director; the chief financial officer; any other officer designated as key managerial personnel by the Board who is a full-time employee and is not more than one level below the directors; and any other officer as may be prescribed by the central government".
- Independent director: An independent director is a member of the board of directors who does not have a material relationship with the company, is not part of the company's executive team, and is not involved with the day-to-day operations of the company.
- Initial Public Offering: An Initial Public Offering (IPO), generally refers to when a company first sells its shares to the public.
- Shareholder: Shareholder refers to any person, institution or company that has ownership of at least one share of a company's stock, also known as equity.
- Sustainability: The United Nations Brundtland Commission defined sustainability as "meeting the needs of the present without compromising the ability of future generations to meet their own needs".

19.14 Model Questions

1. Define corporate governance.
2. Briefly explain the core principles of corporate governance.
3. Discuss the importance of corporate governance.
4. Who are the key participants in corporate governance?
5. Explain the evolution of corporate governance in India.
6. What were the mandatory and non-mandatory recommendations provided by the Kumar Mangalam Birla Committee (1999)?
7. Highlight the mandatory recommendations made by the Narayan Murthy Committee.
8. Discuss the provisions introduced by the Companies Act, 2013 in relation to corporate governance.
9. What do you understand by the Listing Obligations and Disclosure Requirements (LODR)? What are the key obligations and requirements to be met under the SEBI LODR Mandate?
10. Write a note on the Uday Kotak Committee (2017) recommendations.

19.15 Answers to Check Your Progress

1. The primary objective of corporate governance is to ensure that businesses are run in a responsible and transparent manner, and thereby secure the interest of its stakeholders.
2. The principle of 'transparency' in corporate governance denotes that the Board of Directors of a company must ensure that the information material for decision making by its stakeholders shall have clarity, accuracy and timeliness.
3. The Board of Directors shall be primarily responsible for overseeing the management and overall corporate affairs.
4. By ensuring accountability, ethical behaviour and compliance with laws and regulations, a robust corporate governance structure helps in minimizing legal and reputational risks.

5. Yes, shareholders are a key participant in corporate governance along with the directors, and key managerial personnel and officers.
6. Companies Act, 1956.
7. In 1998, the Confederation of Indian Industry (CII), released the Desirable Corporate Governance Code for listed companies.
8. The Securities and Exchange Board of India (SEBI) had appointed the Narayan Murthy Committee to review Clause 49 of the Listing Agreement.
9. The Satyam Scandal of 2009, in which company financials were inflated by $ 1.47 billion revealed the loopholes in the corporate governance structure of India and highlighted the need for overhaul of regulations and a more robust mechanism for corporate governance.
10. A holistic view of the company's financial, social and environmental aspects is provided under integrated reporting, which boosts transparency and help stakeholders make informed decisions.
11. The SEBI set up the Kumar Mangalam Birla Committee in 1999 for the preparation of a 'Code' that would raise the standards of corporate governance in India by considering the perspective of the investors and shareholders.
12. The mandatory recommendations made by the committee would be applicable to listed companies which had a paid up share capital of rupees 3 crores and above.
13. According to the Kumar Mangalam Birla Committee, there should be three independent directors in an audit committee, and a director could act as a chairman of upto five committees across all companies.
14. As per the recommendation of the Narayan Murthy Committee, at least one member of the audit committee should be 'financially knowledgeable'.

15. The Narayan Murthy Committee recommended that personnel who observed an unethical or improper practice (not necessarily a violation of law) should be able to approach the audit committee without necessarily informing their superiors.
16. As per the Companies Act, 2013, a minimum of three directors should be appointed in a public company.
17. A woman director should be mandatorily appointed by a public unlisted company whose paid up share capital is 100 crore rupees or more, or turnover is 300 crores or more.
18. In a public listed company, at least one third of the directors shall be independent directors.
19. A company shall mandatorily constitute a stakeholder committee if it has more than 1000 shareholders, debenture holders, deposit holders or any other security holder in a financial year.
20. Section 177(4) of the Companies Act, 2013 provides the duties of an audit committee.
21. As per Section 211(1) of the Companies Act, 2013, the Serious Fraud Investigation office shall be established to investigate company related frauds.
22. The Nomination and Remuneration Committee shall decide the remuneration for Key Managerial Personnel (KMP).
23. True.
24. Related party transactions are business transactions with the relatives of KMPs or Directors of a company. Such transactions can be entered into only after the fulfillment of certain conditions.
25. Class action suit is a collective suit filed against a company by a group of aggrieved people who have the same grievance.
26. Before the Listing Obligations and Disclosure Requirements (LODR) regulations were introduced, corporate governance rules and disclosure requirements for listed entities were fragmented across various regulations. With the expansion of India's capital markets and increase in the number of listed companies, SEBI

introduced the LODR for streamlining and strengthening corporate governance practices across listed entities.

27. True.
28. True.
29. Two material events that must be disclosed under the LODR mandate are- Mergers and Acquisitions (M&A), and Related Party Transactions (RPTs).
30. The Business Responsibility and Sustainability Report (BRSR) shall be prepared by the top 1000 listed companies based on market capitalization.
31. The Uday Kotak Committee was set up by SEBI in June 2017.
32. The percentage of independent directors recommended by the Committee was 50%.
33. No person who has attained 75 years of age shall be appointed or continue as a non-executive director for a listed company, unless a special resolution is passed to that effect.
34. The Uday Kotak Committee recommended five mandatory board meetings a year in order to ensure that in at least one of the meetings corporate governance issues are discussed and not quarterly financial results.

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Unit-20
Recent Issues and Challenges of Governance, Corporate Failures and Scams in India, Insider Trading, Whistle Blowing

Unit Structure:

20.1 Introduction

Corporate governance is the framework of rules, practices, and processes by which a company is directed and controlled. It balances the interests of various stakeholders, including shareholders, management, customers, suppliers, financiers, government, and the community. Good governance promotes transparency, accountability, and long-term sustainability of business entities. In recent years, India has witnessed rapid economic growth, increased foreign investment, and a rise in the number of listed companies. However, this progress has also been accompanied by a growing number of corporate scandals and governance failures.

From the infamous Satyam scam to the collapse of IL&FS, and the Punjab National Bank-Nirav Modi fraud, corporate failures in India have exposed serious lapses in internal controls, ethical conduct, financial disclosures, and regulatory compliance. These incidents have undermined investor confidence and raised serious questions about the effectiveness of existing governance structures and legal safeguards.

One of the recurring issues in these failures is insider trading, where individuals misuse non-public, price-sensitive information for personal gain. Despite the presence of regulatory bodies like SEBI, the detection and prevention of such unethical practices remain a challenge.

On the other hand, whistle blowing has emerged as a powerful tool for exposing wrongdoing within organizations. However, in India, whistleblowers often face retaliation, lack of legal protection, and organizational apathy, making it a risky endeavor.

This unit explores the recent issues and challenges in corporate governance in India, examines major corporate failures and scams, and discusses the role of insider trading and whistle blowing in influencing corporate integrity. It also evaluates the existing legal and regulatory frameworks, and suggests ways to strengthen governance mechanisms for a more ethical and accountable corporate environment.

20.2 Objectives

After going through this unit, you will be able to-

- *understand* the recent issues and challenges in corporate governance in India,
- *understand* the major corporate failures and scams,
- *explain* the concept and implications of insider trading,
- *analyze* the importance and framework of whistle blowing mechanisms in India.

20.3 Recent Issues and Challenges in Corporate Governance in India

In the Indian corporate world, good governance is essential for maintaining investor trust, ensuring business sustainability, and protecting the interests of various stakeholders. While many companies are trying to adopt better governance practices, several issues and challenges still persist. These challenges affect the transparency, accountability, and ethical functioning of organizations. Let us discuss the key governance challenges faced by Indian companies today.

1. Poor Board Independence and Weak Oversight: One of the major issues in corporate governance is the lack of independence in company boards. Independent directors are appointed to bring objective judgment and monitor the actions of the management. However, in many Indian companies, independent directors are often close friends, relatives, or former associates of promoters. This

compromises their ability to question the decisions of top executives or prevent unethical practices.

Moreover, board meetings are sometimes treated as mere formalities, without serious discussions or checks on financial and operational matters. This weak oversight leads to poor decision-making and allows management to act without sufficient accountability.

2. Conflict of Interest and Lack of Transparency: Conflicts of interest arise when individuals in power use their positions for personal gain, often at the cost of the company or its shareholders. In India, promoter-driven companies are common, where the same group manages the business and controls the ownership. This dual role can lead to decisions that favor promoters rather than all shareholders.

For example, awarding contracts to companies owned by relatives, using company funds for personal purposes, or hiding related-party transactions are some practices that indicate conflict of interest. Many times, such transactions are not properly disclosed in financial statements, resulting in a lack of transparency and misleading investors.

3. Executive Compensation and Shareholder Rights: Executive compensation in some Indian companies is highly disproportionate to performance. While promoters and top executives draw huge salaries and bonuses, the companies may be underperforming or making losses. This raises concerns about fairness and ethical governance.

In theory, shareholders have the right to approve executive compensation and other key decisions through voting. But in practice, retail shareholders have limited power, and institutional investors may not always act in the best interest of minority shareholders. Promoters often hold a majority of voting rights, enabling them to pass decisions without broader consent, undermining the principle of equitable treatment of shareholders.

4. Regulatory Gaps and Implementation Hurdles: India has several laws and regulations to promote corporate governance, such as the Companies Act, 2013, SEBI's Listing Obligations and Disclosure Requirements (LODR), and various clauses related to board functioning and disclosures. However, enforcement of these laws remains a significant challenge.

Regulatory bodies like SEBI and the Ministry of Corporate Affairs (MCA) may lack sufficient resources to monitor every listed company effectively. Delays in investigations, low conviction rates, and weak penalties further reduce the deterrent effect of laws. Companies may comply with the rules in form but not in spirit, submitting reports without actual improvements in governance. Additionally, overlapping jurisdictions between SEBI, RBI, MCA, and other agencies often lead to confusion and delay in enforcement.

5. Challenges in Enforcing ESG Compliance: Environmental, Social, and Governance (ESG) compliance is gaining importance worldwide, and India is no exception. Companies are expected to take responsibility not just for financial performance but also for their environmental impact, labor practices, community welfare, and ethical governance. In India, the top 1000 listed companies are required to submit Business Responsibility and Sustainability Reports (BRSR). However, many firms lack the capacity or willingness to implement genuine ESG initiatives. Disclosures are often superficial and focused on image-building rather than actual impact.

There are also no uniform ESG rating standards, making it difficult to compare or evaluate companies. The lack of ESG awareness among investors and board members further complicates enforcement. Smaller companies often see ESG compliance as a cost burden rather than a value addition.

20.4 Major Corporate Failures and Scams in India

Corporate failures and financial scams have posed serious threats to investor confidence, economic stability, and the credibility of regulatory systems in India. These incidents are often the result of poor corporate governance, unethical practices, weak internal controls, and lack of accountability. In many cases, promoters and top executives misused their positions, while auditors and regulators failed to detect or prevent wrongdoing in time. This section examines some of the most significant corporate scandals in India in recent times. Each case highlights different types of governance failures and offers valuable lessons for the future.

1. Satyam Computers Scam: The Satyam scam, which came to light in January 2009, is one of the biggest corporate frauds in Indian history. Satyam Computers was a leading IT services company based in Hyderabad, admired for its rapid growth and global presence. However, the company's founder and chairman, Ramalinga Raju, admitted to manipulating financial statements for several years. He had inflated the company’s revenue, profit figures, and cash balances to show better performance and attract investors.

The scandal revealed multiple governance weaknesses:

- Board of Directors failed to exercise oversight and approved a controversial real estate acquisition by a promoter-owned firm, which raised eyebrows.
- Auditors (PricewaterhouseCoopers) failed to detect fake bank statements and misreported financials for years.

- Lack of independent verification of financial information enabled the fraud to continue unnoticed.

Aftermath: The scam caused a sharp fall in Satyam's share price and loss of investor confidence. Thousands of employees faced uncertainty. The government intervened quickly and reconstituted the board. Eventually, Tech Mahindra acquired Satyam and merged it with its operations. The case led to increased focus on corporate governance norms, stricter auditing practices, and the introduction of reforms in the Companies Act, 2013.

2. IL&FS Crisis: Infrastructure Leasing & Financial Services (IL&FS) was a major non-banking financial company (NBFC) engaged in infrastructure development and financing. In 2018, IL&FS defaulted on several loan repayments, leading to a major liquidity crisis in India's financial sector. The default amounted to over Rs90,000 crore and impacted banks, mutual funds, and insurance companies. The crisis occurred because of the Governance and Risk Management Failures

- IL&FS had complex corporate structure with hundreds of subsidiaries, making transparency difficult.
- Weak risk management practices and excessive debt accumulation without matching revenue streams led to the collapse.
- The board failed to control the growing debt burden and misjudged the risks of long-gestation infrastructure projects.
- Auditors and rating agencies continued to give favorable reports until just before the default, raising concerns about the reliability of external oversight.

Aftermath: The government took control by dismissing the board and appointing a new management team led by Uday Kotak. The IL&FS crisis shook investor confidence in NBFCs and led to tighter regulations by the RBI and SEBI for shadow banking and credit rating agencies. It also highlighted the need for better risk monitoring and early-warning systems.

3. Yes Bank Collapse: Yes Bank, once one of India's fastest-growing private sector banks, collapsed in 2020 due to growing non-performing assets (NPAs) and failure to raise fresh capital. The bank had been aggressively lending to high-risk borrowers, many of whom defaulted. Its founder and CEO, Rana Kapoor, was later arrested for money laundering and bribery.

The bank failed because of many governance issues:

- The board did not question the aggressive lending practices that led to excessive risk exposure.
- Loans were extended to poor-quality borrowers, many of whom were already under financial stress.
- Lack of internal checks, poor due diligence, and inflated asset quality reports created a false sense of financial health.
- The management also delayed raising necessary capital, despite warnings from RBI.

Aftermath: In March 2020, the RBI imposed a moratorium on withdrawals and took over the bank’s management. A rescue plan was implemented involving investments from SBI and other public-sector banks. The Yes Bank episode exposed the dangers of poor corporate governance in banking and led to stricter guidelines on loan reporting and executive accountability.

4. Nirav Modi–PNB Scam:The Punjab National Bank (PNB) fraud, involving businessman Nirav Modi and his uncle Mehul Choksi, was detected in 2018. The fraud was valued at over Rs13, 000 crore and was carried out through unauthorized Letters of Undertaking (LoUs) issued by PNB officials to help Nirav Modi's companies obtain overseas credit. The Scam occurred because of Governance and Control Failures

- **Internal controls** within the bank were grossly inadequate. Senior officials were able to bypass the core banking system to issue LoUs without collateral.
- There was **collusion between bank staff and external parties**, and no effective checks were in place to detect such fraudulent practices.
- The bank failed to conduct **independent verification or audits** of the transactions for years.
- **Lack of integration** between the SWIFT messaging system and core banking systems allowed fraud to remain hidden.

Aftermath: The scam led to a massive loss of public trust in the banking system. Nirav Modi fled India but was later arrested in the UK, and extradition proceedings are underway. The Indian government tightened norms for issuing LoUs and enhanced internal audit mechanisms in public-sector banks. The case highlighted the urgent need for technology integration, staff accountability, and regular fraud risk assessments in banks.

5. Kingfisher Airlines and Vijay Mallya Case: Kingfisher Airlines, launched in 2005 by liquor baron Vijay Mallya, was once seen as a premium airline with high-end services. However, the airline suffered chronic financial losses and failed to become profitable. By 2012, it had suspended operations due to mounting debt. Mallya and his group companies had availed loans of over Rs 9,000 crore from a consortium of public sector banks. The loans eventually turned into non-performing assets (NPAs), and Kingfisher Airlines was declared a willful defaulter.

The failure or scam happened because of Governance and Ethical Failures, some of which are listed below:

- Misuse of bank loans: Loans sanctioned for the airline's operations were allegedly diverted to other group entities and foreign accounts.
- Lack of collateral and poor appraisal: Many banks extended loans without adequate due diligence or sufficient collateral, possibly due to Mallya's influence and reputation.
- Lavish lifestyle of promoter: Even as the airline was sinking, Vijay Mallya maintained a lavish personal lifestyle, including hosting events and maintaining luxury assets.
- Weak oversight by lenders: Bank officials failed to monitor fund usage effectively and did not act on early signs of stress.

Aftermath: Vijay Mallya fled India in 2016 and has since been residing in the United Kingdom, evading Indian legal proceedings. The Enforcement Directorate (ED) and the Central Bureau of Investigation (CBI) filed multiple charges against him for money laundering, financial fraud, and loan default. In response, Indian authorities took stringent actions, including the seizure and attachment of his assets both in India and abroad.

The high-profile case exposed major loopholes in the financial and legal systems, prompting the government to tighten rules around non-performing assets (NPAs) and strengthen the framework for loan monitoring. One of the key outcomes was the introduction of the Fugitive Economic Offenders Act, 2018, which empowers authorities to confiscate the properties of economic offenders who evade prosecution by staying outside the country. The case also led to more cautious lending practices and stricter due diligence by financial institutions.

6. DHFL (Dewan Housing Finance Corporation Ltd) Scam: DHFL, once a leading housing finance company in India, defaulted on its debt repayments in 2019. Investigations later revealed that the promoters, Kapil and Dheeraj Wadhawan, had committed a massive financial fraud of over Rs 30,000 crore—one of the largest in India's history. The scam shook investor trust in non-banking financial companies (NBFCs) and triggered a broader credit squeeze.

The scam occurred because of the following Governance and Risk Failures:

- Fictitious transactions: DHFL reportedly disbursed loans to shell companies that had no real operations, many of which were linked to the promoters.
- Diversion of funds: Public money was funneled into personal investments, properties, and unrelated businesses.
- Audit and regulatory lapses: Despite red flags, auditors signed off on DHFL's financials for years, and regulatory authorities did not act swiftly.
- Poor corporate governance: The board and senior management failed to enforce internal checks and did not question questionable lending practices.

Aftermath: The Enforcement Directorate (ED) and the Central Bureau of Investigation (CBI) arrested DHFL promoters, Kapil and Dheeraj Wadhawan, and filed charges against them under the Prevention of Money Laundering Act (PMLA) for their involvement in a large-scale financial fraud. The case also brought credit rating agencies and auditors under intense scrutiny for failing to identify and report risks in DHFL's financial practices.

Following the exposure of the scam, DHFL went through insolvency proceedings, and in 2021, it was successfully acquired by the Piramal Group under the Insolvency and Bankruptcy Code (IBC) mechanism. The incident triggered regulatory reforms, prompting RBI and SEBI to tighten governance norms for Non-Banking Financial Companies (NBFCs), enhance transparency in credit evaluation processes, and mandate stricter disclosure standards to restore investor confidence and prevent similar failures in the future.

Apart from the above discussed scams and failures, some of the below mentioned corporate scams, failure or frauds in India are notable too.

- ABG Shipyard Fraud
- Bhushan Steel and Bhushan Power & Steel Frauds
- Sahara Group Controversy
- Rotomac Pens Loan Default Case
- Amrapali Group Real Estate Scam
- NSEL Scam (National Spot Exchange Limited)

20.5 Insider Trading

Insider trading is one of the most debated and closely monitored aspects of corporate governance and financial regulation. It refers to the buying or selling of securities of a company by individuals who possess material, non-public information about the company. Such individuals, known as insiders, include directors, executives, employees, auditors, legal advisors, and others who have access to sensitive corporate information before it is made available to the public.

Insider trading, when conducted unethically or illegally, undermines investor confidence, distorts the level playing field in financial markets, and can significantly harm the reputation and stability of financial institutions. It is considered a **serious market abuse** that compromises the principles of fairness, transparency, and accountability in capital markets.

Insider trading can be classified into **two categories**:

1. Legal Insider Trading: This occurs when corporate insiders—such as directors or employees—buy or sell company shares and report their trades to the stock exchanges as required by law. These transactions are legal if they are carried out without the use of unpublished price-sensitive information (UPSI) and in compliance with regulatory norms.
2. Illegal Insider Trading: This happens when insiders trade based on confidential, material information that has not yet been disclosed to the public. For instance, if an employee knows that a company is about to announce a merger or a huge loss and uses that information to trade in the company's stock for personal gain, it constitutes illegal insider trading.

Examples of unpublished price-sensitive information (UPSI) include:

- Financial results before official declaration.
- Plans for mergers, acquisitions, or takeovers.
- Major changes in key management.
- Issue or buy-back of securities.
- Any significant change likely to affect share prices.

20.5.1 Why Insider Trading is Unethical and Illegal

Insider trading is widely condemned because it violates the principle of fairness in financial markets. When insiders use confidential information for personal gain, it creates an unequal opportunity for retail and institutional investors who base their decisions on publicly available information. This erodes investor confidence and can lead to market volatility.

From an ethical standpoint, insider trading involves a conflict of interest and misuse of trust placed in corporate insiders. It encourages unethical behavior, can lead to manipulation of stock prices, and often signals deeper governance failures within a company. Illegal insider trading is also a criminal offense in India and many other countries, punishable with monetary fines and imprisonment.

20.5.2 Role of SEBI in Detecting and Preventing Insider Trading

The Securities and Exchange Board of India (SEBI) is the apex regulatory authority responsible for regulating the securities market and preventing unfair trade practices, including insider trading. SEBI plays a central role in creating a framework that promotes transparency and accountability in capital markets.

Key steps taken by SEBI to curb insider trading include:

- SEBI (Prohibition of Insider Trading) Regulations, 2015: These regulations provide a comprehensive legal framework for prohibiting insider trading and defining what constitutes an insider, UPSI, and legitimate trades.
- Code of Conduct: Listed companies and market intermediaries are required to establish a code of conduct to regulate, monitor, and report trading by employees and connected persons.
- Trading Window Mechanism: SEBI mandates companies to close trading windows during periods when UPSI is likely to be

generated (e.g., before results announcements), thereby restricting insiders from trading during that time.

- Whistle-blower mechanism: SEBI encourages whistle-blowers to report insider trading through its informant mechanism, offering rewards and protection for those who provide credible information.
- Surveillance and Investigations: SEBI uses advanced data analytics and surveillance tools to monitor unusual trading patterns, investigate suspicious trades, and impose penalties or initiate legal action when violations are detected.

20.5.3 Landmark Insider Trading Cases in India

Over the years, SEBI has investigated several cases of insider trading that highlight the seriousness of this offense in the Indian context. A few important ones include:

- Infosys Case (2019): SEBI initiated action when certain employees were found to have shared unpublished financial information with outsiders. The regulator imposed monetary penalties on the employees involved for violating insider trading norms.
- Axis Bank Case (2017): SEBI penalized employees and related persons for trading in Axis Bank shares ahead of the bank's quarterly financial results. The trades were found to be based on unpublished financial data, which qualified as UPSI.
- Biocon Ltd Case (2021): SEBI barred a senior employee and an external person from accessing the securities market for insider trading related to drug approval announcements.
- Reliance Industries Ltd Case (2007): Though not a classic insider trading case, SEBI fined RIL for manipulating stock

prices and making unlawful gains, showing the regulator's tough stance on unfair trading practices.

Check Your Progress

1. Mention two major challenges in corporate governance in India.
2. Name any two major corporate scams in India.
3. Define insider trading in simple terms.
4. Why is insider trading considered illegal?
5. What is the full form of SEBI?
6. State one key role of SEBI in regulating insider trading.

20.6 Whistle Blowing

Whistle blowing plays a crucial role in promoting transparency, accountability, and ethical conduct in the corporate world. It refers to the act of exposing wrongdoing, fraud, corruption, or unethical practices within an organization by an individual—often an insider—who believes that the public interest is at risk. In a business environment increasingly driven by profits, whistle blowing has emerged as a vital safeguard to ensure good governance, compliance with laws, and the protection of shareholder and stakeholder interests.

In India, the concept of whistle blowing has gained prominence in the wake of several corporate scandals and financial frauds. These cases have highlighted the need to empower individuals to report unethical behavior without fear of retaliation or job loss. Despite the introduction of legal frameworks and corporate policies, whistle blowing continues to face several challenges, including inadequate protection, fear of victimization, and lack of organizational support.

20.6.1 Meaning and Importance of Whistle Blowing

Whistle blowing can be defined as the disclosure of information by an employee or other insider about illegal, unethical, or improper conduct within an organization. This information is usually reported to those in authority or, if necessary, to the public, media, or regulatory bodies.

The importance of whistle blowing lies in the following:

- Preventing fraud and corruption: Timely disclosure of malpractice can help avoid financial losses, reputational damage, and legal consequences.
- Enhancing corporate governance: It reinforces ethical standards and builds a culture of accountability.
- Protecting stakeholder interests: By exposing wrongdoing, whistle blowers act in the interest of shareholders, customers, employees, and society at large.
- Compliance with laws: Encouraging whistle blowing ensures adherence to legal and regulatory norms.

20.6.2 Internal vs. External Whistle Blowing

Whistle blowing can be categorized based on the channel through which the report is made:

- Internal Whistle Blowing: This involves reporting concerns to higher management, ethics committees, or internal grievance redressal systems within the organization. Many companies have formal whistle blowing policies with designated reporting channels to handle such disclosures discreetly.
- External Whistle Blowing: In cases where internal mechanisms fail or when the wrongdoing involves senior management, the

whistle blower may approach regulatory bodies like SEBI, RBI, CBI, or even the media and public. External whistle blowing is often riskier but sometimes necessary to ensure accountability.

20.6.3 Whistle Blowers Protection Act, 2014

The Whistle Blowers Protection Act, 2014 was enacted by the Government of India to provide a legal framework for encouraging disclosures of corruption and protecting whistle blowers. Key features include:

- Protection to individuals who report corruption, misuse of power, or criminal offenses by public servants.
- Provision for maintaining the confidentiality of the whistle blower's identity.
- Penal provisions against those who disclose the identity of whistle blowers or take action to victimize them.
- Empowerment of the Central Vigilance Commission (CVC) to receive and investigate complaints.

However, the Act has limitations. It currently applies only to public sector organizations and government employees, excluding the private corporate sector. Furthermore, certain proposed amendments dilute its effectiveness by restricting disclosures related to national security or other classified matters.

20.6.4 Challenges Faced by a Whistle Blower:

Despite legal and institutional support, whistle blowing remains a difficult choice for most individuals due to several challenges:

1. Fear of Retaliation: Whistle blowers often face threats, job loss, demotion, harassment, or social isolation from colleagues and superiors.

2. Lack of Legal Protection in Private Sector: The absence of a strong legal framework for private companies makes whistle blowers more vulnerable.
3. Limited Awareness: Many employees are unaware of their rights, the company's policies, or the channels available to report wrongdoing.
4. Ineffective Internal Systems: In some organizations, whistle blowing mechanisms exist only on paper and are not implemented sincerely.
5. Delayed or No Action: Whistle blowers may become disillusioned if their reports are ignored or investigated half-heartedly.
6. Cultural Barriers: In some cases, whistle blowing is seen as betrayal or disloyalty, discouraging people from coming forward.

20.6.5 Case Studies of Whistle Blowers in Indian Corporate/Financial System

Satyendra Dubey (NHAI / Golden Quadrilateral Project): Satyendra Dubey was a dedicated and principled engineer working with the National Highways Authority of India (NHAI). He was involved in the Golden Quadrilateral project, one of India's most ambitious infrastructure initiatives, aimed at connecting the major metropolitan cities through a network of highways. During his tenure, Dubey uncovered and reported widespread irregularities and corruption in the award and execution of highway construction contracts. He witnessed how substandard materials were being used, contracts were manipulated, and financial misappropriation was rampant.

Dubey wrote directly to the Prime Minister's Office in 2002, detailing the corrupt practices and naming some of the contractors and officials involved. Importantly, he requested that his identity be kept confidential to protect him from retaliation. Unfortunately, his identity was leaked, and on November 27, 2003, he was tragically murdered in Gaya, Bihar, under mysterious circumstances that pointed to a targeted killing.

His death shocked the nation and brought to the forefront the grave risks faced by whistle blowers in India. Dubey's case became a symbol of the urgent need for a robust legal framework to protect individuals who expose corruption and wrongdoing. The public outrage following his death sparked nationwide debates, media campaigns, and increased pressure on the government, eventually leading to discussions around drafting whistle blower protection legislation. In 2014, the **Whistle Blowers Protection Act** was passed in India, though its implementation and scope remain subjects of ongoing concern and debate. Dubey's story continues to inspire many young professionals and activists, serving as a powerful reminder of the courage and integrity required to confront systemic corruption.

Manjunath Shanmugam (Indian Oil Corporation): Manjunath Shanmugam was a bright, young marketing manager working with the Indian Oil Corporation (IOC). An alumnus of the prestigious Indian Institute of Management (IIM) Lucknow, he was posted in Uttar Pradesh where he was responsible for monitoring fuel quality standards at petrol pumps. During his inspections, Manjunath discovered a particular petrol pump in Lakhimpur Kheri that was selling adulterated fuel, which posed serious environmental and safety hazards and violated IOC's quality guidelines.

Demonstrating integrity and commitment to his role, he ordered the sealing of the pump and took action against the violators. However, after the pump resumed operations without rectifying the issues, Manjunath decided to conduct another surprise inspection. Tragically, on November 19, 2005, he was abducted and murdered by the pump owner and his associates. His body was found in his car with multiple bullet wounds, a brutal end to a young man who had simply tried to do his duty honestly.

Manjunath's murder triggered widespread condemnation and became a rallying point for civil society movements against corruption. Students, alumni, and faculty of IIMs and other academic institutions came together to demand justice. The case led to a speedy trial, and the main accused were convicted and sentenced to life imprisonment, although the death penalty given to one was later commuted.

In the aftermath, the Manjunath Shanmugam Trust was established by his friends and well-wishers to promote ethical governance and support whistle blowers. His sacrifice highlighted the pressing need for not only legal protection for whistle blowers but also stronger corporate governance and accountability mechanisms in public sector undertakings.

ICICI Bank-Videocon Case: The ICICI Bank-Videocon case represents a high-profile instance of alleged corporate misconduct and conflict of interest at the highest levels of India’s banking sector. The controversy centers around Chanda Kochhar, the former Managing Director and CEO of ICICI Bank, who was accused of sanctioning large loans to the Videocon Group, a debt-laden conglomerate, in exchange for personal gains routed through her husband’s business interests.

The issue came to light following a whistle blower complaint that raised questions about the loan approval process and potential quid pro quo arrangements. Investigations revealed that ICICI Bank had sanctioned a loan of approximately ₹3,250 crore to the Videocon Group, which was later classified as a non-performing asset (NPA). Around the same time, NuPower Renewables, a company run by Chanda Kochhar's husband, Deepak Kochhar, allegedly received investments from a firm linked to the Videocon Group.

These revelations triggered multiple investigations by regulatory and enforcement bodies, including the Central Bureau of Investigation (CBI), the Enforcement Directorate (ED), and the Reserve Bank of India (RBI). Chanda Kochhar was asked to step down from her position in 2018, and in 2019, ICICI Bank officially terminated her employment and revoked her entitlements, including bonuses and stock options, citing violations of the bank's code of conduct.

The ICICI-Videocon scandal brought corporate governance practices under intense scrutiny and highlighted the importance of transparency, accountability, and ethical standards in financial institutions. It also showcased the critical role of internal whistle blower mechanisms in detecting unethical practices at senior management levels. The case reinforced the need for banks and financial entities to strengthen their risk assessment frameworks, improve due diligence processes, and ensure that conflicts of interest are adequately disclosed and managed.

Check Your Progress

1. What is whistle blowing?
2. Differentiate between internal and external whistle blowing in one line each.
3. In which year was the Whistle Blowers Protection Act enacted in India?
4. Name any one famous whistle blower in India and the organization they worked for.

20.7 Summing Up

Corporate governance in India faces several persistent challenges, including promoter dominance, weak enforcement of regulations, inadequate protection for minority shareholders, and ethical lapses in corporate behavior. These issues have come to light through major corporate failures and scams such as the Satyam scandal, IL&FS crisis, and DHFL fraud, which exposed serious deficiencies in auditing, regulatory oversight, and internal control systems. One critical aspect undermining fair corporate practices is insider trading—the unethical and illegal act of trading securities based on unpublished, price-sensitive information. Such practices erode investor confidence and market integrity. To counter this, the Securities and Exchange Board of India (SEBI) plays a pivotal role by enforcing disclosure norms, investigating suspicious transactions, and penalizing offenders, as seen in landmark cases involving companies like Reliance Industries and executives from Infosys and Axis Bank. Another important facet of ethical governance is whistle blowing, which involves reporting organizational misconduct or corruption. Whistle blowing can be internal or external and is crucial for promoting transparency and accountability. The Whistle Blowers Protection Act, 2014 was introduced to safeguard individuals who expose wrongdoing in the public interest. However, whistle blowers in India often face serious challenges such as threats, harassment, and lack of institutional support. Notable cases like those of Satyendra Dubey (NHAI), Manjunath Shanmugam (IOC), and the ICICI Bank-Videocon scandal illustrate the risks and importance of whistle blowing in upholding ethical standards in the Indian corporate and financial system.

20.8 Model Questions:

1. Discuss the recent issues and challenges in corporate governance in India with suitable examples.

2. Examine the major corporate failures and scams in India and their impact on the financial system.
3. What is insider trading? Why is it considered unethical and illegal?
4. Critically evaluate the role of SEBI in detecting and preventing insider trading in India.
5. Discuss landmark insider trading cases in India and their implications for market regulation.
6. Define whistle blowing and explain its significance in promoting corporate accountability.
7. Differentiate between internal and external whistle blowing with appropriate examples.
8. What are the key features and limitations of the Whistle Blowers Protection Act, 2014?
9. Discuss the challenges faced by whistle blowers in India and suggest measures to overcome them.
10. Present a detailed analysis of notable whistle blower case studies in the Indian corporate and financial sector.

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