

Corporate Governance
Handout for Foundation Batch
Faculty: Jatin Gupta

Definition

Corporate Governance is the system of rules, practices and processes by which a company is directed and controlled. Corporate governance essentially involves balancing the interests of the many stakeholders like shareholders, management, customers, suppliers, financiers, government and the community in a company

Important principles/values of Corporate Governance

1) Transparency - A corporate entity should take all the necessary measures to keep all the stakeholders' informed about the functioning of the organization. Transparency means openness, a willingness by the company to provide clear information to shareholders and other stakeholders. For example, transparency refers to the openness and willingness to disclose financial performance figures which are truthful and accurate.

2) Accountability - An obligation and responsibility to give an explanation or reason for the company's actions and conduct. The Board of Directors should be made accountable to the shareholders for the way in which the company has carried out its responsibilities.

3) Legality - It should comply with all the laws of the land and should not perform functions contrary to them.

4) Independence - Good corporate governance requires independence on the part of the top management of the corporation, that is the board of directors must be non-partisan and should take all the decisions based on business prudence.

5) Equity and Diversity - Represent different sections of society and promote inclusivity through the appointment of directors and employees from the weaker sections of society.

6) Fairness - Fairness refers to equal treatment, for example, all shareholders should receive equal consideration for whatever shareholdings they hold. In addition to shareholders, there should also be fairness in the treatment of all stakeholders including employees, communities and public officials

Why are Corporate Governance norms needed in India?

Many companies in India, including the large corporate groups, were born as family owned enterprises. Family members occupied managerial positions in such

companies and took all the key business decisions. This practice had blurred the distinction between the company's finances and that of family owners. With the evolution of equity markets, many such family-run businesses listed themselves on the stock markets. This led to a separation of the ownership from the management of firms. Despite this, the promoters continue to wield disproportionate influence over company decisions.

Corporate Governance norms are needed to ensure that a company is run in the interest of all the stakeholders, without the promoters and the management lining their own pockets. Moreover, a company with good corporate governance standards enjoys greater investor confidence, adding value to its share price in the stock markets. Foreign Institutional/Portfolio Investors (FII/FPI) prefer to invest in those companies with good corporate governance.

India has a history of high profile scams like the stock market scams (of Harshad Mehta, Ketan Parekh), UTI scam, Satyam scandal etc. which were termed as the outcomes of failed corporate governance. Hence, there is a need to institutionalize stringent norms surrounding corporate governance to prevent their recurrence.

1) It helps in the brand formation and establishing a strong reputation for a corporate entity which automatically translates into higher profits. Customer relationships are also improved. Ethical governance increases customer loyalty, enhances brand image, and caters to customer service and satisfaction. With ethical business practices, complaints and issues of customers are solved transparently leading to trust in the corporation.

2) Better prospects for investment - It maintains investor confidence as a result of which the company can raise capital efficiently and effectively. **For example -** According to a **study conducted by McKinsey**, institutional investors were willing to **pay an average of 20% more for well-governed companies**.

3) Improved work culture - Corporate governance can have a significant impact on work culture. It ensures greater trust among the employees and results in a positive work environment and therefore higher employee retention rates. It means that a company can save costs associated with the recruitment and training of employees. It provides a proper inducement to the owners as well as managers to achieve objectives that are in the interest of shareholders and the organization.

4) It minimizes wastage, corruption, and mismanagement - In recent times several private entities have been involved in various scams, which have affected the image of the nation. To make India an Investment destination in the future, adherence to the principles of corporate governance is a must. Ineffective corporate governance may result in a financial crisis both for the company and the stakeholders. Shareholders lose confidence in the company and share prices will decline. The high profile corporate governance failure scams like stock market scam, the UTI scam, Ketan Parekh scam, Satyam scam which were severely criticized by the shareholders called for a need to make corporate governance in

India transparent as it greatly affects the development of the country.

5) Role in Public Service Delivery - Corporate entities have been roped in for the delivery of essential public services, ***such as electricity distribution***. Given the dependence of the citizens on the corporate sector, corporate governance has assumed significant importance.

Corporate Governance in India

Corporate governance is not as mature in South Asia like it is in the U.S. or U.K. In India, the effective initiative for corporate governance came from the listed companies and industrial association, Confederation of Indian Industry (CII) in 1997. Ever since India's biggest ever corporate fraud and governance failure unearthed at Satyam Computer Services Limited, the concerns about good corporate governance have increased phenomenally.

In 1999, The Securities and Exchange Board of India (SEBI) made it mandatory for all listed companies in phases. From April 2003, all the listed companies were brought under mandatory requirement to follow the SEBI corporate governance code.

Few New Provisions of Companies Act 2013 for Directors and Shareholders

- One or more women directors are recommended for certain classes of companies
- The maximum permissible directors cannot exceed 15 in a public limited company. If more directors have to be appointed, it can be done only with approval of the shareholders after passing a Special Resolution
- The Independent Directors are a newly introduced concept under the Act. A code of conduct is prescribed and so are other functions and duties
- The Independent directors must attend at least one meeting a year
- Every company must appoint an individual or firm as an auditor. The responsibility of the Audit committee has increased
- Filing and disclosures with the Registrar of Companies has increased
- Top management recognizes the rights of the shareholders and ensures strong co-operation between the company and the stakeholders
- Every company has to make accurate disclosure of financial situations, performance, material matter, ownership and governance
- Whistle Blower Policy- This is a mandatory provision by SEBI which is a vigil mechanism to report the wrong or unethical conduct of any director of the company.

Kotak Committee Recommendations w.r.t Corporate Governance

The Kotak committee has extensively examined the current state of affairs and recommended sweeping changes that will help improve governance and enhance investor confidence. Emphasis has been laid on strengthening the **three gatekeepers**—the board, the auditors and the regulator. It focused on the following:

Independent Directors

- Their strength should be increased from 33% to 50% of the board to protect small investors.
- No board meeting can be conducted without the presence of an independent director.
- Suggested measures so that independent directors inducted in the board are truly independent.

Regarding Audit:

- An audit committee to look into utilization of funds infused by a listed entity into unlisted subsidiaries, including foreign subsidiaries.
- It covers issues in accounting and auditing practises by listed companies and seeks to improve the effectiveness of board evaluation practises.

Strengthening the regulator:

- Strengthening the role of the market regulator to improve the governance practises at listed entities.
- SEBI should have the power to act against auditors if the need arises. • SEBI to develop capabilities to be able to regulate listed companies more effectively and protect the interests of small shareholders.

Other Reforms:

- For government companies, it recommended that the board have final say on the appointment of independent directors and not the nodal ministry.
- It made some radical suggestions to improve the safeguards and disclosures pertaining to related-party transactions.

Although most of the recommendations in the committee's report are incremental in nature, there are a few far-reaching as well, they aim to strengthen corporate governance further particularly in the realm of implementation. These would help in realizing the objectives of Companies Act 2013 and SEBI's subsequent reforms for improving Corporate Governance.

Corporate Social responsibility (CSR)

CSR or Corporate Social responsibility is also referred to as corporate citizenship and is a process by which an organization thinks about and evolves its relationship with various stakeholders for the common good and demonstrates its commitment in this respect by adopting appropriate business processes and strategies.

CSR is not charity or mere donation, but rather a way of conducting business by

which corporate entities contribute to the social good. A socially responsible company should not be limited to using resources to engage in activities that only increase their profits, they must use CSR to integrate economic, environmental, and social objectives with the company's operations and growth.

Advantages of promoting Corporate Social Responsibility

Corporate social responsibility is based on the premise that a business can only thrive if it operates within a thriving society. In that way, the business depends on the community it operates within, and as such, has an ethical and moral responsibility towards that community. A business is perceived as legitimate when its activities are congruent with the goals and values of the society in which the business operates.

Consumers and other companies are likely to shun firms that develop unethical reputations. And arguably, companies that don't pay attention to their social and ethical responsibilities are more likely to stumble into legal troubles, such as mass corruption or accounting fraud scandals – threatening the sustainability of the business itself.

By promoting respect for the company in the marketplace, CSR can result in higher sales, enhance employee loyalty and attract better personnel to the firm. It is also a way to connect to the personal well-being of customers. In this way, the CSR can contribute towards higher profits for the company.

Therefore, by ensuring brand loyalty and consumer patronage, CSR can ensure that the business remains sustainable in the long-term and it stays profitable.

Components of Corporate Social Responsibility

1) Business Ethics - Businesses should integrate core values, such as honesty, trust, respect, and fairness into their policies, practices, and decision-making. It should also adhere to legal standards and rules and regulations.

2) Employee welfare - Good CSR practices should focus on improving the workplace in terms of health and safety, as well as focus on a healthy balance between work and non-work life. CSR activities should also focus on the Diversity of the workforce and include people from marginalized sections of society.

A responsible company should prevent sexual harassment in the workplace and promote respect for the diversity of cultures.

3) Influencing the supply chain- If anyone from the supply chain neglects social, environmental, and human rights concerns it may reflect badly on a company. Therefore, it must use its position to influence the **entire supply chain to adopt ethical business practices**.

4) Environmental concerns- CSR also means that a company should go beyond mandatory requirements and deliver environmental benefits. It would include finding sustainable solutions and reducing adverse impacts on the environment.

Such as ***the reduction of pollutants and emissions*** as well as producing environment-friendly goods and services.

5) Community Empowerment- A socially responsible company must make a positive change in the lives of the local community by executing various projects in partnership with the community.

Legal provisions related to CSR under the Companies Act 2013

- Companies have a net worth of **500 crores or more** (or)
- Companies having an annual turnover of **1000 crores or more** (or)
- Companies having a net profit of **5 crores or more**.

According to the act,

- Companies must constitute a CSR committee of the board comprising 3 or more directors, out of which at least 1 must be an independent director. • The board should report the composition of the committee in its annual report.
- Any such company must spend at least **2% of its average annual profit of the last 3 years**.

Examples of activities permitted under CSR -

- Promotion of Education.
- Eradicating hunger and poverty.
- Gender Equality and women empowerment.
- Improvement in maternal health.
- Ensuring environmental sustainability.
- Livelihood development/skill development.
- Contribution to PM National Relief Fund.

According to the company's Act, Companies must give preference to the local areas in which they operate

Handout for Ethics in Governance

VISION IAS

Faculty: Jatin Gupta

Ethics in International Relations

Ethics in IR refers to the application of morality and principles in solving the various ethical dilemmas that a country faces in the conduct of its International relations with various countries.

The basic issue that countries face in IR is how to reconcile one's national interests with the values one believes in.

Most countries claim their commitment to universal values and try their best to adhere to them. But on many occasions, they find it difficult to guide their actions as per the values they profess.

What is national interest?

Reflects the goals and objectives of a nation in military, cultural, and economic spheres.

Some sources of International Ethics

- UN Declaration of Human Rights
- Geneva Convention for humanitarian treatment in War
- Refugee Convention 1951
- The Paris Climate Deal under UNFCCC ensures climate justice by adopting CBDR (Common but differentiated Responsibility) principle in climate resolve.
- The World Trade Organization (WTO) and its TRIPS agreement address the ethical issues involved in global trade and Intellectual Property Rights.
- There are multiple laws and treaties to address ethical issues regarding the four Global Commons- The High Sea (UNCLOS), the Atmosphere, Antarctica, Outer Space.

Importance of ethics in International Relations

- Ethics help in avoiding the "ego clash" & "ideological clash" between two or more nations.
- Ethics aim at peaceful world, respect for all & equality
- International ethics guides international relations and resolution of international conflicts such as terrorism, territorial disputes and refugee crisis.
- International ethics guides the international environmental efforts to fight against ozone depletion, global warming, etc which are common shared problems and which require actions from many nations who are major contributors to forces generating such problems.
- Collective security efforts such as economic sanctions and military actions against an aggressor state and that the international sphere contains a criminal tribunal for certain international violations.

- Natural disasters and refugee crisis situations require more compassionate view of global community. These are not isolated events and duty of every global citizen to help in the times of crisis.
- Trafficking of human especially women and child is a serious issue and cannot be tackled alone

In August of 1961, Germany and Berlin were split between east and west, resulting in the Berlin Crisis. During the Berlin Crisis, the Soviets attempted to sabotage West Germany and Berlin by blockading their access to food, water, and other basic necessities. The United States and Britain responded by airlifting supplies to Berlin. People may have died without the help of the US and Britain, and it may have been the two nation's leaders' ethical senses that led them to give aid to West Berlin in their time of need.

In 2017, Donald Trump has adopted an "America First" approach to governing the United States. The ethics regarding this decision have been put into question by the international system. President Trump's defiance of free trade, with his desire to place high tariffs on foreign allies to boost America's economy, has been labeled unethical by international leaders.

3 Major approaches to resolve ethical dilemmas in IR

- **Realism:** Most common approach in International Politics. It assumes IR is guided by national self-interest. According to this approach, morality is not an important consideration in a nation's action. In fact, what motivates or guides a nation's actions is its self-interest.
- **Idealism:** Ideals such as peace, human rights, and global justice. According to such people, the goals and means of foreign policy should be based on morality.
- **Principled Realism:** Based on a combination of the first 2 approaches. According to this approach, Foreign policy involves the pursuit of interests based on power as well as fundamental moral values.

Incorporating morality while making decisions serving national interests

- **End based approach/consequentialism:** Action should be judged by its outcomes. Eg- Reliance on nuclear deterrence by US during the cold war era, where the US tried to deter Soviet aggression with the threat of nuclear retaliation. Based on the consequences/end based.
- **Rule-based approach/deontological approach:** According to this approach, morality is fulfilled when action is aspired by fundamental moral obligations. Eg In 1921-22, the US provided famine relief to the Soviet Union even as the US was trying to weaken the new soviet regime. In the 1990s as well Us relied on this approach to justify the food aid to North Korea, even though it regarded North Korea as an enemy state.
- **Tri-dimensional ethics:** An approach that seeks to overcome end based and rule-based decision making by integrating both the approaches. According to this approach, for foreign policymaking to be fully consistent with morality, the goals and results of action must be moral. It is difficult to fulfil.

Elements of ethics in IR

- **Human rights at the heart of the foreign Policy:** Support to democratic rights of the people anywhere in the world is fundamental constituent of an Ethical Foreign policy or in short ethical foreign policies have cosmopolitan virtues.
- **Commitment to multilateralism, prosperity and environmentalism:** It strives to achieve global consensus around issues of universal importance such as Environment, Poverty and Inequality etc.
- **Global Justice and Responsibility to protect:** To act decisively against any act of injustice around the world under the doctrine of responsibility to protect is another constituent of ethical foreign policy.
- **Principle of sacrifice:** According to this principle, if it is in power of any nation to prevent something very bad from happening, for example death due to starvation or genocide, without thereby sacrificing anything of comparable moral significance, one ought to do it.

Ethical challenges/issues in IR

- Neo-colonialism in the name of international Aid rather than aiming at uplifting poverty.
- Issues of Human rights violations being ignored by countries at their convenience
- Lack of responsibilities by the developed countries regarding Global Commons
- International Diplomacy is guided by narrow national interests rather than common global agendas. For example, Terrorism is still not defined internationally.

Dilemma in International relations

- **Ethical belief vs national interest:** India cultivated cordial relationship with Myanmar Junta even though they were involved in gross violation of democratic rights of their citizens.
- **Commercial interest vs bilateral obligations:** Investing in profitable petroleum extraction of Myanmar or in loss making but strategically important Sri Lankan airport
- **Terrorism**

Ethical Issues associated with terrorism

- Preserving human life and rights.
- Recruiting children and women for terrorist activities.
- Good Terrorist vs Bad terrorist.
- Use of violence to suppress terrorism. etc.
- **Refugee Crisis**

Whenever a nation witnesses incoming of refugees to its own territory, ethical debates

comes up because of various questions like:

1. Diversion of limited resources and settlement related issues.
2. Hostility from the other nation
3. Long term implications in case of political dissidents
4. Gentle gesture toward refugees may invite environmental and poverty refugees in future

- **International Aid**

Ethical Arguments for Foreign Aid

- Global Justice
- Helps in building the capacity and empowering local development actors
- Complexities of responding to newly emerging problems

Issues and Criticism

- Proliferation of monoculturalism.
- Self-interest driven nature of foreign aid.
- Hampers National Security. Last year, India banned several Chinese apps and made FDI through government routes mandatory for investments from neighbouring countries
- Modern technologies are preserved for profit motives. Etc.
- Interference in electoral process. There have been allegations by some western countries against covert Russian meddling in their elections. Such incidents can happen in India as well.
- Sovereignty VS Foreign aid. IMF loans to India after the 1991 economic crisis came with severe conditions on macroeconomic policy. Chinese debt trap funding in Pakistan

Refugee Crisis

The principle of no-refoulement is the cornerstone of asylum and of international refugee law. This principle reflects that the commitment of the international community to ensure to all person the enjoyment of human rights, including the rights to life, to freedom from torture or cruelty inhuman or degrading treatment or punishment, and to liberty and security of person. These and other rights are threatened when a refugee is returned to the country where they would face persecution or human right violation. Recently, European countries faced an influx of refugees from war torn Syria and Iraq. Similarly, large number of Rohingyas fled Myanmar and are living in refugee camps spread across Bangladesh and India. There are instances when nations which are perceived as examples of democracies closing their border on these refugees or returning back these refugees to the country where they would meet the fate from which they ran away.

Keeping in mind the UN declaration of Human Rights, these closing of borders and policy of

refoulment adopted in recent refugee crisis has raised several ethical concerns with respect to following:

- Basic human right: By being a citizen, one is granted rights. However, there are certain basic rights which must not only be granted but also be guaranteed by all countries. The most basic is the right to life. Humanity must be treated as end itself.
- Humanitarian responsibility of countries: If no state is willing to accept refugees, they become stateless and may be forced to live in camps, or as illegal migrants. Often, they cannot legally work, or educate their children. Humanitarianism demands that humans accord respectful treatment and meaningful assistance to fellow beings and especially to the vulnerable.
- Doubts raised over the concept of global citizenship and shared responsibility of states: Though countries helping each other in terms of financial resources, there is still a stiff resistance to accept immigrants and refugees even among developed countries thus not sharing the resource burden and justifying their economic capability.
- Lack of empathy towards asylum seeker: It also raises serious questions on democratic values of these countries as this step of refoulment shows lack of empathy of these countries towards the right to live of refugees.

Role of ethics in enhancing comprehensive national power

In present times, military might has reduced to just one component of the comprehensive national power (CNP) or international stature held by nation. Other elements are equally important, for e.g. human capital, which has a constructive and forward looking agenda, soft power including culture and policies, high economic growth as well as social cohesion among different sections of society.

The concept of CNP is based on harmonious relationships between these components and CNP is maximised when these components support each other.

Role of ethics and values in enhancing CNP

- **Human Capital**
 - The development of human capital or human capability demands an environment of freedom and institutions which promote education and free thinking- the basis of all innovations and enterprises.
 - Thus, ethics place a central role in the development of human capital. For example - **ethics of sharing** leads to establishment of the right conditions to exchange knowledge, ultimately resulting into enhanced capabilities and performance by nation as a whole due to the increase in their innovative potential.
 - In fact human capital is built around **shared values**, where individuals and groups are able to trust each other and work together towards a common shared goal. Thus, at its core, human capital involves **willingness of individuals to look beyond their self-interest**.
- **Soft Power (culture and policies)**

- o Ethical stance in international matters helps enhance the soft power of a nation. This can be understood from the following examples.
- o The lack of importance given to ethics and mutual respect to the other nations by **China has undermined its soft power** and good-will in different countries. The aggressive military posturing and forceful approach to democracy has actually put a dent in its soft power.
- o In fact, for developing soft power, a nation has to proactively provide an attractive model of governance based on **ethics of freedom, shared values and preserving space for their citizens** to provide compelling cultural contributions at a grassroots level.
- **Social Harmony**
 - o Without ethics and values, it is not possible to attain social harmony in a nation. The nation has to believe in the ethics of **equity and inclusiveness** for its society to work in cohesion.
 - o In fact, **feelings of empathy and concern for others** developed through contact and interaction with them, provides crucial reinforcement for trust and cooperation among society.
 - o **Values of justice and fairness** go on to play a crucial role in establishing harmonious relationships among people belonging to different classes, religion and caste.
 - o In fact, disharmony obstructs growth of appropriate institutions.

In fact, ethics and values are the underlying theme with respect to the aim of the state itself. As per **Kautilya's Arthashastra**, the state should always aim at establishing peaceful enjoyment of prosperity and welfare of the subject.