

---

LESSON NO. 2.1

---

**BUSINESS ETHICS**

**Structure of the Lesson:**

- 2.1.0 Learning Objectives**
- 2.1.1 Introduction**
- 2.1.2 Definition & Nature of business ethics:**
- 2.1.3 Scope of Business Ethics**
- 2.1.4 Features of Business Ethics**
- 2.1.5 Need and Importance of business ethics**
- 2.1.6 Code of Ethics**
- 2.1.7 Summary**
- 2.1.8 Exercise**
- 2.1.9 Suggested Readings**

**2.1.0 Learning Objectives**

The major objective of this lesson is to provide knowledge about Business Ethics, by focusing on its need and importance for better understanding of the concept.

**2.1.1 Introduction**

Some years ago, one sociologist asked business people, "What does an ethic mean to you?" Among their replies were the following:

"Ethics has to do with what my feelings tell me is right or wrong." "Ethics has to do with my religious beliefs."

"Being ethical is doing what the law requires."

"Ethics consists of the standards of behavior our society accepts." "I don't know what the word means."

**2.1.2 Definition & Nature of business ethics:**

The term "ethics" is derived from the Greek word "ethos" which refers to character or customs or accepted behaviors. The Oxford Dictionary states ethics as "the moral principle that governs a person's behavior or how an activity is conducted". The synonyms of ethics as per Collins Thesaurus are - conscience, moral code, morality, moral philosophy, moral values, principles, rules of conduct, standards. Ethics refers to well- founded standards of right and wrong that prescribe what humans ought to do, usually in terms of rights, obligations, benefits to society, fairness, or specific virtues.

Ethics is a set of principles or standards of human conduct that govern the behavior of individuals or organizations. Using these ethical standards, a person or a group of persons or an organization regulate their behavior to distinguish between what is right and what is wrong as perceived by others. It is not a natural science but a creation of the human mind. For this reason, it is not absolute and is open to the influence of time, place and situation. In bygone times, kings used to keep food

testers who ate the food prepared for the king before it was offered to him. This was royal clinical research to find out if the food was poisoned. The practice did not raise eyebrows because the king was regarded as the most important person in the kingdom, and his life was more precious than that of anyone else. It was the ethics of the time.

- Ethics can be defined as the discipline dealing with moral duties and obligation, and explaining what is good or not good for others and for us.
- Ethics is the study of moral decisions that are made by us in the course of performance of our duties.
- Ethics is the study of characteristics of morals and it also deals with the moral choices that are made in relationship with others.
- Ethics is concerned with truth and justice, concerning a variety of aspects like the expectations of society, fair competition, public relations, social responsibilities and corporate behavior.

### **Business Ethics**

Business ethics is a form of applied ethics. In broad sense ethics in business is simply the application moral or ethical norms to business. Business ethics refers to a 'code of conduct' which businessmen are expected to follow while dealing with others. 'Code of conduct' is a set of principles and expectations that are considered binding on any person who is member of a particular group. The alternative names for code of conduct are 'code of ethics' or 'code of practice'. Business ethics comprises the principles and standards that guide behaviour in the conduct of business. Businesses must balance their desire to maximize profits against the needs of the stakeholders. Maintaining this balance often requires tradeoffs. To address these unique aspects of businesses, rules - articulated and implicit, are developed to guide the businesses to earn profits without harming individuals or society as a whole.

The coverage of business ethics is very wide as it deals with norms relating to a company and its employees, suppliers, customers and neighbors, its fiduciary responsibility to its shareholders. It reflects the philosophy of business, one of whose aims is to determine the Fundamental purposes of a company.

Business ethics stands for the saneness or purity of purpose that is upheld through carefully designed actual practices of business enterprises. It is an embodiment of conscience concern towards execution of business processes in tune with the nobility of the purpose.

### **Definition of Business Ethics**

According to **Andrew Crane**, "Business ethics is the study of business situations, activities, and decisions where issues of right and wrong are addressed."

According to **Raymond C. Baumhart**, "The ethics of business is the ethics of responsibility. The business man must promise that he will not harm knowingly."

### 2.1.3 SCOPE OF BUSINESS ETHICS

Ethical problems and phenomena arise across all the functional areas of companies and at all levels within the company which are discussed below:

#### **Ethics in Compliance**

Compliance is about obeying and adhering to rules and authority. The motivation for being compliant could be to do the right thing out of the fear of being caught rather than a desire to be abiding by the law. An ethical climate in an organization ensures that compliance with law is fuelled by a desire to abide by the laws. Organizations that value high ethics comply with the laws not only in letter but go beyond what is stipulated or expected of them.

#### **Ethics in Finance**

The ethical issues in finance that companies and employees are confronted with include:

- In accounting - window dressing, misleading financial analysis.
- Related party transactions not at arm's length
- Insider trading, securities fraud leading to manipulation of the financial markets.
- Executive compensation.
- Bribery, kickbacks, over billing of expenses, facilitation payments.
- Fake reimbursements

### 2.1.4 FEATURES OF BUSINESS ETHICS

The characteristics or features of business ethics are:-

1. **Code of conduct:** Business ethics is a code of conduct. It tells what to do and what not to do for the welfare of the society. All businessmen must follow this code of conduct.
2. **Based on moral and social values:** Business ethics is based on moral and social values. It contains moral and social principles (rules) for doing business. This includes self-control, consumer protection and welfare, service to society, fair treatment to social groups, not to exploit others, etc.
3. **Gives protection to social groups:** Business ethics give protection to different social groups such as consumers, employees, small businessmen, government, shareholders, creditors, etc.
4. **Provides basic framework:** Business ethics provide a basic framework for doing business. It gives the social cultural, economic, legal and other limits of business. Business must be conducted within these limits.

5. **Voluntary:** Business ethics must be voluntary. The businessmen must accept business ethics on their own. Business ethics must be like self-discipline. It must not be enforced by law.
6. **Requires education and guidance:** Businessmen must be given proper education and guidance before introducing business ethics. The businessmen must be motivated to use business ethics. They must be informed about the advantages of using business ethics. Trade Associations and Chambers of Commerce must also play an active role in this matter.
7. **Relative Term:** Business ethics is a relative term. That is, it changes from one business to another. It also changes from one country to another. What is considered as good in one country may be taboo in another country.
8. **New concept:** Business ethics is a newer concept. It is strictly followed only in developed countries. It is not followed properly in poor and developing countries.

#### 2.1.5 NEED AND IMPORTANCE OF BUSINESS ETHICS

1. **Stop business malpractices:** Some unscrupulous businessmen do [business](#) malpractices by indulging in unfair [trade](#) practices like black-marketing, artificial high pricing, adulteration, cheating in weights and measures, selling of duplicate and harmful products, hoarding, etc. These business malpractices are harmful to the consumers. Business ethics help to stop these business malpractices.
2. **Improve customers' confidence:** Business ethics are needed to improve the customers' confidence about the quality, quantity, price, etc. of the products. The customers have more trust and confidence in the businessmen who follow ethical rules. They feel that such businessmen will not cheat them.
3. **Survival of business:** Business ethics are mandatory for the survival of business. The businessmen who do not follow it will have short-term success, but they will fail in the long run. This is because they can cheat a consumer only once. After that, the consumer will not buy goods from that businessman. He will also tell others not to buy from that businessman. So this will defame his image and provoke a negative publicity. This will result in failure of the business. Therefore, if the businessmen do not follow ethical rules, he will fail in the [market](#). So, it is always better to follow appropriate code of conduct to survive in the market.
4. **Safeguarding consumers' rights:** The consumer has many rights such as right to health and safety, right to be informed, right to choose, right to be heard, right

to redress, etc. But many businessmen do not respect and protect these rights. Business ethics are must to safeguard these rights of the consumers.

5. **Protecting employees and shareholders:** Business ethics are required to protect the interest of employees, shareholders, competitors, dealers, suppliers, etc. It protects them from exploitation through unfair trade practices.
6. **Develops good relations:** Business ethics are important to develop good and friendly relations between business and society. This will result in a regular supply of good quality goods and services at low prices to the society. It will also result in profits for the businesses thereby resulting in growth of economy.
7. **Creates good image:** Business ethics create a good image for the business and businessmen. If the businessmen follow all ethical rules, then they will be fully accepted and not criticised by the society. The society will always support those businessmen who follow this necessary code of conduct.
8. **Smooth functioning:** If the business follows all the business ethics, then the employees, shareholders, consumers, dealers and suppliers will all be happy. So they will give full cooperation to the business. This will result in smooth functioning of the business. So, the business will grow, expand and diversify easily and quickly. It will have more sales and more profits.
9. **Consumer movement:** Business ethics are gaining importance because of the growth of the consumer movement. Today, the consumers are aware of their rights. Now they are more organised and hence cannot be cheated easily. They take actions against those businessmen who indulge in bad business practices. They boycott poor quality, harmful, high-priced and counterfeit (duplicate) goods. Therefore, the only way to survive in business is to be honest and fair.
10. **Consumer satisfaction :** Today, the consumer is the king of the market. Any business simply cannot survive without the consumers. Therefore, the main aim or objective of business is consumer satisfaction. If the consumer is not satisfied, then there will be no sales and thus no profits too. Consumer will be satisfied only if the business follows all the business ethics, and hence are highly needed.
11. **Importance of labour:** [Labour](#), i.e. employees or workers play a very crucial role in the success of a business. Therefore, business must use business ethics while dealing with the employees. The business must give them proper wages and salaries and provide them with better working conditions. There must be good

relations between employer and employees. The employees must also be given proper welfare facilities.

12. **Healthy competition** : The business must use business ethics while dealing with the competitors. They must have healthy competition with the competitors. They must not do cut-throat competition. Similarly, they must give equal opportunities to small-scale business. They must avoid [monopoly](#).

### 2.1.6 Code of Ethics

These are statements of behavioral ideals, exhortations, or prohibitions common to a culture, religion, traditional profession, corporations and trade associations. Codes combine philosophical with admonitions to avoid certain illegal actions and espouse certain moral principles, especially those that elevate personal behavior. The Ten Commandments is the most well-known code of ethics known worldwide. In addition, we have all heard of Code of ethics in the form of Hippocratic Oath that all the Doctors are supposed to take prior to being awarded permission to practise medicine. Poor ethics can shape business productivity, so follow Ten Commandments of Ethical Business Behavior:

1. Be honest, truthful, forthright, candid and sincere.
2. Have integrity: Strive to be scrupulous.
3. Keep your word and abide by the spirit as well as the letter of the law.
4. Maintain fidelity: Be faithful and never disclose confidential information.
5. Always be fair: Demonstrate a commitment to justice, with equal treatment of all.
6. Care for others: Be kind.
7. Respect others in every way.
8. Be a responsible citizen. Obey just laws and protest unjust ones.
9. Rigorously pursue excellence. Never be content with mediocrity.
10. Always be accountable: good leaders lead by example

### 2.1.7 Summary

The present lesson provides knowledge about the business ethics in detail. Business ethics refers to a 'code of conduct' which businessmen are expected to follow while dealing with others. Business ethics comprises the principles and standards that guide behavior in the conduct of business. The scope of business ethics arise across all the functional areas of companies and at all levels within the company. The chapter highlights benefits to company for adopting business ethics.

### 2.1.8 Exercise

#### Short answer questions

- Q.1 Explain business ethics
- Q.2 Code of Ethics.
- Q.3 Scope of Business ethics.

**Long answer questions**

- Q.1 Explain business ethics in detail. Write down its need and importance to the company.
- Q.2 What is the nature of business ethics. Explain its scope in detail.

**2.1.9 Suggested Readings**

1. Bhanu Murthy, K. V. and Usha Krishna: Politics Ethics and Social Responsibilities of Business, Pearson Education, New Delhi. Business, Pearson Education, New Delhi.
2. J. P. Sharma: Corporate Governance, Business Ethics & CSR, Ane Books Pvt. Ltd., New Delhi.

---

**LESSON NO. 2.2**

---

**Principles and Theories of Business Ethics****Structure of the Lesson:**

- 2.2.0 Learning Objectives
- 2.2.1 Theories of Business Ethics
  - 2.2.1.1 Teleological Ethical Theories
  - 2.2.1.2 Deontological Ethical Theories
  - 2.2.1.3 Virtue Ethical Theories
  - 2.2.1.4 System Development Ethical Theories
- 2.2.2 Principles of Business Ethics
- 2.2.3 Summary
- 2.2.4 Exercise
- 2.2.5 Suggested Readings

**2.2.0 Learning Objectives :**

The objective of this lesson is to provide information about theories of Business Ethics in detail and different principles involved in the business ethics.

**2.2.1 THEORIES OF BUSINESS ETHICS :**

The **Ethics** is the branch of philosophy that deals with the principles of morality and the well-defined standards of right and wrong that prescribe the human character and conduct in terms of obligations, rights, rules, benefit to society, fairness, etc.

In other words, the ethics encompass the human rights and responsibilities, the way to lead a good life, the language of right and wrong, and a difference between good and bad. This means it is concerned with what is right or wrong for the individuals and society. The term "**ethics**" have been derived from the Greek word "**ethos**" which means character, habit, disposition or custom. Several philosophers have propounded different types of ethical theories which are listed below:



- 2 [Teleological Ethical Theories](#)
- 3 [Deontological Ethical Theories](#)
- 4 [Virtue Ethical Theories](#)
- 5 [System Development Ethical Theories](#)

Further, ethics can be classified into three major study areas:

**Meta-ethics** is concerned with the theoretical meaning of morality and ethical principles, i.e. what we understand when we talk about what is right or wrong.

- **Normative ethics** deals with the content of moral judgments i.e. determining the moral course of action and includes the criteria for what is right or wrong, good or bad, kind or evil, etc.
- **Applied ethics** is concerned with the actions which a person is obliged to perform in a particular situation.

Thus, ethics are the well-defined standards that impose obligations to refrain human beings from any misconduct, which could be harmful to the self as well as for the society.

#### 2.2.1.1 Teleological Ethical Theories

**Definition:** The **Teleological Ethical Theories** are concerned with the consequences of actions which mean the basic standards for our actions being morally right or wrong depends on the good or evil generated. The following are the types of Teleological Ethical Theories

- a) **Ethical Egoism:** The ethical egoism is a teleological theory that posits, an action is good if it produces or is likely to produce results that **maximize the person's self-interest** as defined by him, even at the expense of others. It is based on the notion that it is always moral to promote one's own good, but at times avoiding the personal interest could be a moral action too. This makes the ethical egoism different from the **psychological egoism** which holds that people are self-centered and self-motivated and perform actions only with the intention to maximize their personal interest without helping others, thereby denying the

reality of true altruism (sacrificing one's personal interest in the welfare of others).

b) **Utilitarianism:** The Utilitarianism theory holds that an action is good if it results in **maximum satisfaction for a large number of people** who are likely to get affected by the action. Suppose a manager creates an annual employee vacation schedule after soliciting the vacation time preferences from all the employees and honor their preferences, then he would be acting in a way that shall maximize the pleasure of all the employees.

c) **Eudaimonism:** Eudaimonism is a teleological theory which posits, that an action is good if it results in the **fulfillment of goals along with the welfare of the human beings**. In other words, the actions are said to be fruitful if it promotes or tends to promote the fulfillment of goals constitutive of human nature and its happiness. Suppose manager enforce employee training and knowledge standards at work, which are natural components of human happiness.

Thus, a moral theory that maintains that the rightness or wrongness of actions solely depends on their consequences is called as a teleological theory.

#### 2.2.1.2 Deontological Ethical Theories

**Definition:** The **Deontological Ethical Theories** hold that the actions are morally right independent of their consequences. A theory asserts that the rightness or wrongness of actions does not depend on the goodness or badness of their consequences. The following are the types of **Deontological** Ethical Theories:

a) **Negative and Positive Rights Theories:** The negative rights theory asserts that an action is right if it protects the individual from harm or unwarranted interference from other people or the government while exercising his right. Suppose an individual has the right to use, sell or dispose of his personal car then the other persons have the correlative duty to not to prevent him from doing whatever he want to do with his car.

The positive rights theory posits that an action is right if it provides or tends to provide an individual with anything that he needs to exist. Suppose an individual has the right to adequate health care services to survive this means other agents, perhaps the government has the correlative duty to provide him with the necessary health care services.

- b) **Social Contract Theories:** The social contract theories posit that people contract with each other to abide by the moral and political obligations towards the society in which they live. This theory is based on the notion that if there is no order and law in the society, then people will have unlimited freedoms, i.e. the right to all things and will resort to all misdeeds such as rape, murder, plunder, etc.

Thus, there will be an endless “war of all against all” and in order to overcome such situation people enter into an agreement with each other to give up some of their freedoms and accept the obligation to respect and safeguard the rights of the others. Thus, an individual gains the civil rights that constitute the social benefits that he is entitled to the extent he fulfills his due obligations towards the society.

- c) **Social Justice Theories:** The social justice theories state that the action will be considered right if it confirms the fairness in the **distributive, retributive and compensatory dimensions** of cost and rewards. The distributive dimension means the perceived fairness in the distribution of social benefits and burden among the group members. The retributive dimension considers the punishment proportionate to the extent of crime while the compensatory dimension is the way people are compensated in relation to the injuries inflicted upon them. For example, if the second-hand smoke hurts the passive or non-smokers at work, there should be a fair distribution of health risk burden and the proportionate punishment should be imposed on the party responsible for it. Also, the affected parties shall be compensated to the extent they have suffered the injuries.

### 2.2.1.3 Virtue Ethical Theories

**Definition:** The **Virtue Ethical Theories** hold that ethical value of an individual is determined by his **character**. The character refers to the virtues, inclinations and intentions that dispose of a person to be ready to act ethically. The Virtue Ethical Theories are based on the notion that developing a sound character is what the life is all about. The character builds a substantive moral foundation for one's actions. It is believed that a person with the strong character has imbibed emotional, intellectual, moral and social virtues to achieve the self-discipline and do the right thing or want what is actually good for him. Whereas, the person with weak character finds himself doing all the wrong things, wanting what is truly harmful and making excuses for all his ill doings. The following are the major types of Virtue Ethical Theories:

1. **Individual Character Ethics:** The individual character ethics hold that the identification and development of noble human traits help in determining both the instrumental and intrinsic value of human ethical interactions. These noble traits are courage, self-discipline, prudence, gratitude, wisdom, sincerity, understanding, benevolence, etc.
2. **Work Character Ethics:** The identification and development of reflective, practitioner, noble traits at works such as creativity, honesty, loyalty, honor, trustworthiness, civility, dependability, shared work pride, empathy, etc. determine the intrinsic and instrumental ethical quality of work life. **For example,** Suppose a manager is facing global competition, huge productivity expectations and requires an effective teamwork, then his work character behavior should be such that he is considered as a role model for task accomplishment and his considerate relations with everyone at the workplace.
3. **Professional Character Ethics:** The professional character ethics hold that self-regulation, loyalty, impartial judgment, altruism, truthfulness, public service determine the intrinsic and instrumental ethical quality of an individual associated with some communities. **For example,** if a business manager of a firm of doctors

detects the double billing for the OT's services, then his ethical professional behavior will enforce him to inform about this to the doctors-in-charge to get the problem solved. And in case the problem still persists, then he will act as a whistleblower and inform about this to the public outside and will not be silent until the problem is rectified. He does all this because of his loyalty towards the professional code of ethics.

#### 2.2.1.4 System Development Ethical Theories

**Definition:** The **System Development Ethical Theories** state that the extent to which organization system is sensitive to the need to develop a work culture supportive of ethical conduct determines the ethical value of actions. The managers who cautiously assess the moral conduct of his employees and retribute (punish) their wrong doings then he is said to have successfully developed the system of ethics. In case, the manager relies exclusively on the character of his employees and do not implement morally supportive Intra-organizational systems and stable processes; then the organization is exposed to the future ethical risk. The major types of System Development Ethical Theories:

a) **Personal Improvement Ethics:** The personal improvement ethics posits that the action is good if it is intended to promote the individual's personal responsibility for the continuous learning, improvement, holistic development and moral excellence.

**For example,** the employees in order to gain expertise in their work enroll in the company's training programmes with a view to improving themselves as well as the organization's functioning.

b) **Organizational Ethics:** The organizational ethics hold that the action is right if it confirms the development of the formal and informal organizational processes which in turn enhances the procedural outcomes, respectful caring, innovation in ethical work culture and systematic justice. **For example,** If there is no employee complaints redressal system in the organization and also the employees do not have

a voice system for feedback then it is the responsibility of the manager to implement such system and give a voice to the employee. By doing so, the manager supports individual and organizational moral development and reduces the intense resistance to the overall moral development.

c) **Extraorganizational Ethics:** The extra organizational ethics asserts that the action is right if it promotes or tends to promote the collaborative partnerships and respect the global and domestic constituencies representing the diverse political, economic, legal, social ecological and philanthropic concerns that affect the firm. **For example,** it is the social responsibility of a manager to consider all the factors external to the organization such as political, legal, social, environmental, etc. that can affect the organizational business processes.

### 2.2.2 PRINCIPLES OF BUSINESS ETHICS

These are the set of principles and practices; that determine acceptable behavior in the business organization. It guides the managers and other executives in taking everyday business decisions. It stresses on the impact of the business decision on the stakeholders, such as employees, consumers, government, society, investors, shareholders and so on.

The important rules or principles of business ethics are as follows:-

1. **Avoid exploitation of consumers:** Don't cheat and exploit consumers by using bad [business](#) practices such as artificial price rise and adulteration.
2. **Avoid profiteering:** Don't indulge in unscrupulous activities like hoarding, black-marketing, sale and use of banned or harmful goods, etc., for the sake of greed to earn exorbitant profits.
3. **Encourage healthy competition:** Don't destroy a healthy competitive atmosphere in the market which offers certain benefits to the consumers. Do not engage in a cut-throat competition. Avoid making attempts to malign and spoil the image of competitors by unfair means.

4. **Ensure accuracy** : Always check and verify the accuracy in weighing, packaging and quality while supplying goods to the consumers.
5. **Pay taxes regularly** : Pay [taxes](#) and other charges or duties to the government honestly and regularly. Avoid bribing government officials and lobbying for special favours.
6. **Get accounts audited** : Maintain accurate business records, accounts and make them available to all authorised persons and authorities.
7. **Fair treatment to employees** : Pay fair wages or salaries, provide facilities and incentives and give humane treatment to employees.
8. **Keep investors informed** : Supply reliable information to shareholders and investors about the financial position and important decisions of the company.
9. **Avoid injustice and discrimination** : Avoid injustice and partiality to employees in transfers and promotions. Avoid discrimination among them based on gender, race, religion, language, nationality, etc.
10. **No bribe and corruption** : Don't give expensive gifts, secret commissions, kickbacks, payoffs to politicians, bureaucrats, government officials and suppliers. Say no to bribe and avoid corruption.
11. **Discourage secret agreement** : Do not make a secret agreement with other businessmen for controlling production, distribution, pricing or for any other activity, which is harmful to the consumers.
12. **Keep service before profit** : Accept the principle of "service first and profit next." The customer or consumer is the most important part of any business. All business activities are done for meeting his needs and for increasing his satisfaction and welfare.

13. **Practice fair business** : Make your business fair, humane, efficient and dynamic. Give the benefits of these qualities to the consumers.
14. **Avoid monopoly** : Avoid forming private [monopolies](#) and concentration of economic power. Monopolies are bad for consumers.
15. **Fulfil customer expectations** : Adjust your business activities as per the demands, needs and expectations of the customers.
16. **Respect consumers rights** : Give full respect and honour to the basic rights of the consumers.
17. **Accept social responsibilities** : Honour responsibilities towards different social groups.
18. **Satisfy consumers wants** : Find out and satisfy the wants of the consumers. Use the available resources to produce good quality goods and services. Supply these goods and services regularly to the consumers. Charge reasonable prices for the goods and services. Give proper after-sales services. Do not produce goods and services, which are harmful to the health and life of the consumers. Remember, the main objective of the business is to satisfy the consumers wants.
19. **Service motive** : Give more importance to service and consumer's satisfaction and less importance to profit-maximization. Make profits by providing services to the consumers. Do not make profits by exploiting the consumers.
20. **Protect group interests**: Protect the interest of the group i.e give employees better wages and good working conditions, give shareholders better rate of dividend, give consumers good quality goods and services at low prices, etc.



21. **Optimum utilization of resources:** Ensure better and optimum utilization of natural and human resources and minimize wastage of these resources. Use the resources to remove poverty and to increase the standard of living of people.
22. **Intentions of business:** Use pure, legal and sacred means to do business. Do not use illegal, unscrupulous and evil means to do business.
23. **Follow Woodrow Wilson's rules :** According to the late American President Sir Thomas Woodrow Wilson, there are four important principles of business ethics. These four rules are as follows:-
  1. **Rule of publicity :** According to this principle, the business must tell the people what it is going to do. It must not create doubts, misunderstanding, suspicion, secrets, etc.
  2. **Rule of equivalent price :** According to this principle, the customer must be given proper value for their money. So the business must not sell below standard, outdated and inferior (poor) goods for high prices.
  3. **Rule of conscience in business :** If the business is conducted properly, then it is beneficial to the society. Otherwise, it is harmful to the society. Therefore, the businessman must have a conscience, i.e. a morale sense of judging what is right and what is wrong. He must be very careful while taking business decisions because these decisions affect the entire society.
  4. **Rule of spirit of service :** The business must give importance to the service motive. That is, priority must be given to render service to human beings over profit.

### 2.2.3 Summary

This lesson explains the theories of Business Ethics in detail and different principles involved in the business ethics. The Ethics is the branch of philosophy that deals with the principles of morality and the well-defined standards of right and wrong that prescribe the human character and conduct in terms of obligations,

rights, rules, benefit to society, fairness, etc. This lesson explain various theories and principles of business ethics.

**2.2.4 Exercise**

Q.1 Explain in detail theories of business ethics.

Q.2 What do you mean by business ethics. Explain its principles.

**2.2.5 Suggested Readings**

1. Bhanu Murthy, K. V. and Usha Krishna: Politics Ethics and Social Responsibilities of Business, Pearson Education, New Delhi. Business, Pearson Education, New Delhi.
2. J. P. Sharma: Corporate Governance, Business Ethics & CSR, Ane Books Pvt. Ltd., New Delhi.

---

**LESSON NO. 2.3**

---

**CORPORATE GOVERNANCE**

**Structure of the Lesson:**

- 2.3.0 Learning Objectives
- 2.3.1 Corporate Governance
- 2.3.2 Need For Corporate Governance:
- 2.3.3 Principles of Corporate Governance:
- 2.3.4 Objectives of Corporate Governance
- 2.3.5 SEBI Code of Corporate Governance
- 2.3.6 Summary
- 2.3.7 Exercise
- 2.3.8 Suggested Readings

**2.3.0 Learning Objectives**

The major objective of this lesson is to provide information about Corporate Governance. The lesson covers the objectives, need and principles for the corporate Governance. The various SEBI guidelines are also discussed in the lesson.

**2.3.1 CORPORATE GOVERNANCE**

Corporate Governance refers to the accountability of the Board of Directors to all stakeholders of the corporation i.e. shareholders, employees, suppliers, customers and society in general; towards giving the corporation a fair, efficient and transparent administration.

“Corporate governance means that company manages its business in a manner that is accountable and responsible to the shareholders. In a wider interpretation, corporate governance includes company’s accountability to shareholders and other stakeholders such as employees, suppliers, customers and local community.” – Catherwood.

“Corporate governance is the system by which companies are directed and controlled.” – The Cadbury Committee (U.K.)

### 2.3.2 NEED FOR CORPORATE GOVERNANCE:

The need for corporate governance is highlighted by the following factors:

**(i) Wide Spread of Shareholders:**

Today a company has a very large number of shareholders spread all over the nation and even the world; and a majority of shareholders being unorganized and having an indifferent attitude towards corporate affairs. The idea of shareholders' democracy remains confined only to the law and the Articles of Association; which requires a practical implementation through a code of conduct of corporate governance.

**(ii) Changing Ownership Structure:**

The pattern of corporate ownership has changed considerably, in the present-day-times; with institutional investors (foreign as well Indian) and mutual funds becoming largest shareholders in large corporate private sector. These investors have become the greatest challenge to corporate managements, forcing the latter to abide by some established code of corporate governance to build up its image in society.

**(iii) Corporate Scams or Scandals:**

Corporate scams (or frauds) in the recent years of the past have shaken public confidence in corporate management. The event of Harshad Mehta scandal, which is perhaps, one biggest scandal, is in the heart and mind of all, connected with corporate shareholding or otherwise being educated and socially conscious.

The need for corporate governance is, then, imperative for reviving investors' confidence in the corporate sector towards the economic development of society.

**(iv) Greater Expectations of Society of the Corporate Sector:**

Society of today holds greater expectations of the corporate sector in terms of reasonable price, better quality, pollution control, best utilisation of resources

etc. To meet social expectations, there is a need for a code of corporate governance, for the best management of company in economic and social terms.

**(v) Hostile Take-Overs:**

Hostile take-overs of corporations witnessed in several countries, put a question mark on the efficiency of managements of take-over companies. This factors also points out to the need for corporate governance, in the form of an efficient code of conduct for corporate managements.

**(vi) Huge Increase in Top Management Compensation:**

It has been observed in both developing and developed economies that there has been a great increase in the monetary payments (compensation) packages of top level corporate executives. There is no justification for exorbitant payments to top ranking managers, out of corporate funds, which are a property of shareholders and society.

This factor necessitates corporate governance to contain the ill-practices of top managements of companies.

**(vii) Globalisation:**

Desire of more and more Indian companies to get listed on international stock exchanges also focuses on a need for corporate governance. In fact, corporate governance has become a buzzword in the corporate sector. There is no doubt that international capital market recognises only companies well-managed according to standard codes of corporate governance.

### **2.3.3 PRINCIPLES OF CORPORATE GOVERNANCE**

The fundamental or key principles of corporate governance are described below:

**(i) Transparency:**

Transparency means the quality of something which enables one to understand the truth easily. In the context of corporate governance, it implies an

accurate, adequate and timely disclosure of relevant information about the operating results etc. of the corporate enterprise to the stakeholders.

In fact, transparency is the foundation of corporate governance; which helps to develop a high level of public confidence in the corporate sector. For ensuring transparency in corporate administration, a company should publish relevant information about corporate affairs in leading newspapers, e.g., on a quarterly or half yearly or annual basis.

**(ii) Accountability:**

Accountability is a liability to explain the results of one's decisions taken in the interest of others. In the context of corporate governance, accountability implies the responsibility of the Chairman, the Board of Directors and the chief executive for the use of company's resources (over which they have authority) in the best interest of company and its stakeholders.

**(iii) Independence:**

Good corporate governance requires independence on the part of the top management of the corporation i.e. the Board of Directors must be strong non-partisan body; so that it can take all corporate decisions based on business prudence. Without the top management of the company being independent; good corporate governance is only a mere dream.

#### **2.3.4 OBJECTIVES OF CORPORATE GOVERNANCE**

Good governance is integral to the very existence of a company. It inspires and strengthens investor's confidence by ensuring company's commitment to higher growth and profits. It seeks to achieve following objectives:

- (i) A properly structured Board capable of taking independent and objective decisions is in place at the helm of affairs;
- (ii) The Board is balanced as regards the representation of adequate number of non-executive and independent directors who will take care of the interests and well-being of all the stakeholders;

- (iii) The Board adopts transparent procedures and practices and arrives at decisions on the strength of adequate information;
- (iv) The Board has an effective machinery to sub serve the concerns of stakeholders;
- (v) The Board keeps the shareholders informed of relevant developments impacting the company;
- (VI) The Board effectively and regularly monitors the functioning of the management team; and
- vii) The Board remains in effective control of the affairs of the company at all times. The overall endeavor of the Board should be to take the organization forward, maximize long-term values and shareholders' wealth.

### **2.3.5 SEBI CODE OF CORPORATE GOVERNANCE**

To promote good corporate governance, SEBI (Securities and Exchange Board of India) constituted a committee on corporate governance under the chairmanship of Kumar Mangalam Birla. On the basis of the recommendations of this committee, SEBI issued certain guidelines on corporate governance; which are required to be incorporated in the listing agreement between the company and the stock exchange.

**An overview of SEBI guidelines on corporate governance is given below, under appropriate heads:**

#### **(a) Board of Directors:**

**Some points in this regard are as follows:**

- (i) The Board of Directors of the company shall have an optimum combination of executive and non-executive directors.
- (ii) (ii) The number of independent directors would depend on whether the chairman is executive or non-executive.

In case of non-executive chairman, at least, one third of the Board should comprise of independent directors; and in case of executive chairman, at least, half of the Board should comprise of independent directors.

The expression 'independent directors' means directors, who apart from receiving director's remuneration, do not have any other material pecuniary relationship with the company.

**(b) Audit Committee:**

**Some points in this regard are as follows:**

- (1) The company shall form an independent audit committee whose constitution would be as follows:**
  - (i) It shall have minimum three members, all being non-executive directors, with the majority of them being independent, and at least one director having financial and accounting knowledge.
  - (ii) The Chairman of the committee will be an independent director.
  - (iii) The Chairman shall be present at the Annual General Meeting to answer shareholders' queries.
- (2) The audit committee shall have powers which should include the following:**
  - i. To investigate any activity within its terms of reference
  - ii. To seek information from any employee
  - iii. To obtain outside legal or other professional advice
  - iv. To secure attendance of outsiders with relevant expertise, if considered necessary.
- (3) The role of audit committee should include the following:**
  - i. Overseeing of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
  - ii. Recommending the appointment and removal of external auditor.
  - iii. Reviewing the adequacy of internal audit function
  - iv. Discussing with external auditors, before the audit commences, the nature and scope of audit; as well as to have post-audit discussion to ascertain any area of concern.



- v. Reviewing the company's financial and risk management policies.

**(c) Remuneration of Directors:**

**The following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the Annual Report:**

- i. All elements of remuneration package of all the directors i.e. salary, benefits, bonus, stock options, pension etc.
- ii. Details of fixed component and performance linked incentives, along with performance criteria.

**(d) Board Procedure Some Points in this Regards are:**

- (i) Board meetings shall be held at least, four times a year, with a maximum gap of 4 months between any two meetings.
- (ii) A director shall not be a member of more than 10 committees or act as chairman of more than five committees, across all companies, in which he is a director.

**(e) Management:**

A Management Discussion and Analysis Report should form part of the annual report to the shareholders; containing discussion on the following matters (within the limits set by the company's competitive position).

- i. Opportunities and threats
- ii. Segment-wise or product-wise performance
- iii. Risks and concerns
- iv. Discussion on financial performance with respect to operational performance
- v. Material development in human resource/industrial relations front

**(f) Shareholders:**

**Some points in this regard are:**

- (i) **In case of appointment of a new director or reappointment of a director, shareholders must be provided with the following information:**
  - a. A brief resume (summary) of the director

- b. Nature of his expertise
- c. Number of companies in which he holds the directorship and membership of committees of the Board.
- d. A Board Committee under the chairmanship of non-executive director shall be formed to specifically look into the redressing of shareholders and investors' complaints like transfer of shares, non-receipt of Balance Sheet or declared dividends etc. This committee shall be designated as 'Shareholders / Investors Grievance Committee'.

**(g) Report on Corporate Governance:**

There shall be a separate section on corporate governance in the Annual Report of the company, with a detailed report on corporate governance.

**(h) Compliance:**

The company shall obtain a certificate from the auditors of the company regarding the compliance of conditions of corporate governance. This certificate shall be annexed with the Directors' Report sent to shareholders and also sent to the stock exchange.

**2.3.6 Summary**

The lesson introduces with Corporate governance concept. Corporate Governance refers to the accountability of the Board of Directors to all stakeholders of the corporation i.e. shareholders, employees, suppliers, customers and society in general; towards giving the corporation a fair, efficient and transparent administration. The lesson explains the objectives and SEBI guidelines.

**2.3.7 Exercise**

Q.1 What do you mean by Corporate Governance? Why it is needed?

Q.2 Explain in detail various objectives of Corporate Governance.

Q.3 Give in detail various provision of SEBI regarding Corporate Governance.

**2.3.8 Suggested Readings**

1. Bob Tricker : Corporate Governance-Principles, Policies, and Practice (Indian Edition), Oxford University Press, New Delhi.
2. J. P. Sharma: Corporate Governance, Business Ethics & CSR, Ane Books Pvt. Ltd., New Delhi.
3. Christine A Mallin: Corporate Governance (Indian Edition), Oxford University Press, New Delhi.

---

LESSON NO. 2.4

---

**CORPORATE GOVERNANCE REFORMS**

**Structure of the Lesson:**

- 2.4.0 Learning Objectives
- 2.4.1 Introduction
- 2.4.2 SEBI Committee / Narayana Murthy Committee Report on Corporate Governance
- 2.4.3 Confederation of Indian industry (CII) recommendations on Corporate Governance
- 2.4.4 Kumar Mangalam Birla Committee Report on Corporate Governance
- 2.4.5 Summary
- 2.4.6 Exercise
- 2.4.7 Suggested Readings

**2.4.0 Learning Objectives**

The lesson introduces with the various corporate governance reforms took over the time. Its explain about SEBI recommendations, CII recommendations and Kumar Mangalam Birla Committee report.

**2.4.1 INTRODUCTION :**

With the formation of corporate form of organizations, the frame work of corporate governance got wide recognition and quite peculiarly it was prevalent in various manifestations throughout the world. The theme of Corporate Governance has got recognition due to the constitution and formation of various committees and formulation of various laws throughout the world.

With respect to India, after the economic initiatives in 1991, the Govt. of India thought it fit to respond to the developments taking placing the world over and accordingly the initiatives recommended by Cadbury Committee Report got prominence. In order to give due prominence Confederation of Indian Industry (CII), the Associated Chambers of Commerce and Industry (ASSOCHAM) and, the

Securities and Exchange Board of India (SEBI) constituted committees to recommend initiatives in Corporate Governance.

However with respect to India, the recommendations of the Kumar Mangalam Birla Committee and N. R. Narayana Murthy Committee constituted by SEBI are more prominent.

Apart from these committees, there are OECD principles and reviews by various other corporate bodies like FICCI, KPMG, ICSI etc. on the corporate governance practices in India.

Some of the recommendations of these committees are as follows:

#### **2.4.2 SEBI COMMITTEE / NARAYANA MURTHY COMMITTEE REPORT ON CORPORATE GOVERNANCE**

##### **Key Issues Discussed and Recommendations of SEBI Committee:**

###### **Audit Committees:**

Suggestions were received from members that audit committees of publicly listed companies should be required to review the following information mandatorily:

- Financial statements;
- Management discussion and analysis of financial condition and results of operations
- Reports relating to compliance with laws and to risk management;
- Management letters / letters of internal control weaknesses issued by Statutory / Internal Auditors
- Records of related party transactions.

###### **Mandatory recommendation:**

Audit committees of publicly listed companies should be required to review the following information mandatorily:

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

- Management discussion and analysis of financial condition and results of operations;
- Reports relating to compliance with laws and to risk management;
- Management letters / letters of internal control weaknesses issued by statutory internal auditors; and
- Records of related party transactions.

**MANDATORY RECOMMENDATION**

All audit committee members should be “financially literate” and at least one member should have accounting or related financial management expertise.

Explanation 1 – The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation 2 – A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual’s financial sophistication, including being or having been a chief executive officer, chief financial officer, or other senior officer with financial oversight responsibilities.

**AUDIT REPORTS AND AUDIT QUALIFICATIONS:****MANDATORY RECOMMENDATION:**

In case a company has followed a treatment different from that prescribed in an accounting standard, management should justify why they believe such alternative treatment is more representative of the underlying business transaction. Management should also clearly explain the alternative accounting treatment in the footnotes to the financial statements.

**NON-MANDATORY RECOMMENDATION**

Companies should be encouraged to move towards a regime of unqualified financial statements. This recommendation should be reviewed at an appropriate juncture to determine whether the financial reporting climate is conducive towards a system of filing only unqualified financial statements.

### 2.4.3 CONFEDERATION OF INDIAN INDUSTRY (CII) RECOMMENDATIONS ON CORPORATE GOVERNANCE

In 1996, the Confederation of Indian Industry (CII) took a special initiative on corporate governance, the first ever institutional initiative in Indian Industry. This initiative flowed from public concerns regarding the protection of investors, the promotion of transparency within business and industry, the need to move towards international standards in terms of disclosure of information by the corporate sector and, through all of this to develop a high level of public confidence in business and industry.

#### **Recommendations:**

- A single board, if it performs well, can maximize long-term shareholder value. The board should meet at least six times a year, preferably at intervals of 2 months.
- A listed company with a turnover of ` 100 crores and above should have professionally competent and recognized independent nonexecutive directors who should constitute
- At least 30 per cent of the board, if the chairman of the company is a non-executive director or
- At least 50 per cent of the board, if the chairman and managing director is the same person
- A person should not hold directorships in more than 10 listed companies
- For non-executive directors to play a significant role in corporate decision making and maximizing long term shareholder value, they need to.
- Become active participants in boards and not just passive advisors
- Have clearly defined responsibilities within the board such as the audit committee and
- Know how to read a balance sheet, profit and loss account, cash flow statement and financial ratios and have some knowledge of various company

laws. This, of course, excludes those who are invited to join boards as experts in other fields such as science and technology

- To secure better effort from non-executive directors, companies should
- pay a commission over and above the sitting fees for the use of the professional inputs. Commission are rewards on current profits
- consider offering stock options, so as to relate rewards to performance. Stock options are rewards contingent upon future appreciation corporate value.
- While re-appointing members of the board, companies should give the attendance record of the concerned directors. If a director has not been present (absent with or without leave) for 50 per cent or more meetings, then this should be explicitly stated in the resolution that is put to vote. One should not re-appoint any directors who has not had the time to attend even 50 per cent of the meetings

#### **2.4.4 KUMAR MANGALAM BIRLA COMMITTEE REPORT ON CORPORATE GOVERNANCE**

The Securities and Exchange Board of India (SEBI) appointed a committee on corporate governance on 7 May 1999, with 18 members under the chairmanship of Kumar Mangalam Birla with a view to promoting and raising the standards of corporate governance. The committee's terms of reference were: (a) to suggest suitable amendments to the listing agreement (LA) executed by the stock exchanges with the companies and any other measures to improve the standards of corporate governance in the listed companies in areas such as continuous disclosure of material information, both financial and non-financial, manner and frequency of such disclosures, responsibilities of independent and outside directors (b) to draft a code of corporate best practices and (c) to suggest safeguards to be instituted within in the companies to deal with insider information and insider trading.

The committee submitted its famous and oft-quoted report to SEBI after several sittings of debates and deliberations. The Kumar Mangalam Birla Committee's report is indeed a veritable landmark in the evolution of corporate governance in



India. The Birla Committee's recommendations consist of mandatory recommendations, and non-mandatory recommendations:

**Mandatory Recommendations:**

- The mandatory recommendations apply to the listed companies with paid up share capital of 3 crore and above.
- Composition of board of directors should be optimum combination of executive & non-executive directors.
- Audit committee should contain 3 **independent directors** with one having financial and accounting knowledge.
- Remuneration committee should be setup
- The Board should hold at least 4 meetings in a year with maximum gap of 4 months between 2 meetings to review operational plans, capital budgets, quarterly results, minutes of committee's meeting.
- Director shall not be a member of more than 10 committee and shall not act as chairman of more than 5 committees across all companies
- Management discussion and analysis report covering industry structure, opportunities, threats, risks, outlook, internal control system should be ready for external review
- Any Information should be shared with shareholders in regard to their investments

**Non-mandatory Recommendations:**

The committee made several recommendations with reference to:

- Role of chairman
- Remuneration committee of board
- Shareholders' right for receiving half yearly financial performance.
- Postal ballot covering critical matters like alteration in memorandum

- Sale of whole or substantial part of the undertaking
- Corporate restructuring
- Further issue of capital
- Venturing into new businesses

These recommendations were to apply to all the listed private and public sector companies, their directors, management, employees and professionals associated with such companies. The Committee recognizes that compliance with the recommendations would involve restructuring the existing boards of companies. It also recognizes that smaller ones will have difficulty in immediately complying with these conditions.

#### **2.4.5 Summary :**

The lesson highlighted the various corporate governance reforms took over the time. It explains about SEBI recommendations, CII recommendations and Kumar Mangalam Birla Committee report.

#### **2.4.6 Exercise**

Q.1 Give recommendations of Kumar Mangalam Birla Committee report.

Q.2 Explain in detail various corporate Governance Reforms .

#### **2.4.7 Suggested Readings**

1. Bob Tricker : Corporate Governance-Principles, Policies, and Practice (Indian Edition), Oxford University Press, New Delhi.
2. J. P. Sharma: Corporate Governance, Business Ethics & CSR, Ane Books Pvt. Ltd., New Delhi.
3. Christine A Mallin: Corporate Governance (Indian Edition), Oxford University Press, New Delhi.

---

**LESSON NO. 2.5**

---

**CODES AND STANDARDS ON CORPORATE GOVERNANCE****Structure of the Lesson:**

- 2.5.0 Learning Objectives
- 2.5.1 Cadbury Committee Report (1992)
- 2.5.2 Greenbury Report On Corporate Governance (1995)
- 2.5.3 Hampel Committee Report On Corporate Governance
- 2.5.4 The Blue Ribbon Committee
- 2.5.6 Summary
- 2.5.7 Exercise
- 2.5.8 Suggested Readings

**2.5.0 Learning Objectives**

The lesson includes various committee reports that explain the various guidelines to be followed under corporate governance. The chapter includes various committees namely Cadbury Committee Report (1992), Greenbury Report on Corporate Governance (1995) Hampel Committee Report and Blue Ribbon Committee Report.

**2.5.1 CADBURY COMMITTEE REPORT (1992)**

The 'Cadbury Committee' was set up in May 1991 with a view to overcome the huge problems of scams and failures occurring in the corporate sector worldwide in the late 1980s and the early 1990s. It was formed by the Financial Reporting Council, the London Stock of Exchange and the accountancy profession, with the main aim of addressing the financial aspects of Corporate Governance. Other objectives include: (i) uplift the low level of confidence both in financial reporting and in the ability of auditors to provide the safeguards which the users of company's reports sought and expected; (ii) review the structure, rights and roles of board of directors, shareholders and auditors by making them more effective and accountable; (iii) address various aspects of accountancy profession and make appropriate recommendations, wherever necessary; (iv) raise the standard of corporate governance; etc. Keeping this in view, the Committee published its final report on 1st December 1992. The report was mainly divided into three parts:

### 1. Reviewing the structure and responsibilities of Boards of Directors and recommending A Code of Best Practice

The boards of all listed companies should comply with the Code of Best Practice. All listed companies should make a statement about their compliance with the Code in their report and accounts as well as give reasons for any areas of non-compliance. The Code of Best Practice is segregated into four sections and their respective recommendations are:-1.

#### i. Board of Directors

The board should meet regularly, retain full and effective control over the company and monitor the executive management. There should be a clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision. Where the chairman is also the chief executive, it is essential that there should be a strong and independent element on the board, with a recognized senior member. Besides, all directors should have access to the advice and services of the company secretary, who is responsible to the Board for ensuring that board procedures are followed and that applicable rules and regulations are complied with

#### ii. Non-Executive Directors

The non-executive directors should bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct. The majority of non-executive directors should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment, apart from their fees and shareholding.

#### iii. Executive Directors

There should be full and clear disclosure of directors' total emoluments and those of the chairman and highest-paid directors, including pension

contributions and stock options, in the company's annual report, including separate figures for salary and performance-related pay.

**iv. Financial Reporting and Controls**

It is the duty of the board to present a balanced and understandable assessment of their company's position, in reporting of financial statements, for providing true and fair picture of financial reporting. The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary. The board should ensure that an objective and professional relationship is maintained with the auditors.

**2. Considering the role of Auditors and addressing a number of recommendations to the Accountancy Profession**

The annual audit is one of the cornerstones of corporate governance. It provides an external and objective check on the way in which the financial statements have been prepared and presented by the directors of the company. The Cadbury Committee recommended that a professional and objective relationship between the board of directors and auditors should be maintained, so as to provide to all a true and fair view of company's financial statements. Auditors' role is to design audit in such a manner so that it provide a reasonable assurance that the financial statements are free of material misstatements. Further, there is a need to develop more effective accounting standards, which provide important reference points against which auditors exercise their professional judgment. Secondly, every listed company should form an audit committee which gives the auditors direct access to the non-executive members of the board. The Committee further recommended for a regular rotation of audit partners to prevent unhealthy relationship between auditors and the management. It also recommended for disclosure of payments to the auditors for non-audit services to the company. The Accountancy Profession, in conjunction with representatives of preparers of accounts, should take the lead in:-

- (i) developing a set of criteria for assessing effectiveness;

- (ii) developing guidance for companies on the form in which directors should report;
- (iii) developing guidance for auditors on relevant audit procedures and the form in which auditors should report. However, it should continue to improve its standards and procedures

### 3. Dealing with the Rights and Responsibilities of Shareholders

The shareholders, as owners of the company, elect the directors to run the business on their behalf and hold them accountable for its progress. They appoint the auditors to provide an external check on the directors' financial statements. The Committee's report places particular emphasis on the need for fair and accurate reporting of company's progress to its shareholders, which is the responsibility of the board. It is encouraged that the institutional investors/shareholders to make greater use of their voting rights and take positive interest in the board functioning. Both shareholders and boards of directors should consider how the effectiveness of general meetings could be increased as well as how to strengthen the accountability of boards of directors to shareholders.

#### 2.5.2 GREENBURY REPORT ON CORPORATE GOVERNANCE (1995)

During the 1990's the issue of **director's remuneration** was becoming a primary concern for investors and the public at large. Specifically, the levels of remuneration of directors in privatized industries were rising and remuneration packages were failing to provide the necessary incentives for directors to perform better. Consequently, it was recognized that corporate governance issues relating to director's remuneration needed to be addressed in a more rigorous manner. This led to the establishment of the Greenbury Committee. The Committee's findings were documented in the Greenbury Report, which incorporated a Code of Best Practice on Director's Remuneration. Specifically, four main issues were dealt with, as follows:

- The **role of a Remuneration Committee** in setting the remuneration packages for the CEO and other directors,

- The **required level of disclosure** needed by shareholders regarding details of directors remuneration and whether there is the need to obtain shareholder approval;
- specific guidelines for determining a **remuneration policy** for directors; and
- **service contracts** and provisions binding the Company to pay compensation to a director, particularly in the event of dismissal for unsatisfactory performance.

As in the Cadbury Code, the Greenbury Code recommended the establishment of a Remuneration Committee, comprising entirely of nonexecutive directors, to determine the remuneration of the executive directors. However, in terms of service contracts, Greenbury recommended **maximum notice period of 12 months** rather than three years as suggested by Cadbury. Following publication, the recommendations of Greenbury were also taken on board by the **London Stock Exchange** and incorporated into the UK Listing Rules. However, unlike the Cadbury Code it was not widely accepted as many believed that the recommendations made did not sufficiently deal with the issue of linking directors pay to the Company's performance in the interests of shareholders.

### 2.5.3 HAMPSEL COMMITTEE REPORT ON CORPORATE GOVERNANCE

The Hampel Committee was established in 1996 to review and revise the earlier recommendations of the Cadbury and Greenbury Committees. The Final report **emphasized principles of good governance rather than explicit rules** in order to reduce the regulatory burden on companies and avoid 'box-ticking' so as to be flexible enough to be applicable to all

Companies. It was recognized that good corporate governance will largely depend on the particular situation of each company. This emphasis on principles would survive into the Combined Code.

Hampel viewed governance from a strict principal/agent perspective regarding corporate governance as an opportunity to enhance long term shareholder value, which was asserted as the primary objective of the company.

This was a new development from the Cadbury and Greenbury Codes which had primarily focused on preventing the abuse of the discretionary authority entrusted to management. In particular, the report favored greater shareholder involvement in company affairs. For example, while the report recommended that *unrelated proposals should not be bundled* under one resolution shareholders, particularly institutional shareholders, were expected to adopt a 'considered policy' on voting. Another key advance was in the area of *accountability and audit*. The Board was identified as having responsibility to maintain a sound system of internal control, thereby safeguarding shareholders' investments (although the Board was not required to report on the effectiveness of the controls).

Further, the Board was to be held accountable for **all aspects of risk management**, as opposed to just the financial controls as recommended by Cadbury. Hampel did not advance the debate on director's remuneration, choosing only to reiterate principles inherent in Greenbury. In particular Hampel did not believe that directors' remuneration should be a matter for shareholder approval in general meeting. This would not become a requirement until the introduction of The Directors' Remuneration Report Regulations in 2002.

#### 2.5.4 THE BLUE RIBBON COMMITTEE

The Blue Ribbon Committee was jointly sponsored by the New York Stock Exchange (NYSE) and National Association of Security Dealers (NASD) for improving the working of corporate audit committees. The Committee has given certain recommendations specifically for the Audit Committees. The recommendations are:

- 1) The members of the Audit Committee should be independent directors and financial literate.
- 2) External auditors being the representatives of shareholders should periodically discuss the quality of company's accounting principles in relation to General Accepted Accounting Principles (GAAP) with the audit committees.
- 3) Statutory auditors should maintain their independence in discharging their professional responsibilities, and



- 4) On an annual basis, the committee should review and discuss with the accountants all significant relationships the accountants have with the corporation to determine the accountants' independence.

Blue Ribbon committee has also recommended that Audit committee should have a formal written charter.

#### **2.5.5 Summary**

The lesson overviews the various committee reports that explain the various guidelines to be followed under corporate governance. The chapter includes various committees namely Cadbury Committee Report (1992), Greenbury Report on Corporate Governance (1995) Hampel Committee Report and Blue Ribbon Committee Report.

#### **2.5.6 Exercise**

- Q.1 Explain in detail Cadbury Committee.
- Q.2 Elaborate recommendations of Hampel Committee and Greenbury Committee.
- Q.3 What are various issues discussed in Blue Ribbon Committee Report.

#### **2.5.7 Suggested Readings**

1. Bob Tricker : Corporate Governance-Principles, Policies, and Practice (Indian Edition), Oxford University Press, New Delhi.
2. J. P. Sharma: Corporate Governance, Business Ethics & CSR, Ane Books Pvt. Ltd., New Delhi.
3. Christine A Mallin: Corporate Governance (Indian Edition), Oxford University Press, New Delhi.

**LESSON NO. 2.6**

---

**GREEN GOVERNANCE, CLAUSE 49 AND LISTING AGREEMENT**

**Structure of the Lesson:**

2.6.0 Learning Objectives

2.6.1 Clause 49 of Listing Agreement

2.6.1.1 Rights of shareholders and role of stakeholders

2.6.1.2 Disclosure and transparency

2.6.1.3 Responsibility of Board

2.6.1.4 Function of the board

2.6.1.5 Independent directors

2.6.1.6 Non-executive Directors' compensation and disclosures

2.6.1.7 Other provision of committee and code of conduct

2.6.1.8 Role of Audit Committee

2.6.1.9 Nomination and Remuneration Committee

2.6.1.10 CEO/CFO certification

2.6.1.11 Report on corporate governance

2.6.2 Green Governance

2.6.3 Summary

2.6.4 Exercise

2.6.5 Suggested Readings

**2.6.0 Learning Objectives**

The lesson explains the requirements mentioned in Clause 49 of listing agreement which a listed company needs to follow. Furthermore, the concept of green governance also explained.

**2.6.1 CLAUSE 49 OF LISTING AGREEMENT**

There are certain requirements mentioned in Clause 49 of listing agreement which a listed company needs to follow. To have a quick review of that important requirement, summary is given below.

**2.6.1.1 Rights of shareholders and role of stakeholders:** Company should seek to protect the rights of shareholders and should facilitate them so that they can exercise their rights. Shareholders should be part of any decision of fundamental change and should have right of voting in general meetings.

They should be allowed to effectively participate in key corporate governance decisions, to questions to board, put up agenda items on general meeting, made clear on voting procedure, and their grievances (including violation of their rights) should be addressed including protection to Minority shareholders. Voting process should be easy and not a costly affair. Company should give timely and sufficient information to shareholders about general meetings like time, place and agenda. Company should inform rights which each class of shareholders possesses before they invest including if any class of holders has disproportionate rights. Company should give equitable treatment to all shareholders including monitory and foreign shareholders who are under same series. Mechanism to avoid insider trading should be in place. There should be mechanism for employee participation and timely sharing of information so that participation in corporate governance can be made. Whistleblower policy should be in place.

**2.6.1.2 Disclosure and transparency:**

Company should disclose material matters timely including BS, P&L, and ownership and governance issues. Company should follow applicable Accounting standards in true spirit and statutory audit should be conducted by competence and independent qualified person. Sharing of information should be timely and should be accessible to all users in cost effective manner. Minutes of meetings should be maintained recording dissenting opinions.

**2.6.1.3 Responsibility of Board:**

- i. All members of board including KMPs to disclose any material interest in ant transaction/matter in any manner whether directly or indirectly.
- ii. Board and management should maintain confidentiality and transparency of information.

**2.6.1.4 Function of the board:** Review of corporate strategies, giving strategic guidance, major plans of action, risk policy, annual budgets and business plans, setting performance parameters, maintaining transparent board nomination process, monitoring potential conflict with different stakeholders, monitoring effectiveness of governance practices, integrity of financials reporting process and internal controls, management, compliances with law, communication with stakeholders, hiring and compensating including succession plan of key executives, overseeing of major capex, acquisition, divestments, work in good faith in a responsible manner , overview process of disclosure and communication, monitoring board evaluation process, training to directors, set a corporate culture and should work in best interest of the company with high ethical standards, and should have independent judgment .Allow independent directors and committee to function properly and also intimate them their role as board members and committee member.

**Composition of Board:**

1. At least one woman director
2. Minimum 50% of the board should be independent if chairman of the board is executive director. If chairman is non executive Director (NED) than 1/3 of the board should be independent. If chairman is non executive but is a promoter or related to promoter or to any person one level below board, than 1/2 of the board should be independent.

**2.6.1.5 Independent directors:**

He is a person who:

- Is a person of 21 years or more
- who possesses integrity and relevant expertise in board's view
- is neither executive director nor a nominee director
- is not related to any of promoter/director of company (including of holding, subsidiary(subs), and associate)

- Who is not and was not a promoter of the company (including of holding, subs and associate) at any point of time.
- Apart from receiving sitting fee/directors remuneration, he does not have or had any time any material pecuniary relationship with company, holding, subs or associate or their promoter/directors in current year and previous two years.
- Same requirement applies for his relative also if they have such transactions with the company amounting to 2% or more of gross turnover or income or Rs. 50 lacs whichever is lower
- Along with his relatives does not hold 2% or more of voting power or his relative does not have or have been in following positions in any of the preceding 3 financial years immediately preceding the financial year in which he is proposed to be appointed..
- employee or KMP of company (co.), holding, subs or associate • employee, partner, proprietor of a CA, cost audit, co secretary firm, of co. holding, subs or associate or
- Employee, partner, proprietor of a legal or consulting firm who has transaction of 10% or more of the firm with co. holding, subs or associate.
- Is or his relative is not a material supplier, customer, service provider, lessor or lessee of the company
- Is or his relative is not a director or CEO of Non profit organization which receive 25% or more of receipts from company or its relatives
- A person shall not serve as an Independent director of more than 7 listed entities (3 listed entities if he is whole time director (WTD) in any listed entity).
- Formal letter of appointment should be issued and terms and conditions of appointment should be posted on website of the company.

- Nomination committee should lay down evaluation criteria of Independent Directors (IDs) and also mention in AR. Evaluation is done by board excluding ID being evaluated. Evaluation becomes basis whether to extend the term or not
- There has to be at least one meeting in a year of ONLY IDs. IDs should review performance of board, chairperson and Non independent Directors (NIDs), and should also assess whether flow of information was adequate with ref to time, quality and quantity between management and board
- Company should make familiarization programme for IDs so that they can have idea of business model of company, nature and risk appetite. Also disclose on website and link in annual report.

**2.6.1.6 Non-executive Directors' compensation and disclosures:** Any fees, compensation should be approved by board and have prior approval of shareholders. Sitting fee to NED does not required prior approval if it is within limits of co act. IDs does not entitle for stock options.

**2.6.1.7 Other provision of committee and code of conduct:**

- i. Board shall meet at least 6 times in a year with maximum gap between two meetings of 120days. Minimum information to be made available to board is in Annex X to the listing agreement.
- ii. A director shall not be a member of more than 10 committees and at the same time he can not act as chairman in more than 5 committees. He needs to update to board regularly about his membership in different committees or boards.
- iii. Board should review compliance report prepared by company including action taken on non compliance if any.
- iv. If an ID resigns or is removed by board and his position is not fulfilled before , than his position should be filled immediately within 3 months or next board meeting which ever is earlier.

- v. A succession plan of Board and senior management should be in place.
- vi. There has to be a written code of conduct for Board and senior management which should be posted on website. AR should have declaration of CEO of compliance of code of conduct by all concerned. Code of conduct should specify duties of IDs.
- vii. IDs should be made responsible for acts or omission of companies which were in his knowledge.
- viii. Company should have whistle blower policy and also safeguard to persons who avail such mechanism. Such policy should be on website as well as annual report

**Audit committee (AC):**

- i. Composition, quorum and meetings
- ii. There has to be a qualified and independent AC with terms of reference (TOR).
- iii. AC should have minimum 3 directors with 2/3 of them independent. Chairman should be ID and should present at AGM.
- iv. iv. Directors should be financially literate at least one of them should have Accounting or financial management expertise.
- v. v. AC may invite finance head or other executives including internal and statutory auditors to present in meeting. Company secretary to act as secretary to meeting.
- vi. AC should meet at least 6 times in a year with maximum gap of 6 months. Quorum is 2 independent directors with minimum 1/3 of AC. vii. AC can investigate any matter within its TOR and can seek information from any employee and can take legal or professional advice from outsider as and when required.

**2.6.1.8 Role of Audit Committee**

- i. Oversight of financial reporting process and ensure disclosure of financial information which is reliable and credible.

- ii.** Recommending appointment, remuneration, terms of appointment and approval of payment for any other service of statutory auditors. Appointment of CFO or finance head.
- iii.** Review with management of annual along with audit report before submission to board with particular reference to - Matters to be included in board report (Directors responsibility statement) - Change in accounting policy, qualification of auditors and explanation thereto, significant estimate judgment by management, significant audit findings and resulting adjustment in books , RPT disclosure , compliance requirement related to financial statements.

#### **2.6.1.9 Nomination and Remuneration Committee**

- i.** Board should appoint such committee of non executive directors (NEDs) which should have minimum 3 directors with 1/3 of them independent. Chairman of committee should be ID. Chairman of the company may be appointed as member of committee but can not chair the meeting.
- ii.** Role of the committee is to formulation of criteria for evaluation of performance of Board and IDs, qualification, independence and attribute of a director and recommend to board a policy for remuneration of Directors, KMP and employees.
- iii.** Identifying a person who can be appointed in senior management or as Director. Recommending to board their appointment and removal and evaluation criteria in AR.
- iv.** Should formulate policy of identifying material subs and such policy should be on company website with link in AR.
- v.** A subs is material, if investment in subs is more than 20% of consol Networth or if subs has generated 20% or more of consol income as per latest audited consol financial statements.
- vi.** An company can not loose control over a material subs by way of divestment without shareholder approval except where divestment is



court approved. vii. If a material subs sells, leases or disposes assets of more than 20% of its assets, than it requires special resolution of holding company's shareholders unless done under court approval.

**2.6.1.10 CEO/CFO certification:**

- vii.** CEO/MD/Manager or WTD and CFO should certify to board that they have reviewed financials statements and they represent true and fair view and not misleading.
- viii.** No fraud, illegal transactions. They have evaluated effectiveness of internal control systems.
- ix.** They have informed to AC and auditors about significant a change in accounting policies, frauds and where employees are involved.

**2.6.1.11 Report on corporate governance:** There has to be separate section in AR on Corporate governance and its compliances. Company should submit to respective stock exchanges compliance report on corporate governance within 15 days from close of the quarter. Company should obtain certificate from auditors or from practicing company secretary about compliance of corporate governance and this certificate should also be attached with Directors report. Non mandatory requirements which are given in Annexure VIII of clause 69 may be implemented by company.

**2.6.2 GREEN GOVERNANCE**

Green Governance is a systematic life-cycle to help an organization drive towards overall sustainability. Organizations often talk about the importance of the environment. They want to become greener, and they also want to improve the bottom line by becoming more efficient when using energy and other natural resources. In reality, this can be often much easier said than done. A number of initiatives work, but many fail. Some achieve marginal results where the efforts far exceed the benefits. Others are counterproductive; they just transfer a green problem from one place to another, or they are hard to align with demanding business goals. When looking at your organization's green program it is important to take a systematic approach to managing it. This is what we call Green

Governance. The life-cycle focuses on continuous improvement and encompasses the following areas:

- Strategy
- Risk Management
- Compliance Management
- Idea Management
- Portfolio Management
- Project Management
- Performance Management & Stakeholder Reporting

Organizations will greatly improve their overall performance if they clearly articulate a strategy with defined objectives and goals and understand the risks in meeting those objectives and goals. This should comply with both required regulations and the organization's internal policies. The solicit ideas from key stakeholders on what can be done to meet the objectives and goals.

### **2.6.3 Summary**

The lesson explains the requirements mentioned in Clause 49 of listing agreement which a listed company needs to follow. the lesson covers the concept of green governance. Green Governance is a systematic life-cycle to help an organization drive towards overall sustainability. Organizations often talk about the importance of the environment. They want to become greener, and they also want to improve the bottom line by becoming more efficient when using energy and other natural resources. In reality, this can be often much easier said than done.

### **2.6.4 Exercise**

- Q.1 What do you mean by Green Governance.
- Q.2 Explain in detail Clause 49 of Listing agreement.

### **2.6.5 Suggested Readings**

1. Bob Tricker : Corporate Governance-Principles, Policies, and Practice (Indian Edition), Oxford University Press, New Delhi.
2. J. P. Sharma: Corporate Governance, Business Ethics & CSR, Ane Books Pvt. Ltd., New Delhi.
3. Christine A Mallin: Corporate Governance (Indian Edition), Oxford University Press, New Delhi.

---

**LESSON NO. 2.7**

---

**CSB : BUSINESS ETHICS AND CORPORATE GOVERNANCE****Structure of the Lesson:**

- 2.7.0 Learning Objectives
- 2.7.1 Introduction
- 2.7.2 Drivers Pushing Business Towards CSR
- 2.7.3 Arguments In favour of CSR
- 2.7.4 Arguments against CSR
- 2.7.5 Debate over CSR
- 2.7.6 Role of Corporate Social Responsibility In Strategic Planning
- 2.7.7 Relation Between Corporate Social Responsibility and Business Ethics
- 2.7.8 Corporate Governance and CSR
- 2.7.9 Summary
- 2.7.10 Exercise
- 2.7.11 Suggested Readings

**2.7.0 LEARNING OBJECTIVES**

The lesson gives information about the concept of Corporate Social Responsibility in detail. This lesson highlights the various drivers that force the corporate to adopt social responsibility. The arguments in favour and against of the CSR are explained in the chapter. The lesson also provide information relating to relationship among business ethics, corporate social responsibility and corporate governance.

**2.7.1 INTRODUCTION :**

Corporate Social Responsibility is not a new concept in India, however, the Ministry of Corporate Affairs, Government of India has recently notified the Section 135 of the Companies Act, 2013 along with Companies (Corporate Social Responsibility Policy) Rules, 2014 "hereinafter CSR Rules" and other notifications related thereto which makes it mandatory (with effect from 1st April, 2014) for certain companies who fulfill the criteria as mentioned under Sub Section 1 of Section 135 to comply with the provisions relevant to Corporate Social Responsibility. As mentioned by United Nations Industrial Development Organization (UNIDO), CSR is generally understood as being the way through which a company achieves a balance of economic, environmental and social imperatives ("Triple-Bottom-Line- Approach"), while at the same time addressing the expectations of shareholders and stakeholders.

**WHAT IS CSR?**

The term "Corporate Social Responsibility (CSR)" can be referred as corporate initiative to assess and take responsibility for the company's effects on the environment and impact on social welfare. The term generally applies to companies efforts that go beyond what may be required by regulators or environmental protection groups.

Corporate social responsibility may also be referred to as "corporate citizenship" and can involve incurring short-term costs that do not provide an immediate financial benefit to the company, but instead promote positive social and environmental change.

Moreover, while proposing the Corporate Social Responsibility Rules under Section 135 of the Companies Act, 2013, the Chairman of the CSR Committee mentioned the Guiding Principle as follows: *"CSR is the process by which an organization thinks about and evolves its relationships with stakeholders for the common good, and demonstrates its commitment in this regard by adoption of appropriate business processes and strategies. Thus CSR is not charity or mere donations. CSR is a way of conducting business, by which corporate entities visibly contribute to the social good. Socially responsible companies do not limit themselves to using resources to engage in activities that increase only their profits. They use CSR to integrate economic, environmental and social objectives with the company's operations and growth ."*

**Definitions of CSR**

There is no universally accepted definition of CSR. Selected definitions by CSR organizations

and actors include:

"Corporate Social Responsibility is the continuing commitment by business to behaveethically and contribute to economic development while improving the quality of life of theworkforce and their families as well as of the local community and society at large"

-----WorldBusiness Council for Sustainable

Development

"CSR is about how companies manage the business processes to produce an overall positive impact on society." Mallen Baker

"Corporate social responsibility is undertaking the role of "corporate citizenship" and ensuring the business values and behaviour is aligned to balance between improving and developing the wealth of the business, with the intention to improve society, people and the planet"

#### **FOR WHOM it's APPLICABLE?**

The companies on whom the provisions of the CSR shall be applicable are contained in Sub Section 1 of Section 135 of the Companies Act, 2013. As per the said section, the companies having Net worth of INR 500 crore or more; or Turnover of INR 1000 crore or more; or Net Profit of INR 5 crore or more during any financial year shall be required to constitute a Corporate Social Responsibility Committee of the Board "hereinafter CSR Committee" with effect from 1st April, 2014. The pictorial representation below gives the representation of Section 135 (1).

#### **2.7.2 DRIVERS PUSHING BUSINESS TOWARDS CSR**

##### **1. The Shrinking Role of Government**

In the past, governments have relied on legislation and regulation to deliver social and environmental objectives in the business sector. Shrinking government resources, coupled with a distrust of regulations, has led to the exploration of voluntary and non-regulatory initiatives instead.

##### **2. Demands for greater disclosure**

There is a growing demand for corporate disclosure from stakeholders, including customers, suppliers, employees, communities, investors, and activist organizations.

##### **3. Increased customer interest**

There is evidence that the ethical conduct of companies exerts a growing influence on the purchasing decisions of customers. In a recent survey by [Envionics International](#), more than one in five consumers reported having

either rewarded or punished companies based on their perceived social performance.

#### **4. Growing investor pressure**

Investors are changing the way they assess companies' performance, and are making decisions based on criteria that include ethical concerns. The Social Investment Forum reports that in the US in 1999, there was more than \$2 trillion worth of assets invested in portfolios that used firms linked to the environment and social responsibility.

#### **5. Competitive labour markets**

Employees are increasingly looking beyond paychecks and benefits, and seeking out employers whose philosophies and operating practices match their own principles. In order to hire and retain skilled employees, companies are being forced to improve working conditions.

#### **6. Supplier relations**

As stakeholders are becoming increasingly interested in business affairs, many companies are taking steps to ensure that their partners conduct themselves in a socially responsible manner. Some are introducing codes of conduct for their suppliers, to ensure that other companies' policies or practices do not tarnish their reputation.

### **2.7.3 ARGUMENTS IN FAVOUR OF CSR:**

The following arguments favour corporate social responsibility:

#### **1. Protect the interests of stakeholders:**

Labour force is united into unions which demand protection of their rights from business enterprises. To get the support of workers, it has become necessary for organisations to discharge responsibility towards their employees.

Caveat emptor ('let the buyer beware'), no more holds true. Consumer today is the kingpin around whom all marketing activities revolve. Consumer does not buy what is offered to him. He buys what he wants. Firms that fail to satisfy consumer needs will close down sooner or later. Besides, there are consumer

redressal cells to protect consumers against anti-consumer activities. Consumer sovereignty has, thus, forced firms to assume social responsiveness towards them. Firms that assume social responsibilities may suffer losses in the short-run but fulfilling social obligations is beneficial for long-run survival of the firms. The short-term costs are, therefore, investments for long-run profitability.

**2. Long-run survival:**

Business organisations are powerful institutions of the society. Their acceptance by the society will be denied if they ignore social problems. To avoid self-destruction in the long-run, business enterprises assume social responsibility.

**3. Self-enlightenment:**

With increase in the level of education and understanding of businesses that they are the creations of society, they are motivated to work for the cause of social good. Managers create public expectations by voluntarily setting and following standards of moral and social responsibility.

They ensure paying taxes to the Government, dividends to shareholders, fair wages to workers, quality goods to consumers and so on. Rather than legislative interference being the cause of social responsibility, firms assume social responsibility on their own.

**4. Avoids government regulation:**

Non-conformance to social norms may attract legislative restrictions. Government directly influences the organisations through regulations that dictate what they should do and what not. Various agencies monitor business activities.

For example, Central Pollution Control Board takes care of issues related to environmental pollution, Securities and Exchange Board of India considers issues related to investor protection, Employees State Insurance Corporation promotes issues related to employees' health etc. Organisations that violate these regulations are levied fines and penalties. To avoid such interventions, organisations have risen to the cause of social concerns.

5. **Resources :** Business organizations have enormous resources which can be partly used for solving social problems. Businesses are the creation of society and must work in the best interest of society, both economically and socially.

6. **Professionalisation :**

Management is moving towards professionalism which is contributing to social orientation of business. Increasing professionalism is causing managers to have formal management education and qualifications. Managers specialise in planning, organising, leading and controlling through their knowledge and subscribe to the code of ethics established by a recognised body.

The ethics of profession bind managers to social values and growing concern for society. Thus, there is increasing awareness of social responsibility. To grow in the environment of dynamism and challenge, business concern does not decide whether or not to discharge social responsibilities but decides how much social responsibility to discharge. A good business anticipates developments and acts in accordance with the currently conceived social responsibilities to achieve the future targets.

**2.7.4 ARGUMENTS AGAINST CSR:**

Corporate social responsibility is limited on the following grounds:

1. **Business is an economic activity:**

It is argued by the opponents of social responsibility that basic function of a business enterprise is to look into economic viability of its operations. It is for the Government to look after interests of the society. The prime responsibility of assuming social responsibility should, therefore, be of the Government and not of the business enterprises.

2. **Quantification of social benefits:**

What measures social responsibility and to what extent should a business enterprise be engaged in it, what amount of resources should be committed to the social values, whose interest should hold priority over others (shareholders should be preferred over suppliers or vice versa) and numerous other questions are open to subjective considerations, which make social responsibility a difficult task to be assumed.



**3. Cost-benefit analysis:**

Any social-benefit programme where initial costs exceed the benefits may not be taken up by enterprises even in the short-run.

4. Lack of skill and competence: Professionally qualified managers may not have the aptitude to solve the social problems.

**5. Transfer of social costs:**

Costs related to social programmes are adjusted by the business concerns in the following ways:

**(a) High prices:**

The costs are passed to consumers by increasing prices of goods and services.

**(b) Low Wages :**

If managers maintain the level of prices, the social costs may be reflected in reduction of wages.

**(c) Low profits:**

If wages are stabilized, profits would be reduced, which will lower dividends to the shareholders. Low profits will reduce managers' desire to further engage in corporate social responsibility

**6. Sub-optimal utilisation of resources:**

If scarce resources are utilised for social goals, this would violate the very purpose of existence of an organisation.

**2.7.5 DEBATE OVER CSR**

After considering the arguments in favour and against the concept of CSR, some points are still left unanswered. These are:

**1. Operational definition of CSR:**

The traditional view on CSR provided no information on business concerns about social values. The modern approach also provides no clear guidelines to managers. Business executives follow their own values and interests about social expectations. Actual meaning of CSR is, however, difficult to determine.

**2. No view of competitive corporate environment:**

Every business operates in the larger business system. It cannot come out of that system and transformation of society within the existing parameters of business system seems to be illusory. Business power is not unified and, therefore, even if they wish, they cannot fully meet the needs of the society. Redirecting resources towards needs of the society can perhaps be possible if government rewrites rules under which business corporations will operate.

**3. Limited ability:**

The proponents of CSR assume that business units have unlimited ability to fulfill social desires. However, it is not so. Business firms have limited ability to respond to social changes. Social actions will increase the costs and prices, which will place these firms at a competitive disadvantage in relation to firms who are not socially responsive.

**4. Lack of uniformity in business policies:**

Solving social problems is not feasible in competitive business environment unless all firms follow the same policy. Government can intermediate and make all competitors pursue the same policy on social problems. Government is in fact, framing standards for businesses to follow with respect to physical environment, occupational safety and health, equal opportunity, consumer concerns etc.

**5. Moral responsibility:**

Business firms feel that they have economic responsibility to produce goods and services. Their economic responsibilities justify their reason for existence. Why should business organizations have moral responsibilities? What are the moral justifications for the same?

**2.7.6 ROLE OF CORPORATE SOCIAL RESPONSIBILITY IN STRATEGIC PLANNING**

Ethics and social responsibility play a substantial role in developing strategic plan for an organization. Strategic plan is a plan to achieve long term objectives of the company and incorporating business ethics in this plan would ensure that company is truly following its ethics and ensuring long term success of

the company. This paper examines the role of business ethics by determining ethical principles and moral problems that can take place in the business. Ethics is required in every policies, procedures, and practices for making strategies. The firms should develop the strategic plan that integrates the organizational culture with ethics and social responsibilities.

At the same time our business assignment help stated that, the main purpose of corporate social responsibility of the organization is to exceed boundary of societal benefits. The strategic plan is affected by CSR of the organization that promotes the ethical activities. By considering the needs and agenda of stakeholders, ethics and social responsibilities are important to develop the strategic plan. Ethics is quite significant to take decisions related to organizational operations. For example, decision related to reduction in some distribution centers has an impact on the environment, where these plants are established. This decision also hampers the vendors and consumers, because there is no source for them to buy the product from the distributional sources. Thus, ethics and social responsibilities help the organization to implement the plan with ethics, principles, and moral values of the society.

### **2.7.7 RELATION BETWEEN CORPORATE SOCIAL RESPONSIBILITY AND BUSINESS ETHICS**

Corporate social responsibility is similar to ideas of social responsibility for individuals and businesses. Some sources provide similar definitions for the two terms, but corporate social responsibility is a specific business approach that [began in the 1950s and 1960s](#), with definitions expanding in the ensuing decades.

There is [no universally accepted definition](#) of corporate social responsibility, , but two features can be used to differentiate corporate social responsibility from other activities: 1) They partly or entirely benefit society and/or general interests; and 2) they are not obligated by law. Other aspects of corporate social responsibility can vary.

- Domains include environmental friendliness, community support, local products promotion, fair employee treatment and more.

- Stakeholders include employees, suppliers, customers, communities, the environment, investors and regulators.
- Policies and activities include cause-related marketing (marketing programs that combine sales objectives and helping worthy causes), sponsorship (connecting worthy causes to a brand or organization for money) and corporate philanthropy (charitable donations).

Some organizations engage in corporate social responsibility activities for intrinsic reasons: to help out and make societal contributions. Another motive is extrinsic, which relates to a company expecting financial or other benefits for socially responsible behavior. Many studies reflect positive organizational outcomes for corporate social responsibility activities, the *Journal of Business Ethics* reports. Finally, a third motive for corporate social responsibility activities is meeting societal expectations and stakeholder pressure.

### Interaction

Corporate social responsibility is a subset of business ethics corporate social responsibility under the normative stakeholder theory, or a philosophy that affirms that business corporations are 'morally' responsible to look after the concerns of a larger group of stake holders which could include owners, customers, vendors, employees and community rather than its stockholders. Some sources define stakeholders as groups that the organization depends on for its existence.

In this context, corporate social responsibility becomes synonymous with the duties and relationship between the business and the environment that facilitates its existence. And thus, it is not enough to cover certain ethical practices in businesses. For instance, corporate social responsibility does not include the ethicality of how the organization pursues profits or subscribes to political associations.

Corporate social responsibility is related to business ethics, but the former is a narrow topic within the latter area. Businesses should use corporate social responsibility along with processes like corporate governance, corporate outreach

and politics, business process redesign and corporate strategy to reconcile with the ethicality of doing business.

### **2.7.8 CORPORATE GOVERNANCE AND CSR**

The conceptualization of CSR was, initially, purely in terms of philanthropy or charity. However, the post-liberalization phase has seen a fundamental shift from this philanthropy-based model of CSR to a stakeholder- participation based model. Furthermore, CSR is gradually getting fused into companies' Corporate Governance practices. Both Corporate Governance and CSR focus on the ethical practices in the business and the responsiveness of an organisation to its stakeholders and the environment in which it operates. Corporate Governance and CSR results into better image of an organisation and directly affects the performance of an organisation.

The OECD principles on Corporate Governance, UN Global Compact Participation throw light on CSR scheme but in India CSR, by virtue of clause 49 of the listing agreement, have been made totally optional.

It is pertinent to mention here that transparency, disclosure, sustainability and ethical behaviour is central theme in both CSR and Corporate Governance. Further, it is worthwhile to mention that CSR is based on the concept of self governance which is related to external legal and regulatory mechanism, whereas Corporate Governance is a widest control mechanism within which a company takes its management decisions. Furthermore, the objectives and benefits of CSR and Corporate Governance are similar in nature, some of them are stated herein below:

- Rebuilding of public trust and confidence by increased transparency in its financial as well as non-financial reporting and thereby increasing the shareholder value.
- Establishing strong brand reputation of the company.
- Making substantial improvement in its relationship with various stakeholders.

- Contributing to the development of the region and the society around its area of operation
- Addressing the concerns of its various stakeholders in a balanced way so as to maintaining a strong market position.

Furthermore, it may be worthwhile to note that in case of unlisted companies there is not robust system of corporate governance, although there are some provisions in the Companies Act, 1956, in this context the relationship between Corporate Governance and CSR is very important and significant. In order to appraise present position of CSR and Corporate Governance, it would be worthwhile to examine the legal and regulatory framework dealing with CSR and Corporate Governance.

#### **2.7.9 Summary**

The lesson provides the relationship among business ethics, corporate social responsibility and corporate governance. Corporate social responsibility is similar to ideas of social responsibility for individuals and businesses. It is worthwhile to mention that CSR is based on the concept of self governance which is related to external legal and regulatory mechanism, whereas Corporate Governance is a widest control mechanism within which a company takes its management decisions.

#### **2.7.10 Exercise**

- Q.1 What do you mean by corporate Social Responsibility. Discuss the arguments in favour and against of CSR.
- Q.2 What is the role of CSR in Strategic Planning.
- Q.3 Why Corporate Social Responsibility is required to follow.
- Q.4 Explain the relation between Corporate Governance and CSR
- Q.5 What do you mean by CSR and Business ethics.

#### **2.7.11 Suggested Readings**

1. Sharma, J. P., Corporate Governance and Social Responsibility of Business, Ane Books Pvt. Ltd., New Delhi.
2. Bhanu Murthy, K. V. and Usha Krishna: Politics Ethics and Social Responsibilities of Business, Pearson Education, New Delhi. Business, Pearson Education, New Delhi.

---

**LESSON NO. 2.8**

---

**ENVIRONMENTAL ASPECTS OF CSR****Structure of the Lesson:**

- 2.8.0 Learning Objectives
- 2.8.1 Environmental Ethics
- 2.8.2 Issues in Environmental Ethics
- 2.8.3 Environmental Movement
- 2.8.4 Concept of Corporate Social Responsibility
- 2.8.5 Corporate Social Responsibility and Environment Protection
- 2.8.6 Business Benefits of Corporate Environment Responsibility
- 2.8.7 ISO 26000
- 2.8.8 CSR Provisions Under Companies Act 2013
- 2.8.9 Summary
- 2.8.10 Exercise
- 2.8.11 Suggested Readings

**2.8.0 Learning Objectives :**

The main objective of this lesson is to give information about environmental ethics that corporate follows for environmental sustainability. This lesson introduces about ISO 26000 also and various CSR provisions under companies act 2013.

**2.8.1 ENVIRONMENTAL ETHICS :**

Environmental ethics is the discipline in philosophy that studies the moral relationship of human beings to, and also the value and moral status of, the environment and its nonhuman contents. The environmental ethics rests on the principle that there is an ethical relationship between human beings and the natural environment. Human beings are a part of the environment and so are the other living beings. When we talk about the philosophical principle that guides our life, we often ignore the fact that even plants and animals are a part of our lives. They are an integral part of the environment and hence cannot be denied their right to live. Since they are an inseparable part of nature and closely associated with our

living, the guiding principles of our life and our ethical values should include them. They need to be considered as entities with the right to co-exist with human beings.

### Concept

The concept of environmental ethics brings out the fact that all the life forms on Earth have the **right to live**. By destroying nature, we are denying the life forms this right. This act is unjust and unethical. The food web clearly indicates that human beings, plants, animals, and other natural resources are closely linked with each other. All of us are creations of nature and we depend on one another and the environment. Respecting the existence of not just other humans but also the non-human entities, and recognizing their right to live is our primary duty. With environmental ethics, **morality** extends to the **non-human world**.

### 2.8.2 ISSUES IN ENVIRONMENTAL ETHICS

- Consumption of Natural Resources
- Industrial and Household Waste
- Climate change
- Global warming
- Overpopulation
- Destruction of Forests
- Environmental Pollution
- Harm to Animals
- Acid Rain

### OUR MORAL RESPONSIBILITY

Another important point in relation to environmental ethics is of our moral responsibility to preserve nature for our **future generations**. By causing environmental degradation and depletion of resources, we are risking the lives of future generations. Is it not our duty to leave a good environment for them to live in? Non-renewable energy resources are fast-depleting and sadly, it isn't possible to replenish them. This means, they may not be available for the future generations.



We need to strike a balance between our needs and the availability of resources, so that the forthcoming generations are also able to benefit from their use.

We are morally obliged to consider the needs of even the other elements of our environment. They include not just other human beings, but also plants and animals. It is only ethical to be fair to these elements and make a responsible use of natural resources. Environmental ethics try to answer the question of whether human beings have any moral obligation towards the **non-human entities** in nature.

### 2.8.3 ENVIRONMENTAL MOVEMENT

An environmental movement can be defined as a social or political movement, for the conservation of environment or for the improvement of the state of the [environment](#). The terms 'green movement' or 'conservation movement' are alternatively used to denote the same. The environmental movements favor the **sustainable management** of natural resources. The movements often stress the protection of the environment via **changes in public policy**. Many movements are centered on **ecology, health and human rights**. Environmental movements range from the highly organized and formally institutionalized ones to the radically informal activities. The spatial scope of various environmental movements ranges from being local to the almost global.

#### Major Environmental Movements in India

Some of the major environmental movements in India are the following:

- Bishnoi Movement
- Chipko Movement
- Save Silent Valley Movement
- Jungle Bachao Andholan
- Narmada Bachao Andholan (NBA)
- Appiko Movement
- Tehri Dam Conflict

### 2.8.4 CONCEPT OF CORPORATE SOCIAL RESPONSIBILITY

The emerging concept of corporate social responsibility goes beyond charity and requires the company to act ethically in the company's business affairs. The

triple bottom line approach to corporate social responsibility emphasizes the company's commitment to operating in economically, socially and environmentally sustainable manner. CSR is based on the idea that successful profitable corporations should take the responsibility for social issues and manage their business in such a way that maximises profit and stockholder wealth while also contributing to the resolution of the social problems. The concept involves notions of human welfare and emphasizes a concern with the social dimensions of the business activity that have direct connection with the quality of life in the society. The word responsibility implies that business organisations were believed to have some kind of obligation towards the society in which they functioned to deal with the social problems and contribute more than just economic goods and services. It is a concept whereby the companies integrate social and environmental concern in their business operations and in their interactions with the stakeholders on a voluntary basis. The main function of an enterprise is to create value through producing goods and services that society demands, thereby generating profit for its owners and shareholders as well as the welfare of the society, particularly through the on going process of job creation. Social responsibility implies the acceptance of a moral imperative to recognise the duties and obligations arising from a company's relationship with customers, suppliers, employees, shareholders and society at large beyond consideration of profit. It refers to business decision making linked to the ethical values, compliance with the legal requirements and respect for people and communities and environment.

#### **2.8.5 CORPORATE SOCIAL RESPONSIBILITY AND ENVIRONMENT PROTECTION**

India has a history of having a compassionate attitude towards environment. But with the passage of time the ethical values towards society have degraded as a result of which judiciary intervened so as to protect the environment. A concept known as corporate social responsibility emerged in the light of right to pollution free environment and the constitutional duty to protect and improve the environment. In order to realise the constitutional objective of protecting

environment the concept of Corporate Social Responsibility was recognised in the legislative enactments. The paper introduces the concept of Corporate Social Responsibility and the [Constitutional](#) commitment towards environment protection. Judicial decisions bring into light the conception of Corporate Environment Liability by streamlining the defaulting institutions.

India is a welfare state. But with the passage of time Indian government has adopted liberalisation, privatization and globalization. Public sector has slowly shifted to private one. Therefore, the new concept of Corporate Social Responsibility [CSR] means a corporate sector shall perform such welfare function towards society which is necessary for maintaining the social interest of the society. In the words of 'Carroll' and 'Buchholtz', the corporate social responsibility encompasses the economic, legal, ethical, and philanthropic expectations placed on the organisations by the society at a given point of time. According to Brown H.R., social responsibility is defined as, "the obligation of a businessman to pursue those policies, to make those decisions or to follow those lines of action which are desirable in terms of objectives and values of the society. Some scholars have defined CSR as a social commitment of a businessman or a social obligation or moral or ethical responsibility or a corporate social philanthropy. In the words of Mahatma Gandhi, business entrepreneurs are trustees and not the owners of the social wealth and they have to spend a part of it for social causes. To describe the principle of trusteeship he quoted, enjoy the wealth, take the minimum which you need, leave the rest to the welfare of community." It cannot be considered as charity. A robust and thriving development sector is central to India's quest for equitable, inclusive and sustainable growth. India's development sector has evolved substantially over the last few decades and is now witnessing unprecedented interest and investments across the value chain.

With the passage of the Companies Act, 2013 the mandate for corporate social responsibility (CSR) has been formally introduced to the dashboard of the Boards of Indian companies. The industry has responded positively to the reform measure undertaken by the government with a wide interest across the

public and private sector, Indian and multinational companies. Building a society which provides equal access to opportunities negates disparities and, is a collective responsibility.

The Companies Act, 2013 has introduced the idea of CSR to the forefront and through its disclose-or-explain mandate, is promoting greater transparency and disclosure. Schedule VII of the Act, which lists out the CSR activities, suggests communities to be the focal point. On the other hand, by discussing a company's relationship to its stakeholders and integrating CSR into its core operations, the draft rules suggest that CSR needs to go beyond communities and beyond the concept of philanthropy. It will be interesting to observe the ways in which this will translate into action at the ground level, and how the understanding of CSR is set to undergo a change. Irrespective of whether a company is polluting or nonpolluting, protection of environment should be the concern of every socially responsible organization. Each company must take steps to make sustainable use of resources, establish a healthy and safe working environment, maintain ecological balance, take proactive steps to minimize waste generation and preserve environment

#### **2.8.6 BUSINESS BENEFITS OF CORPORATE ENVIRONMENT RESPONSIBILITY**

Corporate environment responsibility (CSR) has many advantages that can apply to any business, regardless of its size or sector. The potential benefits from CSR include:

- Better brand recognition
- Positive business reputation
- Increased sales and customer loyalty
- Operational costs savings
- Strategic planning
- Technological innovations
- Better financial performance
- Greater ability to attract talent and retain staff
- Organizational growth
- Easier access to capital

### 2.8.7 ISO 26000

ISO 26000 is the international standard developed to help organizations effectively assess and address those [social responsibilities](#) that are relevant and significant to their mission and vision; operations and processes; customers, employees, communities, and other stakeholders; and environmental impact.

The ISO 26000 standard provides guidance on:

- The seven key underlying principles of social responsibility: accountability, transparency, ethical behavior, respect for stakeholder interests, respect for the rule of law, respect for international norms of behavior, and respect for human rights.
- Recognizing social responsibility and engaging stakeholders
- The seven core subjects and issues pertaining to social responsibility: organizational governance, human rights, labor practices, the environment, fair operating practices, consumer issues, and community involvement and development
- Ways to integrate socially responsible behavior into the organization
- In addition to providing definitions and information to help organizations understand and address social responsibility, the standard emphasizes the importance of results and improvements in performance on social responsibility.

### WHO USES ISO 26000?

Organizations in the private, public, and nonprofit sectors, whether large or small, and whether operating in developed or developing countries, use ISO 26000. All of the core subjects are relevant in some way to every organization.

### 2.8.8 CSR PROVISIONS UNDER COMPANIES ACT 2013

With the enactment of the Companies Act, 2013, India has become the forerunner to mandate spend on Corporate Social Responsibility (CSR) activities through a statutory provision.

While many corporate houses have been traditionally engaged in doing CSR activities voluntarily, the new CSR provisions put formal and greater responsibility on companies in India to set out clear framework and processes to ensure strict compliance. However, what the Companies Act does is bring more companies into the fold and increase the total CSR spend.

**Section 135(1)** of the Companies Act, 2013 provides for the trigger point for the applicability of CSR Provisions and constitution of CSR Committee. The constitution of CSR committee is mandatory in company having:

- Net Worth of Rs. 500 Crore
- Turnover of Rs. 1000 Crore
- Net Profit of Rs. 5 Crore

#### **2.8.9 Summary**

The main objective of this lesson is to give information about environmental ethics that corporate follows for environmental sustainability. This lesson introduces about ISO 26000 also and various CSR provisions under companies act 2013.

#### **2.8.10 Exercise**

**Q.1** explain CSR provisions under companies act 2013

**Q.2**What do you mean by ISO 26000?

**Q.3** Explain Environmental issues and Role of Corporate Environmental Protection in Environment .

#### **2.8.11 Suggested Readings**

1. Sharma, J. P., Corporate Governance and Social Responsibility of Business, Ane Books Pvt. Ltd., New Delhi.
2. Bhanu Murthy, K. V. and Usha Krishna: Politics Ethics and Social Responsibilities of Business, Pearson Education, New Delhi. Business, Pearson Education, New Delhi.