Corporate Governance: A Case study of an Indian Multi-Divisional Company

A thesis submitted during 2013 to the University of Hyderabad in partial fulfilment of the award of a Ph.D. degree in Sociology

BY

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CERTIFICATE

This is to certify that the thesis entitled “Corporate Governance: A Case study of an Indian Multi-Divisional Company” submitted by Vangala Harish Srivatsava bearing Reg. No. 2KSSPH04 in partial fulfilment of the requirements for the award of Doctor of Philosophy in Sociology is a bonafide work carried out by him under my supervision and guidance.

The thesis has not been submitted previously in part or in full to this or any other University or Institution for the award of any degree or diploma.

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DECLARATION

I Vangala Harish Srivatsava hereby declare that this thesis entitled “Corporate Governance: A Case study of an Indian Multi-Divisional Company” submitted by me under the guidance and supervision of Dr. V. Janardhan is a bonafide research work. I also declare that it has not been submitted previously in part or in full to this University or any other University or Institution for the award of any degree or diploma.

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CHAPTER 1
Corporate Governance: Preliminary Discussion

During the last two decades, there has been a continuing discussion on corporate governance emphasizing its importance and relevance in the current economic scenario. The contemporary globalised business environment has increased competition, effectively after the drive towards integration of national economies in general and opening of Indian economy in particular, associated with large scale public interest. It is increasingly being understood that better corporate governance results in enhancing the image of a company and thus improves its reputation, as well as market capitalization. These changing business realities in the contemporary times highlight the importance of governance in general and corporate governance in particular.

The term Corporate Governance conjures up different meanings and explanations. Corporate governance is a concept that envisages a set of systems and checks which ensures that the company is managed properly to the best interests of shareholders, creditors, employees, customers, suppliers, community and government to say the larger society. In other words it is not only a reactive concept implying checks and balances but a proactive process which aims at creating corporate excellence thereby enhancing the value of the firm. The emphasis is on inculcating corporate democracy, fairness, transparency, accountability in operations as well as reporting practices.

Evidently, the significance of corporate governance in the last ten years have designated a new area of academic specialization, though many of its central themes have been subjects of debate in sociology and economics for many years. There has been a growing academic interest to understand changes in the financial and legal organization of business, patterns of political intervention in business, larger development role of business has motivated social scientists, lawyers, schools of business management to take the lead in the development of this emerging specialism. Scott and Blau, (2001) noted that issues of corporate governance and subsequent practices of companies are no longer confined to the smoke filled boardrooms rather generated a large scale academic explanations and also public interest. Before proceeding further into a detailed analysis of various arguments concerning modern business corporation as a social institution and relevance of appropriate governance mechanisms to address the best interests of numerous social actors, it would be befitting to mention the three major reasons for the growing importance of corporate governance in the present scenario.

Firstly, the need for effective corporate governance lies at the heart of modern business corporation and its subsequent ownership pattern. Barle and Means, (1932) described the business organization (corporation) is a distinct entity by its sheer size of operations, sophistication of expertise and diffused ownership, tends to be corporatised with virtually inevitable separation of ownership and management. This earmarks misalignment of interest between owners of the firm and managers of the firm, as the nature of ownership is diffused and real owners (shareholders) are away from day to day executive management of the company, which has been delegated to corporate managers. This separation of ownership and control raises certain agency problems because of self- interests and self-dealing by managers (agents) subsequently leading to misappropriation of owners (principles) wealth by managers, at times loss of stockholder investments. Corporate governance thus, as illustrated by Pearce and Robinson jr. (2005), is an appropriate mechanism to align the interests of principles (corporate owners) with that of agents (corporate managers) by the way of internal and external mechanisms. The system of corporate governance hence stresses the role of board of directors as fiduciaries of stockholders, to monitor, motivate and secure the corporate managers to pursue the interests of shareholders above all. Jacoby (2005) noted that structure and system of corporate governance guide the management on what needs to be done on one hand and monitor/ evaluate managerial performance against set levels of expectations all in the interests of owner and shareholders.

Secondly, a key concern for an effective corporate governance framework is the growth of capital markets globally and cross border flows of capital. The developments in global financial market have potentially influenced the way corporate companies govern themselves. Sundaram and Bradley (2004), opined that these growing trends are well in tune with the demands of globalization in the contemporary times. The increasing reliance on equity/debt markets enabled firms to adopt better standards of governance which in turn create and transfer value to the shareholders.

Thirdly, to be sure, around the globe, societies have been experiencing tremendous social, political and economic change during last quarter century. According to Reed, (2004) 'If we focus on the intersection of two particularly significant areas where majority of changes has been taking place over time – changes in the manner in which corporations are governed and changes in the efforts of developing countries to promote developments'. However, it has not been common to relate corporate governance and development since former has been frequently conceived in terms of obligations of business organizations to shareholders, while later has primarily been understood to be the domain of state involving various micro-macro policies and programmes that result in the realization of goals and priorities of the state. While in actual practice there has always been some relationship between corporate governance and development as the manner and substance of corporate decision making significantly affected development prospects. Recently, the process of economic reforms associated with notion of globalization has led to reduce the role of the nation states in a variety of areas resulted in a move from welfare state to competitive state (Sarangi, 2001). Under these circumstances links between corporate governance and development should become direct and these is increasing incentives provided to corporates' by state clearly demonstrate the same. Today, corporate business organizations are conceived as change agents, collaborates, partners for development. Such a new paradigm and understanding widen the scope of corporate governance as a mechanism for realizing the interests of public, economic development, stability of the economy.

The above paragraphs illustrate the growing importance as well as need for a better, efficient corporate governance systems that address the larger interests of diverse social actors. However, historically it has never been easy - for academicians, business leaders and general public to closely connect the notions of business in general and corporate governance in particular to larger social issues. There has been always suspicion against the purpose, motives of business and these questions will intensify if one tries to correlate business with societal development concerns. This is nevertheless a result of general understanding, reservations of people towards business activity. However, probably one has to understand philosophy of business, locate business as a social institution and societal sub systems to answer these criticalities (concerns) in an elaborative way. So before probing into larger conceptual understanding of corporate governance it is more befitting to analyze the concept of business to understand the relationship between business and society. Moreover this prior understanding of business would enable to arrive at a holistic conceptualization of corporate governance, which is central to the present research endeavor. Such a holistic framework, as Swamy (1999) opined will address concerns of larger development, public good, conservation of resources, employment generation, etc.

1.1 Business Organization: an Introduction

Business is an important institution in the society. Be it for the supply of goods and services, creation of employment opportunities, offer better quality life, or contribute to the economic growth of a county; the role of business is crucial in these regards. Business cannot do with out society and it needs no emphasis that society needs business as much. As Buskirk, Green, Rodgers (1976) defined business appropriately as “a system created to satisfy society’s needs and desires”.

The term business has attracted enormous learned attention in the field of social sciences and business management. The ontological foundation of business has been significantly explained in the works of many scholars especially in Economics. However most of these accounts have missed the humanizing influence and sense of realism in understanding the philosophical discourse of business. A large portion of economic interpretations have devoted itself to an exposition of certain distinct factors say capital, land, labour and organization or management to conceptualize business as a group of productive units that produce and distributes economic goods according to the characteristics of capitalist systems. These economic explanations of business are vague and equivocal, not to say unrealistic because it follows its own analysis into the profounder realism of human relationships, and factors of individual interests and behaviour, that lie at the back of characteristic of "economic man".

A notable re-approachment has initiated in business studies during 1930's especially in the works of eminent sociologists like, Fairchild, Berg, Zald which trace business to sociology and analyzes it as an essential social reality, on the basis of sociological methodology. The business has significantly acquired sociological treatment and refer to be understood as an institution in the society, like many other such social constructs as the state, family, school, the press, the law etc. business has a logical place in this category, as an institution that leads to self maintenance of society (Fairchild, 1937). What then is business in a sociological sense and what claim has it be considered as institution? In spite of great diversity, there is a fairly general agreement among sociologists that an institution is an established integration of social elements for the satisfaction of some major interest, including elements not only certain tangible equipment, but more fundamentally relationships and established modes of social procedure. Thus business is an organization of social elements into a unit designed for the production and supplying of material goods and services. Its essential attribute is the integration of two or more social elements. Sociologists have emphasized the distinct integration of group of factors (capital, land, labour, management) that produce and distribute goods and services.

Various sociologists provided path-breaking illustrations regarding the nature of modern corporations by examining the relationships between corporate business and employees, suppliers, customers, community and larger society. They have provided illuminating discussions of modern business corporation as a functional unit and integral part or subsystems of national economic and social system. These explanations have remarkably drawn a closer connection between an economic entity say corporation and its larger role in the society. Berg (1978) had argued that though corporations are distinct economic entities but they largely depends on society for resources and successful accomplishment of their goals, and corporate behaviour and culture are largely influenced by the beliefs, value systems and attitudes of the given society. The relationship thus is based on mutually exclusiveness and interdependence and this can best illustrated by the systems concept of business.

Sharlekar and Sharelekar (1999) have mentioned that corporation is a total system with in itself and it the same time it is a system with in the larger social superstructure. This approach clearly postulates that the corporation and society interact in a system framework. A corporation is an eco-social sub system of the socio-economic system of an economy. Hence, corporation predominantly receives inputs from society and offers out parts it to its environment i.e. society. In this regard it provides output that is desirable and largely acceptable to the environment. As corporation is a part of a larger social system one can easily understood the significance of the mutual interaction and interdependence between corporation and society.

Alongside, a large number of sociological accounts duly emphasize on the ownership structure of modern business corporations and subsequent issues/ problems that primarily embedded in it. The issue of ownership in case of modern corporation have been significantly addressed in the seminal works of Barle and Means (1932), Zald and Berg (1978) and others. The sociological explanations aptly address these governance problems that are inherent in separation of ownership and control. These concerns lie at the heart of contemporary agency problems through misappropriations of owner’s wealth by the managers. These studies reflect the inherent principles of agency problem and also endeavor to analyze the role of modern business corporations as institutions embedded in the given society. The present study aims to understand these sociological concerns at the backdrop of contemporary corporate governance crisis. This is also an attempt to provide a larger – holistic understanding of corporate governance phenomenon that can address the growing discontinuities and also integrate the same with an appropriate framework to balance and manage the interests of numerous social actors.

1.2 Corporate Business and Societal Environment

The corporations and their governance significantly influence individuals and groups that are largely part of the societal environment. These various groups too often exert powerful influence on the way decisions to be taken thus determining the governance of the corporation. The relationships between these constituent groups to the corporation are often governed by the central laws enforced by the governments and also decided by the private law established in agreements between corporation and its employees, suppliers, customers, investors and the community. These groups and individuals are part of the corporate environment and largely affected by or affect the way corporate decisions have been taken.

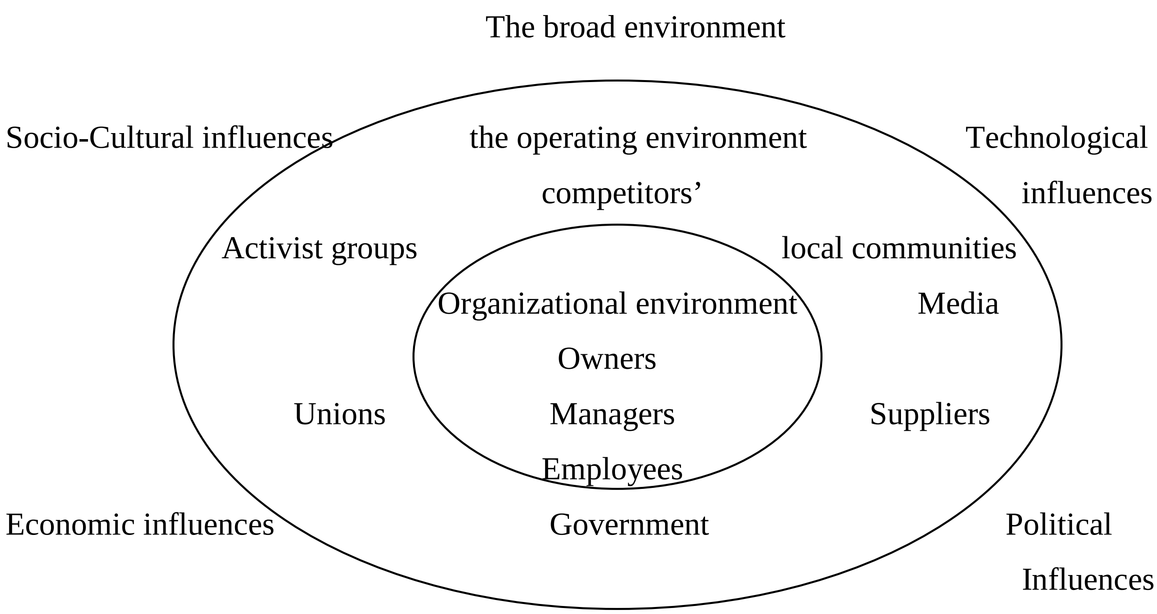
The growing concerns between business corporations and their environment have led to the emergence of new issues in the study strategic management of firms. Parcel and Robinson Jr, (2005) contended that environment as a determinant of success and the extent to which a firm can relate functionally to its external environment. However this understanding of environment is essential at this juncture to draw certain arguments and to build explanations regarding the closer link between corporate and it's various constituents (Stakeholders) who are part to these environments that are either internal to the corporation or external to it.

The corporations have their roots in the large environment. However the concept of environment is complex and one cannot deal with its complexity. Likewise the present analysis of corporate and it's governance in a way tries to limit itself to an explanation of a dimension of environment that comprises namely of stakeholders associated with the corporate, stakeholders in contact, stakeholders served and the stakeholders at large. Goffman (1957) have commented that the environment thus refers to a realm where these stakeholders groups are placed either in the external – broad of operating environment or internal – organizational environment. One point to bear in mind at this departure is the boundary between organization and its operating (external) environment that is never absolutely clear and surrounded by a semi permeable membrane.

Environment refers to all external forces which have a bearing on the functioning of the corporate business. Environment factors or constraints are largely if not totally, external and beyond the control of individual industrial enterprises and their managements. The below figure illustrates various categories of environment and various stakeholders who are part of it.

In the figure 1.1 the broad environment reflects the changes in technologies conditions, economic priorities, political changes and regulatory regimes and socio -cultural factors. As Aswathappa, (1999) accorded the operating environment (external) consists of stakeholders with whom organizations interact on a fairly regular basis, including customers, suppliers, government bodies, local communities, activities groups, unions, media etc. these stake holder groups are largely indirect action elements that influence the decision-making policies of the corporates, importantly al these stakeholders are not equally important for firms success nor do any of them play same role of enforcements. These stakeholders have varying levels of powers to influence the organizations. The crucial concern for organization performance largely depends on the way corporate can manage and balance the interests of these conflicting groups or individuals.

Figure 1.1 Business and Social Environment of a Company



Source: adapted from J.S Harrison, strategic management of resources and relationships: concepts and cases (John Willy and sons Inc: New York, 2003), p. 37

Likewise, Harrison (2003) stated that internal or organizational environment consists of immediate claimants of the corporation. This includes shareholders (owners), Board of Directors, Executive Management and Employees. However the interests of these stakeholders are pivotal concern for corporates at all times and these groups are largely direct action elements.

Thus, a corporation is comprised of various direct and indirect actors both in its internal and external environment. These stakeholders as Jones, (1999) stated, if managed well would become inherent competitive strengths for corporation's success. It is widely agreed notion that firms that maintain and sustain co-operative and long term relationships with its stakeholders, generate more value for itself and as well as for these groups of claimants (Jones, 1999). Hence responding appropriately to these stakeholders and understanding their expectation are central for the firm's success and strategic maneuverability in an ever changing competitive landscape.

The corporate organizations in the contemporary times have realized the apparent need for confirming to wider social expectations. In order to meet the expectations of diverse stakeholders of the society or perhaps to attain legitimacy for existence, corporates have increasingly incorporating stakeholder expectations in their core business functions and strategic operations. This kind of integration fosters co-operative ties and alignment of interests between corporates and stakeholders thereby leads to a mature and holistic understanding of governance that could postulate enhanced value for stakeholders.

With this preliminary understanding of corporate governance and importance of stakeholder relationships, now I am moving towards, methodological orientation of this present research study.

METHODOLOGY

1.3 Statement of the Problem

The problem that is proposed to be explored, analyzed and explained pertains to governance in the corporate sector, the focus being the Indian situation. With capitalism coming of age in India in the contemporary period, effective governance of companies assumes great importance for not only the investing class but for other stakeholders, such as employees, customers, suppliers, local community, and in several ways the ordinary members of the public. In other words it becomes a social question and therefore, a fit question to be examined by social sciences in general and sociology in particular. The present research will endeavor to demonstrate that the social sciences are eminently capable of being invoked in and for an inquiry of this kind. Accordingly, this makes for an interdisciplinary study in the social and management sciences even while being anchored in sociology.

The present study aims to reflect upon a larger and all encompassing explanation of corporate and governance. The terms corporate and governance respectively, have attracted great deal of attention from an array of academicians and practitioners both in terms of philosophical underpinnings and theoretical discourses. Ironically, corporate governance which is seemingly relevant contemporary phenomenon lacks such wider conceptual understanding and limited in terms of use as well as applicability. The present study set forth these central ideas and attempts to examine corporate governance as governance for what? Governance for whom? Governance for which purpose? However these concerns are by and large universal because the nature and role of corporates have been significantly expanded in the current times so there is a growing need for analyzing the way corporates govern in the contemporary economy and society.

Thus the study focuses on the issues of corporate governance and need for stakeholders relationships for sustained value creation and growth. The corporate governance in this connection was understood and demonstrated by the reflections of the wider stakeholders of the corporates who are part of, affected by or effect the way corporate decisions are made. Thus, the present research tries to understand while examining how managers perceive it? How stakeholders view it? And how such an actions realize strategic aims of the corporates all exclusively?

1.4 Scope of the Study

The research study can be complex, all exclusive and tries to include a large number of factors for analysis. A point to be borne in mind is the scope of the study, which in turn helps the researcher to actively identify what to include and exclude from the given research endeavor. A concrete explanation of the scope further guides the researcher to include key variables on which data is sought and analyzed. However wider the study in its scope, certain delimitations are imperative for practical purposes. In the same way the present study is complex and relatively wider in scope but it however limit itself to a set of attributes and propositions which enable the study to reflect on key concerns that have being identified in the research problems.

The given complex nature of corporate governance issues that are central to effective functioning of a modern business organization might tempt researchers to include everything that bear a meaning to it. The scope of the present study is limited, at least not to include everything or any thing that happens in a company but to study particular concerns which have linkage for understanding governance framework of the concerned. The scope of the study is however limited to examine or investigate the functional relationship between corporate governance and stakeholders relationships. Interestingly, though scope is limited to corporate and stakeholder relations but it includes the wider, complex relationships that have established between corporates and its stakeholder groups say shareholders, employees, suppliers, customers, community, government etc. the study includes the nature of these relationships, internal mechanisms that govern these relationships, strategic orientation towards stakeholders relations and normative principles that are attached to these relationships which are largely based on core values and principles of corporate concerned.

Most of the attributes included in the present study have significantly guided by theoretical perspectives (stakeholder) of corporate governance. The nature of firm-stakeholder relationship and strategic imperatives of corporates are guided by the descriptive/instrumental concerns of the stakeholder's perspective of corporate governance. Thus theoretical framework largely constructs the scope of the present study in determining what to include, accumulate, systematically explain and predict the phenomenon concerned. However, such a reliance on theoretical concepts to guide delineation, design and data collection remains one of the crucial strategies because of its apparent importance for doing case studies.

1.5 Limitation of the Present Study

One notable limitation of the present study lies at the heart of corporate governance framework and regulations enforced in the national law of governing companies. The focus of the study is Indian scenario of corporate governance; where there is no mandatory/legal enforcement regarding all stakeholders representation and participation in the way companies govern. In India there is no legislation that universally enforces all stakeholder interests in the way companies discharge responsibilities and take certain strategic decisions. Though company law and legal enforcement by securities exchanges clearly prescribe mandatory provisions for protection of specific stakeholder's interests, but no law has so far prescribed on employee participation on boards, protection of local community interests, customer protection and supplier interests by the regulatory bodies. Therefore the present study aims to re-approach the corporate governance issues from efficiency of internal mechanisms, mutual arrangements between company and stakeholders. It is evident that companies that predict risks from divergent stakeholder constituents and focused on long term growth have established co-operative arrangements with stakeholders even though it is not been mandatory from regulatory compliance aspect of corporate governance. The efficiency and professionalism of these internal mechanisms contribute to the company overall governance and provides a wholistic understanding to their policy of governance and subsequent practice. However it is exclusive practice for certain corporates at least in India, hence such a stakeholder orientation cannot be generalized for all other or rather universally mandated for Indian corporates since the Company Law does not make mandatory claims for such a practice in reality.

Another limitation is the correlation between stakeholder relationships and firm performance. However it is not the limitation for present research study but universal phenomenon for many studies on instrumental concerns of stakeholder relationships and firm's performance where the earlier research failed to demonstrate it profoundly. To be sure, one should not treat this as a limitation because the present study aims to reflect on the nature of the firm and stakeholder relationship from actor's perspective and attempts to generate larger understanding of corporate governance policy and practice. The study only emphasizes the relationship between stakeholder orientation and firm's performance in general, but not in obsolete terms of firm's financial gains and losses. The study however highlights certain key stakeholder relationships and profitability and growth, but this casual relationship is not the all exclusive focus of the study. Besides, the study aims to explore and explain the way corporate managers perceive stakeholders interests and stakeholders reflections on corporate governance. The cause and effect relationship can be found between corporate governance policy of the company and its practices of stakeholders' management.

1.6 Methodology – Research Method

The present research exercise follows the case study method. The case study method is more befitting given the nature of complexity, diversity and richness of the phenomenon – 'corporate governance'. As we have clearly seen in the earlier sections, an in-depth and comprehensive understanding of corporate governance can be only completed when it is examined in-depth by definitive account of case. The problem of study clearly reflects that policy and practice of corporate governance for stakeholder value should thus require in depth inquiry that can provide a rich description of the phenomenon from participant's perspective. The present research exercise aspires to comprehend corporate governance policy and practice of an Indian corporate from the participant's point of view (both managers and stakeholders). The case study thus accounts for particular descriptive and inductive understanding of the corporate governance at case company and its orientation towards stakeholder's interests, complex realities of implementation etc. By and large case study approach is an appropriate methodological fit for the present study and seeks to illuminate ones understanding of the issue-corporate governance-in totality.

However, it can be questioned for being single case and problems of wider applicability and generalizations. In this connection the present research study does not claim that findings can automatically be generalized. The case studied is an example and unique because of well-defined policy of corporate governance coupled with an effective practice of stakeholder relationships. Although the study dealing with only one case, it is not perhaps unreasonable that the ideas derived from studying the present case can be re-considered for further research and could be treated as a modest contribution to the knowledge in the realm of corporate governance

Once the method is derived for conducting a research study, the next step that assumes pivotal importance specifically for doing case study is the necessary arrangements for the study. It should essentially begin with selection of the case, intrinsic and instrumental interest in selecting a particular case, the need for the study of particular case, design of the case study, research questions and propositions, tools of data collections, techniques for data analysis so on and so forth. Amongst, the primary need is to identify a particular case to study the research problem concerned.

1.7 Identification of the Case:

A case may be simple or complex and inquiry on the case may be long or short. In case of present study, selection of the appropriate case assumes a good deal of importance because such a holistic understanding of corporate governance that ensures stakeholder value cannot be easily traceable in the policies and practices of large companies. Secondly, as Yin (1991) observed the case company should be specific one and bounded system i.e. combination of working parts, purposive and an integrated system. Thus the case company for the present study has chosen on the basis of its outstanding existence from the beginning, nature of ownership and management, philosophy of corporate governance, shareholding pattern, stakeholder orientation etc. However identification of case company requires methodological focus on understanding its corporate governance framework, vision, core values, internal mechanisms and representative nature to the problem of the present research study.

The case company selected for the present study is ITC Limited - a diversified; multi business, multi divisional conglomerate in India. ITC has identified for its long existence in India from 1910 onwards, sound and value driven corporate governance policy, standardization of procedures for governing the company across the divisional units, primacy over stakeholder interests, practices of world class reporting standards and disclosures, institutionalization mutual arrangements/relationships with stakeholder and lastly, substantial premium given to sustainable value creation for the stakeholders and to the nation.

The ‘case’ company had been incorporated in 1910 as Imperial Tobacco Company at Kolkata. It has changed the name from Imperial Tobacco Company to Indian Tobacco Company in 1974 then later on became ITC limited and assumed true multi business nature in 2001. The company has remarkable market positioning in fast moving consumer goods business, a special stand alone position in cigarette manufacturing, packed foods, garments retailing, greeting, gifting and stationary, safety matches and agarbati making. Along with FMCG segment, the company has strong presence in Hotel and Tourism business. ITC gained remarkable position in Hotel business by strategically collaborating with worlds largest hotel chains.

Apart from FMCG and Hotels, the case company has dominant presence in Paper boards and specialty paper business because of its state of art technology and backward integration. ITC foray into this business reflects its early signs of diversification from core cigarette business to non-core paper business. ITC also acquired leadership in agri-business which is a major source for its foreign exchange through exporting leaf tobacco and agricultural commodities. These four businesses FMCG, Hotels, Paper boards and specialty papers, Agri-business are the major business of ITC and governed as autonomous divisions. Each of this division is again a strategic business unit of the company and by and large governed by efficient corporate governance policy. However, apart from these divisions, the case company also owns certain other companies, some of which are wholly owned subsidies like ITC InfoTech, Surya Nepal private limited and Land base. The other group companies are treated as associated companies with equity ownership by strategic partners. ITC- filtorona and International travel house falls in this category.

In this connection the present case – ITC Ltd is undoubtedly complex, largely diversified conglomerate, and however studying such a diversified conglomerate requires abundant resources and time. So the present study aims to study corporate governance practices of the ITC, but however limits the empirical investigation to core business of the company. Thus cigarette manufacturing has been chosen from FMCG segment, Paper boards and specialty from paper board and packing business, commodity marketing and leaf tobacco exporting have identified from agribusiness. This strategic identification not only for functional purposes of the study but in reality these divisions are relatively old in terms of existence and known for their relationships with stakeholder groups from long time.

1.8 Selection of Divisions

Thus, India tobacco division (ITD) - , Paperboards and Specialty Paper Division (PSPD), Agri Business Division (ABD) and Indian Leaf Tobacco Development Division (ILTD) have been selected among several other divisions of ITC ltd. These divisions are widely known for efficiency in operations and contributions to the total profits of the company. According to the recent annual report of the company these four divisions contributes more than 85% of the profits to the case company.

1.9 Sample of the Study

The present study used the stratified random sampling strategy. The sample includes various employees various levels and other stakeholders of the company. The breakup of the sample selected for the present study is illustrated in following table.

Table 1.1 Sample of the Study

S.No	Division	Apex Managers	Senior Managers	Middle Managers	Junior Managers	Workers	Suppliers	Customers	Local Community	NGOs	Total
1	Corporate Office	2	1	-	6	-	-	-	-	-	9
2	Paper Boards and Speciality Papers	1	4	8	2	33	1	-	57	5	111
3	India Leaf Tobacco Development	1	1	16	2	36	14	2	54	4	130
4	Agri. Business Division	2	3	5	3	7	43	-	33	3	96
5	India Tobacco Division	-	2	4	1	47	-	-	30	4	88
Total		6	11	33	14	123	58	2	174	16	437

The study covered 437 respondents across the four divisions of the company. These respondents include 64 managers (at various levels) which represents 14.6% of sample, 123 Workers (at all divisions) representing 28.1% of the respondents, 58 Suppliers (at 3 divisions) covering 13.2% of sample, 2 customers (in 1 division) representing 0.45% of the sample, 16 NGOs (at all divisions) covering 3.6% of sample and 174 respondents from the local community (at all divisions) covering 39.8% of the total sample.

1.10 Design of the Study

According to Yin (1993) development of research design is a difficult part of doing case studies because unlike other research strategies, the potential catalog of research designs for case studies has yet to be developed. However, for case studies, four major types of designs are relevantly identified in the literature following a 2 x 2 matrix. One pair of categories consists of single case and multiple cases. The second pair occurs in combination with either of the first pair, is based on the unit or units of analysis to be examined in the research study. The present study adopts single case (embedded) research design to sufficiently cover the complex nature of research problem and also to examine the issues at depth across the selected division of the case company – ITC limited.

The present case study involves more than one unit rather to say several sub/intermediary units for analyzing and investigating the pertinent research problem i.e. corporate governance. In the present study though the major focus is on a single case ITC Ltd, but significant attention is also given to various subunits. This is primarily because although case study might be about corporate governance policy and practices of ITC Ltd, the analysis of such a top down process must include outcomes of certain internal arrangements at sub unit (division) level that in turn contribute to realize the aims and objectives of policy framework of the case company. Thus the present research design is essentially an embedded, single case study where the main unit is the company as a whole, several intermediary units are selected divisions of ITC and the smallest unit is the individual stakeholder of the company. Such a design serves as an appropriate guideline to study the corporate governance policy and primacy of stakeholder interests of the case company by examining how policy has been practical at divisional level and how an individual stakeholder perceives it and how positive relationship between policy and perceived reality can thus be established.

The following are five essential components of the present research design

1) Unit (s) of analysis.
2) Research Questions.
3) Propositions.
4) Linking of data to propositions.
5) Criteria for interpreting the research findings.

The first three components are explained in the following paragraphs and remaining two will be addressed in the subsequent sections on data analysis in the present chapter.

1.10.1 Unit of Analysis

Most investigators generally encounter confusion in defining the unit of analysis at the outset of doing case studies. Yin (1993) identified that the fundamental problem of indifference is in defining what is ‘case’ that has plagued many researchers to logically identify the basic unit of analysis to start a well-organized case study.

For the present study the ‘case’ is a particular business corporation. The research endeavor attempts to analyze the corporate governance of the case company and the focus is on the practices of stakeholder management. Thus the company is the primary unit of analysis because it in a way is a potential case that aims to provide empirical explanations to the research questions and substantiate the propositions of research study.

Though primary unit of analysis is the case company – ITC Ltd. but such an explanation of corporate governance cannot be wholly understood by locating exclusively at the top management level. As it is mentioned earlier, the case company is multi-divisional and significantly forayed into numerous related as well as unrelated businesses. Thus the practices of corporate governance have to be understood at the level of divisions because these divisions actively collaborate, coordinate and often conflict with the stake holders. The analysis therefore, must include these sub units because it offers a right way to comprehend how corporate governance is understood and practiced by the company? How managers treat stakeholders and how stakeholders perceive the company? This will enable us to construct a stakeholder view of the company by analyzing the corporate practices at the level of company (primary unit), divisions (intermediary units) stakeholder groups like Trade Unions, NGOs, and individual stakeholder i.e. employee, beneficiary, customer, supplier (smallest unit)etc.

The present study at each level of analysis use different data collection techniques ranging from documents /reports to interviews, discussions and observations. Before we move on to the detailed discussion on research questions, propositions and objectives of research etc it would be more befitting to highlight the possible scenarios that will be encountered in the present study.

1.10.2 Development of Descriptive Scenario

The design of the present study requires a careful development of idealized scenarios of the two systems of corporate governance typified on the basis of shareholder perspective or stakeholder perspective. These draft scenarios were initially based on the research literature and consultation with the research supervisor. The importance of these scenarios in the study design cannot be underestimated. The completed scenarios became the basis for developing data collection protocols that ensures case study to include desirable, logically coherent data (Yin, 2009). This in turn enables final description as a combination of what may be expected and then found. The driving question underlying the development of these scenarios is to examine 'what is the specific focus of a company's corporate governance system'?

The research project could possibly encounter any or the entire following scenario:

1) The company concerned is following a philosophy of governance which is oriented only or very largely towards shareholders where as academic theory laid much emphasis on the stakeholders. The company concerned is largely indifferent to the concerns of stakeholders.
2) The company concerned is adopting a philosophy of governance that is oriented towards stakeholders, but still, in practice having a significant tilt towards maximizing shareholder value only. The company represents nominal stakeholder orientation.
3) The company concerned is practicing a philosophy of governance which is holistic – an integrated understanding which does not view one aspect as more important than others but which understands that satisfaction of every section is a prerequisite to the satisfaction of a particular section. Thus, shareholder satisfaction is as much as important and is as dependent on other stakeholder satisfaction and vice-versa. This approach of the company reflects active commitment to all and has a great implication for theory as much as for empirical (analysis) of Indian business.

The above quest thus opens up a field for social science inquiry, requiring as it does, a multi-pronged investigation and techniques of research. These would be a mix of techniques that would be need-based aiming at desiring reliable and valid data. However this aspect would be further discussed at a later stage in the present chapter.

1.10.3 Research Questions

The present study is largely descriptive, instrumental and also exploratory to some extent. Hence, it as such, has a series of questions but no specific hypothesis for examining and analyzing the present research problems. Some of the crucial research questions are as follows:

1. What does corporate governance mean to the case company in the sense of what is its understanding of the concept?
2. How the company is grounding its understanding in practice i.e. in terms of its implementation?
3. How the corporate governance framework of the company is being able to integrate the concerns of various stakeholders?
4. How company managers perceive stakeholders interests and how stakeholders view particular case company's governance system?
5. What is the role of internal mechanisms for strengthening relationship between corporation and its stakeholders?

1.10.4 Propositions of the Present Study

As for third component of research design, each proposition directs attention to something that should be examined within the scope of present study. Some of useful propositions are illustrated below:

Firstly, if good governance constitutes the sine-qua non for corporate success, a success situation which is not only demonstrable with reference to the profit and loss account of the company concerned but by certain indicators that, in aggregate go on to establish a good will and appreciation in stakeholders (public) perception (Post, et.al, 2002).

Secondly, stakeholders' view that has been incorporated into firms' core functional and operational areas positively related to firm's reputation and corporate performance in the long run (Freeman, et.al, 2007)

Thirdly, the CG policy alone is not sufficient, but other internal systems and institutional arrangements does contribute to manage the interests of stakeholders by establishing mutually enforceable links particularly with employees, shareholders, suppliers and customers (Post, et.al, 2002).

Fourthly, firms often integrate one stakeholder with other to meet the expectations of some other key stakeholders i.e. integrating suppliers with employees to create customer value or employees and customers for creating shareholder value (Mitchell and Agle, 1997).

Fifthly, a corporate governance policy that can address broad range of stakeholder issues with appropriate practices may be difficult, but companies if interested in long term value creation, stability and sustainability positively formalize their relationships with stakeholders in the external and internal environment (Freeman and Evan, 1990).

1.10.5 Objectives of the Study

The present research process has been traversing a path in the course of which the following items of inquiry are also being considered along with significant explanations to the above said propositions. They are as follows:

- To trace the background of emergence of idea of corporate governance in the Indian private sector.
- To gain comprehensive understanding of the regulatory framework governing Indian corporate sector particularly Indian Companies Act and other regulations prescribed by regulatory bodies like SEBI, DCA etc.
- To examine the role of internal systems of the corporation for strengthening relationships between firm and its stakeholders.

    In this connection IR systems – HR practices, Customer relations management, Supply chain Management, Investor relations and Corporate Social responsibility practices of the case company has been examined to understand the efficiency of these systems in creating enabling relationships with stakeholders.

- To understand whether and how Indian business in general and case company in particular is understood in the light of ongoing global debate on corporate governance.

1.10.6 Techniques of Data Collection:

Doing a case study begins with the definition of the problems or issues to be studied and the development of a case study design. However many researches associate the doing of a case study actually with the collection of the case study data and this particular section focus primarily on this activity.

The present research study is based on the primary data collected from the field sites (particularly, the divisions above mentioned) as well as secondary data in terms of material secured from secondary sources like draft reports (SEBI, CII, DCA) company codes of corporate governance, annual financial statements management discussions and analysis, corporate governance report, disclosure information to shareholders and other corporate documentary evidences. This will facilitate to collect all relevant archival and documentary data pertaining to company law, the relationship between regulatory bodies and case company (ITC Ltd.), ownership structure, corporate governance philosophy, code of compliance etc.

The present study aims to examine the relationships between firm and key stakeholders. The data thus sought to be collected is specifically to understand the relationship between firm and its employees, firm and local community, firm and suppliers, firm and its key customers, firm and shareholders. A point to be mentioned in this connection is data pertaining to shareholders is examined at the level of case company – ITC Ltd. because the co-operative ties with these important stakeholders is established by the company as such. There is little relevance for shareholders at the divisional level because the active link with them is always established by the company through disclosure of information and mechanisms to foster transparency and accountability. The other stakeholder groups are actively involved at the divisional level. The divisions are provided with autonomy in terms of framing their relationships with these claimants. However, company governance policy, values and philosophies largely influence the way divisions deal with employees, suppliers, customers, local community but to have more concrete understanding, the data should be collected at the level where it is being effectively practiced and implemented.

However, the present study does not intend to collect information regarding all stakeholder at all divisions. Certain key stakeholders are selected at every divisional level and data is obtained to understand how divisions are establishing effective links with their key stakeholders. While certain stakeholders like employees, local community is examined at every division level (ITD, ILTD, PSPD, and ABD); whereas data pertaining to customers are only examined at ILTD since ILTD as a division built on their customer relations management. The data obtained on supplier management is essentially from two divisions ILTD and ABD, largely because these two are know for their supply chain management practices and empowerment of suppliers as suppliers are key stakeholders for growth and profitability.

The above mentioned pattern of stakeholder –firm relationships are examined on the basis of data obtained mainly through primary and secondary sources. The present study is based on five different sources: Documentation, Archival records, Interviews, Direct observation, Participant observation. The data pertaining to present research is largely obtained by using these techniques and the kind of data obtained by using each of this is summarized below.

1.10.6.1 Documentation

This is essentially explored to collect the relevant secondary data for the present study. The memorandum of settlements or long term agreements between workers union and company management, reports of the company especially on corporate social responsibility and corporate governance, management discussions and analysis, evaluation reports of the concerned programmes/initiatives of the company, and other internal documents say balanced score card, corrective and preventive action, environment, health and safety policy etc. are some of the major sources of secondary data that are obtained through documentation. Alongside, news clippings and other articles appearing in mass media, company law reviews, and draft reports on CG by SEBI, DCA, and CII serve as important sources for understanding the issues pertaining to governance of the case company.

1.10.6.2 Archival records

The archival records of the company and its divisions are another source of obtaining necessary data for the present study. This particular data is collected through the organizal records of the selected divisions, such as total number of workers, number of people benefited through developmental initiatives, budgets allocated for CSR activities, number of customers served over a given period of time, annual general body meeting procedures, organizational charts etc. The archival data pertaining to company law development, regulatory changes in the sphere of corporate governance has also obtained for understanding changes and contemporary trends of corporate governance regulations in India.

These two techniques has been deemed relevant for the present study because they are not only helpful in verifying or corroborating the data obtained from other sources, but also enables to analyze the relationship between company and shareholders, government, employees, local community etc. Similarly, the following techniques are the other major sources for obtaining primary data relevant for the present study.

1.10.6.3 Interviews

One of the most important sources of case study information is interview technique. The primary data pertaining to the present study has been collected by establishing interface with personnel comprising top management, senior management and middle managers of the company and its selected divisions through preliminary interviews. These interviews are mostly open-ended in nature, where data information pertaining to certain facts of matter as well as respondents opinion about stakeholders are sought to be collected. These interviews are in-depth where certain broad and open-ended questions regarding division's relationships with stakeholders were asked to respondents to understand the way they perceive stakeholders. Alongside, focused interviews are also conducted in some cases, where certain set of questions were asked to obtain more specific information regarding the particular practices of the divisions. The open-ended interviews were largely conducted with middle managers, worker's union representative, local community leaders, NGOs and focused interviews were with senior and top management personnel, individual workers, suppliers and customers, and individual beneficiaries.

Thus intensive and in-depth interviews with management personnel belonging to different departments say HR and Personnel, Social Development, Marketing, EHS, Finance and other stakeholders such as employees, local community, suppliers, and creditors with regards to all relevant matters of governance have undertaken by a detailed un-structured interview schedule.

1.10.6.4 Direct Observation

The direct observation is also an important source of information in case of the present study. Several field visits to the ‘case study sites’, has given an opportunity for direct observation which served as yet another source of evidence, as the phenomenon of interest pertaining to the study has not been purely historical and so some relevant conditions are available for observation in the field.

These observations are informally noted throughout the field visit involving observations of meetings between management and workers union representatives, common activities of the employees residing in the factory township, factory work, production activities, health and recreation facilities, CSR programmes, stakeholder meetings, training programmes for beneficiaries, attitudes of the managers, communication procedures and the like. The evidence obtained through observations is useful in providing additional information about the topic being studied.

The data thus, has been extensively collected with regard to all stakeholders – employees, stakeholders, suppliers, customers, local community and management. The following table in the next page illustrates the units of analysis and kind of data obtained to examine the relationships between firm and stakeholders. The table 1.1 illustrates that the present study demonstrate an emphasis for using multiple sources for obtaining relevant data. A major strength of present case study is the opportunity leveraged by collecting and analyzing different sources of evidence whether being primary or secondary at every level.

Table 1.2 Field Sites, Units of Data Collection and Sources of Data

Unit being characterized	Total System (ITC LTD)	Intermediate Units ITD,PSPD,ILTD,ABD	Stakeholders – Employees, community, shareholders, suppliers, customers, NGOs	
	Historical data, issues, policy, ownership, codes, values, core principles of CG	History and Emergence	Leaders (Trade Unions, Local community, NGOs, User Groups etc)	Individual Stakeholders
ITC LTD	CG policy, Reports, Disclosures, Values (secondary data)	Governance framework Policy guidelines (secondary)	Shareholder value Shareholder relations Compliance	
ITC and Divisions ITD, ILTD,PSPD, ABD	Historical emergence Operations Divisional management Powers and authority (secondary data)	The practice of stakeholder relations, Allocation of funds Internal controls (primary & secondary)	Long term agreements Mutual arrangements Customer focus CSR (primary & secondary)	Empowerment • Employee • Supplier • Community (primary)
Stakeholders • Employees • Community • Shareholders • Suppliers • Customers	Principles of CG Stakeholder primacy Supplier management Customer focus (secondary)	IR systems Links with community Supplier relations Customer centrality	Trade Union leaders on IR practices community leaders on CSR programmes Customer's views on CRM practices (primary)	Individual workers reflections Farmers views Individual beneficiaries Perceptions on CSR (primary)

1.11 Data Analysis

The analysis of case study evidence is one of the least developed and most difficult aspects of doing case studies (Yin, 1993). The present study acknowledge this particular problem, takes utmost care for not becoming stalled at the analytical stage and present the evidences collected during field in an appropriate analytical manner by largely relying on two general strategies of analyzing case study evidence.

The present study significantly relays on theoretical propositions developed at the outset. The primary objectives and design of the case study presumably were based on these propositions, which in turn reflected in set of research questions, review of literature etc. Thus the present study basically aims at linking of date to the propositions. One promising approach that the analysis adopts is “pattern matching”, where several pieces of information from the same case may be related to some theoretical proposition. The pattern-matching technique is a way of relating data to the propositions that have developed at the outset of doing case study.

A second general analytical strategy of the present study is to develop a descriptive framework for organizing the case of ITC Ltd, as the study had addressed certain descriptive concerns. The data pertaining to management perception and stakeholder views are significantly identified and analyzed to build explanations that enable to develop a vivid description of the particular case and its holistic understanding as well practice of corporate governance.

Alongside, the present study also employs simple time-series analysis to understand and explain changes in corporate governance practices, magnitude of CSR programmes and transformation of the case company from core cigarette business to non core business like commodity marketing, paper boards, foods, retailing etc.

With this foregoing analysis of research issues and methodology orientation, now we move on to the final section: scheme of chapterization

1.12 Scheme of Chapterization

The thesis is broadly divided into eight chapters. Chapter I describes historical back ground of the study, need for good Corporate Governance, methodology of present study objectives of the study, research questions, propositions, tools of data collection, sources of data etc.

The second chapter understands conceptual framework of corporate governance. This chapter includes intensive description of attributes to corporate governance, emergence of corporate governance issues world wide, development of various codes, regulations internationally and stylized models of corporate governance practices in various countries.

The third chapter attempts to explain dominant as well as prevailing theoretical perspectives of corporate governance available in the literature of discipline such as sociology, economics, political economy, and philosophy and management science. This chapter provides an in depth description of ownership and control debate highlighted in the literature on sociology of modern corporations and also rise of managerialism and board systems perspective emphasized by the perspectives of economic sociology. This chapter examines the neo-classical, institutional and transaction cost perspectives of economics to explain the agency theory and agency problems in the joint stock companies. This chapter also illustrates ethical perspectives and management sciences approach of corporate governance. Thus highlighting the theoretical concerns at the backdrop of corporate governance issues, this chapter further focus on perspective of present study – stakeholders approach to corporate governance.

The forth chapter focus on corporate governance in Indian scenario. This chapter analyzes Indian corporate law, ownership style of Indian companies in general, issues of dominant and minority shareholders, legal/regulatory developments in the realm of corporate governance in India. This chapter also describes and examines prevailing studies on corporate governance with reference to India.

The fifth chapter introduces the empirical context of the present study. The chapter largely focuses on the historical emergence of the case company ITC Limited, ownership changes, nature of business, and origin and development of the selected divisions ITD, ILTD, PSPD, ABD and their specific units included in the present study.

The sixth chapter significantly examines the agency problems in ITC Ltd during the early 90s and corporate governance transgressions thereafter. The chapter describes how ITC had initiated the governance reforms in light of these challenges, and how this has enabled the company not only to fix these problems but also develops a mechanism of internal controls for competitive advantage. This chapter essentially is based on the documentary evidence and archival records pertaining to corporate governance procedures and practices of the company.

The Seventh deals with the primary stakeholder relations of the company/divisions. This chapter largely based on empirical data collected in the field work. The analysis is focused on shareholder relations, employee relations and work systems, enabling links with local community through a strategic approach, supplier relations and customer focus of the selected divisions. This chapter attempts to link the empirical data to the propositions, objectives of the present study.

The final chapter elaborately focuses on the report of the present study. Alongside the chapter analyzes utility of the present research, problems in corporate governance research, changes in legal paradigms, corporate governance reforms essentially for Indian society.

CHAPTER 2

2

Corporate Governance: History, Systems, Models and Codes

The present chapter is organized in two sections. The Section - A attempts to provide a comprehensive understanding of corporate governance by placing various issues that are central to it in the literature of social, management sciences and law. The Section - B aim to assay developments in the field of corporate governance. This explains various stylized models, systems and structures, regulatory measures in the international arena and most importantly contemporary developments in global corporate governance practices. Together, this chapter highlights conceptual issues in corporate governance practice and comparative systems of corporate governance in developed, developing economics of the world. The present chapter also focuses on growing integration of world economics and tries to examine whether this results in convergence or divergence of corporate governance systems worldwide through the lens of political economy perspective.

SECTION – A

Corporate governance has succeeded in attracting a good deal of public interest because of its apparent importance for the economic health of corporations in particular and society in general. However, the concept has poorly defined primarily because it potentially covers a large number of distant economic phenomenon. Hence, given the variety of perspectives and models of corporate governance, different scholars, practitioners have come up with different definitions that essentially reflect their special interest in the field. Moreover it is not surprising that there exist many definitions of corporate governance. Some have a narrow, operational focus and equate corporate governance with working of board of directors, for ensuring accountability of senior management. Similarly, broad definitions of corporate governance cover the entire network of formal and informal relations in the corporate economy and their consequences for society in general. Thus, the presence of several contending definitions in the field of corporate governance, where in some tends to be narrow and some much broader, an appropriate way for any researcher to define the concept is perhaps to list a few of different definitions (rather than mentioning one) that could possibly enhance or comprehend the concept in a befitting manner.

2.1 Definitions

Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporations, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decision on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance (OECD, 1999).

Cadbury committee (1992) defined corporate governance as a system by which companies are directed and controlled. It is an encompassing system (not individual parts) that envisages the direction by board of directors and control exercised by shareholders of the business corporation.

A notable point with regard to the above mentioned definition is that the former is in consistent with later. To be precise, Cadbury Committee definition of corporate governance has been incorporated in the OECD code on corporate governance for more meaningful explanation.

The World Bank (1999) states that from a corporate perspective, corporate governance is about maximizing value subject to meeting the company’s financial, legal and contractual obligations. From public perspective, corporate governance is about nurturing an enterprise while ensuring accountability in the exercise of power and patronage by firms. The bank’s framework states further that the role of public policy is to provide firms with the incentives and discipline to minimize the divergence between private and social returns and to protect the interests of stake holders.

According to Marry O Sullivan (2000) corporate governance is a system comprising social institutions that influence the process of strategic investment in corporates which revolves around three major decisions viz. what type of investments or resource allocations are made, who controls this decision and how returns from successful investments are distributed.

Daily et.al, (2003) defines corporate governance as the determination of the broad uses to which organizational resources will be deployed and the resolution of conflicts among the myriad participants in corporate organizations.

Deakin and Huges (1997) states that at a fundamental level, corporate governance is concerned with the relationship between internal governance mechanisms of corporations and society's conception of the scope of corporate accountability. It is a system that directs how internal procedures can be adapted to a hider social purpose.

Another notable definition by Sundaram & Bradly (2004) contends that corporate governance refers to the top management process that manages and mediates value creation for, and value transference among, various corporate claimants (including the society – at – large), in a context that simultaneously ensure accountability towards these claimants.

According to Blair (1995) corporate governance implicates" the whole set of legal, cultural and institutional arrangements that determine what publicly traded corporations can do, who controls them, how that control is exercised, and how the risks and returns from the activities they undertake are allocated.

These above said definitions reflect a mature, holistic and wider conception of corporate governance. Corporate governance is thus comprised of systems and procedures which ensure the efficient functioning of the firm in a transparent manner for the benefit of all the stakeholders and being accountable to them. Allen (1992) viewed that these definitions essentially envisage social entity model of the corporation that underscores the role of business corporations while holding them accountable to the large society.

However, in sharp contrast to the above definitions that set forth the big picture, stand some focused definitions which are based on property or contractarian conception (Allen, 1992) that rooted in the principal – agent model of corporate governance.

Shleifer and Vishny (1997) states that corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. They argued that how do the suppliers of finance get managers to return some of the profits to them? How do they make sure that managers do not steal the capital they supply? And how do suppliers of finance control managers?

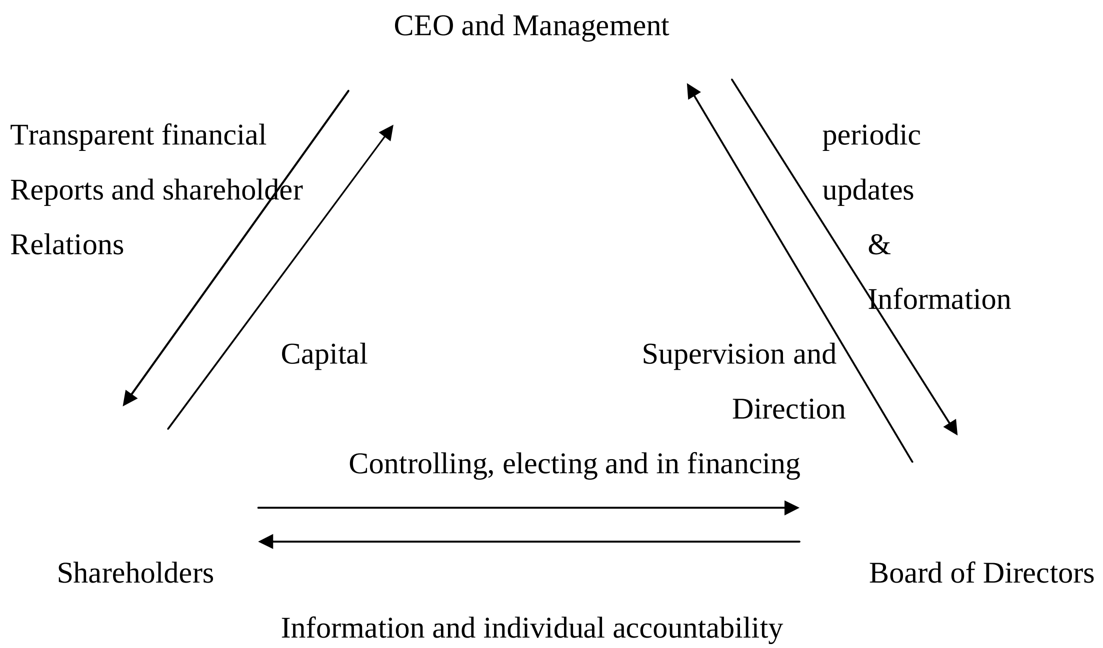
Another key definition by Oliver Hart (1995) defines that corporate governance is the sum of process by which investors attempt to minimize the transaction and agency cost of doing business which a firm.

According to Mathiesen (2002) corporate governance is a field in economics that investigates how to secure / motivate efficient management of corporations by the use of incentive mechanisms, such as contracts, organizational designs and legislation. This is often limited to the question of improving financial performance, for example, how the corporate owners can secure and motivate that the corporate managers will deliver a competitive sate of returns.

Thus one can understand complex magnitude, scale and scope of corporate governance from the foregoing definitions. The inherent complexities of phenomenon pose difficulties for arriving at all encompassing definition of corporate governance. It is primarily because some commentators take too narrow a view and say it is the fancy term for the way in which directors, auditors and management handle their responsibilities towards shareholders. Others use the expression as if it were synonymous with shareholder democracy. Thus corporate governance is a topic recently conceived, as yet ill-defined and consequently blurred at the edges. The corporate governance is a subject, as an objective or as a regime to be followed for the good of shareholders, employees, customers, suppliers, community indeed for the reputation and standing of the nation and its economy.

2.2 Corporate Governance System

The corporate governance framework within which organizations operate fundamentally concerned with two key questions – whom should organizations serve and how should the direction and purpose of an organization determined? The corporate governance framework relates not only to the powers of key participants but also the process of supervising executive decisions and action and issues of accountability. The framework primarily intends to acknowledge and realize the expectations of shareholders through or appropriate mechanism of internal control by the board of directors. This is illustrated in the following diagram.



The corporate governance framework consists of three key actors and internal relationships that enable smooth functioning of a corporate organization. The above diagram clearly represents the key constituents-Shareholders, Board of Directors and top management in the corporate governance framework of an organization. The framework also envisages the relations among these participants. Now, it is befitting to examine role of responsibilities of these actors, inter – relationships amongst and how did they contribute to the effective functioning of the corporate governance framework of a business organization.

2.2.1 Shareholders

Shareholders are often referred to as the owners of the corporation, but the corporations legal personality raises questions about whether it can be owned in any meaningful and effective way. However as the owner of a corporation, shareholder 'owns' is a certificate representing entitlement to a proportional share of corporation. In realty the only thing that shareholder has is the stock certificate that entitles him to particular rights and obligations that are set by the laws of the land. The rights of shareholder are classically defined as (i) right to sell the stock (ii) the sight to bring suit for damages it the corporation's directors or managers fail to meet their obligations. (iv) the right to seek certain information from the company and (v) certain residual rights following company's liquidation once creditors and other claimants paid off.

The relationship between shareholders and board of directors is central to the corporate governance framework As a result of dispersed ownership, relatively small holding the shareholders could not exercise control over management and unable to incur excessive costs for monitoring the self-dealings and appropriation of managers. So, the elected representatives of shareholder i.e. board of directors are expected to assume these fiduciary duties on behalf of real owners of the corporations. Thus shareholders delegate responsibilities as owners of the company to the directors who are responsible for corporate strategy, operations and supervision. According to Raju (2004), Shareholders always expect board of directors to safeguard their interests and create value for their investments.

The relationship between shareholders and executive management is crucial and most sensitive one in the corporate governance framework Shareholders provide financial investments, and in return, management is responsible for running the company well and delivering timely and accurate financial reports. As suppliers of finance, the shareholders provides capital and obtain certain residual control rights i.e. right to make decisions in critical circumstances like bankruptcy, financial wrongdoings (Grossman and Hart, 1986). Likewise, shareholders along with board are expected to provide oversight over management. Shareholders as owners of the company oversee director's report, annual accounts and approve nominations for directors at the annual general meetings. Shareholders consent is necessary for mergers and all crucial matters of importance regarding a company's functioning (Marchi Raju, 2004).

2.2.2 Board of Directors

The board of directors of a company is the center of corporate governance framework. The role and responsibilities have been addressed significantly in several reports and codes of corporate governance. The Board controls, monitor managerial competence, approve resource allocation, decide business policy issues and facilitate development, implement and monitor corporate strategy. Board of directors are entrusted with several responsibilities, where in some of them are entitled by law and some are guaranteed by codes and regulations.

Usually, the board of directors delegates to the top management of the company, and through them to other senior management. The directors assume responsibilities and monitor executive management on behalf of shareholders.

The board of directors selects and plans the succession of chairman or chief executive officer. Board also appoints or approves other members of the senior management. Alongside, board of directors also ensures the integrity of corporations accounting and financial systems (OECD, 1999). The board of directors should maintain an attitude of constructive scepticism and act with integrity and demonstrate commitment to the corporation.

The board of directors understands and review annual operating plans and budgets, review management plans and approve significant corporate actions. In a nutshell board of directors performs all key and strategic functions and tries to balance the power of management, while ensuring accountability and transparency in corporate governance practices.

The corporate boards are charged with the task of approving strategy and budgets and the task of setting compensation. The board is also typically responsible for answering that the firm acts in a legal and socially responsible manner (Sundaram et.al, 2004). The corporate boards generally composed of executive directors (who are members of the managements team); and non-executive directors, who are outsiders. These non – executive directors are often nominee directors (Promoters, institutional investors, banks) or Independent directors. Alongside, boards are organized into various committees like audit committee, remuneration committee, nomination committee, shareholders grievance committee etc. that carry certain key functions.

The relationship between board and shareholders assumes significance in the contemporary corporate governance framework. There have been a number of attempts to reforms the boards so that directors are more accountable to shareholders, who actually elected them. Generally boards of directors are individually responsible to the shareholders (in letter) and entitled with duties that safeguard the interests of owners, who cannot involve in day to day management of business. However, the link between shareholders and board of directors received far less scrutiny than other relationship in the corporate governance framework. This is mainly because, directors are not clearly aware of what shareholders expect and they are in a way distant from shareholders that forbid them to make informed choices to safeguard owners interests. Thus there is an apparent missing link in the relationship between board and shareholder because board is unclear about the preferences of shareholders and shareholders have little say about who represent them. Hence, in the context of prevailing missing link in governance framework a director's allegiance shifts from shareholders to the nearby board room where fellow directors and management fill the void (Montgomery and

Rhonda, 2003). This movement skews the above governance triangle, move directors closer to management, and sets the stage for cordial, consensus – driven environment for which boards are widely criticized.

The relationship between board and top management is based on information flow to directors and strategic supervision, planning provided by board to management. This relation has been severely criticized and the bone of contention for contemporary corporate governance regulations. The apathy, passive role of board of directors in checking management actions has led to high profile financial scandals and scams.

Thus, in principle, the board has an important role to play, but there are some reasons to doubt its effectiveness in practice. Notably, most of these questions are raised against the efficiency of non-executive directors. It widely believed that in academic literature that outside directors play a larger role in monitoring management than inside directors. Fama (1980), for instance argues that the inclusion of outside directors as professional referees enhance the viability of the board in achieving low – cost internal transfer of control. This also lowers the probability of top management colluding and expropriating shareholders. Outside directors are usually respected leaders from business and academic communities and have incentives to protect and develop their reputation as experts in decision control (Fama and Jensen, 1983).

However, some scholars expressed that the non-executive directors may not do an efficient job of monitoring for several reasons. Hart (1995) opined that they may not have significant financial interest in the company, and they may therefore have little to gain personally from improvements in company performance. Second, non-executive directors are busy people (they may themselves be chief executives or sit on many company boards) and probably have little time to think about the company affairs, or to collect information about the company (Shleifer and Vishny, 1997). Finally, non executives may owe their positions to management, who proposed them as directors in the first place. As well as feeling loyal to management, they may want to stay in managements good graces, so that they can be related and continue to collect their fees.

2.2.3 Top Management

Top – Management is a catch – phase for those who work at the apex, and companies often define their ‘top’ as no more than seven or eight most senior officers. Interestingly, much of the world beyond the company halls and capital markets, however top management is personified almost solely by chairman or chief executive. The readers of world's business press know that Jack Welsh runs GE, Michael Eisner rules Watt Disney Company, Warren Buffet is Berkshire Hathaway; Fujio cho drives Toyota, Jurgen Schrempp steers Daimler Chrysler, Microsoft by Bill Gates and LN Mittal sets the tone for LN Group etc. Davis and Useem, (2004) noted that the academic research too, had long been drawn to the same pinnacle of the pyramid, partly on the conceptual premise that the chief executive is the manager who matters, and partly on the pragmatic ground that little is publicly known about except CEO or chairman.

There conceptual and pragmatic underpinnings for shinning the light solely on CEO however have eroded in-recent years as companies redefined their operations and researchers re-convinced their methods. The academic research expanded the field of view from chief executive to the entire upper echelm that consists of top management of the firms. Thus these corporate leverage populations in corporate leverage positions have become central tenets of corporate governance framework. Now, let's examine the role and responsibilities of top management that runs the corporations day to day business operations.

First and foremost responsibility of CEO and Top management is to direct and operate the corporation in on effective and ethical manner. They are primarily accountable to stockholders, who actually delegated control to them over day – day management of business. So, they should inform shareholders and other stakeholders periodically about key strategic decisions or how the resources provided by stakeholders have put into efficient use.

The top management team generally takes lead in strategic planning. They identify and develop strategic, annual operating plans and budgets. They should identify risks in the product, capital, labour market and plan appropriate ways to manage overall risk profile of the corporation. Finally, the top management is responsible for the integrity of corporation's financial reporting systems. It is in all senses, the responsibility of management to produce financial statements that fairly present the corporation's financial condition and thus permit investors to understand the business and financial soundness and risks of the corporation. The top-management thus, plays a significant role in mediating or go-between company and board of directors, company and shareholders.

The role of top management has been widely criticized in the classical and contemporary corporate governance literature primarily because of the equivocal relationship between shareholders and top management. The shareholders provide capital to the firms, delegated decision making to management and expect good returns for the capital they supplied. They are unable to exercise real control due to diverse nature, relatively small proportion of holdings and excessive monitoring costs. These factors by and large bestow management with unchecked control that some time act as an incentive to steal owners money, strip corporations assets and indulge in financial irregularities. The shareholders are always uniformed, unable to understand the magnitude of certain strategic choices and financial reporting procedures even if informed that further adds to their apathy and passive role in determining corporate decisions. Though shareholders, on paper, elect boards to monitor top-management but presented with a fait accompli because boards join with management more often and erode shareholders interests.

The above analysis adds to one's confusion and questions the credibility of corporate governance framework. A point to bear in mind that the fore going analysis reflects classical agency problem between shareholders and managers as principals and agents. The contemporary corporate governance literature and regulations essentially aims at solving these issues of ownership and control so that interests of owners and managers can be aligned in one way or other. As Ward., (1997) illustrated that the growing regulations to protect shareholders and activism by institutional investors, mutual funds etc. have relatively controlled the excessive management discretion and attempted to regain some influence that owners had over their firms in the yester years.

Thus, it is clear from the forgoing analysis that balance of power in corporate governance is delicate one and it relies on three critical anchors – shareholders, management and the board of directors. Each of this has important responsibilities of its own, but their interactions are effective corporate governance framework. When they work together as a system, they provide powerful set of checks and balances. But when pieces of the system are missing or not functioning well, the system as a whole can be dangerously unbalanced.

Thus, the above analysis of corporate governance clearly highlights the ensemble nature of this complex phenomenon. The corporate governance is an all-encompassing system with several complementary subsystems such as decision systems, remuneration systems, ownership structure etc. These subsystems or incentive mechanisms primarily acts as internal controls, that enhance efficiency of various actors in the system on the hard, God contributes to the overall effectively of corporate governance structure. These subsystems notably acts as balancing mechanisms, checks the misuse of power, limits the control exercised by different participants in corporate governance system. For instance, incentive based compensation align the interests of owners and managers, representation of investors on company board monitor the management actions, market for corporate control regulate managers behaviour etc. However, much detailed analysis of internal and external mechanisms would be resorted in the following section.

2.3 External and Internal Mechanisms of Corporate Governance

There are five major elements of the external environment of corporate governance: capital markets, product market, labour market, market for corporate control and regulatory environment.

External capital markets – both equity and debt markets – exercise sizable control over firm both because of the fact that firms have to subject themselves to its scrutiny whenever they wish to raise external funds. The capital markets notably, determine the structure of ownership of the firms, either debit or equity, dispersed or concentrated ownership. As Jensen (1986) argues that capital markets comprises of individual, institutional investors, stock exchanges and other regulatory agencies that exercise discipline over the firm policy with regard to leverage and dividend payments.

The capital markets shape the ownership structure of the firm there by influence several sub systems of the corporate governance system that mentioned above. The concentrated equity ownership by institutional investors, pension funds, insurance companies, banks or large individual owners enable them to monitor and control the management, thereby perhaps contributes to corporate performance and represent their interests effectively (Shleifer and Vishny, 1997). Thus, ownership structures that dominated by capital market players i.e. large block holders, institutional investors occupy key positions in the board and effectively monitor decision systems, incentive system, performance monitoring systems and often encourage market for corporate control i.e. other firms to takeover etc. The capital markets in the contemporary times, at least in advanced economics have become vibrant, dynamic and vigilant on firms, hence become an active external control mechanism of corporate governance.

The discipline imposed by product marks is obvious. In competitive economic systems, firms that cannot consistently produce cheaper, faster, better and innovative products that consumer demands will not survive in the long run. Sundaram and Bradly, (2004) have noted that the competition will ensure only the fit to survive. The product markets comprises of both a firm's market and market of other firms who have invested in that. For instance, if firms A is negatively performing in its product markets then firm B,C,D who invested in A (these firms can be institutional investors, pension funds also) cannot hold their investments in firm A for risk, because there firms too have their own product markets. Thus consequently there firms exert control over firm A or threaten to withdraw their investments in it. Shleifer and Vishny (1997) argued in this fashion and agree that product market competition is probably the most powerful force towards economic efficiency in the world. The intense competition in product market may reduce returns on capital because of excessive investments diverted to technological up-gradation, innovation, R&D and hence cut the amount the managers can possibly expropriate. Fama, (1980) also contended that along with product market, the labour markets especially that of managerial labour too ensure that managers from better performing firms will be rewarded and worse performing firms will be penalized in the market place.

The regulatory environment can be a strong source of external discipline. Quite apart from the plethora of laws at the state and national levels that controls or circumscribes a firms behaviour directly, regulators intervene in the activities of contemporary corporations through passage and application of numerous provisions relates to governance, accountability, protection of interests etc. The role of regulatory bodies have gained prominence due to number of corporate governance problems, frauds, financial scans, misappropriation of wealth by companies in the recent times. Many countries today have developed efficient regulations on corporate governance. The regulatory developments in corporate will be dealt in section B of present chapter.

The last but not the least is the market for corporate control, commonly referred as takeover mechanism. This is the most widely known external mechanism of governance. Especially in Anglo-American settings, because in other national contexts however an active take over market have yet to develop or still in infancy. This market ensures the under performers will get weeded out through acquisitions and acquiring firms extract higher value from these firms by putting them to more efficient uses (Sundaram and Bradley, 2004). The active market for corporate control ensures that such a threat of takeovers will always be present. The existence of such a threat is sufficient to ensure its disciplinary governance role of the top-management.

A great deal of theory and evidence supports the idea that takeovers address governance problems and acts as an efficient mechanism of corporate governance (Manne, (1965), Jensen, (1988)). The most important point is that takeovers typically increase the combined value of the target and acquiring firm indicating profits are expected to increase afterwards (Jensen and Ruback, 1983). More over takeover targets are often poorly performing firms (Palepu, 1985) and their managers are removed once the takeover succeeds. Takeovers, thus, are widely interpreted as the critical corporate governance mechanism in the US & UK, where large shareholders are less common, thus hostile takeovers has emerged as particulars mechanism for consolidation of ownership, without which managerial discretion cannot be effectively controlled (Jensen and Ruback (1983), Mayers, (1990), Easterbrook and Fischel (1991))

In this connection, a poorly run corporation will suffer a low stock market valuation, which creates an opportunity for outsiders with better management to buy the firms through a tender offer to the dispersed shareholders of the targeted firms. If shareholders accept this offer, acquires control of the target firm and solar replace or at last control, the management (Manne, 1965). Takeovers can thus be viewed as rapid – fire mechanisms for corporate control.

There are also, numerous internal mechanisms of corporate governance, but I will only focus on five of the more immediate and important ones. They are (1) structure and role of the board of directors, (2) role of top management (3) nature of compensation systems (4) nature of employment practices and (5) nature of internal control systems and incentive systems in place to measure and reward performance of employees of the firm.

The role of boards in the corporate governance process is central, as we have already noted. The board of directors are generally elected by shareholders to monitors top management and ratifies major decisions of the company. Precisely, they act on behalf of the shareholders; in extreme cases the board may replace the company's chief executive and other members of the management team (Hart, 1995).

The corporate boards are charged with the task of approving strategy and budgets and the task of setting compensation. The board is also typically responsible for answering that the firm acts in a legal and socially responsible manner (Sundaram, Bradley, Chipani and Walsh, 2004). The corporate boards generally composed of executive directors (who are members of the managements team); and non-executive directors, who are outsiders. These non –

executive directors are often nominee directors (Promoters, institutional investors, banks) or Independent directors. Alongside, boards are organized into various committees like audit committee, remuneration committee, nomination committee, shareholders grievance committee etc. that carry certain key functions.

In principle, the board has an important role to play, but there are some reasons to doubt its effectiveness in practice. Notably, most of these questions are raised against the efficiency of non-executive directors. It widely believed that in academic literature that outside directors play a larger role in monitoring management than inside directors. Fama (1980), for instance argues that the inclusion of outside directors as professional referees enhance the viability of the board in achieving low – cost internal transfer of control. This also lowers the probability of top management colluding and expropriating shareholders. Outside directors are usually respected leaders from business and academic communities and have incentives to protect and develop their reputation as experts in decision control (Fama and Jensen, 1983).

However, some scholars expressed that the non-executive directors may not do an efficient job of monitoring for several reasons. First, they may not have significant financial interest in the company, and they may therefore have little to gain personally from improvements in company performance (Hart, 1995). Second, non-executive directors are busy people (they may themselves be chief executives or sit on many company boards) and probably have little time to think about the company affairs, or to collect information about the company (Shleifer and Vishny, 1997). Finally, non-executives may owe their positions to management, who proposed them as directors in the first place. As well as feeling loyal to management, they may want to stay in managements good graces, so that they can be related and continue to collect their fees.

Another internal mechanism in corporate governance: the CEO and top management. The role of this corporate leveraged population in corporate leveraged position has been significantly highlighted in the preceding sub section in this present chapter (sec 2.4.3.). This anchor of corporate governance plays a significant role in mediating or go-between Company and board of directors, company and shareholders.

The compensation and control systems are internal mechanisms of corporate governance as they are responsible for aligning the reward (and punishment) systems to the goals of the firm. For instance, are managers paid with fixed salaries and bonus, or they also compensated with stocks and stock options? The later type of compensation would presumably better to align the managers and shareholders interests if the stated goal of the firm is to create shareholder value (Sundaram et. al, 2004).

The final internal governance issue and perhaps the most important from stand point of day to day operations of the firm, is the nature of employment practices. These mechanisms address certain typical questions: how are employees hired and promoted? How is their human capital built and retained? How long do they stay with the firm? Does firm have a relationship based contract with employees or provide a lifetime – employment guarantee, or does it hire and fire at will or deal with its employees on an arms-length?

It is clear from the fore going analysis, that a good corporate governance system depends on how well checks and balances are placed in or efficiency of various internal and external mechanisms to regulate and control the corporate behaviour. Now, we shall move on to second section, that deals with recent developments in corporate governance regulations and codes of best practices, International stylized models of corporate governance and cross national convergence of regulations and models of governance.

SECTION B

2.4 International Codes and Regulations on Best Practices in Corporate Governance

Corporate governance codes and regulations proliferated in the 15 years since the Cadbury code of best practices cane into effect in the United Kingdom. In the past five years alone, new codes have emerged in every G7 country except Japan. These governance reforms generally emanates from national governments, securities commissions, stock exchanges, investors and investor associations and other supra national organizations. To describe simply, there regulations embody their view of what good governance is all about. The Cadbury code, for instance, made 19 recommendations addressing the structure, independence and responsibilities of boards; effective internal financial controls and remuneration of directors and executives. As, it has mentioned earlier, regulation is an important mechanism in corporate governance and it significantly effect the why corporates function is the economy. The following paragraphs describe various codes and regulations in corporate governance internationally in a chronological order.

The early regulations in corporate governance initiated in United Kingdom in the year of 1986. The first legislation, the financial services act came into being to effect and broaden the role of stock exchanges. In a year later US published Tread way commission report to essentially deal with fraudulent financial reporting. This report highlighted the need for a proper control environment, independent audit function to avoid misinterpretation of financial report.

The debate on corporate governance received a boost as a series of financial sandals that unearthed in UK during late eighties and early nineties. Several corporations collapsed and this severely impacted economy and society as a whole. As a result the first organized response has initiated through Cadbury committee set up by London stock exchange that brought out the pioneering Cadbury code as a response to these series of scandals and corporate failures among UK listed companies (Ghosh, 2004).

2.4.1 Cadbury Committee on Financial Aspects of Corporate Governance (1992)

The Cadbury report made 19 recommendations, many of which attempted to address what were seen as recent failures in corporate governance, were board of directors had been dominated by top management and chief executives. The Cadbury committee recommended that boards of public quoted companies should have minimum of three non-executive directors, who should be independent of the company. In addition, Cadbury report recommended that companies should have an audit with minimum of three members, a nomination committee to recommend board appointments and a remuneration committee to recommend remuneration of executive directors. The member ship in these key committees should be wholly or mainly non-executive directors (Wearing, 2005).

The Cadbury committee suggested certain important changes especially regarding separation of responsibilities between chairman of the board and chief executive of the company. It argued for clear division of two roles, so that no single individual can have unfettered powers of decision. However, the committee has made certain mandatory provisions specially with regarding to Director’s role and responsibilities in explaining and reporting on effectiveness of the company systems of internal controls that have become controversial subsequently.

Many of the recommendations of Cadbury Committee have been made mandatory by London stock exchange in 1992.

2.4.2 Kings Committee on Corporate Governance (1994)

In South Africa, which has some distractive features in terms of the styles of corporates governance, the main code on corporate governance was produced in 1994 by Mervyn King Committee. This Committee recommended for effective internal audit function, establishment of audit committee, observance of highest level of business and professional ethics and internationally accepted accounting standards. This committee has made several notable suggestion by keeping in view of social ethical, environment and cultural values attached to business in South Africa. Thus, as a matter of fact the committee also covered worker's participation, affirmative action programmes and a code of ethics in its recommendations.

The development in corporate governance as a result of Cadbury committee report has significantly influenced several nations in Europe to design similar codes in their own economic context. As a result, French equivalent of the Cadbury report, the Vienot report was published in 1995, and its Dutch equivalent, the Peters report was published in 1996.

2.4.3 Greensbury Committee on Characters Remuneration (1995)

The Greensbury Committee was formed after widespread public concern over what were seen as excessive amounts of remuneration paid to directors of quoted companies and newly privatized companies in the United Kingdom. The committee noted that high risk compensation to corporate executives on the basis of performance and stock price has subsequently increased short-termism and led to staff reductions, pay restraint for other staff members (Greensbury, 1995). The Greensbury committee was keen to ensure that director's remuneration was linked to performance, and the committee however did not seem to see a problem with high levels of pay per se, as long as they were justified on the basis of company's financial result.

Greensbury committee notably addressed the problem of severance package to departing directors whose performance had not been noticeably successful, but who still managed to leave the company with generous compensation for loss of office. The Greensbury report developed many of its recommendations from the earlier Cadbury report. The committee recommended for remuneration committee consisted of non-executive directors. These non-executive directors should have no financial interest in the company.

2.4.4 Hampel Committee and the Combined code 1998.

In the United Kingdom, the early reports such as, Cadbury and Greensbury have intensified corporate governance regulations and some of their recommendations generated excessive debates. One such aspect is director's responsibilities of reporting on the effectiveness of a company's system of internal controls. As a result of widespread criticism from various industry circles, the reporting requirements of directors have restricted only to internal financial controls as against the effectiveness of the company's system of internal control (Marchi Raju, 2004)

The Hampel committee was created in 1995 to review implementation of the findings of the Cadbury and Greensbury committees. However, it took five years for the committee to restate the original Cadbury recommendations on internal control reporting. This repot extended the director's responsibilities to "all relevant control objectives including business risk assessment and minimizing the risk of fraud". Most of the recommendation of the committee were accepted and published by the London stock exchange as the combined code principles of good governance and code of best practice.

The stipulations contained in combined code require among other things the board should maintain sound systems of internal control to safeguard shareholders investment and the company assets. The directors should at least, annually conduct a review of effectiveness of the group systems of internal control and should report to shareholders regarding all controls, including financial, operational and compliance controls and risk management (combined code, 1999)

2.4.5 Turnball Committee guidelines on corporate governance 1999

Turnball guidance published in 1999 extended the provisions set out by the combined code. It stated that board of directors should confirm that there was an on-going process for identifying, evaluating and managing the key business risks.

The report argued that one common denominator behind past failures in the corporate world was the lack of effective risk management. It contends therefore that board of directors were not only responsible but also needed guidance not just reviewing the effectiveness of internal controls but also for providing assurance that all significant risks had been reviewed and effectively managed.

2.4.6 Higgs Review on Effectiveness of Independent Directors 2003

This committee had been commissioned by the UK government to review the role and effectiveness of non-executive directors, following financial scandals including Enron and WorldCom. Public confidence in non-executive directors had been eroded because most of non-executive and independent directors are recruited to company boards primarily due to their personal contacts. The Higgs review made a number of recommendations for the combined code to be revised, for instance enhancing the role of the senior independent director, detailing the role of the non-executive director and the duties of the nomination committee.

2.4.7 Sarbanes – Oxley Act 2002

This act is a radical piece of corporate legislation by the United States congress, regarded by many commentators as the single most important legislation since securities exchange act of 1934. In the USA, corporate crisis associated with high profile companies such as Enron, WorldCom, Global crossing, Tyco etc. seem to have hastened the introduction of the Sarbanes – Oxley legislation.

The Act introduces sweeping corporate law changes relating to financial reporting, internal controls, personal loans from companies to their directors, whistle blowing and destruction of documents. In addition, Sarbanes – Oxley restricts the range of additional services that an audit firm can provide to a client. There are increased penalties for directors and professionals who have conspired to commit fraud. Some examples follow of its provisions.

The Act requires that all periodic reports containing financial statements field with the securities exchange commission must be accompanied by a written statement by CEO of the company. The section 1102 of the act provides that knowing and willful destruction of any record or document with intent to impair an official proceeding carries fines or imprisonment up to 20 years.

The section 806 provides protection to for employees who provide evidence of fraud. The legislation also established a public company accounting oversight board (PCAOB) to be responsible to the securities exchange regulation of auditing in US companies, inspection of accounting firms and disciplinary proceedings.

However, as a result of the Sarbanes – Oxley legislation, some companies felt that burden of compliance was too high in relation to the perceived benefits. The companies were reporting to spending millions of dollars revamping their internal controls, upgrading compliance regimes, writing codes of ethics, setting up hotlines for internal complaints, writing governance principles and board committee charters (wearing, 2005).

The above mentioned codes and regulations very in scope and details, but most tackle four fundamental issues of corporate governance. Fairness to all shareholders, whose rights most be upheld, accountability by the board and management, transparency or accurate and timely financial and non-financial reporting and responsibility for the interests of minority shareholders and other stakeholders and for abiding by the letter and spirit of law. Policy makers around the world increasingly argue that codes embodying these principles not only protect investors against fraud and poor stewardship but also may help to reduce corporates cost of capital.

The proliferation of codes and regulations may be attributed to two reasons. First, inherent flexibility of a code as opposed of a law and second, it is impossible to legislate on every aspect of corporate behaviour in a detailed way and statutory prescriptions may sometimes in appropriate for many governance issues. Some commentators are also apprehensive about the affectivity of codes because of apparent lack of enforcement and statutory validation to codes. However, despite of apparent lack of teeth, codes undoubtedly improved corporate governance practices in various countries. Codes has intensified broader policy debates about regulation of business, educated companies and very often prescribed best practices. Most importantly these codes were drafted by powerful institutional investors, stock exchanges and securities commissions often by national governments, whose importance thus cannot be undermined.

There are several ways through which codes can be made further effective. If codes are combined with mandatory disclosures, a practice known as "Comply or Explain" may leads to effective corporate governance practices. These requirements force companies to think carefully because any depart from code must be publicly justified. The Cadbury code, adopted by London stock exchange demanded that listed companies reveal in their annual accounts whether they were complying with it-and if not way.

Ultimately, corporate governance codes and laws most support each other. All countries have legal statutes covering important areas pertaining to business corporations. Corporate governance codes can encourage best practices in these statutes and also other areas that have not been sufficiently addressed in the laws. Moreover the boundary between laws and codes will shift over time and vary by country.

In spite of enormous success of corporate governance codes and regulations in promoting change some scholars have expressed that certain shortcomings and excessive developments might jeopardize the use of codes. The codes in the first place may leads to ‘Regulation Creep’ (Coombes and Wong, 2004). The regulators may tempted to broader their scope and add more provisions because codes generally improve corporate governance. For example in the UK, Highs review of 2003 recommended 82 provisions as against to 45 provisions in combined code of 1998 and 19 provisions in Cadbury code of 1992.

Secondly, the excessive emphasis in the contemporary times is on complying rather than explaining. The companies’ attempts to show why they have deviated from the code are dismissed without thought and comply or explain approach ultimately interpreted as ‘comply or breach’.

Finally, the progressive convergence of codes around the world might generate a tendency – ‘one size fits all’ among policy makers and practitioners. This might sometimes leads to unintended consequences. For instance, a blind forth adoption of best practices of corporate governance in developed countries by developing countries might not yield favourable results because many issues by the codes are not practically relevant of for them. The corporate governance codes thus, must first embody the prevailing conditions, issues rooted in one’s own country and culture.

2.5 Models of Corporate Governance: the Global Perspective.

An important ingredient in all corporate governance systems is monitoring of managerial activity by various elements of the system. Monitoring can be undertaken by the board of directors, individual shareholders, concentrated holdings of shares such as mutual funds and pension funds, bondholders, books or workers (Harper, 2000).

A nation’s system of corporate governance can be seen as an institutional matrix (North, 1990), that structures the relations among owners, boards, and top-managers, thus determine the goals pursued by the corporation. The nature of this institutional matrix is one of the principle determinant of the corporate governance structure and economic vitality of a society (Davis and Useem, 2004).

There is a wealth of written literature on comparative corporate governance systems with the bulk of it focusing on four major economies – US, UK, Germany and Japan. The literature in all guises emphasized the prevailing systems in these economies and attempted to conceptualize the differences amongst on the basis of several factors that are internal to these individual economies. There systems are classified differently by different scholars: outsider and insider based (Mayers, 1994), market centric and bank based (Cohen, 2000), contractual and communitarian (Sundaram, Bradly, Chipani and Walsh, 2004), high-tension and networking (Charkam, 2000), Market based and blockholder (Becht, Bolton,Roell,2002) and market based vs relationship based model (Marchi Raju, 2004). The first order in the above categorization refers to corporate governance models in US and UK, whereas second order refers to models prevailing in Germany and Japan. However recent literature on comparative corporate governance envisages another two relevant models prevailing in transitional economies (the newly privatized countries such as Russia and Middle East) and emerging economies (India, Hong Kong, Singapore and Malaysia). Thus, dyadic models are replaced with quadrilateral in the recent times. In the following sections an attempt is made to describe the governance quadrilateral and patterns of governance associated with each model.

2.5.1 ***Market centric governance model***

This model also referred as out-sider model of corporate governance widely practiced in the US and UK. The model postulates classical separation between ownership and control. Since equity ownership is widely dispersed (Barle and Means, 1934) among large number of institutional investors and small shareholders, control thus vests with professional managers. This model also referred to as principal – agent model where shareholders, the principles entrust the management of firm to managers, the agents. The model envisages reducing the agency costs and mitigate classic agency problem that arises as a result of dispersed ownership. The model concerns to align the interests of shareholder and managers prima facie, so that managers can create value for shareholder’s investments.

The capital markets notably strong and liquid in market centric economies because of god investor protection norms. While relying on markets to provide the governance to corporations, this model also stresses on other monitoring arrangements, like incentives and disciplinary techniques designed to achieve strong managerial performance. The unique aspect of the equity market in the market centered system is the widely held nature of securities and lack of significant inter-corporate, individual / family and bank holdings.

The compensation of management is tied to firms performance is essentially to align the interests of management and shareholders. The board of directors are fundamental to the control of corporations, charged with directing and managing the business of the corporation on behalf of the owners. The board of directors entrusted with the responsibilities like appointing and monitoring management, communicate with shareholders and other stakeholders, ensuring internal controls and management information systems to function effectively etc. In addition, the shareholders too, monitor management and board of directors. They vote for directors at annual meetings, express consent or descent on certain key strategic actions of management etc.

In addition to the monitoring activities of shareholders and board of directors, markets also provide a monitoring and, in some situations a disciplinary faction. The markets here include the securities market, market for corporate control, market for management services, product market. These markets however have devised their own techniques to alleviate corporate governance problems (Bhasa, 2004).

The market for corporate control is an important means to solve the principle – agent problems. In the prototypical case, poor management in a widely held company leads to low stock price. A potential acquirer believing that it can improve the performance of the either by removing management or generating economics of scale will either make a friendly bid for the equity of the firm or if incumbent management is not inclined to transaction make a hostile bid. Takeovers are quite common in this model, and takeover bids are frequently facilitated by the existence of one or more institutional shareholders who tender their shares to the bid and make it successful (Halpern, 2000).

Market for managerial labour is effective in these countries that threaten a poorly performing manager to find a new job. The ready managerial labour market helps in mitigating governance problems to a large extent. Ready supply of competent and qualified managers in the managerial markets acts as a stick for incumbent managers to perform well. Bad performance can be immediately replaced with the surfeit of talent available outside. Hence, the existence of managerial labour market helps in aligning the interests of manager with that of shareholder. Alongside, the product plays a typical role in this mode. If a firm operates poorly relative to its competitor ultimately will find itself in financial distress and in the extreme bankrupt.

The underlying discussion of market based governance system is based on the assumption that the companies have widely held equity. The model has to be modified if there are concentrated holdings of equity and debt this possibility is considered in depth in the following section.

2.5.2 Relationship Based Governance Model.

This model of governance is characterized by concentrated stockownership and illiquid capital markets. The shareholders of corporations under such a model are driven by long-term commitment and are in a position to monitor managerial action, thus avoiding the incurring of agency costs. Banks dominates the ownership shares by holding large amounts of equity in corporations. Banks are seen to be directly involved in the operations of the firms in terms of monitoring, decision making etc. Quite unlike market based model firm, where banks or the debt holders withdraw from corporations in crunch situations, in this model banks commit themselves to bailing out corporations that are having bad times. Hence, the governance model is largely understood to be relationship based model. The Japanese, French, German and Korean models are good examples of this governance model.

This model is primarily considered to be the most effective model of governance, despite being characterized by weak and illiquid capital markets. The relationship model is also beset with many problems. The dominance of banks in decision making process steals from the management its professional expertise and the corporation is managed as per the whims and fancies of a few financial analysts. However, since unlike the market based firms, there is no separation of ownership and control, thus problems of managerial expropriation of shareholders money do not arise in these firms. Instead, what is observed mostly is the conflict of interests among multiple stakeholders. While the banks might want to get stable returns, the managers may be interested in personal growth etc. (Bhasa, 2004).

While some differences can be observed in the governance patterns of the relationship based economies, the primary thread that unites them is the centrality of a web of relationships to run a corporation. However many commentators have criticized these firms for being highly concentrated in nature, besmirched with the attendant problems of non – specialization. The promoters double up as managers in most cases and if not excessive intrusion by the majority shareholders and the banks in the day to day operations may lead to corporate governance problems in the firm where majority shareholders expropriating the value of minority shareholders. However some researchers felt that these firms have, despite their illiquid markets and concentrated ownership structures stayed alongside the Anglo – American firms and also consistently performed better.

2.5.3 Transition Governance Model

Central and eastern European countries and the newly independent states (former Soviet Union) typically constitute the population of economies that have adopted this governance model. Interestingly, this form of governance model has been coerced on their economic systems given their penchant to open their markets for capital requirements (Bhasa, 2004).

This model is characterized by weak, illiquid yet emerging stock markets, transition from a state – led enterprise to gradually seeping diffuse structures; transition in legal systems towards the competitive and functional systems; weak institutional set up to confront governance problems, poor investor protection mechanisms, lack of financial discipline in terms of coercing the government to refinance loss making enterprises (Berglof and Von Thadden, 1999), and weak institutional investors.

Though these firms are trying to adopt best practices of both market – centric and relationship based models in terms of opening up the economy – strengthening capital markets, ensuring relationship based market structures. However, the general apathy that can be found in weak investor protection mechanisms, excessive state intervention and artificial diffusion of ownership has marred their progress.

The state intervention is a significant impediment for this model of governance. These firms in transitional economies made recurrent efforts to emulate market centric model by diffuse ownership structures, but what is commonly observed in these firms that ownership has always been concentrated earlier state owned corporations and now private individuals and business groups held them (Akai and Kim, 1995).

The Primary weakness of this model of governance is that access to external capital is almost choked since investors do not find the transition systems to be convincing (Jackson and Bilser, 1994). The insider bias that could be realized through privatization has weakened the financial system of transitioned economies through misallocation and mis appropriation of assets (Bhasa, 2004).

This model of governance is a recent experiment with the governance adoption models. Much is to be seen and discovered regarding the efficiency had effectively of this model. Whether markets succeed in correcting their governance problems or whether states bolster their financial and legal systems to keep in take with the emerging governance need is a matter of speculation.

2.5.4 Emerging Governance Model

This governance model is much less discussed in literature, on comparative corporate governance unlike the transitional economies model which is an experiment to assimilate the best of market centric and relationship based model. This type of governance system is a fairly successful attempt in replicating governance models of successful economies.

This model is characterized by the existence of vibrant capital markets, successful transition from state held specialty sectors to widely held firms; existence of relationship based models as well as market centric governance mechanisms; emerging managerial labour class; formal and functional legal systems; existence of both family held firm as well as widely dispersed firms. This model of governance is a unique experiment amid the much established insider and out sider models.

The Business groups dominate these economics with family retaining a significant amount of control and ownership, and spread across wider – cross section of industries. These business groups primarily managed and held by the families have modelled their control patterns on the relationship based model of firms. However unlike these firms, the family firms in emerging markets have also embraced the market models of governance by listing themselves on the vibrant stock exchanges.

These economies have enabled a pragmatic shift in understanding of corporate governance mechanisms. While, cross holdings coupled with concentrated and pyramidal ownership structures is one feature of the model. India and Taiwan are the best examples of this model of governance.

However, like all other models of governance this model too besets certain short comings. The existence of business groups often leads to conflicting interests such as transfer pricing, asset stealing, insider trading etc. Some of these attendant problems have relatively solved by the increasing realization of state role in the governance process, gradually emerging market for corporate control and growing activism by investors groups.

This model however, has translated the existing systems into practically feasible mechanisms. But still much needs to be achieved in rationalizing this model of governance. Since justification, for the existence of both insider and outsider oriented models simultaneously in one economy, is governed by practical conversion of the strengths of these models in to new governance paradigms like market – centric and relationship based structures yet to be fully accomplished.

It is clear from the foregoing analysis that corporate governance systems are developed in an institutional matrix that is particular to the country's economy, society and law concerned. However, we try to enlist the tendencies of convergence among various systems of corporate governance now, by invoking political economy perspective in the era of globalization.

The political economy perspective envisages that the Globalization drive affects different intuitional components of corporate governance regimes in different degrees and among countries the degree of impact varies. It has examined two categories of variables to describe these charging dynamics. One category is composed of the tripartite institutional structure of corporate governance regimes, such as corporate law, financial market regulations and labour law. A second set of variables is constituted by different types of political economic systems like new-liberal, neo – corporaratist and statist. The present section combines these sets to construct the governing convergences in systems of corporate governance as a result of globalization. Importantly, to bear in mind the new – liberal economies denote United States and U.K, neo-corporatist implies Germany and statist economies symbolize France and Japan.

The globalization's primary impact has been the financial system and capital markets which provides the mechanism to influence national economies. As a result of globalization the financial markets are largely affected in neo-liberal, neo-corporate as well as statist economies. However, the neo – liberal and neo – corporate economies are one step ahead than third category to embrace the changes through appropriate regulations.

The financial markets regulations given more powers to investors in US & UK (neo-liberal) and paved the way for enacting several regulations in Germany (neo-corporate) to adopt superior accounting standards, disclosure practices etc. However in France and Japan, little changes have occurred in capital market regulations and states remains to be powerful, even withstanding competitive pressures from global capital markets (Halpern, 2000).

The company law reveals a moderate, but surprisingly a variable degree of cross national convergence. The company and corporate law regimes underwent significant change in U.S. incorporating anti-takeover provisions in the federal as well in the state laws. The legal changes pertaining to company law and governance have been increasingly widened in the United Kingdom since 1990s. The UK has enacted several regulations, a few to mention Cadbury code, Greensbury code, Hampel recommendations, Combined code etc. to regulate and enhance governance of UK listed companies.

The new – corporatist economy – Germany and Statist economy like France too underwent significant changes during 1990s to adopt best practices in company law as a result of globalization. However, Japan did not have any major changes in company law regimes except creating on independent securities regulatory body. The changes in corporate and company laws converge to a large extent across these nations. Most of them have adopted best practices of governance and significantly incorporated these provisions in pertinent company laws (Cohen and Cioffi, 2000).

While, the financial market regulations, company laws continue to change across these economies, leaving labour law regimes untouched even at the time of increasing globalization. This is primarily because of sensitivity of labour issue and concerns for political stability of national political economies.

The labour markets remained resilient to the global pressures and on the whole remained stable. There are no significant changes pertaining to labour law in neo-liberal neo – corporatist and static economies of US, UK, Germany, France and Japan. There is absolutely no enhance of evidence in US, UK, France and Japan, whereas in Germany, the courts have opposed attempts to circumvent board co-determination practices (Cohen and Cioffi, 2000).

The above mentioned analysis clearly indicates that there is a growing convergence in corporate governance systems in neo-liberal, neo – corporatist and to a less extent in static economies. The convergence in the realm of capital market regulations, company law can be observed in case of neo- liberal and neo – corporatist economies of US, UK and Germany. However, static economies still holds back in the continuing trend of convergence of corporate governance regime as a result of globalization.

3

CHAPTER 3
Corporate Governance: Theoretical Perspectives

The present chapter deals with the theoretical background of corporate governance. The chapter attempts to provide an understanding of corporate governance by unveiling rich theoretical orientation pertaining to the concept and practice. The chapter primarily analyzes two dichotomous modes of though in corporate governance theorizing. It also explains the perspective employed in the present study.

Much of the current debate on corporate governance has centered on practical issues, including corporate fraud, the abuse of managerial power and social irresponsibility. In essence, the debate is about how to solve the perceived problems in corporate practice. Letza, et.al, (2004) noted that corporate governance is about building effective mechanisms and measures, either in order to satisfy current social expectations or to satisfy narrow expectations of shareholders.

The debate on Corporate Governance nevertheless has touched many deep-seated, fundamental questions - what is the purpose of the corporation? In whose interest is the corporation is run? Who should control the corporation? How should they control it? In general, corporate governance as we have outlined in the earlier chapters, is about the understanding and institutional arrangement for relationships among various economic actors and corporate participants who may have direct or indirect interests in a corporation such as shareholders, directors/ managers, employees, creditors, suppliers, customers, local community, government and the general public. Different perspectives in theory result in different diagnoses of and solutions to the problems of corporate governance practice.

The fundamental perspectives on corporate governance can be broadly categorized into two contrasting paradigms: shareholding and stakeholding (O’Sullivan, 2000; Kakabadse and

Kakabadse, 2001; Friedman and Miles, 2002). However, such a division hinges on the purpose of the corporation and its associated structure of governance arrangements understood and justified in theory. On the one side is the traditional shareholding perspective, which regards the corporation as a legal instrument for shareholders, to maximize their own interests – investment reruns. On the other hand, is the stakeholding perspective that newly emerged in the later 20th century, which positions itself on the contrary to the traditional approach. It viewed the corporation as a locus in relation to wider external stakeholders interest rather than merely shareholders wealth. Employees, creditors, suppliers, customers and local community are major stakeholders often mentioned and emphasized with in a board definition of stake holding (Freeman, 1984). The stakeholders' participation in corporate decision makings, long-term contractual associations between the firm and stakeholders, interest relationship and business ethics are the major proposals for stakeholders' management (Donaldson & Preston, 1995).

The contemporary analyses or corporate governance draw more attention to evaluating and judging the superiority of either the shareholders model or stakeholders model and often take part in one-sited arguments, sometimes with a slight modification such as are enlightened shareholder model (Gamble and Kelly, 2001) and as enlightened stakeholders model (Jensen, 2001). The analyses seldom step outside the narrow confines of their respective interests to investigate the theoretical genealogy, ideology presuppositions and value systems behind and underpinning these perspectives.

The present chapter attempts to survey and critically examine both the shareholders and stakeholders perspectives on corporate governance. The chapter also tries to comprehend other dominant perspectives in Law, Sociology, Political Economy that offer valuable insights into rethinking corporate governance and overcome part of the short coming of current over abstracted / over – static theorizing in corporate governance literature.

3. 1 Corporate Governance Theorizing

The corporate governance theory is based on two dominant theorizations, i.e., shareholding and stakeholding. These two perspectives act as fundamentals for corporate goals and in the present context they enable us to uncover rich theoretical perspectives that are attached to these dominant modes of thought. The shareholders perspective includes various theoretical models built in Economics, Sociology, Law, Management, Political Economy, Ethics, similarly the stakeholders framework comprises of several inter-disciplinary theories of corporate governance that are typically a synthesis of economics and ethics, management and sociology in particular.

3.2 The Shareholding Perspective:

The shareholding perspective as an orthodox approach to the understanding of corporate governance has its origin in the fundamental idea of private ownership rights as the foundation of capitalism. The traditional wisdom is that private ownership is fundamental to a desirable social order and to the development of an efficient economy, and thus private ownership rights are inherent to corporate governance (Gamble and Kelly, 2001). The underlying notion of private ownership is the ideology of individualism which emerged in 15th & 16th century England as a result of the emerging mercantilism, reformation and renaissance that gradually broke from the old feudal society and required a new definition of social order and regulation. The individualism initially emphasized such conceptions as individual separation, freedom and autonomy (Tricker, 2000). With the development of capitalist economy during the 17th, 18th and 19th centuries, when corporation began to emerge in England at first as a charted form for overseas trading and subsequently as a legislated form as a mechanisms for raising capital and business expansion. The individualist ideology thus, has inherited by corporate law theory in interpreting the nature of incorporation. The right to incorporate is arguably inherent in the right to own property and write contracts and that the corporation is a legal extension of its owners -shareholders (Allen, 1992). The inherent property rights theory also insisted that although a company is regarded as a legal person separate from its owners, the nature of shareholders as the company owners never changes and the company is obliged to serve the interests of its shareholders as corporate members. Corporate property should be treated as a private association which demands the minimum of government regulation and interference (Gamble and Kelly, 2001).

The shareholding perspective obtained further support during a fierce debate in corporate personality in the late 19th century. One side of the debate is referred to as the aggregate or fiction theory, advocated by German jurisprudent Rudolf Von Jhering and American jurisprudent Wesley N Hohfeld. These scholars asserted that the corporation as a legal group is created by the State and is no more than a private association of shareholders. The new form of corporate property is the aggregation of individual property rights under an objective name, united by contract and protected by Company Law. The shareholders as owners of the corporation demand certain legitimate obligations from the corporations and managers of the corporations have a fiduciary duty to act in the interests of shareholders (Baker, 1958; Mayson et.al, 1994).

The shareholder view of corporate governance was further justified during 20th century especially in the neo-classical economics that asserts the important of principles of free market, economic efficiency and profit maximization. Many scholars have contended that individuals owning private property and pursuing self-interests ensure the most efficient economic activities and outcomes (Hayek, 1969). The business corporation thus, owned by shareholders must aim at maximizing profits to enhance shareholders value. The corporations should not act on any other purposes beyond shareholders.

The shareholder perspective locates corporate governance issues in the basic premise of protecting shareholders' interests and effectively aligning managers and owner's interests through several institutional arrangements. This protectionist approach to shareholders was largely because of a universal agency problem due to separation of ownership and control in the large business corporations (Shleifer and Vishny, 1997). To reiterate, the corporate governance issues become enormous academic and practical importance as corporations grown bigger, shareholding become diffused and separation of ownership manager become the order of the day during early 19th century. As a result shareholders have to delegate control to few directors and managers to run the company. Thus the widening gap between owners and managers increased a potential risk that directors and managers may become self-serving and act on their own will at the expense of all shareholders. Hence, shareholding perspective of corporate governance emerged an a response to deal with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment and to make sure that managers do not steal the capital or invest in bad projects (Shleifer & Vishny, ibid.).

With this background reasons for shareholding approach, we now more into a more elaborate account on diverse theoretical perspectives advocated in the field of economics, sociology, Law political economy, ethics etc.

3.2.1 Neo - Classical economics and theory of firm

The problem of corporate governance was initially identified in the works of notable Neo – classical economist – Adam Smith in 1776 (1937), who noted that the directors in a joint stock company could not be expected to be as vigilant and careful with other people's money as they are with their own. He opined that managements potential negligence always prevail as an issue in public companies. However, apart from Adam smith, most of New-Classical theorists have ignored these issues of the internal organization and largely concentrated on economic modeling techniques on the basis of orthodox micro – economic analysis that is virtually synonymous with the theory of the firms (Michel, 1997). Their models exclusively purpose to explain the relationship between demand, costs and output and bears little relation to the innovating, multi-product, "flesh and blood organizations that business men call 'firms' (Penrose, 1958). The overriding orthodoxy thus, led to economist's concentration on defining model of the firm that would be able to predict the direction and magnitude of price changes which occur in response to events taking place outside the very narrowly defined firm. As result, the theory of firm has vehemently criticized and inadequate to be a theory of organization.

The new classical theory of firm thus treats firm as an empty box or a production function. This theory is indeed, a theory of markets in which firms are the only important actors (Jensen and Meckling, 1976). The neo-classical orthodoxy has been challenged on several fronts from and within economics and other disciplines. The neo- classicalist assumptions on theory of firm were defined by economists and others during 1960s as a result of a seminal work by Adolf Barle and Gardiner means in 1932 that highlighted the internal organizational governance problems as a result of separation between owners and managers. This work have led to subsequent development of theory of firm i.e., managerial and behavioral.

Before proceeding further in to theory of firm, it is befitting to provide brief review of Barle & Means arguments as it serves as historical background for subsequent development of corporate governance theory and practice till date. It is uncommon to find any academic work on corporate governance that has not mentioned Barle & means account on 'Modern Corporation and Private Property'.

3.2.2 Barle and Means - Separation Thesis

The 'Modern Corporation and Private Property' appeared in the early stages of great depression, but it was more a product of the 1920s or more generally a period after 1890 that culminated in the stock market crash of 1929. Although the book is best known for the author's focus on ownership and control, the topic represents only one component of their discussion. Barle and Means began by arguing that capital in the United States had become heavily concentrated during the previous few decades and vested with a relatively small number of companies with enormous power. As these firms grew, it became increasingly difficult for the original owners to maintain their majority stockholdings, and stocks became dispersed among a large number of small shareholders. The consequences of this dispersal, Barle and Means suggested was the usurpation of power by the firm's managers, those who ran the day to day affairs of the firm. These managers were having interests not necessarily in line with those of the stockholders. The owners preferred that profits be returned to them in the form of dividends for example, managers preferred either to reinvest the profits or, in more sinister interpretations, to further their own privileges, in the form of higher salaries or perquisites. Barle and Means contended that since managers are removed from the pressures of stockholders, becomes as a self-perpetuating oligarchy and unaccountable to the owners whom they more expected to represent.

Barle and Means surveyed 200 largest U.S. non-financial corporations in 1929 and found that 44% of them had no individual ownership interest, with as much as 20% of stock, a share that they viewed as an approximate minimum necessary for control. Barle and Means classified these 88 firms, which accounted for 58% of total assets among top 200, as management controlled. They have concluded that in only 11% of firms did the largest, owners hold a majority of the shareholding.

However, Barle and Means concern about the separation of ownership from control was not only about manager's lack of accountability to investors. It was also about manager's lack of accountability to society in general. They means thus, managers are small group, sitting at the head of enormous organizations with the power to build, and destroy, communities, to generate great productivity and wealth, but also to control the distribution of that wealth, without regard for those who elected them (the stockholders) or those who depend on them (the larger public).

The separation of ownership and control and use / abuse of managerialism posed a major challenge to the neo-classical orthodox theory of firm, which consider firm as a unitary actor that responds to market. As mentioned, internal organization of firm in the sense who controls the firm is irrelevant in this view, of firm. The assumptions of Barle and Means created rumblings among economists and they in turn responded to the challenges posed by Barle and means by defining theory of firm to accommodate the growing concerns over managerialism.

3.2.3 Managerial Theory of the Firm

The managerial theory regarded the neoclassical assumption of profit maximization as being inadequate because it does not take into account the competitive conditions in which a firm operates, which can allow managers to enjoy considerable discretion (Williamson, 1963). The managerial theory of firm attempts to model the way in which managers will exercise their discretion. The managerial theory regarded managerial discretion may sometimes detrimental to the shareholder's interests. The theory centers on the proposition that managers will seek to maximize the scales of their firms through manipulation of market valuation of their firms over the long-term in order to avoid the threat of takeover. A more appropriate analysis of managerial discretion and utility maximization can be found in the models of Oliver Williamson highlights certain behavioral determinants that give more room for managers to maneuver and act in self-interests.

Williamson's managerial theory of firm argues that the managerial utility function includes such variables as salary, security, power, status, prestige and personal excellence. Of all these variables only salary is measurable and others are non-pecuniary and essential for manager's personal satisfaction. In particular staff expenditure on emoluments and funds available for discretionary investment gives a positive satisfaction to managers because these expenditures are source of security and reflect the power, status, prestige and professional achievement of managers.

Williamson's model identifies the inherent problems in excessive managerial discretion. Manager's attempts to increase staff because being head of a large staff is a symbol of power, status and prestige may prove counterproductive for the value of the form. Similarly, managerial emoluments or slack payments in the form of expense accounts, luxurious offices, company jets, cars etc. often have zero productivity and instigate governance problems in the firm. Thus excessive discretionary investments give satisfaction to managers because it allows them to materialize their personal favorite projects. This leads to managerial appropriation of owner's wealth for personal satisfaction and subsequently leads to standard corporate governance problems between owners and managers.

Thus managerial theories of firm with in economics are a response to managerialism, but they don't necessarily endorse managerialist thesis. They stand apart from other sociological accounts on managerialism in several respects. The managerial theory of firm also departs from orthodox theory of firm which considers management as just another input for maximization of profit. This theory for first time introduced behavioral attributes to economic modeling and offers constructive arguments for growing governance problems and mis-alignment of interests between shareholders and managers.

3.2.4 Behaviourial Theory of Firm

The behavioral theory of the firm, as developed by Cyert and March, focuses on the decision making process of the large multi-product firm under uncertainty in an imperfect market. Cyert and March (1963) deal with the large corporate managerial business in which ownership is divorced from management. The theory developed from the concern about the organizational problems which the internal structure of such firms creates and from the need to investigate their effect on the decision-making process in large corporations. The basic premise of behavioral theory of firm rests on following assumptions.

1. The firm as a coalition of groups with continuing interests.
2. Definition of the goals of the firm by the top management
3. Means for the resolution of the conflicting demands and interests of the various groups of the firm coalition.
4. The process of decision making for the implementation of the goals by the management.

The behavioral theory of firm is conceived as a coalition of different groups which are connected with its activity in various ways: managers, workers, shareholders, customers, suppliers, brokers and as so on. Each group has its own set of goals or demands. For example workers want high wages, good conditions of work and managers want high salaries, power and prestige. The shareholders want high profits, growing capital and market size where as customers want low prices and good quality and service. The most important groups, however, with in frame work of behavioural theories are those most directly and actively connected with the firm, namely the managers, the workers and the shareholders.

The behaviourial theory of firm contends that management is key to internal organization of the firm. The top management is responsible for goal setting, resolving conflict among participants and decision making activities. The managers are responsible for profit maximization of the firms, where in they are interested in attaining satisfactory rate of profit or to hold a satisfactory share of the market. (Michel, 1997). The behavioural theorists introduced rationality component in theorizing of firms and argues that managers are bounded rational in the sense that intendedly rational, but only limited so. Their behaviour in organizations and decisions on key matters is, if not wholly rational, at least in good part intendedly so (Simon, 1979). The bounded rationality thus, justifies the satisfying behaviour of the large corporate firms. The top management and board of directors decide the goals of the firm to attain satisfactory performance.

The behavioral theory of firm recognize firm as a coalition of groups and management is central to goal setting, attaining satisfactory performance and resolving conflicts in the internal organization of the firm. The behavioural theorists however do not completely reject neo-classical theory, instead they focus on a different set of problems, specifically the internal allocation of resources and the process of setting prices and out puts (Cyert and March, 1979). Unlike, the traditional theory, firm is not treated as a single-goal, single-decision unit, but as a multi-goal and multi decision organizational coalition.

The neo-classical, managerial and behavioural theories of firm have further evaluated and contextualized by the later economic theorizing especially in neo-institutional economics literature. The present chapter set out three major strands in neo-institutional economic theorizing: Agency theory, Transaction costs and property rights theory to position the development of corporate governance theory in the contemporary times.

3.2.5 Agency Theory

Shleifer and Vishny, (1997) regarded agency theory as an overwhelmingly dominant theoretical perspective applied in corporate governance studies. The agency theory has been proposed as an explanation of how the public corporation could exist, given the assumption that managers are self-interested. This theory has the first satisfactory explanation of the public corporation since Barle and Means (1932) pointed out some of the key problems inherent in the separation of ownership and control.

The agency theory has been developed by Ross (1973) and by Jensen and Meckling (1976) among others applying the principal – agent model to the corporation the shareholders as principals delegate their decision making rights to an agent (managers) but maintain their rights to the residual income. The agent-manager has a fiduciary duty to the shareholders whose main goal is to receive the highest yield possible i.e. managers should maximum profits. The managers as agents often use the delegated power in their hands to maximize their own utility instead of shareholders / principals welfare. Therefore managers are un-trustworthy and must be fully monitored. There are two issues occurring in the agency relationship with which agency theory is concerned. The first is that because it is difficult or expensive for the principal to know performance of the agent, the principal cannot verify that the agent behaved in appropriate manner. The second issue is that the principal and agent may prefer different actions because of different attitudes towards risk (Eisenhardt, 1989). These two problems are further elaborated below.

An agency relationship consists of an agreement under which one party, the Principal, engage another party, the agent, to perform some service on the principal's behalf. There are many agency relationships exist with firms. For instance, the shareholders appoint board of directors on their agents to manage firms. The Boards, in turn, delegate much of the operating authority to top managers, while managers assign tasks to lower-level employees. As we have discussed, there is good reason to believe that the interests of principals and agents are not naturally aligned. These are agency problems omnipresent in firms primarily because the agent-managers have incentives to take actions that increase their utility at the expensive of shareholder-principals.

The above said assumptions are fundamentally because of excessive managerial discretion (Williamson, 1964) and asymmetric information between agents and Principals in an agency relationship. The asymmetric information leaves managers with an opportunity to pursue their own interest rather then interests of the Principals. Since Principals cannot freely observe the actions of the agent, the agents can generally engage in activities such as Shirking and Perquisite taking (Jensen & Mekling 1976) without those activities always being detected by principals. Nevertheless, the principals too usually limit such behaviour by establishing appropriate incentives for the agent in the contract and by incurring monitoring costs. The Agents also might incur bounding costs to help guarantee that they will not take certain actions or to ensure that the principal will be compensated if they do (For example, the Agents might buy insurance policies that pay the Principal in case of theft). The agent is willing to incur these expectations to increase the amount paid to the agent by the Principal for the agent’s services. If, monitoring costs cannot align the interests of Principals and agents this results in residual loss and increase the agency costs in the firm.

The second issue for wide spread agency problems between owners and managers is because of differential attitudes to risk. The problem here is that the principal and the agent may prefer different actions because of the different risk preferences and exposures (Eisenhardt, 1989). The managers typically have substantial levels of human capital and personal wealth invested in the firm. This large investment can make managers overly risk averse from the stand point of owners, who at least in the large public corporations typically hold only a small fraction of their wealth invested in any firm. The common stock of large corporations thus, fundamentally held by many investors with well diversified portfolios. As a result, investors are not overly concerned about the fortunes of any one company and tend to be risk neutral because their earnings on stock tend to balance out over their entire portfolios: i.e. one firm is lucky will another firm is unlucky. The managers in contrast, receive large fractions of their incomes form individual companies and care greatly about the fortunes of their firms. This difference in outlook implies that managers (agents) of a firm can often be viewed as being more risk averse than the owners (principals) of the firm. This leads to agency conflicts where in owners being risk neutral and agents being risk averse due to personal preferences towards risk as such.

The agency perceptive thus, deals with the governance issues deep seated in contemporary corporate forms of business organization. The agency theorists also expressed explicit concerns over the ways through which these problems of governance in business corporations can be solved and identified appropriate mechanisms to solve the misalignments of interests between principals and agents. The two streams of agency theory offered profound ways to deal with this problems these two streams of agency they is exorcized have to uncover more appropriate explanations for agency problems.

The agency theory from its roots in information economics has developed along two lines: positivist and principal – agent (Jensen, 1983). These two streams share a common unit of analysis: the contract between the principal and agent. The concept of contact is the most favored metaphor used in agency theory. It believes that all social relations in economic interaction are reducible to a set of contracts between principals and agents. The role of contracts serve as a vehicle for voluntary exchange (Alchian and Demsetz, 1972). The firm, thus can be best viewed as a nexus of contracts and contractual relations exist not only between shareholders and managers, but with other stakeholders such as employees, suppliers, customers, local community etc (Jensen and Meckling, 1976).

The contract between principals and agents define the firms organizational governance framework - to say allocation of decision right, performance evaluation and reward systems. The contracts also provide an important set of constraints that helps to resolve and control incentive problems between principals and agents. The contractual structures ensures that agents / managers act in the principals interests and there by determine the most efficient contracts growing the principal and agent relationship the interest of owners (Letza, Sun and Kirkbridge, 2004)

3.2.6 Transaction Cost Economics

The Transaction Cost Economics departs form Neo-Classical views of firm by treating firms as centers of various activities including production function. Thus it argues that co-ordination between separate activities takes place with in firms and this coordination is the defining characteristic of firms as they really exist. Williamson (1981) described that transaction cost economics is closely associated with the study of industrial organizations because it posits that firm engages as a result of need to reduce transaction costs. Transaction cost approach to corporate governance perspective (theorizing) has been the beneficial of distinguished antecedents (Williamson, 1984). Prominently - Ronald Coase's classic article on the nature of the firms (1937) that describes the firm rather them in technological terms (as a production function). Firms and market are described as alternative modes by governance, the choice between which principally decided by transaction cost differences. Awaiting operationalization, Coase's 1937 article was much cited and little used (Coase 1972:67). The operationalization of transaction costs finally got underway in the 1970s. Once begun ,TCE has successively progressed into pre-formal, semi-formal and fully formal modes of analysis, (Willamson,1996) However, in first transaction cost works Williamson dealt with vertical integration - or in more mundane terms, with the make-or-buy decision. This indeed turned out to be a proto typical problem there by followed analyzing certain key themes like human actors, unit of analysis, the nature of firm, purpose, empirical evidence and efficiency creation.

Williamson's work assumes that firms are profit maximizing, and profit maximization involves cost-minimization. By implication, it is an equilibrium theory. It assumes rationality on the part of principles (owners) and /or agents (managers). Where it differs is in stressing transaction costs as well as production costs. Williamson, indeed envisions that production costs on being analogous to the costs of building and running as ideal machine, while transaction costs are those costs which are increased by departures from perfection, such as friction. In the economic sector, the ideal machine would be a perfectly efficient market. As we know such a market fundamentally requires full information to be available to all parties among perfect competition, among other factors. Departures from this perfection (often referred as "market failures") can result in firms increasing costs when they attempt to buy or sell goods or services. For example, lack of information among alternative suppliers might lead to paying to higher price for a good. Lack of information about a customer's credit worthiness might result in a bad debit. These are referred to be transaction costs. Williamson argues that firms want to maximize the total costs which are made up both production and transaction costs. Under some circumstances transaction costs may be lower if the transaction takes place in an open market, which in other situations costs will be lower if managers coordinate the transactions internally (Williamson,1999)

However, Commons (1961) was first to suggest that the ultimate unit of economic investigation should be the transaction. He typically opaque term for a transaction is a unit of transfer of legal control. According to him transactions constituted as essential mechanisms in firms whether it is bargaining transaction between buyers and sellers or managerial transaction between managers and owners. For our purpose of understanding transaction cost approach to corporate governance, we'll draw centrality of information processing to control managerial opportunism and self – dealing.

TCE's contribution to understand corporate governance rests in specifying the variables that determine which governance structure and contractual scheme enable firms to lower transactions cost there by proposing numerous incentive mechanisms that align the interests of principals and agents. In TCE illustration of corporate governance, we also need to mention the assumptions, unit of analysis, variables of transaction cost approach essentially because of the very fact that any understanding of corporate governance would be incomplete unless we understand the basis problems that solidify any attempt of theorizing.

Transaction costs economics eschews hyper-rationality in favour of bounded rationality according which human actors are intendedly rational but only limited so (Simon,1961). It refers to the fact that people have limited memories and limited cognitive processing power. Bounded rationality assumes that all complex contracts in a real world economic situation are unavoidably incomplete because one cannot assimilate all the information at disposal, and cannot also work out the consequences of the information accurately (Williamson, 1999).

Another attribute is self-interest. TCE goes beyond the orthodox description of simple self-interest seeking to include strategic behaviour – which manifests itself as adverse selection, moral hazard, and more generally, as opportunity. Accordingly, human actors will not reliably disclose true conditions upon request or self – fulfill all promises. Contract as mere promise, unsupported by credible commitments, will not, therefore, be self –enforcing (Williamson, 1999). Thus opportunism as Williamson explains refers the possibility that people will act in a self-interested way ”with guile” that is, people may not be entirely honest and truthful about their intentions or they might attempt to take advantage of unforeseen circumstances that gives them the chance to exploit another party. However TCE does not assume that all people will act opportunistically some of the time, and that one can’t propose in advance who is an opportunist and who is not (Maher,1997).

These two assumptions are important contextual factors in corporate governance theorizing that offered by transaction costs economics. These views substantiate and father elaborate the classical principal and agent problem (Barle and Mens,1932) managerial discretion (Williamson, 1964).

To reiterate, transaction is the basic unit of analysis and it must contain in itself the principals of conflict, mutuality and order (Commons, 1932). The transaction cost economics operationalizes the basic dimensions with respect to which significant transaction cost consequences accrue. The real explanatory power of transaction cost theory comes from three key attributes / dimensions / variables are the frequency with which transactions recur, the uncertainly (disturbances) to which transactions are supported by transaction specific assets (asset specification). These three dimensions determine whether transaction costs will be lowest in a market or in a hierarchy and also envisages appropriate governance structures and incentive mechanism to coordinate the transaction between firm and it's stakeholders, there by attempts to mitigate risk of higher transaction costs.

The transaction cost economics shares a similar platform with agency theory, anchored from organizational economics standpoint to address important issues faced in an organizational setting. Like agency theory, contracts exists at the least of transaction cost economics and if provides little instances of managerial transaction between agents (managers) and principals (Owners) which transfer the physical control of a unit from one party to others.

Transaction cost economics in a nutshell highlights the issues of transaction costs as a result of managerial discretion that take place in modern industrial organizations. These costs are result of what is exchanged between principal and agent and costs to agreements between them. For instance, managerial transaction occurs inevitably in modern business enterprises where in service is transferred to professionally qualified managers (agents) leads to technological separation of ownership and control. With operational control as being given away by owners (principals) to managers which begins new dynamics in the firms as managers assume more control over firms because of a variety of reasons. With a well working interference between owners and managers the transactions are smooth and owner's interest are taken care by managers but what if owners and managers pursue different interests, what happens when managers assumes more control and start appropriating owners wealth? What happen when this friction arises between principles and agent? The economic counter part of this friction is otherwise referred as transaction cost. The transaction costs are result of frequent breakdown, in-alignment of interests between principal and agents.

Transaction cost economics apparently jaundiced the views of agency theory that contends human actors as bounded rational and opportunistic in transacting situations (Williamson, 1983). The opportunism goes beyond the assumption of self-seeking which prevails in conventional micro-economics. According to transaction cost economics opportunism allows for strategic behaviors involving self-interest seeking with guile. It includes and limited to more blatant forms such as lying stealing and cheating. Opportunism more often involves subtle forms of deceit more generally refers to the incomplete or distorted discloses of information especially, to calculated efforts to misled, distort, disguise or otherwise confuse (Williamson, 1985). The opportunity in transaction thus leads to problem of transaction costs In the firm because of problem of entrancing contracts to check this behaviors on past of agents.

The exchange between the managers and principles hence becomes imperfect and leads to higher degree costs associated with managerial transactions. The transacted items remain imbalanced because managers continue to receive remuneration even though they do not fulfill the expectations or interests of owners who actually hired them. The information asymmetry between managers and owners adds to management's advantage since they control the information of the firm as operational controllers of the business and not letting it known to owners. This will leads to governance problems in the companies by increasing managerial transactions costs due to excessive monitoring costs, perquisite consumption, pet projects, hampered capital access, resisting replacement, resisting mergers, engaging in excessive risk taking and power struggles, excessive diversification and finally self-dealing transfer pricing.

3.2.7 Corporate Governance: Incomplete Contracts Approach:

This approach examines the need of corporate governance mechanisms on the basis of suitable illustrations drawn from contract theory, agency theory and transaction cost economics. The proponents of this approach argue that issues of corporate governance arise in an organization whenever two conditions are present. First, an agency problem or conflict of interest involving members of an organization – these might be owners, managers, workers, or consumers. Second, transaction costs are such that this agency problem cannot be dealt with through a contract. These two arrangements are illustrated in the following paragraphs.

In the absence of agency problems, all individuals associated with an organization can be instructed to maximize profit or net value or to minimize costs. Individuals carry out activities, effort and other costs are reimbursed directly and no incentives are required to motivate them. This reflects the situation assumed to hold in the standard neo-classical theory of firm where no governance structure is required to resolve disagreements essentially due to the absence of agency problems (Hart 1995).

Secondly, principal – agent theory departs from neo-classical assumptions by supposing that some costs, effort choices are private information and hardly available for observation. Thats why principal-agent theory laid excessive emphasis on incentive alignment and risk sharing. Although agency theory is useful for insights into why managers might be given performance related pay, the theory does not itself provide a role for governance structure. The reason is that optional principal – agent contracts are comprehensive in the sense that a contract specifies all parties obligation in all future states of the world, to the fullest extent possible. Thus, optimal principal-agent contracts are comprehensive; it is hard to find a role for governance structure. The reason is that governance structure matters when some actions have to be decided in the future that have not been specified in initial contract: governance structure provides a way for deciding these actions. Agency problems hence alone do not provide a rational for corporate governance (Hart, 1995).

The governance structure does matter in large public listed corporations if agency problems are present and contracts are incomplete .Oliver Hart (1995) departed from standard principal-agent model that supposes - it is costless to write a compressive contract that govern all transactions between firm and its stakeholders. He argued that in reality, however, contracting costs may be large. Following, transaction cost literature, Hart has identified three costs that are particularly important is designing contracts. Firstly, costs of thinking about all the different eventualities that can occur during the course of the contractual relationship, and planning to deal with them. Secondly, costs of negotiating with other parties. Thirdly, costs of writing down the plans in such a way, that they can be enforced by third party.
Given the nature of these transaction costs, the parties will not write a comprehensive contract. Instead they will write a contract that is incomplete i.e. the contract will have gaps and missing provisions- future actions will be specified only partly and in some cases not mentioned at all. This contractual incompleteness leads to re-negotiations as and when new information arises and there may be legal disputes to the extent that the initial contract is ambiguous (Hart and Grossman 1986).

In an Arrow-Debreu economy as assumed by agency theory that agents can cost lessly write all state contingent contracts. As a result, all decisions are made ex-ante and all quasi-rents are allocated ex-ante, thus no room for governance. But as highlighted above the world of business is largely characterized by incomplete contracts in reality. These incomplete contracts between managers and shareholders require the use of corporate governance mechanisms to bridge the gaps in contracts (Sinha, 2005). Corporate governance structure thus, can be seen as a mechanism for making decisions that have not been specified in the initial contract more precisely, corporate governance allocates residual rights of control over the firm's non-human assets; i.e. the right to decide how these assets should be used, given that a usage has not been specified in an initial contract.

Thus, incomplete contracts approach highlights that some contracts contingent on future observable variables are costly (or impossible) to write ex-ante, leaves room for governance ex-post. In such a world quasi-rents must be divided ex-post and real decisions that must be made (Zingals, 1998). Corporate governance structure hence, shapes the ex-post bargaining over quasi-rents generated by a firm.

Oliver Hart (1995) illustrated that even though shareholders in case of large public companies have residual control rights in the form of votes, are too small and diversified to exercise residual control on a day to day basis. Given this, they delegate day to day control to board of directors, which intern delegates it to management. Secondly, due to dispersion, shareholders have little of no incentive to monitor management. Because of separation of ownership and control, lack of monitoring, managers of a public company will pursue their own goals at the expense of those of shareholders. Hart (op.cit.) reiterated the importance of board of directors and large shareholders; the threat of proxy fights and takeovers to constrain & check managerial appropriation. The in complete contracts approach underscores the importance of ex-ante incentives, efficient bargaining, risk sharing, as some crucial measures to reduce ex-post contracting governance problems (Zingals, 1998).

3.2.8 Myopic – Market Approach

Though the myopic market model (Charkham, 1994) agrees with the principal-agent or finance model that the maximization of shareholders interests is the focus, it argues that the fundamental flaw of existing corporate governance approach is its excessive concern with short-term market value. This Anglo-American Corporate governance approach systematically undervalued certain long-term expenditures, particularly capital investment, research and development spending because of immediate pressure or interest from hostile takeover. The short sighted markets thus force otherwise diligent managers to concentrate solely on the current share price and ignore the long-term value creation of the firm, or take decision against the threat of hostile take over at the expense of shareholders interest.

The Myopic-Market approach criticizes the finance model of Corporate Governance because of an excessive- concern for short term returns that forces managers to judge their actions only on the basis of their effect on share price. However, this model assets that share price is not always a useful indicator of firm value and the capital market is not always an efficient selection mechanisms. It views take over threat becomes simply a distraction from the true task of creating long-term competitive advantage for the firm. Marris (1971) averred that take-over can not act as a substitute for the arduous, painstaking and show work of internal growth. Internal growth requires careful planning, training of personnel, product development, innovative marketing strategies and building relationships with suppliers etc. (Joshi, 2004)

Myopic Market approach can thus be seen to support organization-control perspective. The objective of corporate governance theory and practice, according to Charkam (1994) is to create an environment in which managers and shareholders are encouraged to share long-term performance horizons, such as increasing shareholders loyalty and voice, reducing the shareholders exit, encouraging relationship investing and empowering other groups (employees, suppliers, local community etc.) to have long-term relationship with the firm. These investments enable firms to enhance employee participation, disclosure information, prohibition of insider trading and board representation to other stakeholder constituencies (Porter, 1992, Letza, Sun, Kirkbridge, 2004).

3.2.9 The Abuse of Executive Power Approach

Like above mentioned myopic market approach, this approach too rejects the conventional principal-agent or finance to understand issues participating to corporate governance. The abuse of excessive model (Hutton, 1995; Kay and Siberston, 1995) views that the purpose of a business corporation is to serve the interests of stakeholders as a whole. This approach asserts that objective of executives is to act as stewards of the corporate interest as a whole. The major problem in the current corporate governance theorizing is that it allows excessive power to executive managers who may abuse their power in pursuit of their own interests. The supporters of this approach argue that current institutional restrictions on managerial behaviour based on the notions of self-regulation and market discipline are ineffective and inadequate (Letza, Sun, Kirkbridge, 2004). They appeal for statutory changes in corporate governance, such as fixed four-year term for chief executive officers, independent nomination of non-executive directors and more powers for executive directors.

3.2.10 Political Economy Approach

Another important approach to corporate governance theory emanates from the perspective of political of economy. This approach looks at corporate governance as a system of two parts comprising inside and outside stakeholders. The insiders are supposed to make up the corporate governance system and outsiders - political system. Roe (1994) followed this categorization to make a distinction between production system or colloquially main street and financial system or Wall Street.

Hellwing (2000) emphasized that the distinction between insiders and outsiders is crucial in the working of the system. He opines that informal, discreet give and take between managers and other stakeholders enable to create and cultivate alliance between managers and political system, media, trade unions etc. The two systems thus, are linked together because of this above said exchange of favors. Managers, however as insiders have control over corporate resources and insulate themselves from outsiders to maintain autonomy. Manager's power to immunize themselves from outsiders is arguably unchecked and in practice they have residual rights through non voting shares, cross-holding, anti take-over measures etc.

Interests of various outside stakeholders get articulated with varying degrees of precision. The interests of shareholders, employees, creditors, suppliers and community are justified and substantiated by several exogenous safeguards such as protection laws of workers, pollution control regulations, bankruptcy or insolvency laws etc. (Freeman and Evan, 1990). The political economy approach of corporate governance essentially links corporate governance with its regulation by these considerations or by alliances between corporate executives, politicians, creditors, employee organization, supplier groups, consumer associations etc. This approach primarily understands corporate governance issues with the help of mutual exchange among various interested parties. The following diagram illustrates the actors in corporate governance system.

Political economy approach attracted significant attention by academicians, researchers and practitioners in the recent times (La porta, Sheleifer, 1999). The political regulation of corporate governance indeed, became a prime concern with the wake of high profile financial scandals that shook the western capital markets in the early 80s. The political economy approach also facilitated a discourse in terms of understanding comparative corporate governance system especially - Germany, US, UK, France and Japan etc.

3.3 Sociological Approach to Corporate Governance

Sociological attempts define corporate governance broadly to include the social organization of firms and their relation to their environments including their relationship to states (Fligstein and Freeland, 1995). This intimately links governance issues to viability of the industrial enterprise. Unlike economic accounts which focused on efficiency considerations, sociological approaches accord social, political and control factors. Sociological accounts emphasize the issues of external control and wide range of independence interactions with competitors, suppliers, capital markets, employees, communities and the state. It assumes that corporate governance must ensure stable, predictable, relationship with each of these sets of actors in order to achieve efficiency profitability and growth. In this chapter, we consider three general sociological approaches that relevant to comparative corporate organization: resource dependency (Burt, 1983) Network approach (Powell and Smith 1994) and power perspective on board of directors (Zald, 1969).

The recourse dependence theory relay implicitly or explicitly on two sorts of views, one that focuses on the management of dependence and the other that argues that environmental dependence as key to organizational survival. The former argues that actor's power with in the organization depends on their ability to control and solve internal and external resource dependencies (Pfeller & Salancik, 1978). This ability can derive from actor's position with in the firm, knowledge and other links to external bases of power (Zald, 1969). If there is Shift in resource dependencies, there is potential shift in the balance of powers.

Burt (1983) has used such resource dependence arguments to model network connection between firm and industrial sectors with special emphasis on links between suppliers and customers in the US economy. He concluded that changing market conditions i.e. perfect competition to bilateral monopoly leads to power advantages and disadvantages for the firms. Many others, for instance, Mizruchi & Stearns (1988), have used a similar approach in examining networks of connections between owners, managers & banks, arguing that the patterns of interaction among these actors shape the possibilities for firm behavior.

Another important sociological approach to corporate governance theory is power based perspective to understand the role and functions of the institution of board of directors. Mayer N. Zald (1969) developed in similitude to the resource based view of the firm and highlighted functions and conditions of powers of board of directors who are entrusted with formal as well as legal responsibility for controlling and maintaining organizational operation and effectiveness. He provided a theoretical synthesis of propositions about the power and influence of board of directors, who bear unique resources based in legal rights, in monitory control, in knowledge, or even in force of personality etc.

Zald (op.cit.) maintains that the relative power of board members either based on this access to and control of relevant external resources or based on knowledge relevant to the ongoing separations of the corporation. Power thus may based on external bases such as stock ownership, external funding, community legitimization or knowledge, economic status etc. Board of directors hence, with dominant shareholding, control of external funding and community legitimization have significantly high influence. Similarly board of directors with knowledge regarding decision making, detailed familiarity with the specific organization or general expertise about given technical process enjoys selectively higher level of power in composition with others who do not possess these detachable resources.

Sociological approaches to the corporate governance can be thus, been as a progression away from efficiency principles and towards more diffuse set of political and cultural explanations, although this is by no means universally the case. Sociologists also tend to shy away from making claims that an organizational form is efficient in a Neo – classical sense instead they assumes only that organizational forms are effective i.e. that they promote several of the organization. Power with in and across firms, states, resource dependence are the basic elements of sociological theorizing about corporate organization (Filgstein and Freeland, 1995). However a point to bear in mind both economic and sociological approaches implicitly or explicitly conceptualize corporate governance as a problem of managing interdependencies be it agency costs, transaction costs, power, knowledge, institutional legitimacy etc. Both however use very different rhetoric to describe their objects. For instance, economic models focuses on internal control, hierarchy, motivation, incentive alignment mechanisms whereas sociological approach emphasizes external control and wide range of interdependencies – with competitors, suppliers capital markets, customers, communities, and employees and the state.

3.4 Stakeholders approach to corporate governance

The stakeholders view departs form the argument that stockholders have a privileged place in the business enterprise. The arguments of stakeholder approach dates back to some of early works in the area of business management such as Chester Barnard (1938), Barle and Means (1932), that opines business corporation as a major social institution with a purpose to serve society. The function of executives, thus to instill a sense of moral purpose among employees of the corporation.

The stakeholder notion is indeed a deceptively simple one. It says that there are other groups to whom the corporation is responsible in addition to stockholders; those groups who have a stake in the actions of the corporation (Freeman and Reed, 1983). The word stakeholder coined in an internal memorandum at the Stanford Research Institute in 1963, refers to "those groups without whose support the organization would cease to exit". The list of stakeholders originally included shareowners, employees, customers, suppliers, lenders, and society. From this original work at SRI, the historical trail diverges in a number of directions as Sturdivant (1983) rightly claims that the precise origins of stakeholders theory equates responsibilities and objectives of business corporation and maintains that the objectives of the firm should be derived by balancing the conflicting claims of various stakeholders in the firm: managers, workers, stockholders, suppliers, customers (Ansoff, 1965).

For most part the development of the stakeholder concept was slow during the late sixties and early seventies, except for the continued work at SRI by a number of researchers and consultants. A notable exception is the work of Eric Rhenman (1968) and Bussell Ackoff (1974) wherein Rhenman applied the stakeholder concept to industrial democracy in Sweden, and Ackoff rediscovered stakeholder analysis to propound an open system view of organization and argues that may problems can be solved by the redesign of fundamental institutions with the support and interaction of stakeholders in the system.

Stakeholder approach gained further momentum since the publications of Edward Freeman's Landmark book, Strategic management: a stakeholders approach (1984), the concept of stakeholder has embedded in management scholarship and in managerial thinking. Freeman (1984) made a persuasive case that systematic managerial attention to stakeholder interests is critical to firm success. With this brief introduction about the concept of stakeholders and it's historicity, lets explicate the definition on of stakeholder: who is a stakeholder and what is a stake?

Freeman and Reed (1983) proposed two definitions of stakeholder. In a wider sense, which includes groups who are friendly or hostile and in a narrow sense, which captures the essence of the SRI definition, but in more specific sense.

The wide sense of Stakeholder – Any identifiable group or individual who can affect the achievement of an organization's objectives or who is affected by the achievement of an organization's objectives. This includes public interest groups, protest groups, government agencies, trade associations, competitors, unions, as well as employees, customer segments, shareowners etc.

The Narrow sense of stakeholder – Any identifiable group or individual on which the organization is dependent for its continued survival. This comprises of employees, customers, certain suppliers, key government agencies shareholders and certain financial institutions etc.

Freeman & Reed (1983) categorization of stakeholder is in consonance to Freeman's early definition and SRI conceptualization respectively. However, these definitions are certainly one of the broadest conceptions in the literature unambiguously open to include virtually every one. In contrast, Clarkson (1995) offers one of the narrow definitions of stakeholders as voluntary or involuntary risk bearers: "voluntary stakeholders bear some form of risk as a result of having invested some form of capital – human or financial, something of a value, in a firm. Involuntary stakeholders are placed at risk as a result of a firm's activities. But with out the element of risk there is no stake" a stake, in this sense, is only something that can be lost. The use of risk to denote stake appears to be a way to narrow the stakeholder field to those with legitimate claims, regardless of their power to influence the firm or the legitimacy of their relationship to the firm.

However, narrow views of stakeholders are based on the practical reality of limited resources, limited time and attention, and limited patience of managers for dealing with external constraints. In general, narrow views of stakeholders attempt to define relevant groups in terms of their direct relevance to firm's core economic interest. In contrast, broad view of stakeholders is based on the empirical reality that companies can indeed be virtually affected by, or they can vitally affect almost any one. The ultimate aim of broad view of stakeholders is firm centered or system centered; that managers acting towards all their stakeholders for firm-centered purposes of survival economic well-being, damage control, taking advantage of opportunities and winning alliances etc.

Along side, Mitchell, Agle and Wood (1997) classify the term stake to differentiate between groups that have a legal, moral or presumed claim on the firms and an ability to influence the firm's behaviour, direction, process or outcome. They differentiated claimants and influences as former may have legitimate claim or illegitimate ones but they may or may not have any power to influence firms. Unlike this, the later have power over the firm weather or not they have valid claims or any claims at all and weather or not they wish to press their claims.

The stake holders hence, identified as primary or secondary; as owners and non owners of the firms ; as owners of capital or owners of less tangible assets ; as actors or those acted upon ; as those existing in a voluntary or an involuntary relationship with the firm; as rights holders, contractors, or moral claimants; as resources providers to or dependents of the firms ; as risk takers or influences ; and as legal principals to whom agent- managers bear a fiduciary duty. Mitchell, angle and wood (1997) also identified three following attributes of stakeholders: 1) stakeholders power to influence firms 2) the legitimacy of stakeholder's relationship with the firms 3) the urgency of the stakeholders' claims on the firms.

The following section outlines the central theses of stakeholders approach and thereby presets a stakeholder theory of corporation which is in contrast with conventional input-output model of the firm.

3.5 The Central focus of Stakeholder Theory:

Thesis 1: The stakeholders' theory is unarguably descriptive. It presents a model describing what the corporation is (Donaldson & Preston, 1995). It describes the corporation as a constellation of co-operative and competitive interests possessing intrinsic value. Several aspects of this model have been tested in many studies for descriptive accuracy.

Thesis2: The stakeholders theory is also instrumental. It establishes a framework for examining the connections. If any, between the practice of stakeholders' management and the achievement of corporate performance goals. The principal focus of interest here has been the proposition that corporations practicing stakeholder management will, others thing being equal, be relativity successful in conventional performance terms (profitability, stability, growth. etc.)

Thesis 3: Although theses 1 and 2 are significant aspects of stakeholder's theory. Its fundamental basis is normative and involves acceptance of the following ideas;

a) Stakeholders are persons or groups with names & faces and legitimate interests in procedural and / or substantive aspects of corporate activity. (Freeman et.al, 2002). Stakeholders thus, are identified by their interests in the corporation, whether the corporation has any corresponding Functional interest in them.

b) The interests of stakeholders are of intrinsic value (Reed, 1999) that is, each group of stakeholders merits consideration for its own sake and not merely because of its ability to further the interests of some other group – such as shareowners.

Thesis 4: The stakeholder theory is managerial in the broad sense of term (Freeman et.al, 2007). It not only simply describe existing situations or predict cause – effect relationship; it also recommends attitudes, structures and practices that, taken together, constitute stakeholders management requires; as its key attribute, simultaneous attention to legitimate interests of all appropriate stakeholders, both in establishment of organizational structures and general policies and in case – by – case decision making. This requirement holds for any one managing for effecting corporate policies, including not only professional managers, but shareholders, employees and others. Stakeholder theory that Donaldson & Preston (1995) argues does not necessarily presume that managers are the only rightful locus of corporate control and governance.

The aforementioned central theses are elaborated to further stakeholder theory of modern corporation that is in many respects contradict conventional theories of corporate organization namely financial model or to say 'theory of the firm'.

3.6 Aspects of Stakeholder Theory: Descriptive, Instrumental and Normative

3.6.1 Descriptive Stakeholders Theory –

This theory considers that organization is what one finds at the center of co-operation and competition situations, each of which possesses its own intrinsic value. (Pesqueux and Damak – Ayadi, 2005)

The theory is being used to describe, and sometimes to explain, specific corporate characteristics and behaviors. For example, stakeholder theory has been used to describe (a) the nature of the firm (Brenner and Cochran, 1991), (b) the way managers think about managing (Brenner & Molander, 1977), (c) how board members think about the interests of corporate constituencies (Wang & Dewhirst, 1992), and (d) how some corporations are actually managed (Clarkson, 1991; Kreiner &Bhambri, 1991), (e) the diffusion of societal information (Ullmann 1995), (f) the notion of target stakeholders (Mitchell et.al., 1997), (g) the significance attributed to each stakeholder, something that vary depending on the phase that a firm has reached in its life style (Jawahar and Mclaughin, 2001)

However, in contrast to other alternatives - little descriptive theory or research, which describes how organizations interact with stakeholders, exists in the extant of stakeholder management literature. Brenner and Cochran, (1991) were the first to propose a descriptive stakeholder theory of firm. According to them "the stakeholder theory of firm posits that the nature of an organization's stakeholders, their values, their relative influence on decisions and the nature of the situation are all relevant information for predicting organizational behavior".

In another attempt at descriptive theory, Jones (1994) proposed that "managers behave as if stakeholders mattered because of the intrinsic justice of their claims on the firm. These claims, have found some empirical evidence in the investigations of some researchers. Recently, Mitchell, Agle, and Wood (1997) developed a descriptive stakeholder theory on the basis of certain propositions about stakeholder identification and salience to corporate managers. They have grounded upon the moral legitimacy of a stakeholder's claim, the stakeholder power to influence the firm, and the urgency of the stakeholder's issue. The central thesis of their theory is that stakeholder salience will be positively related to the cumulative number of stakeholder attributes of power, legitimacy and urgency.

Jawaher & Mclaughlin (2001) proposed another descriptive theory of corporation based on organizational life cycle model, resource dependencies approach. They accord that business corporations are unlikely to fulfill all the responsibilities they have toward each primary stakeholder group. Instead they are likely to fulfill economic and all non-economic responsibilities of some primary stakeholders but not others and over time, to fulfill responsibilities relative to each stakeholder to varying extents. Their illustrations based on the premise that organizations face different pressures and threats at different stages in the organizational life cycle. Therefore, at different stages different stakeholders become critical for organizational several. Consequently depending on who is the critical stakeholders are at each stage, an organization is likely to use different strategies to deal with those critical stakeholders verses other stakeholder group.

Jawahar & Mclaughlin (op.,cit.) have suggested that an organization could adopt different approaches to deal with each primary stakeholder group, including pro-action, accommodation, defense and reaction. There approaches characterize the corporate strategy toward social responsiveness and risk elimination (Caroll, 1979). The pro-action involves doing great deal to address a stakeholder issue, including anticipating and actively addressing specific concern etc. Relative to pro-action, the strategy of accommodation is less active approach of dealing with stakeholder issues. The defense strategy involves doing only the minimum legally required to address stakeholder issues. Finally, the strategy of reaction involves either fighting against addressing a stakeholder's issue or completely withdrawing and ignoring the stakeholders.

Jawahar & Mclaughlin (2001) applied these strategies to evaluate the importance of stakeholders at various level of organizational life cycle via start-up to high growth stage to mature stage, there finally to decline / transition stage. They have developed testable propositions regarding each of stages and described which stakeholder groups becomes primary at each stage and different strategies to deal with their concerns. For instance, at start – up stage companies adopt proactive governance strategies towards creditors, shareholders and customers, defenses to the claims of government and community interests and accommodate the claims of employees and suppliers. However at high – growth stage, companies tends to be risk – averse and adopt proactive approach towards creditors, shareholders, employees, suppliers and trade unions, and by and large accommodate the interests of customers, community etc. In the decline stage companies becomes risk-seeking and primarily adopt proactive approach towards shareholders, creditors, customers, govt. tends to accommodative to the interests of employees & suppliers and becomes reactive to trade unions and community claims. Thus, strategies of the governance differs from stage to stage where in some stakeholders becomes critical and some are there fore neglected.

The descriptive stakeholder theory justified in many surveys regarding top-management behaviour. The studies by Brenner & Molander (1977) and Clarkson (1991) attempt to distinguish firms that practice stakeholder management from those that does not. The studies revealed that significant number of firms in first category. Managers however, may not make explicit reference to stakeholder theory, but a majority of them apparently adhere in practice to one of the central tenets of descriptive stakeholder theory namely, their role is to satisfy a wider set of stakeholders, not simply the shareowners.

3.6.2 Instrumental Stakeholder Theory

The theory, in conjunction with descriptive / empirical data where available, is used to identify the connections, of lack of connections, between stakeholder management and the achievement of traditional corporate objectives such as profitability and growth. The usage of instrumental theory employed by Donaldson and Preston (1995) is to establish (theoretical) connections between certain practices and certain end states. There is no assumption that the practices will be followed or that the end states are desirable. In instrumental theory of stakeholder approach to corporate governance, statements are hypothetical - if ‘X’ then ‘Y’ or if you want ‘Y’ then do ‘X’ in this sense ‘X’ is an instrument for achieving ‘Y’.

Instrumental theory links ‘means’ and ‘ends’ and contains such statements as “certain outcomes (corporate performance) are more likely if firms and managers behave in certain ways”. A fundamental assumption is that the ultimate objective of corporate decisions is market place success, and stakeholder management is a means to that end. Thomas Jones (1995) presented the most well articulated instrumental theory by synthesizing economics of contracting with ethical considerations. He makes a case for the general proposition that if firms contract with stakeholders on the basis of mutual trust and co-operation, they will have a competitive advantage over firms that do not. In general, instrumental stakeholder theorists stop short of explaining specific links between Cause (stakeholder management) and effect (corporate performance) in detail, but such links are certainly implicit.

Jones (1995) contribution to instrumental stakeholder theory largely rests on his approach to combine economics of contracting with ethical notions, there by develop a model of efficient contracting that answer several problems imminent in economic model of corporate governance. The agency problems, transaction costs & issues of team production can be minimized through employing effective contracts with stakeholders which, subsequently leads to competitive advantage of the companies. Thus Jones (op.,cit.) presented more or less a theory of competitive advantage that is a reflection of instrumental orientation towards stakeholders interests by corporate managers.

The theory of competitive advantage can be summarized as follows. (a) the firm is characterized by relationship with many stakeholders, (b) the 'contract' as a metaphor applies to these relationships (c) the firm – therefore can be seen as a " nexus of contracts' (d) corporate managers are the contracting agents of the firm and (e) markets tend towards equilibrium and, intern produce a tendency toward efficient contracting. The contracting process gives rise to agency problems, transaction costs and problems of team production, thus efficient contracting will be profoundly affected by the costs of solving these commitment problems. Jones (1994) argues that firms that solve commitment problems efficiently will have competitive advantage over those that do not. Further, became ethical solutions to commitment problems are more efficient than mechanisms designed to curb opportunism, it follows that firms that contract with stakeholders on the basis of mutual trust and co-operation will have a competitive advantage over firms that do not.

The source of competitive advantage does not, of course mean that firms employing ethical contracting frameworks will always out perform firms in which contracting mechanism are based on the assumption of opportunism. However all else being equal, firms in the former group will experience reduced agency costs, transaction costs, and costs associated with team production. More specifically, monitoring costs, bonding costs, search costs, warranty costs and residual losses will be reduced. The resources saved will benefit not only the firm employing ethical contracting but also stakeholders with whom it contracts. In such cases, overall contracting costs are reduced, and the benefits are shared among the firm and its stakeholders.

Jones (op.cit) stressed that the emphasis of instrumental theory is mutual trust and co-operation. However, nothing in the theory suggests that trustworthy cooperative firms must also be trusting dupes. He made no assumptions that a moral firm will always have equally trust worthy and co-operative stakeholders. A notable point in instrumental theory of Thomson Jones is contingent, descriptive and empirical. It is contingent on certain type of behavior, describes the result (outcome) of the postulated behavior and also posits an empirically testable link between the behaviors and outcome.

The claims of instrumental theory of stakeholder approach to corporate governance has been justified in number of empirical works by Batiton, Hill and Sundaram, 1989; Berman et.al, 1999; Heugens et.al, 2002). Notably, Berman et.al, (1999) study 81 US based firms reveals firms address stakeholder concerns will enhance financial performance. They have demonstrated a direct linkage between variables like employee orientation, customers focus enhance financial performance. The study also illustrates a moderate indirect link between firm's overall strategy, stakeholder relationships and financial performance. Similarly, Heugens et.al (2002) study of firms in Dutch food industry reflected that firms that breed trust-based, co-operative ties with their stakeholders will have a competitive advantage over firms that do not. These studies thus, in spite of different methodological orientations have generated implications suggesting that adherence to stakeholder principles and practices achieve conventional corporate performances objectives as well or better than rival approaches.

3.6.3 Normative Stakeholder Theory

Much of the literature in stakeholder management is from the normative realm, which concerns how managers should deal with corporate stakeholders. One of the central tenets of normative stakeholders theory is the firms should attend to the interests of all their stakeholders - not just their stockholders. A common theme among these scholars is that firms should treat stakeholders as ends (Clarkson, 1995; Evan& Freeman, 1983;). In general, scholars prescribe how all stakeholders should be treated on the basis of some underlying moral or philosophical principles.

The theory is primarily employed to interpret the function of the corporation, including the identification of moral or philosophical guidelines for the operation and management of corporations. Berman et.al, (2002) opined that normative approach reflects intrinsic stakeholders' commitment of the business corporations. According to this model managerial relationships with stakeholders are based on normative, moral commitment rather than a desire to use those stakeholders solely to maximize profits. In short, a firm establishes certain fundamental moral principles that guide how it does business- particularly with respect to how it treats stakeholders - and uses those principles in corporate governance.

The normative approach generated from two distant, albeit related, sources with in the business ethics literature. One genesis is that the fact that firm's decisions effect stakeholders' outcomes. Ethics, generally speaking, deals with obligations that arise when an individual or corporate manager's decisions affect others regardless of precisely what constitutes an ethical decision; decisions made with out any consideration of their impact on others are usually thought to be unethical. Donaldson and Preston (1995) highlighted that stakeholders' interests have intrinsic worth. That is certain claims of stakeholders are based on fundamental moral principals. A firm cannot ignore these claims simply because honoring them does not serve its strategic interests. In a sense, these claims are independent of, and should be addressed prior to corporate strategic considerations. Jones et.,al. (1999) rightly said that stakeholder's interests form the foundation of corporate strategy it self, representing "what we are and what we stand for" as a company.

The second genesis of a normative stakeholder theory is based on moral principles. However, the argument that making a strategic commitment to morality is not only conceptually flowed but is also ineffective. First, strategically applying ethical principles – i.e. acting according to moral principles only when doing so is business advantage – is by definition, not following ethical principles at all. In addition, Quinn and Jones (1995) argued that if the purpose of acting ethically is to acquire a good reputation that, intern will provide a firm with economic benefits. It that case way not pursue good reputation directly with out the intellectual excursion in to moral philosophy? In some cases, of course the behavior of managers will consider with that dictated by ethics, but in others it may not. What difference do ethics make if one can act instrumentally with out reference to ethics?

Jones (1995) argued form a combined perspective of ethics and economics that the instrumental benefits of stakeholder management paradoxically result only form a genuine commitment to ethical principles. He argued that firms that create and sustain stakeholder relationships based on mutual trust and co-operation will have a competitive advantage over those that do not.

The normative basis for stakeholder theory connects with more fundamental and better-accepted philosophical concepts. Normative foundation of stakeholder theory criticizes traditional economic theory, model of management control and shareholder supremacy. The use of normative stakeholder analysis in the fields of business ethics and business and society however can vary with respect to the scope of what is to be investigated. For instance, one can limit one's focus to the responsibilities of management in the "context of existing laws or institutions or one can ask broader questions about possible need for change to existing laws & institutins (Hendry, 2001)

3.7 Managerial Approach to Stakeholder Theory

Interest in stakeholder theory has continued to grow in the recent times. However, a number of theorists have changed the theory with having become detached form the challenges of contemporary business (Jones and Wicks, 1999; Gioia, 1999). To resolve this problem freeman (2007) has proposed a managing for stakeholder model to stakeholder theory. A managerial approach would focus less on separate normative, descriptive and instrumental claims about firms in general and focus more on studying complex business problems which are not early sortable to neat categories (Freeman, 2000).

Freeman and Evan developed names and faces approach to stakeholder management. This approach differs in three key respects from the established literature. First, a names and faces approach focuses on the process of value creation in contrast to other theorists emphasis on firm – level competitive advantage (Jones, 1995) or corporate social performance. Second, names and faces approach is focused on the managerial decision making process. Finally, it bases stakeholder identity on individual relationships. This is a critical departure from the dominant streams of stakeholder research and their emphasis on generic stakeholder roles.

"Names and Faces" is an attempt to describe a managerial approach to stakeholder theory. Freeman & Evan developed this approach on the basis of Hertz Gold's practices of individualized customer relationships in American rental car industry. In contract to instrumental theory of Jones (1995), this approach elaborates the process of value creation & completive advantage interns of literature from entrepreneurship. Value creation thus, explained as creation and exploitation of new goods and services by paying attention to individual stakeholders, significantly through strategic decision making.

Freeman (2000) extended thesis 4 to replace concerns of other theses and theorists advocating them. He contended that stakeholders' theory as managerial, as intimately connected with the practice of business, of value creation and trade. This original impetus, in the sense of redescribing the practice of value creation and trade is to ensure that those with a stake in this practice had attention paid to them.

The basic idea of 'Managing for Stakeholder' (Freeman, 2007) is quite simple. Business can be understood as a set of relationships among groups which have a stake in the activities that make up business. Business is about how customers, suppliers, employees, financiers, communities and managers interact and create value. The business thus, can be best understood as how these relationships work and executive's responsibilities in managing these relationships.

However, the impact of stakeholder approach on management practice is difficult to establish as much of contemporary commentary on corporate governance is trapped in the rhetoric of a 'stakeholder verses shareholder' debate. Once strategic management is divided into this 'false dichotomy' (Freeman & Mcvea, 2001), stakeholder theory can be mischaracterized as anti-capitalist, anti – profit and anti – business efficiency. For this reason the words of stakeholder management have mostly been related to descriptions of a small number of radical businesses that are run very different from mainstream corporations.

3.8 Contrasting / Combining Approaches

Each of these uses of stakeholder theory is of some value, but the values differ in each use. The descriptive aspect of stakeholder theory reflects and explains past, present, and future states of affairs of corporate and their stakeholders. Although descriptions are simple, this branch of stakeholder theory usually expands to generate explanatory and predictive propositions and equally desirable exploration of new areas. The instrumental uses of stakeholder theory make a connection between stakeholder approaches and commonly desired objectives such as profitability. Instrumental uses usually stop short explaining specific links between cause (stakeholder's management) and effect (corporate governance) in detail but such linkage is certainly implicit. This well established impact understanding of cause, forms central focus of much quoted works such as Stanford Research Institute definitions and numerous studies by Freeman & colleagues, Jones, Donaldson and Preston etc.

In normative uses, the correspondence between the theory and the observed facts of corporate life is not a significant issue, nor is the association between stakeholder management and conventional performance measures a critical test. Instead, a normative theory attempts to interpret the function of and often guidance about, the investor owned corporation on the basis of some underlying moral or philosophical principals (Donaldson & Preston, 1995). Although both normative and instrumental analyses may be prescriptive (Jones, 1997), they rest on entirely different bases. An instrumental approach is essentially hypothetical: is says in effect "if one wants to achieve (avoid) result X, Y, or Z then one must adopt (don't adopt) principles and practices A, B or C". the normative approach, in contrast, is not hypothetical but categorical; it says "do (don't do) this because it is the right (wrong) thing to do"

A Striking characteristic of the stakeholder literature is that diverse theoretical approaches are often combined with out acknowledgement. Indeed, the temptation to seek a three-in-one theory – or at least to slide easily from one theoretical base to another-is strong. The blurring boundaries between these three approaches often encouraged scholars to purpose a stakeholder theory of corporation that presents a combined framework for describing, evaluating and managing corporate social performance.

Jones and Wicks (1999) provided convergent stakeholder theory – a notable attempt that examine the nature of divergence and propose a means of unification of two broadly held perspectives in stakeholder theory namely- social science based and normative ethics approach. The central argument is that neither of the emergent forms of stakeholder theory is incomplete with out the other and that convergent stakeholder theory, which combines normative and instrumental elements, meets many of the criteria for successful integration of normative and empirical theory. They also argue that convergent stakeholder theory, by being explicitly and unabashedly normative, represents a new way of theorizing about corporate organization and demonstrates how managers can create ways of doing business that are both moral and instrumental.

Jones & Wicks (1999) developed the convergent theory on the lines of taxonomy of stakeholder theories that proposed by Donaldson & Preston (1995). They have rightly focused on both the convergence and divergence among social science and normative accounts to stakeholder theory there by proposed that should reduces and shared understanding among scholars regardless of implicit & explicit disagreements enable a hybrid understanding of stakeholder theory namely “convergent stakeholder theory”. The shared values pertaining to the purpose of corporation and behavior of the top management is in convergence among the stakeholder theorists of both stripes. The shared values such as the intrinsic worth of the claims of all legitimate stakeholders, the rejection of managerial entrenchment, a concern for others and the compatibility of morality and capitalism – are more or less a universal concern for both instrumental and normative theories.

Jones and Wicks thus proposed a hybrid form of stakeholder theory, primarily synthesizing the propositions & central tenets of instrumental & normative approaches. Of course this reflects the early conceptualization of Jones in 1995, but more towards an agreeable conceptual fit that has a normative component as well as instrumental logic.

The following are salient characteristics of a class of theories that represent a convergent stakeholder approach.

(1) The firm is publicly held and operates in a competitive market economy
(2) Human behavior is both varied and malleable
(3) Convergent theory is a theory of stakeholder relationships (a broader term than contracts or transactions)
(4) It is simultaneously normative and instrumental; offering both normative standards of behavior and arguments that adherence to those standards will lead to outcomes that are both normatively and practically acceptable.
(5) It is managerial in focus instructing managers with respect to the way in which relationships with corporate stakeholders should be structured.

Jones and Wicks (op.cit.,) thus, merged both approaches to constitute a hybrid theory that examine possible relationships between the normative and empirical branches of business ethics. They have argued, that three possibilities: parallelism, symbiosis and integration are present in the convergence model. Parallel development implies that the two strands share little but an interest in same kind of behavior. Symbiosis means that two models of inquiry take insights from each other but remain “essentially distinct in their theoretical principles, methodologies and meta-theoretical assumptions” (Weaver & Trevino, 1994). Integration as Jones & Wicks implied that the two theories can be seen as elements of a single theory and involves a conscious “commingling of the core of the two disciplines” (1994).

Jones & Wicks (1999) propositions on convergent theory have generated intense debate among the academicians and practitioners. Freeman (1999) criticized such grand theorizing on the basis of two important propositions that goes away on two separate grounds, namely (a) Donaldson and Preston typology of “ normative – instrumental –descriptive” stakeholder theories (b) linkage between instrumental theory and ethics. He asserted that each of these claims is at best dubious and together they lead theorists such as Jones and Wicks in precisely wrong direction. Freeman criticized Jones and Wicks for countenancing the Donaldson and Preston typology as useful. He argued that such distinction leads to separation thesis, and reductionism thus inappropriate and unproductive. This highlighted that delaying heavily on the fact - value - or descriptive (categorization would) normative – distinction separate the discourse of business from the discourse of ethics. Now, if one drops the tripartite typology of Donaldson & Preston then there is no need for anything like convergent stakeholder theory. Indeed, there is nothing to converge - no separate contributions for philosophers, management theorists and social scientists. There are just narratives about these narratives - what freeman terms is theory.

Freeman (1999) criticized linking instrumental theory and ethics which wrongly combines and jumbles up the normative and the empirical ideas about stakeholder theory. However freeman acknowledged the theoretical efforts of Jones and Wicks in terms of emphasizing instrumental theory as promising approach and linking it to broader areas of management scholarship. He opined that building such grand theories for integrating the many strands of stakeholding is nothing but a per chant for conserves and agreement is current state of art of management theory. Furthermore what one need is not more theory that converges but more narratives that are divergent that reflects different but useful ways to understand corporate governance is stakeholder terms.

Similarly, Trevino and Weaver (1999) emphasized that proposed convergent theory lacks the kind of explicitly delineated and empirically testable constructs, variables, and explanatory relationships that characterize more established social science theories. They are skeptical whether the proposed convergent theory has problem showing effectiveness, parsimony in terms of providing answers to important covetable and empirical questions at a rate that compares well with other theories or not?

The stakeholder theory as Trevino & Weaver suggests is best characterized as stakeholder research tradition which, incorporate shared concepts (such as stakeholders) and a common, normative concern for organization - stakeholder's relations. Donaldson & Preston (1995) have provided an analysis of these shared concepts and concerns and Jones and wicks (1999) offered alternative explications. Thus rather than generating a convergent theory, this shall refer as a sociological process of convergence in which theorists contribute to the ongoing development of a research tradition that incorporate theories of a different kind, but focused on a general domain of interest (for instance, organization-stakeholders relation).

Despite of these criticalities, Jones and Wicks - made substantial progress towards showing that two critical elements - social science and normative ethics – merge, and their effort is critical for the growing literature on stakeholder theory. They have argued for a theoretical integration / hybridization that is fit in terms of conceptual importation, theoretical reciprocity and theoretical unity. At the same time, they confess that "if integration means that the same methods must be employed in the defense of the normative core and the supporting instrumental theory, full integrative of normative and empirical theories is highly improbable" (Jones & wicks, 1999). Hence, Jones and Wicks grant that even at the level of basic methodology, stakeholder theory seems struck with divergent approaches. These different methodologies are doomed to co-exist with in the same theory; in other words stakeholder theory's normative component demands normative methodology, but its empirical component demands empirical methodology.

A part from combining and contrasting, convergence and divergence, the three - fold categorization of stakeholder theory via descriptive - normative - instrumental (Donaldson & Preston, 1995) helps to stake out the intellectual domains of two broad groups of scholars interested in stakeholder theory respectively social science based and ethics based. This categorization also explicates some structure to early stakeholder theorizing. The three part typology that has been discussed in this chapter makes some aspects of stakeholders thinking explicit, though rooted in a centuries old philosophy of science. The descriptive theory examines the way that the world really is or to say firms & managers actually behave in certain ways. Similarly, normative theory prescribes how the world should be, so much so like firms and managers behave in certain ways towards stakeholder's interests. Likewise, instrumental theory links means and ends or in other words, certain out comes are more likely if firms and managers behave in certain ways.

In spite of good intensions, three-fold typology suffers from several short comings. Freeman et.al (1999) disagreed over the propriety of diving the field into three theoretical realms: normative, instrumental and descriptive. Such taxonomy is inappropriate and unproductive essentially because of reductionist logic and indeed, no sharp distinctions among three forms of stakeholder theory.

Albeit, difference of opinions prevailed Donaldson and Preston's typology of stakeholder theory (1995) recommends the attitudes, structures and practice that taken together constitute a stakeholders management philosophy. Darryl Reed (1999) offered critical theory approach to three fold typology which, can be grounded in the work of Jurgen Hobermas and second generation critical theorists. Reed (1999) opines that such an approach agrees with the basic distinction of different forms of analysis put forward by Donaldson and Preston (1995), although it prefers the terms positive, strategic and normative analysis. One important advantage of critical theory approach is that it is able to provide a strong epistemological basis for the distinction between these different forms of stakeholder theory. Reed applied the discourse theory logic of Habermas (1987) that elaborated in "The theory of communicative action". In his discourse theory Habermas distinguished different types of speech acts (and discourses) which makes different kinds of validity claims (and involve different modes of justification). These include constantive speech acts which make claims to truth, moral speech acts which make claims to rightness or procedural justice, ethical speech acts, which make claims to goodness, pragmatic speech acts, which make claims to effectiveness, and so fourth. Thus one can derive the difference between three uses of stakeholder theory by the fact that they make different types of claims and involve different forms of reasoning for their justification. Positive or descriptive uses of stakeholders' theory make claims to truth and or justified through constative discourses. Strategic / instrumental uses make claims of effectiveness and employee pragmatic discourses and normative uses of stakeholder theory may involve different types of claims such as rightness or goodness and be justified through different types of discourses like normal or ethical.

Thus, critical theory approach provides potentially helpful views that substitute some of weakness of the agreement part fourth by Donaldson and Preston (1995) there by offers a strong epistemological basis for distinguishing different forms of stakeholder theory and their subsequent uses.

Thus, the chapter analyses corporate governance issues from different perspectives. The finance model (Shleifer and Vishny, 1997), the stewardship model (Donaldson and Davis, 1994), the stakeholders model (Freeman, 1984). A similar typology developed by Blair (1995) also summarizes four competing models in the current studies of corporate governance, each with its own diagnosis of and solutions for the Anglo-American governance issues (Letza, Sun, Kirkbride, 2004). The four schools of thought are the principle – agent or finance model (Jenson and Meckling, 1976), the myopic market model (Charkam, 1994), the abuse of executive power model (Hutton, 1995), and the Stakeholder model (Freeman, 1984; Blair, 1995). Interestingly, majority of these models are conceptualized to offer constructive inputs to the existing governance problems in the western markets. These typologies are indeed, equivocal and serve more as a descriptive categories then obsolete classifications.

CHAPTER 4

4 Corporate Governance: the Indian Context

The Indian corporate sector has seen substantial and significant changes in the last ten years. The process of globalization as well as the economic reforms of 1991 initiated by the Indian State, ended decades of relative stagnation, lethargy, and the stranglehold of family business. A major part of the story is about the way global forces have been reshaping the Indian business sector, with strong competitive pressures on Indian companies, reworking of the financial landscape and far reaching changes in the stock market. One implication of this is the huge premium on transparency. Corporate Governance is at the heart of liberalization, because crucial issues concerning ownership and control, management integrity, accountability and the impact of these features on the economy particularly the corporate business sector. The general lack of seriousness of company boards, concentration of power in management cliques, un-ethical if not illegal business practices have contributed to the endemic lack of credibility of Indian business. A crucial objective of the reform of the corporate sector has been to overcome this legacy. India is still a developing country and it can scarcely afford to live with the incubus of a corporate system that constrains growth not only because business families are unwilling to yield control but also the management of companies lacks credibility with investors. Corporate governance as Banaji (2000), opines is therefore critical, not in the mechanical sense of a magic wand that will help companies to boost their share prices, but in the long term sense of creating a credible and professionally driven business system that has the potential to transform living conditions for the vast majority of population. However this huge agenda involves more than corporate sector and includes a wide range of issues such as enforcement of laws, culture of professionalism etc.

The issue of corporate governance has attracted explicit attention in India from academics, researchers, government, the popular press, industry and capital markets with the adoption of structural adjustment and globalization policy by the government in July 1991 when the economy opened up of its industrial and finance sector to international competition and increased private ownership. Many sectors which are hallmarks of state power and sovereignty has recently unlocked for foreign direct investment and private Indian ownership. Given the strategic import that this de-regulation ascribes to the private sector, it is indeed, critical that appropriate structures of corporate governance are in place. Reed and Mukherjee (2004) stated that two particularly significant areas where change has been taking place over the past two decades – the manner in which corporations are governed and the efforts of developing countries to promote development. Thus, various efforts have been taken at industry and government regarding the formulation of a well defined code of corporate governance in India since the second half the 1990s.

While traditional approaches viewed the two areas as independent of each other, and have studied them exclusively, they are in the real world interlinked through the process of 'economic reform'. The editors hold that there has always been some relationship between corporate governance and development 'as the manner and substance of corporate decision making has significantly affected the development process

However, in spite of the fact that adoption of international corporate governance practices has made little difference in India, CG still has the potential to play a very important role in India's long run and sustainable economic growth. To take note of, since liberalization, Indian economy has registered a spectacular growth in the size of its stock markets i.e. number of firms listed and value of the shares listed or the market capitalization. The importance of corporate governance reflected the growth that Indian stock market has made in the last decade. Unfortunately, the scams and scandals by many firms which are listed and made public issues at large premia with help of obscure investment banks have simply vanished subsequently by saddling around 11 million small investors with illiquid stocks of these defunct companies.

A good system of corporate governance in India thus, has recognized as important for the domestic economy, in that it can raise efficiency and growth; particularly when stock markets are playing an increasingly significant role in financing investment. Corporate governance has implications for the functioning of Indian financial system in terms of: better allocation of capital overtime, the ability of Indian firms to raise funds overseas and compete internationally, reducing likelihood of a domestic financial crisis etc. Som (2006) views that an effective CG system will ensure that the larger current account deficits can be financed with longer term and less speculative funds, reducing the chances of an external crisis in the future.

The Indian corporate governance system shows some features of the Anglo-American (outsider based) system at the same time, it exhibits some important characteristics of the German-Japanese (insider based) system. For instance, the share of small investors in corporate equity is about 40 percent - comparable with that in the USA at the same time prevalence of inter-corporate holdings, business groups and networks, domination of banks reflects a closer connection to German - Japanese system. However, some say that the Indian system now veering towards Anglo-American system. Reed (2002) argues that in India, as in most parts of the developing world, it seems to have been decided – with out much debate at all – that a text book version of Anglo-American model is required panacea. This has occurred despite the fact that model has been subjected to substantive criticism in the Anglo-American world itself since 1980s.

The present chapter deals with governance issues pertaining to corporate sector in India. The chapter is organized into four sections as each section structured to address certain specific claims related to the governance problems in Indian context. Section 1 deal with structural characteristics of Indian corporate sector historically via ownership structures, sources of capital, legal and financial changes etc. where as section 2 highlight central issues of Indian corporate governance. Section3 focuses on contemporary aspects of corporate governance regulations in terms of various legislations and codes. Section 4 elaborate challenges of Indian corporate governance and how these concerns can be effectively handled by adopting Anglo-American model.

4.1 Structural Characteristics of Indian Corporate Governance

Historically, the beginning of corporate governance started in India during the colonial times as the first Indian companies came in to existence around 1650 AD in south India. This section briefly examine the Managing Agency System - the first historical model of corporate governance in India, the conglomerate or Business House model – which was in effect from 1956 to 1991 and the new Anglo-American model – which traces its emergence in the recent economic reforms era.

4.1.1 The Managing Agency Model of Corporate Governance

In India, modern corporations emerged out of the ‘managing agency system’. The terms managing agents and managing agencies were used to designate individuals or business firms (partnerships or private companies) that entered into a legal contract with joint stock companies to manage the affairs of the later (Reed, 2002). Managing agency houses found the joint stock form convenient to attract savings from a large number of investors. Initially managing agencies were predominately established by merchant families because of quick turnover of capital and small quantity of capital to be spread over a relatively large number of ventures. Managing agencies as business enterprises served three basic functions. First they started or promoted new companies. Typically, a businessman or a group of businessmen would float a company with their own capital. After it became successful, they would then sell off most or all of its shareholding, but still retain control over the company through the managing agency contract. Second, managing agencies often manage the existing companies because of their managerial expertise, prestige and links with the European market. Third, managing agencies provided important financial functions due to their ability to attract new investors, to secure bank loans etc. Rungta (1970) viewed that these factors made managing agencies attractive to joint stock companies especially at a time when the credit system and capital markets were still in their infancy.

Panini (1988) had noted that managing agency system have been tailor-made for Indian entrepreneurs whose business ventures rested on the institutions of family and kinship. However, the managing agency was novel development in that it shifted the locus of corporate power and control from the level of the individual joint stock company to a parent or Apex Company - the managing agency. Most of the Indian managing agencies were founded as partnerships among members of a single family. Managing agents thus, could control large business networks through inter-corporate investments and interlocking directorships. This nexus between managing agency and the business family established the structural basis for the family controlled conglomerates that have dominated the Indian economy since independence.

A second key characteristic of the model involves profit generation. As Reed (2002) argues, in managing agency model sources of profit did not lie in innovations or gains in productivity, but rather was related to inflation, intermediation, trade as well as commissions and fees. The profits thus, were earned through the generation of artificial scarcities and inflationary effects of these scarcities. Alongside, malpractices like investment of one company's surplus in others with the same agent, asset stripping and subordination of company interest to agent's interest became common practices in this model overtime.

The third important feature of the model was managing agents' total grip over the companies which, intern made shareholders and other directors as powerless. The agents enjoyed long tenures and ensured that it was impossible to remove them, once the agency agreement was signed even though they actually reduced their own holding to insignificant proportions. The managing agents therefore assumed control rights of the companies and denied any basic voice to shareholders. Shareholders participation was not only minimized but they were also subjected to exploitation because of inter-corporate investments and they were forced to finance losses of other companies. The agents also used to acquire stakes of foreign investors at high premia which were financed from the coffers of the company controlled by agents and details of these deals seldom provided to shareholders. Joshi (2004), accords that managing agents frequently limit shareholder participation through controlling the issue of securities so as limit participation and also inserting special terms & conditions of stockholding.

There were several consequences of managing agency system as a result of its unfair profit strategies. As Reed (op.cit) argues it allowed for an accelerated pace of accumulation of capital at one level which, aided the process of industrialization. However, the process did not encompass systematic backward and forward linkages but developed out of ad hoc profit seeking tendencies of business. So much to say, the logic of laissez – faire capitalism, while succeeding somewhat in producing industrial development in the west, failed to produce the same outcomes in India's colonial context. The industrialization failed to generate social wealth either in the form of wages or in the form of shareholder outcomes due to managing agency system. Rungta (1970) opines that managing agents quite blatantly violated the basic rights of shareholders, and sought consciously to exclude them from having any effective voice in which firms were governed. The managing agency system dominated the Indian business world up to independence. It formally abolished in 1969.

4.1.2 The Business House Model of Corporate Governance

After independence, an ambitious programme of planned Industrial development with an interventionist approach by new India government has began to designate an accelerated pace of industrialization and growth in the economy. Some scholars believed that this new development model with extensive government control not only blessed by business elites, but was also largely authored by them. As a result, though there was state planning various restrictions on economic activity, there were also many new opportunities for domestic business. Particularly, well-positioned to take advantage of these new opportunities were the leading Indian managing agents who began very actively promoting new businesses. These *promoters* became the central actors in India's post colonial corporate economy, providing the basis for the rise conglomerates or "business houses" a they are commonly known in India.

However, the basics of Indian trade and industrial policy were first articulated in the famous Bombay Plan of 1944 – a memorandum authored by the leading industrialists of the day- and later formalized in to the well developed Industries (Development and Regulation) Act of 1951 and the Industrial Policy resolution of 1956. The Indian Five-Year Plans has been chosen as key vehicles for implementing the strategy laid down by these acts. These two acts laid out first ever organized response in terms registration and requirements related to the scheduled industries in the independent India. The government also reserved the right to investigate, suggest required changes, regulate prices, supply and distribution of produces of Indian companies. The objectives of this set of regulations, which obviously went far beyond the cost/profit considerations and intended to promote economic growth and employment through support for both large industrial corporations and small and medium sized businesses. In practice, it created a set of institutional barriers to entry for smaller firms, resulting in a systematic weakening of competition, and became fraught with rent-seeking abuses by political/bureaucratic and business elites. These laws nevertheless, were not always properly enforced, and the problems in corporate governance often have been pointed out as impediments to the sound performance of Indian companies.

Topalova (2004) argued that mandatory licensing system of Industrial (development and regulation) act limited the firm's ability to expand its capacity, change product mix, introduce new processes and import machinery and equipment etc. Alongside, Capital issues (Control) act of 1947 curtailed the freedom of firms to issue securities and rise capital. The early regulations thus, put in place a regime and culture of licensing, protection and widespread red-tape that bred corruption and stilted the growth of corporate sector. Chakrabarti (2005), opined that the situation grew from bad to worse and inefficiency became the hallmarks of the Indian corporate sector.

As a companion to the Industrial (development and regulation) act and Industrial Policy Resolution, the Indian parliament also enacted The Companies Act of 1956 with a professional long term objective to lay the basis for a "socialist pattern of society". Though it represented the emerging common law tradition but nevertheless largely reflected British corporate law. The law inline with the Anglo-American model delineate protection to certain pragmatic issues like abuse of shareholders' rights that had become rampant in the managing agency system. The companies act of 1956 accorded power (excessive) to the central government to monitor, regulate, and control the affairs of the companies, including establishing the types and structure of companies and registration and reporting requirements.

The firm financing was also largely controlled and regulated by government through the institution of controller of capital issues and subsequent legislation Capital Issues (control) Act passed in 1947. This act required that official permission to be obtained for the issue of all types of securities and, more importantly, mandated that the prices of all corporate securities be determined by CCI (Reed, op., cit). A point to bear in mind at this juncture that historically in India, the capital market has been weak and played very small role in financing corporate activities. The number of shareholders too, remained very small fraction of the population and for its part, the commercial banking sector also tended to shy away from financing industry.

The ‘license-permit-raj’ overtime became inefficient and led to excessive concentration of wealth and economic power in the Indian industry. Monopolies Inquiry Commission of 1964 concluded that overall concentration of economic power had increased since 1950. It revealed that 75 out of 83 business groups accounted for 44% of the total paid up capital of the corporate sector. Similarly, Hazari (1966) study of 1000 Indian companies reflected the ownership and control aspects of Indian business firms. The study highlighted the predominance of interlocking directorships, holding companies and pyramidal structures which led to the subsequent consolidation of family business and concentration of economic power among few business families in India.

Significant changes in the financing of industry took place in 1969. First, the government nationalized the commercial banking system. Nationalized banks were now required to make decisions not exclusively on profit calculations, but also according to government directives designed to promote economic development which, required banks to channel funds to certain, buy government securities, maintain high reserve requirements etc. in addition to that development finance became prime objective of banking sector. Business promoters were precluded from owning more than 40% of equity in their businesses. Alongside, the government fostered a number of financial institutions for facilitating the allocation of industrial credit. These included both public financial institutions (PFIs) funded by the central and state governments as well as investment institutions such as insurance companies and mutual funds along with nationalized banks. Reed (op.,cit) viewed that this regime of corporate financing through PFIs and associated institutions referred to be known as ‘development banking”

Thus, firm financing was largely catered by public sector banks (lending institutions) and development financial institutions (investment institutions) from 1970s. The Development Financial Institutions (DFIs) broadly referred to include i.) Public Financial Institutions like Industrial Development Bank of India (IDBI), the Industrial Finance Corporation of India (IFCI) and Industrial Credit and Investment Corporation of India (ICICI), ii.) public sector insurance companies notably Life Insurance Corporation of India (LIC), General Insurance

Corporation (GIC), New India Assurance (NIA) etc. and iii.) Public sector mutual funds such as Unit Trust of India (UTI).

The Development Financial Institutions (DFIs) provided crucial credit support to the growing needs of Indian industry. Public Financial Institutions (IDBI, IFCI, and ICICI) facilitated term-lending functions and offered low-cost funds to industry at subsidized rates. Similarly, state owned insurance companies (LIC, GIC, UIA etc.) invested major portion of their funds in government and other approved securities, extended assistance to infrastructure projects and also provided financial assistance to corporate sector through term loans and underwriting / direct subscription to corporate shares and debentures. Likewise, Mutual Funds like UTI and others belonged to Public Sector Banks and insurance companies played a vital role in providing equity investment support to Indian companies. Thus, DFIs provided majority of external finance to Indian companies which can be illustrated in the following chart.

However, these significant changes in the financing had organizational ramifications with regard to ownership structure and control of Indian companies in the post – independent era. To reiterate, after independence the leading Indian managing agents took advantage of new economic opportunities to promote new businesses. The promoter – much like the managing agent – was to float new ventures by contributing a minimal amount of equity capital, and then raising the rest through public offerings or from public financial institutions. Typically, a single promoter promoted large number of related or unrelated ventures, and thereby come to gain control over network of firms. This dynamics subsequently gave rise to conglomerate of the ‘business house ‘. Such conglomerates typically consisted o a network of companies, each of which was promoted by the members of a particular business family. The control and decision making center of the conglomerate, indeed, - the apex company - which thereby coordinated issues like investment decisions, allocation of groups profits, relationship between various firms in the group etc.

Reed (op.cit,) explained that, the method of promoting companies has arguably resulted in widely held corporate structures. The development financial institutions too have became an important source of external capital that amounts around 40% of shareholding in Indian companies during 1971 to 1981. The largest stake in major Indian companies is usually held by DFIs especially - the Public Financial Institutions like IDBI, ICICI, ICFI and other lending institutions like PSBs, Insurance companies and Mutual funds. The prime reason for this could be attributed to government's use development banks to promote industrialization. This extensive participation in ownership by PFIs potentially gave them the ability to control firms through the nominee directors. The intent, however was only to only to protect the interests of the Indian (shareholding) public not to exercise control. Their participation on the board is essentially due to the specific clauses in their loan agreements namely, the convertibility clause, which allowed the DFI to convert its loan into equity if the company defaulted on its debt obligations, and nominee director clause which gave them a right to appoint one or more directors to the board of the borrowing company. The institution of nominee directors has also made mandatory by several acts of the parliament notably the MRTP Act of 1970. Although DFIs exercised considerable control on Indian firms but in reality the corporate control continued to be exercised by the two predominant mechanisms of the earlier model – interlocking directorates and intercorporate investments.

In India, intercorporate investments - devised in a manner that promotes integration between financial and industrial activities – have proved to be particularly effective devise for helping family business groups to maintain control with little equity. There are primarily two mechanisms through which intercorporate investments occur. Firstly, direct interlocking of equity between two companies belonging to the same house. Secondly, circular chains of investments between companies of the same group. Similarly, interlocking of directorates as a control mechanism whose consequences were threatening for professionalism in business. In 1950-51, 9 leading Indian industrial families held 600 directorships, with Dalmia and Singhania holding 200 of them (Joshi, 2004). One hundred individuals were found to hold 1700 directorships, 30 of them holding 800 directorships. Indian Companies Act of 1956 however, limited the number of directorships that an individual can hold, but this restriction is generally acknowledged to have been much too weak to serve as an effective control on interlocking directorates. For instance, few years after passing the resolution a study by Mehta (1961), showed that top ten industrialists held 183 directorships and seven leading industrial families held 303 directorships or partnerships. These figures are substantially higher than in the U.S or U.K at that time.

However, the large corporations were able to grow rather robustly during the interventionist period, this does not mean that small shareholders benefited proportionally. First, effective control through intercorporate investment, interlocking directorates enabled business families to distribute the benefits in accord with their own interests and insulated them from any voice that other shareholders might seek to raise though formal channels like AGMs, Shareholder resolutions, second, soft credit administered by the DFIs, in combination with weak equity markets meant the strategy was also ineffective.

4.1.3 The Anglo-American Model of Corporate Governance

While many large corporations thrived under the business house model, a crisis was brewing in the Indian economy through out the 1980s. There were several dimensions to this crisis, including low foreign exchange reserves, high fiscal deficits, the huge losses suffered by public sector enterprises, an over expanding web of subsidies etc. The situation reached its zenith in 1991, as record low foreign exchange reserves and high fiscal deficits forced the Indian government to turn to the IMF and World Bank. The World Bank's assistance - US \$ 500 million in the form of structural adjustment loan, mandated a comprehensive reform programme. The IMF loan, US \$ 1.78 billion later on would formally put an end the interventionist period and usher in the era of neo-liberal economic reforms in India (Jalan, 1992).

The economic reforms since 1991 have brought many changes to the environment in which Indian companies previously operated. The principle aim of these reforms was to strengthen market discipline and promote greater by putting an end to the "license raj", namely through abolition of the Industrial Development and Regulation Act (1951) and amendments to the Companies Act and several other major laws which has imposed a heavy legal and regulatory burden on the Indian corporate sector. In addition, the foreign trade regime was liberalized through reducing tariff rates, lowering non-tariff barriers, streamlining of import licenses, increasing foreign investment opportunities and improving shareholder rights. Those apart, Indian companies were also allowed to enter into joint ventures with multinational enterprises more freely, import new technologies and capital goods, expand productive capacity and introduce new products with out obtaining industrial licenses.

These reform efforts, especially - the changes in company law and other major laws, changes in the financial and banking sectors, as well as in trade, foreign investment and industrial policy - have resulted in India moving much closer to an Anglo-American model of corporate governance. The following pages will outlines the nature of some of these changes, before going on to assess their importance in addressing certain key issues germane to corporate governance in India.

The key area of reform as mentioned, involved the liberalization of the capital market. Up until 1992, the price of share issues by Indian companies was fixed by the Controller of the Capital Issues (CCI), and was guided by the CCI act of 1947. One of first step towards liberalization as Reed (op.,cit) highlights the CCI act was repealed, and subsequently the pricing of shares was ‘set free’. So companies could have free access to capital market and they could price their security issues freely, subject only to the conditions of Securities Exchange Board of India (SEBI). Accordingly, lifting controls on capital issues and allowing free pricing of shares boosted the Indian stock market as many companies have come with fresh share issues. On the other hand Indian public too have participated enthusiastically by buying shares.

The number of new issues in the primary market was 455 in 1991-92 and the amount of capital raised was Rs. 9441 crore. By 1994-95 the number of new issues rose to 1686 which mopped up Rs. 37,328 crore. Ironically, the initial impact of de-regulating share prices was quite devastating, leading eventually to a huge securities scam in 1992. The scam brought to light the immediate need for a regulatory body and as a result SEBI, which was originally established in 1988 elevated to the level of capital market regulator in 1992 through the Securities Exchange Board of India Act of 1992.

Notwithstanding the good intentions of new policy regime, dubious practices of Indian business reached a peak around mid 1990s in the atmosphere of freedom from government controls. Preferences share allotments, price rigging, insider trading, asset stripping, exorbitant prices of new issues, accounting jugglery and lax project implementation have dented the future of newly emerging capital markets in India. Companies of Modi, Singhania, Thapur and several other groups involved in scandals and fleeced investors. Thus, liberalization and deregulation of capital markets also gave an impetus to bad loans by banks and mindless equity investments by Mutual funds. Many of the small investors lost money as well as hope and confidence due to unprecedented scams during 1992-99. Private promoters on the other hand made windfall profits through buy back of shares, raising the paid up capital, inter corporate investments etc. Alongside, SEBI as a statutory body has been opposed by corporate community and stock brokers as they were reluctant to divulge inside information to a quasi governmental body. As a result of this opposition, SEBI not only remained subordinate to government in key areas but also enjoyed no executive authority.

Another key change has been the deregulation of the banking industry including the development banks. The government requirements and directives to channel funds to certain sectors, buy government securities etc have been repealed, so that banks can now make decisions purely on the basis of standard profit calculations.

Though the deregulation of capital market and banking sector, some how resulted in poor changes initially, but these implications has far flung changes significantly in the realm of corporate finance in India. The share of internal reserves and surplus funds in project finance has declined continuously. Indian firms today rely exclusively on external finance i.e. funds raised externally which includes both borrowed funds and share capital. The equity capital especially continued increase in the last 25 years. Finance from debenture and bond issues increased in the 1980s but incrementally went down. Companies have reduced their borrowing among borrowings, dependence on financial institutions has gone down but that on promoters has gone up. The table 4.1 illustrates these trends in company finance in India.

Table 4.1: Trends in Corporate Finance in India

	% of sources		
Sources	1971 to 1981	1981 to 1991	1991 to 1996
Number of companies	83	319	530
a. share capital –Indian	28.5	37.5	41.1
of which equity capital	26.5	37.5	41.0
b. share capital – foreign	0.2	0.1	5.5
c. reserves and surplus	11.8	3.4	1.6
d. Loans, of which –	53.3	39.6	45.3
Financial institutions	24.1	22.5	12.1
Banks	15.5	6.6	10.0
Promoters, Directors, friends	0.6	1.0	8.7
Debentures, Bonds	4.5	18.2	6.1
Miscellaneous	1.7	1.2	0.4

Indian corporate sector is supported by a well-established equity market. Currently, there are 23 registered stock exchanges in India, with total market capitalization of US$131 at the end of 2002, equivalent to 26% of GDP and compared with 21% in 1990 (Tapalova, 2004). The equity market is dominated by Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). The external sources of finance continue to dominate in case of Indian companies with an average of 67% during 1990-2002. For the year ending m arch 2002, external financing accounted for 56% of total corporate funds raised, with slightly more than two-fifths of this from equity (capital) markets including bonds and debentures. In addition, new financial instruments such as commercial paper, certificates of deposit and inter corporate deposits have gained popularity as source equity financing.

Tapalova (2004) concluded that the dependence on debt though incrementally decreasing from 1990 but still continues to be crucial for Indian companies in the era of liberalization. Importantly, borrowing from banks and other financial institutions remained two key sources to meet capital requirements of the Indian companies. Over and above the borrowing from banks continue to raise from 25.7% in 1989 to 36.8% in the year of 2002. Likewise, the financial institutions increased their contribution to overall debt financing from 17.9 to 19.9 during the same period.

Tapalova (2004) observed that, the debt-to-equity ratios of the median firms of the corporate sector as a whole have fallen consistently during 1989 to 2002, largely due to faster growth of equity funding rather than debt reduction. This perhaps, partly reflects the fact that the development financial institutions which initially provided subsidized loans to Indian companies have reduced their lending activities in recent years; while commercial banks have yet to step in fill the breach. The growing equity participation has important ramifications specifically with regards to ownership and control in the Indian companies.

Indian corporate sector has grown steadily over the past two decades in terms of number of registered companies and amount of paid up capital. The corporate sector consists of closely held (private limited) and publicly held (public limited) companies, with approximately 6,19,000 registered companies in 2004, about 40% of which are in the manufacturing sector. Private limited companies compromise the majority of firms in the corporate sector, but account for less than one – third of total paid-up capital. Government – owned enterprises (both public and private limited) are comparatively few in number but large in size, accounting for more than 25% of the paid up capital. The share of total output by government enterprises has been declining since the start of reforms, falling from 32% of gross industrial value added in 1991 to 25% in 2002.

The ownership of Indian corporate sector tends to be concentrated in the hands of firm promoters and, to a lesser extent, small investors as indicated in the above table. Promoters' hold 48% of paid up capital for all manufacturing companies in 2002, and as high as 71% government owned companies. The prevalence of cross-holdings of ownership, together with heavy owner participation, makes Indian corporate control closer to an insider one as characterized by Sarkar and Sarkar (2000). The small investors hold 32% of equity shareholding in India which could be comparable to that of the US and UK. While inter-corporate holdings are much higher and financial institutions hold a much smaller share of equity as compared to other countries.

Sarkar and Sarkar (op. cit.), classified the principle holders of corporate equity as a.) directors and their relatives; b.) corporate bodies; c.) foreign investors; d.) term-lending institutions, primarily composed of the three government controlled / promoted development financial institutions and state finance corporations; e.) institutional investors, namely government owned mutual funds and insurance companies; and f.) public. Of the six groups, the first five can be considered as large shareholders or blockholders.

Corporate bodies are on average substantial blockholders in private companies belonging to business groups, and holds 25% of equity in 42% of Indian companies. Directors and relatives (promoters) hold on average of 21% of equity ownership in private stand alone companies and have more than 25% of equity ownership in 26% of companies. The relatively high portion of concentrated shareholding by directors and relatives and inter-corporate holdings is on account of the predominance of family-owned business, a feature that is typical of corporates in developing countries. Among other major equity shareholders – institutional investors nearly monopolized by UTI, have substantial holdings in group companies, both domestic and foreign. Financial institutions on average hold lower blocks of equity in comparison to institutional investors. The individual (retail) investors though significantly controls 40% of equity in Indian companies but their equity holding is less than 25% in case individual firms. The data is illustrated in the following table.

Table 4.2 Equity Holding in Indian Companies

Type of Company	Mean equity holding (in %) by					
	Directors & relatives	Corporate Bodies	Foreign	FIs	Insti. investors	Public
Private companies belongs to business groups	8.2	33.5	9.3	4.2	10.3	34.5
Private stand-alone companies	21.3	18.5	7.4	3.2	3.2	46.4
Foreign companies	0.8	18.3	42.0	4.3	12.2	22.4

belongs to business Groups						
Foreign Stand-alone companies	2.8	14.0	43.1	1.7	8.4	30.0
All sample companies	15.4	23.8	10.1	3.6	6.2	40.9
% of sample companies in which equity holdings is greater than 25%	26.6	42.5	12.8	2.5	6.7	-

(Source: Sarkar and Sarkar, 2000)

The changes in the equity ownership of firms have brought certain notable changes with regard to the governance of Indian companies. These changes not only aimed to curtail managerial expropriation in Indian companies as promoters are dominant shareholders or encouraging the financial institutions who are characterized largely as passive shareholders and mostly supportive of management's positions. These developments have meant to ensure more discipline of capital markets as they supply majority of extra-firm finance in the changing times. Case of fraud, corruption, market manipulation and other malpractices in the equity can render capital market reforms desultory and leads to low investor confidence. Effective corporate governance thus, becomes necessary in order to restore the credibility of capital markets to facilitate the flow of investment finance to firms. A host of developments have taken in the form of codes and regulations during the reforms period. This include, the reports of the task force of Confederation of Indian Industries (CII) in April 1997, committee of SEBI in 1999, Draft Report of Kumara Mangalam Birla committee on Corporate Governance in 2000, Advisory group of RBI in 2001, and RBI consultative group of directors of banks and financial institutions in 2002, Naresh Chandra committee, Ganguly committee report, Narayana Murthy committee report 2004, Companies (amendment) Bill 2004, Clause 49 of listing companies agreement in 2006, JJ Irani Committee report in 2007, Corporate Governance Voluntary Guidelines in 2009 so on and so forth. Albeit some variations and change of emphasis, these reports place a huge premium on 'transparency and accountability' in Indian corporate practices. The other areas covered in all these reports, include size, composition charter, responsibilities and meetings of the board of directors; tenure of directors; accountability to shareholders and stakeholders; access to information; nominee directors and their remuneration; committee on grievances of the shareholders; executive Vs non-executive chairmen of the board; audit committee; remuneration committee; nomination committee; board procedures; accounting standards and financial reports; disclosure and transparency; auditor Independence; responsibilities of individual and institutional shareholders; and matters relating to the implementation of Corporate Governance practices.

The Anglo-American model of corporate governance outlined three primary avenues through which the exit and voice options of shareholders can be exercised to ensure the accountability of management. These are Companies act of 1956, the market for corporate control and participation of public financial institutions and institutional investors on the management boards of the companies. Firstly, the company act of 1956 has been revised and several new reforms were incorporated into the revised act. These include a strengthening of disclosure norms, the establishment of an investor education and protection fund, the establishment of national advisory committee on accounting standards etc. The new act reversed previous restrictions on buy back of shares, inter-corporate investments and also provided tough regulations to prevent insider trading and related party transactions.

Secondly, the market for corporate control – takeover market - regulated through substantial acquisition of shares and takeover regulations act of 1997. Under current regulations, the acquisition of 10% shares triggers a minimum public offer of 20%. The market for corporate control has considerably improved in recent years due to capital market reforms and development.

The Corporate governance reforms are closely associated with certain macro-economic changes in the Indian context. For instance, free pricing of shares are encouraged by deregulation of capital market and similarly deregulation of banking sector has led to buy back of shares. Likewise, deregulation of trade policy allowed foreign ownership of equity and relaxation on limits to corporate expansion / diversification boosted by liberalization of foreign investments and repeal of Foreign Exchange Regulation Act (FERA). These changes, resulting in shift from the business house model to Anglo-American model, are summarized in the following table.

Table4.3 Structure of corporate governance in independent India

	The business house model	The Anglo-American model
Formal structure of governance	• Single-tiered board of directors • Role for nominee directors	• Single-tiered board of directors • Reduced role for nominee directors with a move toward abolishing nominee directors altogether
Macro-economic context	• Direct government intervention in capital markets through pricing of corporate securities • Development banking – heavy use of financing from public financial institutions • Protected, non-competitive product markets • Stringent controls on foreign ownership as well as portfolio investment • Regulation of foreign exchange expenditure by firm • License-permit-quota regime • No buybacks of its own shares by a firm	• Anglo-Americanization of capital markets with deregulated pricing of corporate securities. • A more "marketized" model of development banking; banking system more continuation oriented toward profit generation- but of the dependence on financing from public financial institutions. • Limited reduction in protection • Relaxed controls on foreign ownership as well as portfolio investment • Reduced regulation of foreign exchange expenditure by firms • Abolition of license-permit-quota regime • Firms allowed to buyback their own shares through open market operations takeover code the corporate governance codes
Control Proximate	• Minority ownership (of group companies by the apex company)	• Minority ownership (of group company by apex company)
Other mechanisms of control	• Interlocking boards • Intercorporate investments • Debt financing through PFI • Discouraging shareholder participation • Control of share offerings	• Interlocking boards • Inter-corporate investments • Private (or regulated) placement of stocks • Mergers (of group firms) • Discouraging shareholder participation

Source: Reed (2002) p.p. 259

The above table illustrates the similarities between both the corporate governance structures in India. The aspects of formal structure of governance, ownership and control mechanisms of Business House model remained relatively unchanged even with adoption of Anglo-American model of corporate governance. The following section highlights the issues central to Indian corporate governance and response of Anglo-American model and new reforms to these key issues.

4.2 Issues Central to Corporate Governance in India

It is clear from the fore mentioned, the governance of large Indian corporations entrusted on promoters eventually belongs to a handful of wealthy families. These promoter shareholders use control pyramids to effect their executive powers on the companies. We also explained that control pyramids such as interlocking of directorates and inter corporate investments make companies vulnerable to a range of serious governance problems. To reiterate, these problems can have adverse macro-economic effects when they extend across sufficiently large part of the Indian corporate sector. The central issue of corporate governance problems in India is not conflict between management and owners as in the US and the UK, but a conflict between the dominant shareholder and the minority shareholder. Most of the companies have controlling shareholders – either promoters or apex firms controlled by promoters and wealthy families.

Varma (1997) argued that the problem of ***dominant / controlling shareholder*** can be explicitly seen in case of three large categories of Indian companies. First, Public Sector Units (PSUs) where the government is the dominant shareholder and the general public holds a minority stake often as little as 20%. Second are the Multi National Companies (MNCs) where the foreign parent is the dominant shareholder. Third, the Indian business groups where the promoters together with their friends and relatives are the dominant controlling shareholders with large minority stakes (see Table Sarkar & Sarkar), government owned financial institutions hold a comparable stake, and the balance is held by general public.

The situation of Indian business groups is more complex than in PSUs and MNCs where there are clearly defined dominant shareholders. In Indian business groups namely, private – stand alone companies, private companies belong to groups; the concept of dominant shareholder is more amorphous for two reasons. First, the promoters' shareholding is spread across several friends and relatives as well as corporate entities. Second, the aggregate holding of all these entities taken together is typically well below a majority stake (Sarkar and Sarkar, 2000). In many cases, the promoter may not even be the largest single shareholder. In such instances what makes promoters the dominant single largest? The reasons can be attributed to two factors. Firstly, the preferential allotment of shares which ascribes majority of control rights to promoters than cash-flow rights. Secondly, passive role of Development Financial Institutions, Mutual Funds, public sector banks and insurance companies which holds a large chunk of shares in Indian companies. Thus, lack of assertive role of financial institutions leaves promoters as effective controlling shareholders in India.

However, the issues of ***insider ownership*** are indeed common for corporate governance structures of many developing economies. As mentioned earlier owner – manager governance system dominates in Indian firms. The firms are closely held and ownership rests either with family or apex companies. The insiders' hence hold absolute control of the firm's resources independent of their holding in the firm which might be very low. These insiders dominate the boards of governed companies. The corporate boards therefore - a crucial mechanism in ensuring equitable treatment towards all stakeholders eventually becomes as a mechanism to perpetuate the promoter's interests. Thus, lack of effectiveness of Indian boards, passive role of institutional investors and absence of shareholders activism has led to the misappropriation of funds, expropriation of public money by promoters.

Similarly, insider ownership has led to numerous corporate actions such as preferential allotments, appointment of independent directors, share buy-backs, dividend decisions, stock splits, delisting of equity shares, inter-corporate transfer of wealth (tunneling), investments in joint venture companies, sweat equity allotments, re-organization of companies etc. through which investors are misled and exploited. The controlling shareholders also employed unfair means to inhibit shareholder participation by holding Annual General Meetings (AGMs) at a time and place not convenient for a majority of shareholders.

Insider ownership poses different kind of agency problems in Indian context due to exercise of control rights in access of cash flow rights. As a result, it is reasonable to assume that misappropriation of firm's revenues by these dominant shareholders is a distinct possibility in Indian companies. Phani et.al (2003) opined that the probability of such behavior on the part of these promoters is also rendered very high due to the lack of strong investor protection investor protection mechanism.

Another issue of importance in Indian corporate governance is role of institutional ***nominee directors*** representing DFIs, PFIs, Mutual Funds, PSBs and Insurance companies on company boards. As we mentioned at many places in the present chapter these financial institutions were crucial during the erstwhile planned era of economic development as an important source of external funds. However, they have been criticized for being sleepy or dormant, in the sense that not taking any active part in the corporate governance of their portfolio companies.

The literature on large shareholders however, asserts that these institutional shareholders, as compared to the dispersed ones, are in a better position to make company management accountable. As Shleifer and Vishny (1997) highlighted that prevalence of large shareholders leads to convergence of interests and the 'efficient monitoring' since – large shareholders are likely to be more efficient than small and dispersed shareholders in monitoring company management. They argued that large shareholders with substantive investments as well as significant voting power likely to mitigate collective action problem present among dispersed shareholders and also likely to engage in relational investing and be more committed to the company in the long run. At the same time there are potential costs of large shareholders in terms of the 'conflict of interest', where in large shareholders may often pursue non-profit maximizing objectives for their personal benefits that might be detriment of minority shareholders (Sarkar and Sarkar, 2012). Paradoxically, often different types of large shareholders, like institutional investors and managers may 'strategically align' or collude mutually in a way to reduce company value and hurts the interests of minority investors.

The Financial Institutional Investors have maximum risk exposure and, are there fore, an effective mechanism for resource allocation in India. Although their percentage of contribution to total borrowings in Indian corporates has declined considerably from 28% in 1991 to 24% in 1998, they still regard as crucial for firm financing. Several guidelines and legislations by government *inter-alia* protect the rights and interests of these development institutions through nominee directors and convertibility clauses. In spite of this these institutional nominees have not played any active role once they invested in the companies except in few cases where the corporate decisions were seemingly adverse to FIIs. Otherwise, they generally support the management or 'vote with their feet'. Banaji (2001) argued that FIIs typically do not look at the agenda of shareholder meetings, do not attend AGMs, and do not exercise voting rights, unless some thing goes drastically wrong of if a takeover situation occurs. They neither participate actively in setting the agenda of board / shareholder meetings nor led or joined a coalition for the purpose of producing specific changes.

Patil (2001) also criticized that FIIs typically focuses on market capitalization, firm performance, liquidity than corporate governance policy and practices of their portfolio companies. Their investment decisions ironically, based on firm performance not on i*ndependence* of board or accounting practices etc. As a result, investments are short sighted and misguided which subsequently resulted in accumulation of non-performing assets in their portfolios. A notable example in this regard is Industrial Finance Corporation (ICFI) which reported 33.3% of total assets as NPAs as of march 2004. Similarly, Unit Trust of India (UTI) – a state run largest mutual fund established to provide stable and reliable income to small investors became sick in 1998 and admitted that its net asset value was below Rs. 10 after 34 years of investing.

These criticalities led to serious confusions regarding the genesis and role of the institutional nominee dorectors on corporate boards. The corporate India as reflected in a longitudinal study by Banaji and Mody (2001) opposed the regular appointment of nominee directors on portfolio company boards except in case of an actual or potential default because of price-sensitive information which might leads to conflict of interest. However, opposition to nominee directors is an infringement of their rights as shareholders as major shareholder the institutions have a right to board representation. Several studies indeed, reflected the relationship between Large Shareholders and firm performance. Sarkar and Sarkar (2012), Patil (2001), Phani et.al. (2004), Mohanty (2003) highlighted the linearity between presence of nominee directors and positive firm performance in Indian companies.

Another crucial issue in Indian corporate governance is ***Insider Trading*** about which both promoters and institutional investors are accused off and often throw down the gauntlet in each other camps. The 'insider trading' specifically refers - to trading in securities on the basis of certain undisclosed price-sensitive information by a person or institutions – undermines investor confidence in the fairness and integrity of capital markets. The dominant shareholders such as promoters and large institutions some times engage in activities which, leads to their benefits and financial suffrage of small investors. The cases of insider trading are more common in India especially in mergers and acquisitions. Varma (1997) pointed that some promoters have merged small companies in which they have large stake into a larger more widely held company at a swap ratio which is highly not in favor of the later.

Likewise, financial institutions that have representatives in their portfolio companies also have been charged of insider trading at numerous instances. As these investors has their nominees on boards, some times avail price sensitive information through board meetings and thereby involved in insider trading since they actively operate in capital markets on day to day basis. However, financial institutions argue that possibility of insider trading would hold with much greater force for the promoter / management groups that are in control of management. Patil (2001) criticizes several promoter groups for engaging in active trading in their own stocks as well as in large number of subsidiaries on the basis of price sensitive insider information. There are numerous instances of insider trading in India which requires a chapter length treatment, but of course not to neglect at this juncture – HLL v. SEBI in 1996, Reliance Industries Ltd. (RIL) v. SEBI in 2001, Rakesh Agarwal v. SEBI in 2001, ACC v. SEBI 2003 etc.

It is clear from the foregoing that the structural characteristics of the Indian corporate sector make the corporate governance problems in India very different from that in say the US of the UK. The governance issue in the US and UK is essentially that of disciplining the management who have ceased to effectively accountable to the owners (shareholders). The problem in the Indian corporate sector be it PSUs or MNCs or the private sectors is that disciplining the dominant shareholder and protecting the minority shareholders. The board of directors who are accountable to the owners would only be one which is accountable to the dominant shareholder; it would not make governance problem any easier to solve. It can be solved not by building effective boards but by forces outside the company such as regulatory pressures and voluntary efforts which will be examined in the following section.

4.3 Codes and Regulations of corporate governance in India

A good corporate governance system is rooted in an appropriate combination of legal protection of investors and some form of concentrated ownership. The US and UK systems rely more heavily on stronger legal protection, while German and Japanese are characterized by more concentrated equity ownership by banks and holding companies. Indian corporate governance system is a combination of both - a comprehensive blend of law, markets, regulations by interested parties and voluntary codes of self -discipline etc. This section delineates some of the notable codes and regulations of corporate governance and their efforts in addressing the problems of corporate governance germane to India.

4.3.1 CII Desirable Code on Corporate Governance

The Confederation of Indian Industry code on corporate governance (1997) was the first ever organized attempt as new competitive pressures reshaping Indian economy in the wake of liberalization and de-regulation. The code denied the possibility of having a German style two-tier board in case of Indian companies. It has for the first time recommended 'Independent Directors' for listed companies having turnover that exceeds 100crores where chairman of the board is also the Managing Director. In such cases, half of the board should have independent directors, or at least 30%.

The code reported the intensity of interlocking of directorships and recommended that no single person should hold directorships in more than 10 listed companies and also made mandatory attendance record for board of directors which should be made explicit at the time of re-appointment. It has laid down elaborate provisions for Audit Committee for listed companies that should comprises of all non-executive directors (independent). The audit committee at the same time should consists of at least three members with clear terms of reference and access to all financial information in the company and also should periodically interact with statutory and internal auditors. The audit committee should also assist the board in corporate accounting and reporting.

Alongside, the code asserted to safeguard the rights of shareholders and recommended that companies should inform shareholders about the high and low monthly averages of their share prices, performance and prospects of their major business segments. It has upheld high disclosure standards and recommended for mandatory certifications by CEOs & CFOs on company accounts. The code has criticized the role of nominee directors belongs to FIIs, PFIs, DFIs and Banks and recommended for their subsequent withdrawal from corporate boards. The code indeed, acknowledged the rights of creditors and allowed FIIs representation on portfolio companies, only incase of serious and systematic debt default or provision of insufficient information.

CII code has failed to gain wider acceptability though it contains a package of best practices for effective corporate boards, high disclosure standards and transparency and protection of creditor rights. The reason for this may be attributed the vary fact that it explicitly reflects the views of powerful business lobby which seeks to restrain the extent of institutional intervention.

4.3.2 Draft Report on Corporate Governance by Kumar Mangalam Birla Committee

The failure of CII code has prompted the capital market regulator – SEBI to step in and fill the void. SEBI appointed a committee chaired by Kumar Mangalam Birla to develop appropriate code of corporate governance that aptly designs a code enlisting the practices worldwide. The committee divided their recommendations in to two types, mandatory and non-mandatory. The code has been adopted by SEBI, as Banaji and Mody (2001) opined it as a statutory code and seeks self-regulation of business to have the force of law. It made elaborate provisions and ascribes the importance to the role of board of directors in corporate governance. It commented that the objective and purpose of corporate governance is to create shareholder value with out being detrimental to the interests of other stakeholders.

Beyond outlining the role of the board, SEBI committee also discusses the composition of boards. It made mandatory provisions that board should have at least 50% of independent directors in case of chairman is an executive, otherwise at least one-third in case of a non-executive chairman. It also restricted the maximum directorships to 10 and committee chairmanships to 5 in case of listed companies. It also strongly recommended for an independent audit committee, comprises of all or majority of non-executive directors (with at least one having financial and accounting knowledge) and chaired by an independent director. The audit committee should meet at least thrice in a year with an appropriate quorum. The audit committee must have access to information from any employee and can investigate any matter and also permitted to seek out side legal / professional service.

Alongside, it also recommended for setting up of remuneration committee with all non-executive directors and chaired by an independent director to decide the remunerative packages for executive directors. It strongly recommended for at least 4 board meetings in an year with a gap of four months. It also recommended that companies should provide consolidated accounts for subsidies where they have majority shareholding. It prescribes high disclosure standards (mandatory) such as Management Discussion and Analysis – a segment in annual report that includes industry structure, opportunities, threats, outlook, risk, HR/IR policies, details of directors, compliance report etc.

The SEBI committee at the same time upheld the rights of shareholders by directing listed companies to send quarterly, half yearly financial results and significant events and reports to shareholders. It has also given mandatory directives to constitute a shareholder grievance committee headed by non-executive director to look in to shareholder complaints and grievances. However, a key aspect in this code that certainly has a potential impact is – Independent directors. SEBI defines the notion of independence as ‘ directors who are apart from receiving directors remuneration do not have any material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in the judgment of the board may affect their independence of judgment (SEBI, 2000). Further, all pecuniary relationships or transactions of the non-executive directors should be disclosed in the annual report.

SEBI committee report was a well-thought out response to address critical issues pertinent to Indian corporate sector. It has proposed an Anglo-American model of corporate governance through independent board of directors, audit-remuneration-investor grievance committee, prohibiting insider trading, segmental reporting and consolidations of accounts, high disclosure standards etc. Much of its recommendations have been significantly addressed in the subsequent years.

4.3.3 Narayana Murthy Committee (SEBI) Recommendations

SEBI committee headed by NR Narayana Murthy recommended for a stronger and stricter regime of corporate governance. An appraisal of the recommendations (largely voluntary) reveals that board practices have further elaborated by incorporating certain provisions such as training for board members, elimination of nominee directors, a financially literate audit committee comprised of non-executive directors, code of conduct for board members and protection of independent directors from civil and criminal litigation etc.

Above and beyond board's role in promoting effective corporate governance, the committee also recommended that the related party transactions should be approved by audit committee. More importantly, the SEBI committee provided much larger definition of corporate governance (similar to NYSE) and suggested higher disclosure practices like the management should explain and justify any deviation from accounting standards, CFO/CEO certification, performance evaluation of non-executive directors etc.

Notably, the recommendations focused explicitly on problems of insider ownership and control, effectiveness of board of directors to check certain malpractices like related party transactions, faulty Initial Public Offerings, irregularities in accounting practices etc.

4.3.4 Clause 49 of Listing Agreement

In February 2000, the Securities Exchange Board of India issued a letter to all the stock exchanges proposing that 'a new clause, namely clause 49, be incorporated in the listing agreement' called 'corporate governance', contains eight section dealing with the Board of

Directors, Audit Committee, Remuneration of Directors, Board Procedure, Management, Shareholders, Report on Corporate Governance, and Compliance respectively. This became mandatory for large companies in 2003 and subsequently turns out to be a regulatory framework for all listed companies by January 2006. The salient features are as follows:

a.) The board of directors of a company shall have an optimum combination of executive and non-executive directors with not less than fifty percent in case of chairman being an executive and one-third in case a non-executive chairman.
b.) The definition of NR Narayana Murthy committee on 'Independence'- has been upheld by the clause 49 agreement.
c.) A qualified and independent audit committee comprises of minimum three members where two-thirds of the members shall be independent directors.
d.) The audit committee shall have oversight of company's financial reporting process and also review the accounts of subsidiary companies.
e.) A statement in summery form of transactions with related parties of business shall be disclosed by the companies.
f.) The company's management shall provide MDA along with director's report in the corporate governance section of annual financial report.
g.) The companies shall display quarterly results and presentations made to analysts in their official websites.
h.) CEO i.e. managing director and CFO i.e. whole time finance director shall certify the annual financial statements.
i.) There shall be separate section in corporate governance in the annual report of a company with a detailed compliance report on corporate governance.
j.) Company shall obtain certificate from either auditors or practicing company secretaries regarding compliance of conditions of corporate governance.

The regulations have initially included the nominee directors appointed by financial institutions as independent directors, however, this has revised recently and nominee directors are no longer considered to be independent as they actively represent their respective institutions on the board. These guidelines enabled Indian corporate governance norms on par with the global standards and in particular, the much discussed and debated aspects of the Sarbanes-Oxley and Combined code. The matrix in following page illustrates comparison of the guidelines of the Clause 49, SOX 2002 and Combined code 2003. It is evident from the following table that Indian corporate governance features some best practices which are comparable to the best in the world. It has also found out in CG Watch: a joint report brought out by CLSA Asia- Pacific Markets and ACGA in Comparative Analysis of Clause 49 to SOX and Combined code

Table No. 4.4: Comparative analysis of Clause 49, SOX and Combined Code

Topic	**Clause 49 (Listed Companies)**	**US- SOX & Combined Code**
Board	- Independence (gen.. majority) - Internal Control System - Disclosure & Code of Conduct	- Independence - Internal Control System - Disclosure & Code of Conduct
Audit Committee	- Independence (2/3) & Financially Literate - Review audit & internal audit	- Independence & Financially Literate - Review audit & Internal audit
Disclosures	- Compensation - RPTs - Risk Management & Accounting Standards - Use of Proceeds	- Compensation - RPT's - Risk Management, etc…not required, but generally provided - Use of Proceeds
Certifications	- CEO & CFO – Financials, Internal Control, Comply with Laws, Changes in Policy	- CEO & CFO – Financials, internal controls, etc…
Compliance	- Certificate on this. - Disclosure compliance or not with mandatory and non-mandatory req'ts.	- Similar, but no requirement to disclose if meet non-mandatory requirements.
CG Reports	Quarterly	Not required though often provided
Subsidiary	- Significant issues report to parent board - Independent directors	Important issues as per state corporate law.

Non Mandatory	- Training - Whistleblower policy - Evaluate non-executive board - Limits on independence	- Whistleblowers much more prevalent - Training not required, but often provide. - Performance evaluation - Greater discussion on compen. Levels
Penalties & Enforcements	De-Listing	- Large criminal penalties (individuals & companies) - Large civil penalties (public & private)

Source: ASCI,2007 and Combined Code 2003

2007, that India ranks high among the Asia governance league tables and reflects that India now fulfills all the standards regard best practices in corporate governance and compares quite favorably with all the major countries in the Asia region (ASCI, 2007).

4.3.5 Naresh Chandra Committee Recommendations on Auditor's Independence

In view of growing importance to corporate governance, the Department of Company Affairs appointed a high level committee in 2002 to examine and propose a suitable code in consonance with global standards of corporate governance. The committee primarily focused on the relationship between statutory auditor and company, and recommended apt procedures for appointment of auditors, rotation of audit firms, restriction on non-audit services and more importantly the independence of auditing function.

The report prohibited any direct financial interest in audit client, receiving any loans and guarantees from the company and strictly barred external audit firm to have any business relationship with the company. It also adhered for compulsory rotation of audit partner and disclosures by auditors with regard to contingent liabilities, qualifications, replacements and independence etc. The report acknowledges the importance setting up of a disciplinary mechanism in the interest of adequate control and quality to curb the corporate malpractices and to uncover fraud. Alongside, the report also suggested for effective independence of directors, percentage of independent directors, minimum board size of listed companies, disclosure on duration of board meetings etc.

The recommendations are basically sound and well thought out of and subsequently adopted by the professional auditing body in India, i.e. ICAI (Institute of Chartered Accountants of India)

4.3.6 SEBI (insider trading prohibition) Regulations

The SEBI made significant amendments in its earlier insider trading regulations which, was originally enacted in 1992, to incorporate more appropriate measures to deal with a crucial insider ownership problem in India – Insider Trading. The regulations prohibited the self-dealing by promoters or other parties in company securities on the basis of certain price sensitive information such as buyback, amalgamations, mergers or takeovers, intended declaration of interim dividend etc.

Similarly, the regulations also barred companies to trade in securities of another company or associate of that other company while in possession of any unpublished price sensitive information. It has empowered the corporate boards to investigate, record and report in case of insider trading. It has elevated the company secretary to a compliance officer to ensure that those violating the code are punished under the act. The regulations also imposed penalty for contravention of code of conduct by communicating or disclosing the price sensitive information.

In contrast, the changes made in the SEBI regulations 1992 cast a heavy burden on listed companies and other market intermediaries, self regulatory organizations, Stock Exchanges, public financial institutions, professional firms because of proposed formulations of model code of conduct for prevention of insider trading.

4.3.7 Companies (Amendment) Act; JJ Irani Committee Report

The companies (amendment) act of 2002, and it subsequent recommendations by JJ Irani committee (2007) envisaged to address certain grey areas in Indian corporate governance as well as in company law. This is a notable attempt to incorporate the prevailing best practices of various codes and reports to provide more appropriate comprehensive legal framework to regulate, monitor the intrinsic problems in corporate governance systems. The significant areas are – related party transactions, protection of minority shareholders and investor educations etc.

The recommendations suggested that transactions/contracts in which directors or their relatives are interested should be regulated through either a “Government Approval-based regime” or through a “Shareholder Approval and Disclosure-based regime”. The committee looked into international practices in this regard and felt that the latter approach would be appropriate in the future Indian context. The Law should impose a duty on every director to disclose to the company, the contracts or arrangements with the company, whether existing or proposed or acquired subsequently, in which he, directly or indirectly, has any interest or concern. The revised act suggested that directors shall make disclosures with in a stipulated time and failure to do so should be treated as default. Alongside, it has prohibited certain transactions, between company and director or persons connected with director, in respect of sale, purchase of goods, materials or services etc. Similarly, details of Transactions of the Company with its Holding or Subsidiary / Fellow Subsidiary or Associate Companies in the ordinary course of business and transacted on an arms length basis should be placed periodically before the Board through the Audit Committee, if any.

The Law aims to strike a balance between the rule of the majority and the rights of minority. The minority shareholders’ therefore, have to be given a voice to make their opinions known at the decision making levels. The law provides for such a mechanism if necessary. In cases where minority has been unfairly treated in violation of the law, the avenue to approach an appropriate body for protecting their interests and those of the company should be provided for. The law tries to balance the need for effective decision making on corporate matters on the basis of consensus without permitting persons in control of the company, i.e., the majority, to stifle action for redressal arising out of their own wrong doing. The recommendations upheld the rights to shareholders to be heard, during meetings of the company, incase of oppression and mismanagement, during mergers and acquisitions etc. The committee also recommended for setting up of Investor Education and protection fund to cope with gradual increase of investor community in India and regain confidence in the capital markets.

4.4 Corporate Governance in India: status report and challenges

The corporate governance systems in India reveals more or less Anglo-American model with unitary boards, independent directors, higher standards of disclosure, committee systems and certainly, upholding shareholder rights and provisions for protecting minority interests. The World Bank's Report on the Observance of Standards and Codes (ROSC) (2004) highlights that Indian corporate governance system is in similitude with OECD code with respect to shareholders' protection standards. The basic rights of shareholders to secure methods of ownership, transfer of shares, obtain relevant on corporation, participate and vote in AGMs, elect members of the board and share profits have been largely observed in Indian scenario. The equitable treatment of shareholders' (minority and foreign) to obtain effective redress for violation of their rights and insider trading / self –dealing (though prohibited) continue to be crucial areas and partially observed in India.

Disclosure standards and Transparency norms with regard to financial and operating results of the company, objectives, key executives, and remuneration packages are not only high but also strictly adhered and followed in India. The annual report, audit committee, independence of board of directors, compliance certifications by CEO/CFO, board procedures are largely observed in tune with international standards of corporate governance. Likewise, Indian corporate governance also acknowledges the role of other stakeholders and assures that the rights of stakeholders such as employees, customers, suppliers and local community are protected even though the codes and regulations does not make any explicit reference to 'other stakeholders'.

However, in reality Indian corporate governance also differ with international regulations on certain key issues. The separation of role of Chairman of the board and Chief executive officer is one crucial aspect which has not been focused so far in Indian regulations. At the same time codes and practices though appear similar to international standards but indeed, a tougher regime with respect to board structure and independent directors, board meetings, nomination and election of directors etc is some what missing in India. Excessive control by founders/ promoters still exist which acts as a potential impediment to professionalization of

Indian business. The failure of Indian boards, low accounting practices and transparency, lack of surveillance and enforcement mechanisms and the court system, absence of shareholder activism are some of the persistent issues in India.

To conclude, the Indian corporate governance system is in transition, towards the Anglo-American corporate governance with strong capital market. However, the market control perspective is as yet quite distinct to India because of hybrid nature (German/Japanese – US/UK) reflecting the features of other systems which will also remain for some more time at least till capital market takeoffs and market for corporate control – takeover market becomes aggressive. Joshi (2004) noted that investors are increasingly well-informed about true company performance due to detailed disclosure requirements and also able respond quickly to any market offer. However, the role of nominee directors and lack of assertiveness has been much debated issue in many codes and regulations on corporate governance in India.

5

CHAPTER 5
ITC: Organization Profile

Contemporary Corporate Governance analysis recognizes that the essential core of a corporation consists of three interrelated elements – Strategy, Structure and Practices. The Corporate Governance framework, discussed in chapter 2 and 3 involves all three and emphasizes the importance of their appropriate alignment, both internal and external, to the successful performance of the company. This chapter is a bridge between the theoretical analysis presented in the Part 1 and the empirical analysis that follow in the next 2 chapters. This chapter introduces the history and evolution of ITC Limited, where the research has been carried out and identifies Corporate Governance issues that have been critical for the selected divisions. It also brings out the problems that the company faced in balancing the diverse interests of its stakeholders – Employees, Farmers, Indian Shareholders, Parent Company and the Government. This chapter also illustrates the development of professional approach and forward looking ability of the company at a time when the history of the country itself was changing dramatically.

5. 1 Introduction

ITC is one of India's foremost private sector companies with a market capitalization of over US$10 billion and a turnover of US$3 billion. Forbes magazine has rated it amongst world's leading companies. Among India's private sector corporations, ITC ranks third in pre-tax profits. ITC has a diversified presence in cigarettes, hotels, paperboards and specialty papers, packaging, agri-business, branded apparel, packaged foods and confectionary, greeting cards and other FMCG products. ITC is rapidly gaining market share even in its new businesses of branded ready-made garments, greeting cards, packaged foods and confectionary, while it is an outstanding market leader in its traditional businesses of cigarettes, hotels, paperboards, packaging and agri-exports. ITC is considered to be nationalistic to the core as one of India's most valuable and respected corporations, which contributes substantially to the country's revenues, employment, exports and socio-economic development. ITC's strength emanates from its corporate strategy that aims at creating multiple drivers of growth anchored on its time-tested core competencies: large distribution reach, superior brand-building capabilities, effective supply chain management and acknowledged service skills in hotel business. In the not too distant future, ITC's strategic forays into new businesses are likely to get it a significant share of these emerging high-growth Indian markets. For instance, ITC which has 3.5 lakh tonnes capacity in paper and paperboard in its four production units including its 1 lakh tonnes of Elemental Chlorine-Free (ECF) paper for food packaging, has announced in August 2005 its plan to invest Rs. 2500 crores during the next 5 years to enhance its production of ECF by two lakh tonnes, which will increase the company's total capacity to 5.5 lakh tonnes in the segment. Likewise, the company, encouraged by the tremendous response to its new food products such as "Ashirwad" brand atta and Sunfeast brand biscuits, achieved more than 100 per cent growth in turnover in this fast-growing segment. Against a modest turnover of 400 crores in 2004 the ITC Foods increased the turnover to more than Rs. 1200 crore by the end of the financial year 2011.

ITC continuously endeavors to enhance its wealth generating capabilities in a globalizing environment to consistently reward its 1.50 lakhs shareholders, fulfill the aspirations of its stakeholders and meet societal expectations. ITC employs over 20,000 people at more than 60 locations across India.

5.2 History and Evolution

The story of Imperial Tobacco Company of India Limited (currently ITC Limited), extraordinary though it may sound, starts long before the company was established, or even thought of. It starts not in India, but in the United States of America and the United Kingdom. The formation of its parent company BAT was formed in the year 1902, by merging of two companies, Imperial Tobacco Company (of Great Britain and Ireland), and American Tobacco Company (ATC) to stop the self-damaging exercise among them. Buck Duke (James Buchanan Duke; the Founder of ATC) became the first Director of the company with his company holding a majority of 67% shares of BAT. The real story started much before in the year 1890, when Duke captured Ogdens of Liverpool and started a tobacco war in Britain. Imperial Tobacco took the war in turn to the markets in America. This led to price-cutting by both the giants of tobacco business. Huge Price cutting and discounts led to shrinking of bottom lines of both the companies and as compromise they finally came to agree that they shall not encroach each other's domestic market and that they shall not fight in other foreign markets. Indeed, formation of BAT was an outcome of these developments and this new entity was to market cigarette products outside UK and USA.

BAT entered the Indian market in 1906; and the seed of BAT's presence in India, once sown grew rapidly. Within five years of entering in India, its operations had expanded to include the manufacture of cigarettes, the procurement and processing of tobacco and the setting up of a full-fledged selling organization. This last was the Imperial Tobacco Company of India Limited, which came into being on 24th august 1910. In this study we study this company, which was destined in the course of its century to be buffeted, bruised and finally burnished by the winds of many challenges and changes.

When BAT decided to exploit the market opportunity in India, it perceived its operations in the country to be rather like a three legged stool, with the three legs representing Manufacture, Raw material procurement, and Sales respectively. Indeed, the first step, BAT took in this three pronged advance towards the Indian market was the establishment of a factory, and in November 1905, it incorporated a new company in England to undertake this venture (Basu, 1984).

This was Peninsular Tobacco Company, which BAT owned to all intents and purpose through its shareholding of 70 percent. However, an in due course BAT's share in Peninsular was bought over by Imperial Tobacco Company in India and the London incorporated Peninsular Tobacco company itself would be winded up and its assets were acquired by Peninsular Tobacco Company In India.

The Imperial's main thrust at the start was to promote sales both of imported cigarettes and those manufactured at company's factor in Monghyr. It was the first factory of the company, which was set up in 1907. In the year 1910, duties on imported tobacco were enhanced appreciably causing an enormous fall in imports in India. This has provided stimulus to indigenous manufacture of cigarettes. Recognizing that the Peninsular Tobacco factory at Monghyr, then producing 750 million cigarettes a year, would not be able to cope with the additional demand, the company set plans to establish another factory.

The Bangalore factory was established in 15th July 1912, sprawling over thirty seven acres which were purchased from civil and military station in what then were fields on the outskirts of the city. Today, Bangalore factory is part of the largest cigarette making complex in the country. Apart from the factory, the complex also has the only machine development unit to be attached to a cigarette factory in India. By 1990 the factory achieved a benchmark of processing 5500 Kg of tobacco each hour and 50 million cigarettes were manufactured daily comprising of premium brands of ITC's cigarettes.

By 1924, Peninsular Tobacco Company, with a unit in Monghyr and another in Bangalore, was ready to set up another factory. It seemed logical to locate this factory in northern India where the volume of sales was growing faster than anywhere else at that stage. Saharanpur, which is situated in Kolkata and Mumbai railway line, which is widely connected up till west Punjab, was an obvious choice. This Factory was set up in May 1926.

It was at this stage that BAT decided prudently to set a separate company to handle the procurement and purchase tobacco in India and actively encourage farmers. Increasing demand for cigarettes coupled with heightened duties had already prompted the decision to establish the Bangalore and Saharanpur factories. A subsequent greater quantity of tobacco was needed to carry uninterrupted production at these factories. It was becoming evident that a full-fledged company would be needed to handle leaf requirements and to this end a new company was floated in July 1912 called Indian Leaf Tobacco Development Company. The ownership of this company was batted backwards and forwards before it finally became a division of ITC Limited in 1975. The hallmark of this company was to discover more promising tobacco growing area in the south India. The company had opened buying depots at 3 places of Guntur district namely Parchur, Nambur and Chilakaluripet.

With the ready market for their lead and middle man being eliminated, the farmers began to derive definite benefit immediately but it was in 1922 that the fortunes of the entire farmer community took a giant step forward. This was the year in which the company decided that it would build a tobacco re-drying factory at Chirala. The Chirala factory had become an important milestone in the annals of the company. Though its operations were simple, expansion at this factory was rapid. Apart from grading and re-drying the leaf, hundreds of people were employed in 'stripping operations' at a daily rate. Within few years, the workforce who was initially mixed but latter had women, increased from about 500 to 6000. Till 1984, when the factory was closed on the advent of mechanization, about 1500 women and 500 men who were employed in chirala factory came from marginalized community.

In spite of enlightened self-interest, the ILTD improved matters and their method of tackling the problem was to revolutionize the tobacco production in the country. It was the method that was to bring relative prosperity to the Indian farmer, to help them become independent and secure, and it resulted in the establishment of an enviable and enduring relationship between ILTD and the farmers. The payments to farmers were made in cash which involved the transport and disbursement of large sums of money. The fact that ILTD came to have such good standing with the people in whose territory it worked was in large part due to the inherent ability of the mangers to get on with the local population.

ITC Limited acquired its fourth cigarette manufacturing factory at Kiddorepore during 1935 from Carreras India. This was part of the larger reorganization strategy of BAT to streamline its investments in India.

ITC's had setup Packaging & Printing Business in 1925 as a strategic backward integration for ITC's Cigarettes business. The first factory was Started in Monghyr and later on a second establishment was found in Tiruvottur in Tamil Nadu. Today ITC Limited has become India's most sophisticated packaging house.

The political and economic scenario of the country has changed after Indian Independence in 1947. The Government legislations to that requiring Multinational Corporations to dilute their equity has led to first disinvestment in ITC during 1954 wherein firstly Rs 1 crore worth of shares was offered to Indian Public. This in itself did not seriously affect BAT’s position, but it did give the company an indication of the things to come. With the enactment of FERA in 1973, the BAT’s shareholding has further declined to below 40% in the company. By 1980s, the Indian Government through the shares held by various State run Financial Institutions had become the single largest shareholder in ITC Limited.

This gradual process of disinvestment has changed the priorities of the company. The dependence of the company on the manufacture and sale of cigarettes had to be reduced through diversification. The company prioritized to identify projects for new businesses which would fit within the framework of the government’s planning policies and would yield large and stable foreign exchange earnings.

However, the choice of suitable diversification project was in fact a difficult one. Many considerations have to be taken into account, prime amongst them the attitude of government, which at that stage was distinctly un-sympathetic. In the wake of business interests the ITC Limited Board of Directors found themselves involved in a tricky balancing act between the national interests and those of major shareholders. BAT was not interested in investing in ventures such as paper or cement nor was ITC in a position to do so because any such major project would have involved a large capital investment, coupled with long gestation period. Finally, the need to intensify export promotion and focus on foreign exchange earnings led ITC to opt for three areas of diversification. These were Tourism sector where the intention was to set up a chain of hotels, in the field of general exports which would include various miscellaneous products and marine foods.

ITC Limited took a plunge in 1971 with the export of marine products and achieved good earnings in the first year. However, the company went into trouble due to absence of physical checking of inventories and perishable nature of marine products, which increased operating costs beyond the limits of viability. These factors had unfortunately led to the closure of the foods division in 1979. However, ITC Limited had experimented with varying degrees of success in the export of cut tobacco, paper and paper products, surgical dressings, insulators, hand tools, handicrafts, leather goods and garments.

Likewise, one other product in the ITC’s list of general exports needs mention, due to the sense of social responsibility which provided greater motivation than foreign exchange earnings. ITC promoted carpet manufacturing company called Triveni handlooms limited with its headquarters at Kanpur for export customers. The carpets were woven traditionally and were of coarse quality that did not command much of a market. Yet the weavers were undoubtedly talented. ITC decided that this was a worthy support. Though the promotion was small it constituted as one of ITC’s success stories. Within a short span of 12 months the project had become successful with turnover of 80 lakhs. However, the experiment was short lived due to host of reasons like, quality considerations, credit problems and fluctuation of international currencies.

In 1975, the Company launched its Hotels business with the acquisition of a hotel in Chennai which was rechristened 'ITC-Welcomgroup Hotel Chola' (now renamed as My Fortune, Chennai). The objective of ITC's entry into the hotels business was rooted in the concept of creating value for the nation. ITC chose the Hotels business for its potential to earn high levels of foreign exchange, create tourism infrastructure and generate large scale direct and indirect employment. Since then ITC's Hotels business has grown to occupy a position of Leadership, with over 100 owned and managed properties spread across India under four brands namely, ITC Hotels - Luxury Collection, Welcom Hotels, Fortune Hotels and Welcom Heritage.

The Government's desire that companies like ITC should both participate in core industries and develop backward areas led to ITC's involvement with another major project, that of the manufacture of paper and board. In 1979, ITC entered the Paperboards business by promoting ITC Bhadrachalam Paperboards Limited. However, ITC was hesitant to make such an enterprise a division of the Company for fear of the impact it would have on its balance sheet. So it took the alternative route of promoting a separate company in which it held a substantial shareholding. The factory was erected within a matter of twenty-seven months, a record in itself. With ecology being a prime concern, great attention was paid to the environment. Effluents were meticulously treated before being discharged into the Godavari river and pollutants were trapped before fumes were released into the air. Continuing afforestation programmes were taken in hand including those in partnership with neighborhood farmers who had fallow land. Having aware of their own needs, the project also initiated a cyclical operation of tree support which ensured a continuing supply of the right quality of pulp wood to the factory without affecting the balance of nature. The combination of a modern plant, professional management and a committed workforce achieved Bhadrachalam Paperboards productivity levels that were extraordinary in the paper industry, even judged by international standards.

The Bhadrachalam Paperboards amalgamated with the Company with effect from March 13, 2002 and became a Division of the company named Bhadrachalam Paperboards Division. In November 2002, this division merged with the Company's Tribeni Tissues Division to form the Paperboards & Specialty Papers Division. ITC's paperboards' technology, productivity, quality and manufacturing processes are comparable to the best in the world. It has also made an immense contribution to the development of Sarapaka, an economically backward village in the state of Andhra Pradesh. It is directly involved in education, environmental protection and community development. In 2004, ITC acquired the paperboard manufacturing facility of BILT Industrial Packaging Co. Ltd (BIPCO), near Coimbatore, Tamil Nadu. The Kovai Unit allowed ITC to improve customer service with reduced lead time and a wider product range.

In 1985, ITC set up Surya Tobacco Co. in Nepal as an Indo-Nepal and British joint venture. In August 2002, Surya Tobacco became a subsidiary of ITC Limited and its name was changed to Surya Nepal Private Limited. In 2004, the company diversified into manufacturing and export of garments.

In 1990, ITC acquired Tribeni Tissues Limited, a Specialty paper manufacturing company and a major supplier of tissue paper to the cigarette industry. The merged entity was named the Tribeni Tissues Division (TTD). To harness strategic and operational synergies, TTD was merged with the Bhadrachalam Paperboards Division to form the Paperboards & Specialty Papers Division in November 2002.

The 90s were challenging years for the company. The company had decided that diversification into new businesses was not only desirable but necessary. The Board of Directors had identified various diversification opportunities whilst enhancing the business and meeting national priorities. The company had decided to continue its strong hold on the core sector, such as cigarettes, paper boards, Hotels, whilst using competencies to grow in the other sectors like power, aviation, FMCG and oil seeds and exporting of commodities.

As part of diversification strategy, the company moved into castor and oil seeds industry, where the company had experience in agricultural commodity from seed to processed product through fruitful collaborations with farmers combined with its expertise in marketing and distribution. The company had started a sunflower oil project to conserve foreign exchange through reduction of imports. ITC set up ITC Agro Tech, to supply high quality hybrid seeds and provided meteorological data, to finally bought back the sunflower oil seed from the farmers' doorstep. ITC Agro Tech had achieved its target of becoming India's largest producer of branded edible oil in the private sector by 1993. In the same year, ITC and Zeneca Seeds of UK set up a joint venture company to develop a superior range of hybrid seeds suitable to growing conditions in India.

By 1995, a series of proposed diversification schemes into power sector, aviation, FMCG sector were discussed. However, the company had formally shelved its plan to diversify into unrelated areas like power and food. This was due to an open conflict with its foreign shareholders, BAT Industries of the UK. The parent company demanded that the ITC Ltd should plan to focus on its core competencies for future growth.

ITC therefore decided to focus more on its cigarettes, leaf tobacco, hotels, packaging and paper divisions in the coming years. The board accepted the company's plans to invest Rs1,900 crore by 2000 for its future plans. The ITC Agro Tech divested 51.4 percent stake in the ConAgra foods of the US.

During 1990, by leveraging the agri-sourcing competency, ITC set up the Agri Business Division for export of agri-commodities which is currently India's largest exporters. ITC's unique and now widely acknowledged E-Choupal initiative began in 2000 with soya farmers in Madhya Pradesh. Now it extends to 10 states covering over 4 million farmers. Also, through the 'Choupal Pradarshan Khet' initiative, the agri services vertical has been focusing on improving productivity of crops while deepening relationship with the farming community.

ITC launched line of premium range of notebooks under brand Paperkraft in 2002. To augment its offering and to reach a wider student population, the ‘Classmate’ range of notebooks was launched in 2003. Classmate over the years has grown to become India's largest notebook brand and has also increased its portfolio to occupy a greater share of a student’s school bag.

ITC also entered the Lifestyle Retailing business with the Wills Sport range of international quality relaxed wear for men and women in the year 2000.

In 2000, ITC spun off its information technology business into a wholly owned subsidiary, ITC InfoTech India Limited, to more aggressively pursue emerging opportunities in this area. Today ITC InfoTech is one of India's fastest growing global IT and IT-enabled services companies and has established itself as a key player in offshore outsourcing, providing outsourced IT solutions and services to leading global customers across key focus verticals - Banking Financial Services & Insurance (BFSI), Consumer Packaged Goods (CPG), Retail, Manufacturing, Engineering Services, Media & Entertainment, Travel, Hospitality, Life Sciences and Transportation & Logistics.

ITC's foray into the Foods business is an outstanding example of successfully blending multiple internal competencies to create a new driver of business growth. It began in August 2001 with the introduction of 'Kitchens of India' ready-to-eat Indian gourmet dishes. In 2002, ITC entered the confectionery and 2003 witnessed the introduction of Sunfeast as the Company entered the biscuits segment. ITC entered the fast growing branded snacks category with Bingo! in 2007. In just over a decade, the Foods business has grown to a significant size under seven distinctive brands, with an enviable distribution reach, a rapidly growing market share and a solid market standing.

In 2002, ITC's philosophy to enhance the competitiveness of the entire value chain found yet another expression in the Safety Matches initiative. ITC now markets popular safety matches brands like iKno, Mangaldeep and Aim.

ITC's foray into the marketing of Agarbattis (incense sticks) in 2003 marked the manifestation of its partnership with the cottage sector. Today, Mangaldeep is a highly established national brand and is available across a range of fragrances.

ITC entered the Personal Care Business in 2005. In seven years, the Personal Care portfolio has grown under 'Essenza Di Wills', 'Fiama Di Wills', 'Vivel' and 'Superia' brands which have received encouraging consumer response and are also being progressively extended nationally.

Thus, today ITC Limited is not just a tobacco company, but it is well known for read-to-eat foods, biscuits, atta, hotels, agri exports, speciality paper and others. The diversification in the 'FMCG and others' category has gathered pace and ITC earns 50% of revenues from these non-tobacco businesses. It is competing with the major and veteran players like Pepsico, Haldirams, Hindustan Unilever Limited, MTR, Nestle, in this segment

The above history of the company describes diversification strategy of the company and how it has reduced the presence of cigarette business in public eye, taking much interest in fresh ventures and achievements as a corporate citizen. A clear re branding by the company has taken the Wills brand’s association much beyond cigarettes, so that the equality built over the decades due to ITC’s dominance in the cigarette market is reaped by other products like apparel. Alongside, businesses such as hotels, packing and paperboards, which were initially separate companies, have now become divisions of ITC, and grown in size and scale too. The paper, paperboards and packaging business, which was once a struggling subsidiary, is today a thriving division accounting for a sixth of ITC's revenues.

5.3 ITC’s Vision and Mission

The vision of the company is well captured in its corporate positioning statement: “Enduring value for the shareholder, for the Nation”. Vision of the company is to “Sustain ITC's position as one of India's most valuable corporations through world class performance, creating growing value for the Indian economy and the Company's stakeholders”. The company would like to achieve its Vision by its Mission to “To enhance the wealth generating capability of the enterprise in a globalizing environment, delivering superior and sustainable stakeholder value".

- **Core Values**

ITC has adopted certain Core values that would enable the company to be a customer-focused, high-performance organisation which creates value for all its stakeholders. They are as follows

- **Trusteeship**

As professionally managed company the ITC is conscious to redeem the "trust" of all its stakeholders by adding value all the time.

- **Customer Focus**

To deliver to the customer his/her needs in terms of value, quality and satisfaction.

- **Respect for People**

To give respect and value people in all respects and uphold humanness and human dignity.

- **Excellence**

To do what is right, do it well and win.

- **Innovation**

For better processes, products, services and management practices.

- **Nation Orientation**

Being aware of its responsibility to generate economic value for the Nation. In pursuit of business goals the company adheres to compliance with applicable laws and regulations at all levels.

5.4 ITC's Corporate Strategies

ITC is a board-managed professional company, committed to creating enduring value for the shareholder and for the nation. It has a rich organisational culture rooted in its core values of respect for people and belief in empowerment. Its philosophy of all-round value creation is backed by strong corporate governance policies and systems.

ITC's corporate strategies are as follows:

- Create multiple drivers of growth by developing a portfolio of world class businesses that best matches organisational capability with opportunities in domestic and export markets.
- Continue to focus on the chosen portfolio of FMCG, Hotels, Paper, Paperboards & Packaging, Agri Business and Information Technology.
- Benchmark the health of each business comprehensively across the criteria of Market Standing, Profitability and Internal Vitality.
- Ensure that each of its businesses is world class and internationally competitive.
- Enhance the competitive power of the portfolio through synergies derived by blending the diverse skills and capabilities residing in ITC's various businesses.
- Create distributed leadership within the organisation by nurturing talented and focused top management teams for each of the businesses.
- Continuously strengthen and refine Corporate Governance processes and systems to catalyse the entrepreneurial energies of management by striking the golden balance between executive freedom and the need for effective control and accountability.

5.5 Shareholding Pattern

The first disinvestment of 6 percent of BAT's equity holding in ITC took place in 1954 when Rs. 1 crore worth of shares were offered to the Indian public. This in itself did not seriously affect BAT's position but it did give the company a taste of things to come, and there was a growing conviction that this disinvestment was only a beginning. But in any case, BAT probably recognised as the largest single shareholder still had control over the company. Though the Indian shareholding had increased substantially, it was dispersed over a large number of individual shareholders, each having a small shareholding. No one had a large enough block of shares to cause any anxiety. This continued to be true until financial institutions entered the picture.

In 1958, the newly created state run insurance companies, namely General Insurance Company and Life Insurance Corporation of India thought ITC a good investment, thereby acquired a shareholding of 1,51,100 shares by buying from the open market. By 1968, this figure had risen to 1,90,000 shares. The GIC, including its constituent units, and the Unit Trust of India had also begun to buy some shares.

The ITC Ltd further proceeded to dilute its equity, by offering Rs. 3.79 crore worth of shares at a premium of Rs. 3 per share, thereby increasing Indian shareholding from 6.6 percent to 25 percent. As a consequence the Life Insurance Corporation (LIC), Unit Trust of India (UTI), General Insurance Company (GIC) and ICICI Ltd received a firm allotment of shares worth of 1.66 crore. By 1973, LIC, GIC and UTI had once again increased their shareholding through market operations. The presence of financial institutions had taken significant dimension in 1974, when BAT planned to dis invest in order to increase the Indian shareholding to 40 percent. The government institutions have acquired Rs. 2.80 crore worth of shares that were divested by the foreign shareholders. This has led to board level changes in the company, wherein LIC, Industrial Finance Corporation of India and Industrial Development Bank of India had nominated Non-executive directors to safeguard their interests. These developments, indeed, made the parent company to appoint a non-executive director to the ITC Ltd board, to keep itself abreast of developments and protect its investments in a more systematic manner.

Today, the largest single shareholder is, as it happened, not BAT but the Government of India through the shares held by the Indian financial institutions. Their acquisition of shares in ITC has been a gradual process that started in a limited way with the first disinvestment in 1954, as referred earlier. The company thus, not only diluted its foreign shareholding ahead of legislative/political pressure, but had also entered new areas of business which were in line with the governmental thinking. However, in 2002, the parent company-BAT had attempted to increase its shareholding in ITC Ltd by acquiring the shares which UTI had in the company. Their efforts were not been successful as other financial institutions objected to this move.

The table no. 5.1 illustrates the Shareholding Pattern of ITC ltd. for the period of 10 years from 2002 to 2011. As can be seen from the table, the highest shareholders were Banks, Financial Institutions, Insurance Companies and Mutual Funds followed by Overseas Corporate bodies. The table enables to understand the stylized models of Corporate Governance proposed by Tan (1999), of shareholding pattern which is based on Insider model.

Table No. 5.1: Shareholding Pattern in ITC Ltd

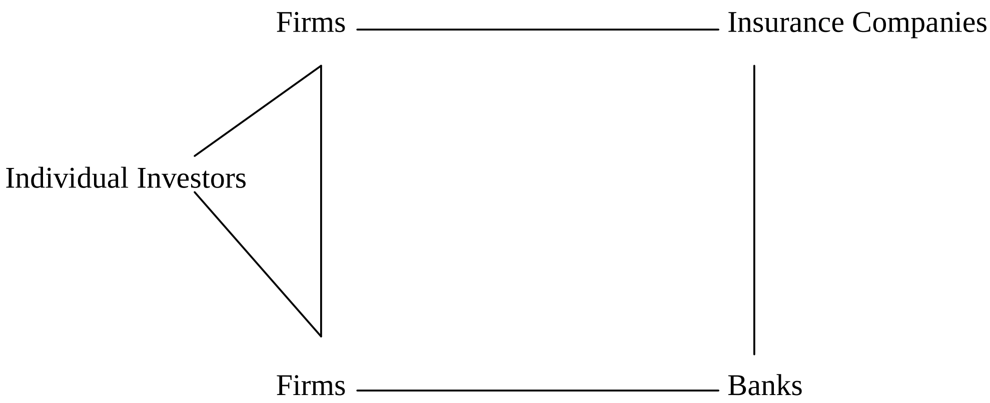
Particulars	Years									
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Tobacco Manuf. Association of India	26.9	26.74	26.73	26.6	26.4	26.39	26.34	26.3	26	25.66
UTI	11.79	11.78	9.87	11.18	11.87	11.93	11.9	11.88	11.74	11.59
LIC	10.47	13.59	11.33	10.61	11.74	12.7	13.65	13.61	13.72	12.92
Middleton Investment Co. Ltd.	4.4	4.37	4.36	4.35	4.32	4.31	4.3	4.29	4.25	4.19
Citibank, New York	4.35	3.9	3.9	2.98	1.83	1.48	1.39	-	-	-
New India Assurance Co. Ltd.	2.99	3.01	2.86	2.65	2.6	2.49	2.36	2.3	2.24	2.16
Oriental Insurance Company Ltd	2.46	2.43	2.17	2.05	1.97	1.98	1.94	1.9	1.85	1.71
General Insurance Corp. India Ltd.	2.22	2.38	2.05	1.97	1.98	1.99	1.99	1.96	1.92	1.88
National Insurance Comp. Ltd	2.03	2.02	1.93	1.88	1.84	1.83	1.79	1.73	1.72	1.69
Rothmans Intl. Ltd	1.4	1.39	1.39	1.39	1.38	1.37	1.37	1.37	1.35	1.33
ICICI Prudential Life Insurance Ltd.	-	-	-	-	-	-	-	1.39	1.39	1.83

Source: adopted from annual financial reports of the company from 2002-2011

5.5.1 Insider-based Model of corporate governance

Insider-based system of Corporate Governance does not have an active market for corporate control where in the entire Governance is vested with Promoters, Large Shareholders, Financial Institutions and Commercial Banks. This model can be best illustrated in figure 5.1.

The outsider-based model can be considered to address issues stemming from disenfranchisement of corporate ownership and executive domination of the board. These models have developed in different social and commercial environments. Large block of shareholders usually assume a more active management role in these models of Corporate Governance. This model often directly facilitates production efficiency and harmonizes the interests of a wider range of stakeholders including employees of the company. Human capital and the employees investment in developing firm specific resource, are considered to be given due importance in this model. This stylized model is prevalent in Japan and Germany.



The above discussion of the various models in their stylized forms is not meant to be exhaustive. For instance Corporate Governance models of the vibrant business corporations set up in South East Asian countries, China and India may constitute another distinct model. However, they are not well understood and there are few systematic studies of these Corporate Governance forms. Rather, the purpose of examining the above stylized models is to show the diversity of practices, objectives and underlying philosophies.

5.6 Segmental Growth: A Description

ITC, have posted stellar performance during 2003 - 2011, with an impressive top line growth and high quality earnings reflecting the robustness of its corporate strategy of creating multiple drivers of growth. This performance is particularly noteworthy when viewed against the backdrop of the extremely challenging business context, namely, the steep increase in excise duties and arbitrary increases in VAT on cigarettes, brand building and incubation costs of the new FMCG businesses, the impact of the significant investments made in augmenting distribution infrastructure and the gestation costs of the large investments in the Hotels business.

In 2011, the net turnover of Rs. 21167.58 crores grew by 16.6% primarily driven by 23.1% growth in the non- cigarette FMCG businesses, 22.9% growth in Agri business and 17.6% growth in the Hotels segment. Given these positive fundamentals, the Company has been rapidly scaling-up its new FMCG businesses comprising Branded Packaged Foods, Personal Care Products, Education and Stationery Products, Lifestyle Retailing, Safety Matches and Incense Sticks (Agarbattis) with Segment Revenues growing at an impressive compound annual growth rate of 35% during the last 5 years. The table 5.2 illustrates the 10 years of financial information at ITC Limited.

Table 5.2: 10 years at Glance

								(in Crores)	
Year Ending 31st March	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Gross Income	11176.47	12027.92	13542.39	16447.51	19557.14	21878.74	23593.64	26814.32	31399.1
Excise Duties	5141.1	5332.6	5667.13	6370.9	7056.36	7320.31	7446.79	8046.39	9360.3
Net Income	6035.37	6695.32	7875.26	10076.61	12500.78	14558.43	16146.85	18767.93	22038.8
Operational& Admin Exp	3712	4109.85	4846.89	6463.15	8207.88	9543.59	10753.38	12079.16	14046.27
PBDIT	2323.37	2585.47	3028.37	3613.46	4292.9	5014.84	5393.47	6688.77	7992.53
Depreciation	237.34	241.62	312.87	332.34	362.92	438.46	549.41	608.71	655.99
PBIT	2086.03	2343.85	2715.5	3281.12	3929.98	4576.38	4844.06	6080.06	7336.54
Interest	29.84	24.79	42.43	11.93	3.28	4.61	18.32	64.75	68.38
PBT	2056.19	2319.06	2673.07	3269.19	3926.7	4571.77	4825.74	6015.31	7268.16
TAX	684.84	726.21	836	988.82	1226.73	1451.67	1562.15	1954.31	2280.55
PAT	1371.35	1592.85	1837.07	2280.37	2699.97	3120.1	3263.59	4061	4987.61
Dividends									
Ordinary Dividend	418.84	558.83	882.97	1134.7	1364.5	1543.18	1633.87	4452.33	4002.09
Special Dividend								2448.78	1483.92

The table 5.3 describes the revenues generated in the key segments of ITC's operations. From the above table it can be seen that agri products and paper boards and paper are major revenue generators for ITC apart from cigarettes during the study period.

Table 5.3 Segmental Reporting in Crores

Items	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Cigarettes	60,865 (8013.58)	63,415 (8756.82)	65,387 (9223.6)	69,998 (9996.39)	75,894 (11,322.80)	81,265 (12,824.42)	80,723 (13815)	78,370 (15100)	84,040 (17277)	81,723 (19821)
Smoking tobacco	71 (6.9)	75 (6.78)	77 (6.44)	73 (5.94)	93 (6.64)	164 (9.09)	195 (9.7)	297 (13.7)	54 (4.31)	27 (4.5)
Unmanufactured tobacco	20,531 (194.04)	25,721 (232.9)	35,012 (259.3)	35,932 (273.76)	45,714 (356.31)	49,691 (422.34)	62,028 (511.4)	63642 (782)	85,242 (1442.5)	75,812 (1291.4)
Printed materials	4,063 (45.3)	3,672 (44.1)	5,892 (59.05)	7,939 (75.93)	7,725 (74.06)	11,361 (111.5)	19,300 (163.19)	22525 (207)	23,831 (236.17)	26,076 (297.91)
Agri Products	6,51,613 (773.54)	11,45,960 (1039.8)	6,11,641 (1024.28)	5,40,486 (936.36)	10,82,811 (1569.59)	24,08,203 (2238.01)	8,49,639 (2423)	463150 (2169.6)	275951 (2300.7)	4,36,126 (2771.7)
Paper Boards and Paper	1,82,649 (509.1)	1,75,220 (530.43)	1,69,582 (554.64)	2,36,920 (765.88)	2,90,109 (938.37)	3,01,196 (1016.4)	3,29,423 (1255.3)	3,66,474 (1512.3)	4,31,885 (1808.5)	4,26,478 (2017.67)
Hotels	160.28	192	254.49	573.02	777.8	978.7	1,093	1014.5	904.9	1067.9
Miscellaneous (Branded Garments, greeting cards, Branded packed foods like Staples, Biscuits, confectionary)	24 -	110.5 -	83,461 (450.93)	2,07,547 (590.26)	3,44,745 (1,044.86)	4,98,376 (1,769.22)	- (878.5)	- (1187.1)	- (1156.57)	- (1477.23)

5.7 ITC Ltd: A Prologue to Multi-Divisional Structure

Since organization structure is an important part of basic framework of management of enterprise, experiments in organization design have been a feature of the evolution of management thinking and practice. As enterprises encounter changing environments and adopt different strategies for achieving growth and improving performance, they tend to review and modify the structure and processes of the organization. Traditionally, ITC Ltd has been a single product organization and created separate companies for implementing diversified projects. However, as the company became large and operated in multi-product, multi-market situations, the limitations of functional structure and Holding-form of enterprise became more glaring and then product based divisional structure was adopted.

Before dealing with the specific issues, it may be appropriate to briefly explain the concept of Divisional Structure. In a seminal work published in 1965, Alfred Chandler pointed out that 'structure follows strategy' and 'growth without structural adjustments can lead to economic inefficiency'. He also observed that usually there was time lag between a new strategy and the adoption of a new structure. Chandler (1965) opined that different strategies call for different structural changes. For instance, the strategy of vertical integration or expansion can be managed by strengthening the functional structure but the strategy of diversification into new products or new geographical areas requires multi-divisional structure. Chandler's work inspired many researchers to explore the relationship between strategy, structure and performance. Many studies were conducted in United States, Britain, France, Germany and Japan, where in the divisional structure found widespread organisational scenario. Maheshwari (1985); also noted that the divisional structure has received importance as an organisational alternative in 1980s as several Indian companies had set up product based and location based divisions. However, he noted that many of these attempts were half hearted and failed to produce satisfactory results.

The case of ITC Ltd; is nevertheless, different from many others. The company followed the Multi-Divisional Structure to create product based autonomous divisions, with a focus on strategic diversification into new products and new geographical areas. Logically, the company had retained certain staff functions as corporate functions to provide advice/service to all the divisions. The corporate headquarter exercises control over the divisional operations on behalf of the top management.

As a Mutli-divisional company, the ITC Ltd, further, balances the terms of sales volume and profit across the divisions. Generally, if one division accounts for a large proportion of the company's turnover and exercise influence over corporate decisions it is detrimental to other divisions. The company stroked a perfect balance, though 55% or more of a company's business currently located in a single division, the India Tobacco Division.

Evidently, divisionalization implicates decentralization of power; accountability for performance and a large degree of autonomy for the division. The ITC Ltd's divisional structure is thus, characterized by a small and compact corporate office where the members of the top management are less concerned with day to day operations and are more involved in planning and ensuring future performance and facilitating the achievement of agreed performance by the divisions. The divisional decisions which may have influence beyond the divisional boundaries however, involve consultation and approval at the corporate management.

Further, ITC's success of the divisional structure relates to the selection of the divisional management teams. These teams are accountable for the business performance of the division and possess perspective skills appropriate for growth. It is recognized that to be effective, an organization structure must be liked by appropriate support systems for planning, budgeting, performance, interview, control, information etc. Thus, a divisional budget is an essential pre-requisite of a divisional structure. In the absence of such a budget it is difficult to ensure accountability for performance of the division.

The multi-divisional structure at ITC overcomes the problems of accountability, coordination and also strengthens relationships between various divisions and between the divisions and the corporate head office. These divisions are guided by clear norms and procedures in respect of (1) product/market boundaries; (2) management and utilization of common resources and facilities; and (3) determination of transfer price where services and products of one division are used as inputs by another division.

Thus, with autonomous divisions operating effectively in their respective spheres, the need for cooperation between divisions is also high at ITC Ltd. The table 5.4 and the figure 5.2 illustrates that while each division was not only effective, anything which required contribution from more than one division has also been considered. Typically, the loyalty to one's division tends to transcend the corporate loyalty in case of ITC Ltd.

Figure 5.1 The organization Structure of ITC Limited

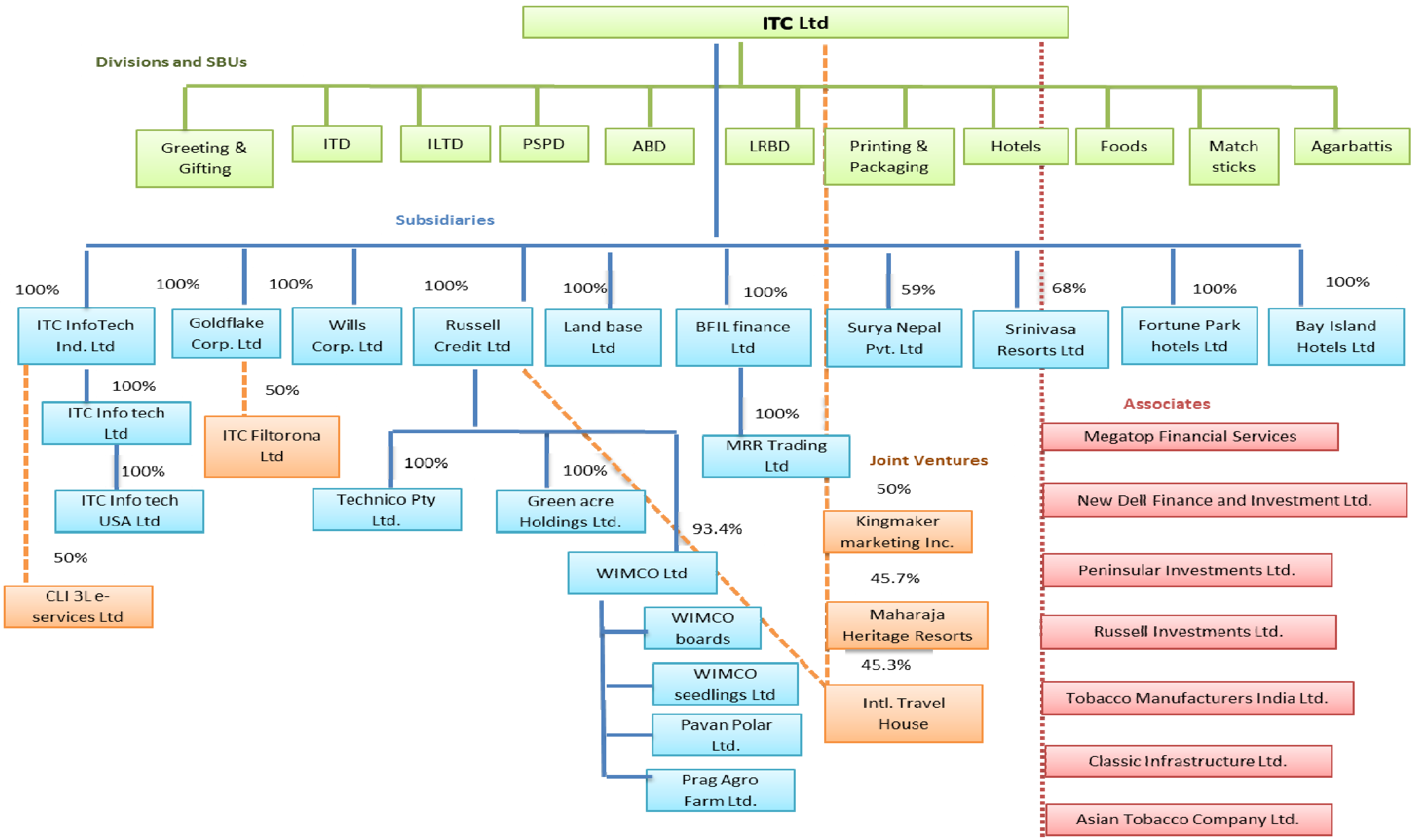


Table 5.4: Primary segment information (business segments) **(Rs. in Crores)**

Business segments/ Year	2002		2003		2004		2005		2006		2007		2008		2009		2010		2011		2012	
	Ext.	Int.	Ext.	Int.	Ext.	Int.	Ext.	Int.	Ext.	Int.	Ext.	Int.	Ext.	Int.	Ext.	Int.	Ext.	Int.	Ext.	Int.	Ext.	nt
FMCG-Cigarette	8020.92	-	8764	-	9230.27	-	10002.54	-	11329.74	-	12833.7	-	13825.6	-	15115.07	-	17283	-	19827	-	22250	-
FMCG-Others	21.63	0.43	108.47	0.73	303.58	0.58	562.15	1.24	1011.92	1.55	1701.45	2.94	2508.25	2.8	3010	4.04	3638	2.95	4473	8.63	5537	6.96
Hotels	160.28	2.1	192.09	1.32	254.49	3.04	573.02	4.23	777.85	5.5	978.71	6.96	1093.48	6.72	1014.56	5.71	904.92	5.89	1067	9.41	996	10
Agri business	967.75	180.03	1272.95	385.19	1285.74	423.03	1220.7	559.37	1954.67	723.77	2719.57	971.79	2503.03	1365.41	2284.44	1561.54	2388	1473.9	2969	1828	3507	2187
Paper boards, paper and packing	669.51	361.5	687.37	475.4	740.96	512.33	991.17	574.14	1150.25	745.48	1271.62	828.44	1425.58	938.75	1719.46	1102.5	2044	1188.8	2315	1351	2579	1550
Segment Total	9840.09	544.06	11024.88	862.64	11815.04	938.98	13349.58	1138.98	16224.43	1476.3	19505.05	1810.13	21355.94	2313.68	23143.53	2673.79	26259	2671	30604	3197.7	34871	3754

Source: CMIE Database

5.8 The study Area: Divisions taken for Study

It can be understood from the foregoing analysis that the present case – ITC Ltd is undoubtedly complex and a largely diversified business conglomerate. However, studying such a diversified conglomerate requires abundant resources and time. So the present study aims to study corporate governance practices of the ITC, with a focus on core business of the company. The study had selected cigarette manufacturing from FMCG segment, Paper boards and specialty from paper board and packing business, commodity marketing and leaf tobacco exporting from agribusiness. This strategic identification is not only for functional purposes of the study but in reality these divisions are historically old in terms of existence and known for their relationships with stakeholder groups from long time.

Thus, India Tobacco Division (ITD), Paperboards and Specialty Paper Division (PSPD), Agri Business Division (ABD) and Indian Leaf Tobacco Development Division (ILTD) have been selected among several other divisions of ITC ltd. These divisions are widely known for efficiency in operations and contributions to the total profits of the company. According to the recent estimates these four divisions contributes more than 70% of the profits to the case company.

The above divisions have headquarters in Bangalore, Hyderabad, and Guntur respectively, while their operations are not confined to headquarters alone, but found in distant and numerous locations. ITD has its manufacturing units in Mounghyr, Saharanpur, Bangalore, Kolkota (Kiddorepor), Hosur etc. In the same way PSPD operations are located in Badrachalam, Bollaram, Kovai and Tribeni. Similarly ILTD have processing plants at Chirala and Anaparthi, whereas ABD have enormous presence in Madhya Pradesh, Uttar Pradesh, Andhra Pradesh, Karnataka, Rajasthan etc. say in 11 states as of now. The field sites for the present study are limited to Bangalore cigarette factory for ITD, Badrachalam unit of PSPD, Chirala Unit of ILTD and Bhopal (MP) operations of ABD have been selected for carrying out filed work and collecting primary date regarding stakeholder relations.

These locations have been playing significant role in terms of turnover and profitability of the ITC Limited. Nevertheless, these locations are specific with regards to their history and operations. For instance ITD's bangalore cigarette unit was started in 1912 and is unique in terms of its employees management practices. IR systems are essentially based on productivity bargaining and mutual agreements between management and workers. Alongside, this unit has witnessed widespread Trade Union Movement and faced turbulent time during 1980's. The unit also underwent several changes especially during the time of changing physical location of the unit from Cox Town to Devanahalli. Likewise ITC-PSPD's division was the first unit commissioned by ITC in 1979. This unit marks the beginning of a new chapter in ITC's move from core tobacco to non-core business. The unit has undergone numerous challenges from its inception of being located in interior tribal area of Andhra Pradesh. The unit has remarkable production capacity of 5 paper machines and its state of art environmentally friendly technologies.

In the similar way, ITC-ILTD's Chirala unit marks the beginning of ITC's venturing into Southern India. This unit was established in 1922 and today it is the largest leaf tobacco sourcing, processing and exporting line operating by the ITC-ILTD. The establishment of this unit in a way reflects ITC's social concerns and the unit is unique in terms of its linkages with diverse stakeholder groups say customers, suppliers and community. While ITC-IBD operations at Bhopal (MP) depicts its foray into a large scale commodity marketing and IDB's Bhopal operations was increasingly significant in the way the firm established linkages with farmers on the basis of information and communication technologies. ITC's E-Choupal Movement was first initiated in MP with the launch of an internet portal Soya choupal which enabled farmers to know the necessary information regarding crops, pesticide use, weather forecast, prevailing prices in local, national and international mandis on the basis of the data disseminated through ITC's Internet Portal – Soya Choupal. Today, E-Choupal gained wide spread attention by the National Government, National and International business schools and more importantly paved the way for rural marketing and the way towards bottom of the pyramid.

Thus, the field sites selected for the present research study are instrumental and intrinsic (Stake, 2003) for the case company's growth, profitability, performance and linkage with stakeholder groups. They are instrumental because they provide insights in to the ground realities of functional integration with the diverse stakeholders and also play a supportive role for understanding the larger issues of corporate governance. These empirical findings facilitates for in depth understanding of the corporate governance practices of ITC Ltd in its contexts and situations at the bottom level where the case is as a complex entity operating with number of stakeholder groups like employees, customers, suppliers, local community, physical environment and regulatory bodies. The case may be here seen as typical because choice of such a case will enable advance understanding of top down / top management process called corporate governance and its efficiency in integrating the issues with sheer operations at the bottom level.

The present study thus, intrinsically examines the nature of stakeholder relations / practices at the divisional level to facilitate a better understanding of the corporate governance policy of particular case. The purpose of the present study is not to understand abstract construction or generic phenomena but to describe and explain the intrinsic value of these relationships vis a vis corporate governance practice to the particular case company.

5.9 Conclusion

Thus, ITC Ltd has grown to its present status of one of India's premier companies with a multi-product portfolio from a single product in the initial years. ITC's businesses are as vast as they are different, from tobacco to hotels, from paper to foods, from high end retailing to international commodity trading. These businesses differ in their vary nature, the manner of their evolution and methods of their operations.

Nevertheless, ITC, like any other Indian corporate has been highly influenced by economic liberalization, globalization and the wide challenges and opportunities they have opened. To adopt themselves to a market situation replete with risks and to attract larger investments, the ITC have adopted transparent, open and internationally best practices in governance.

Many would agree that ITC has achieved significant milestones – some of them very prestigious indeed, through its strict adherence to excellence in every one of its operations. Today, about half of its net revenues of Rs. 18,000 crore comes from cigarettes, and the other half from hotels, paper boards, infotech, agri-business and now increasingly, foods and personal care. The company has pioneered social initiatives; though most of them are related to its industrial pursuits, but it has gone much beyond to espouse the causes of the underprivileged and the rural poor.

As every company has its history, the ITC too had a tragic past. Excise Evasion Case, Financial Irregularities, Tussle with Parent company on excessive diversification and the turbulence with-in the company for control were certain acts of commission and omission within the organisation which never came to the knowledge of ITC's stakeholders and general public until the BAT-ITC spat and the company's FERA violations came to limelight in 1996. All these have been an important learning experience for ITC Limited. It exposed the potential consequences of resolving internally, externally relevant issues on governance aspects, and it revealed the need for a proactive approach. Most importantly, these controversies made ITC acutely aware that it is operating in the global environment, where the issues of good governance, board practices and internal controls are given utmost priority. The next chapter elaborates these issues at length.

CHAPTER 6

6

Professionalization of Management; Agency Crisis and the Advent of Governance Thinking at ITC

To reiterate, ITC was incorporated in 1910 as a private limited company to manufacture cigarettes of certain British and American companies in India. In 1954, ITC became a public limited company by acquiring the manufacturing business of Tobacco Manufacturers (India) Ltd and Lithographic Printers (India) Ltd through its Indian Leaf Tobacco Development division. Though ITC clearly dominated the cigarette business, it soon realized that making only a single product, especially one that was considered injurious to health, could become a problem for long-term profitability and sustainability of the company. In addition, regular increases in excise duty on cigarettes started having a negative impact on the company's profitability. To reduce its dependence on the cigarette and tobacco business, ITC started to diversify into new businesses. Initially, these diversification strategies have been supported by BAT, however, soon created a rift between the Indian management and Parent company. This chapter focusses on the agency problems in ITC Ltd during the early 90s and corporate governance transgressions thereafter. The chapter describes how ITC had initiated the governance reforms in light of these challenges, and how this has enabled the company not only to fix these problems but also develops a mechanism of internal controls for competitive advantage.

6.1 ITC Ltd: The Early Diversification

Evidently, the company diversified into new businesses to reduce its dependence on the cigarettes and tobacco business. It had set up a marine products export division in 1971. The company also reorganized itself and emerged as a new organization divided along product lines. In 1975, ILTD was made a division of ITC. In the same year it set up its first hotel in Madras. The company forayed into textile business with the promotion of Tribeni Handlooms in 1977. ITC also promoted Bhadrachalam Paperboards in 1977 to make papers and paperboards. In 1981, ITC diversified into the cement business and bought a 33 percent stake in India Cements from IDBI. This investment, however, did not generate the synergies that

ITC had visualized and, two years later the company divested its stake. In 1986, ITC established ITC Hotels, to which its three existing hotels were sold. In the same year, ITC entered the financial services business by setting up its subsidiary, ITC Classic Finance.

In the early 90s, the company has established ITC Agro Tech, based at Hyderabad to provide complete value chain services from supplying high quality hybrid seeds and providing meteorological data, to finally buying back the sunflower oil seed from the farmers' doorstep. Within a short period ITC Agro Tech Ltd has become the lifeline to the cultivators of the Kurnool area in Andhra Pradesh and achieved its target of becoming India's largest producer of branded edible oil in the private sector (Roy, 1992). In line with these developments, the company had set up a joint venture with Zeneca Seeds of UK to develop a superior range of hybrid seeds suitable to growing conditions in India. Both ITC and Zeneca Seeds had equal participation in the joint venture. This venture focussed on marketing 'Adarsh' brand of seeds to deliver improved crop yields to the Indian farmers.

On the wake of globalization, the ITC has also planned to explore opportunities in the high growth sectors like Power, Aviation and Foods. The company charted a systematic plan to diversify into aviation sector and considered to set up a new company for the purpose. The proposal to enter aviation sector was mooted by International Travel House, the travel management company of ITC and the already operational hotels and travel companies were to be synergised. Economic Times (1994) on Feb 16 stated that the company management had initiated discussions with leading airlines like Singapore Airlines; Malaysian Airlines; Aer Lingus; and two other leading South American airlines.

Thus, the company has transformed itself into a vibrant group. It has diversified interests in cigarettes, agri-business, Edible oil, paper and packaging, hotels. For the year ended March, 1992, ITC had sale of Rs. 2,968.1 crore and gross profit was Rs321.8 crore. ITC manufactured cigarettes (75 per cent of sales), agro-products (10.5 per cent) and paper and printing products (3.3 per cent). It also sold unmanufactured tobacco (5.4 per cent) and the hotel business accounted for 3.1 per cent of sales. Its cigarette factories were located in Calcutta, Bombay, Saharanpur and Munghyr, the paper plant at Tribeni in West Bengal and the printing and packing plants in Madras and Munghyr. ITC planned setting up a Rs100 crore, 600 tonnes per day mustard oil refinery in Rajasthan. ITC has opened offices in London, New York, Dubai and Singapore .

Despite successful diversification into non-core sectors, the company had faced some operational problems in 1993-94. After the 1994 stock market scam, ITC Classic Finance was left with a huge portfolio of illiquid assets. With ITC unable to bail out its subsidiary, the decision to sell ITC Classic became unavoidable. Similarly, Its International Business Division (IBD), posted operational losses of over Rs. 80 crore. The agri-business, paper and aqua products divisions had also posted losses. Similarly, its 3 investment companies, Sage, Elan and Pinnacle did not performed well due to depressed market conditions. In the wake of these developments, the parent company and other shareholders insisted ITC’s management to revisit their diversification strategy and suggest a road map for revival of loss making divisions.

ITC commissioned consultants McKinsey & Co., undertook a detailed study of the businesses of the company and made suitable recommendations. McKinsey advised ITC to disband diversification plans to power and aviation; withdraw from the agri-business where it was incurring losses and to concentrate on its core strengths. They had proposed ITC to disband its International Business Division (IBD) as part of its restructuring. The Mckinsey’s report concluded that the mainstay business of the IBD would be shifted to other group companies- ITC Agro Tech Ltd, ITC Minota Aquatech Ltd and ITC Global Holdings Pte. They opined that the diversified business of IBD would be divided among subsidiaries and group companies on the basis of specialisations. While the agri exports business was to be handed over to ITC Agro Tech Ltd, the commodities trading activities was proposed to be handed over to ITC Global Holdings and the aqua farms business was to be handed over to ITC Minota.

Alongside, the liberalisation reforms have made BAT to plan an increase of its equity in ITC from 31 percent to majority ownership of 51 percent. The BAT wanted a majority control in ITC through a preferential allotment and divestment of ITC’s business outside tobacco and financial services. But unlike other Indian companies with a foreign parentage (Colgate, Procter and Gamble, Castrol) who have so readily welcomed the renewed interest and infusion of investment from overseas, for ITC, BAT's intent posed an existential dilemma. Ever since ITC has been both Indian managed and Indian- led, its Independent-minded management has, over the years, successfully transformed ITC's profile from a 'tobacco and cigarettes company' to a widely diversified enterprise. ITC has diversified into areas such as hotels, edible oils, paper, printing and packaging. The Financial Institutions under the government of India also supported the ITC’s management and opposed the move from BAT.

This had left BAT Industries with no option than halt its desire to increase its equity from 31 percent to 51 percent. Thus in the face of fierce opposition from ITC and others, the BAT had agreed to respect ITC's aspirations to become a multinational corporation (Business World, 1994). Nevertheless, most of new businesses of ITC were alien businesses for the 25 billion pound sterling BAT group which is world's second largest cigarette maker.

6.2 The Emergence of Governance Problems

During the 1980s and 1990s, ITC’s image and management approach was threatened because of various allegations of unethical practices of the company. These included excise violation, FERA violation, insider trading and mismanagement of funds. A tussle between BAT and ITC over management control seemed to have worsened matters further.

6.2.1 Excise Violations

Till 1983, excise on cigarettes was based on the price at which they were sold. Many cigarette companies had resorted to under-invoicing to reduce the excise duty payable. Rumors floated that distributors returned a part of the premium earned in the market to the manufacturer. The excise department initially accused ITC of receiving such ‘flow-backs’, however, later dropped these charges for lack of evidence. The 1983 budget announced that excise would be charged on the basis of the printed price. When this system was also abused, the government introduced in 1988 a new system where excise was charged on the basis of the cigarette length.

A Business India article (8-22 May, 1995) reported that top ITC managers had been involved in various unethical dealings. One common practice involved declaring large stocks of good cigarettes to be damaged and therefore, ‘deemed for destruction’ (classified internally as DD). ITC would then claim a refund of excise duty paid for these cigarettes. Distributors sold these cigarettes to the trade and passed on a part of the realization to the executives.

6.2.2 The BAT and ITC Spat:

ITC had always received BAT’s full support since its first Indian chairman - Ajeet N Haksar’s time. ITC’s diversification into non-tobacco businesses had received BAT’s approval, even though these businesses were alien to BAT. With the change of leadership, as J.N Sapru took over Chairmanship, the relations with BAT have further improved. The Indian management's good equations with BAT had resulted in the parent company's wholehearted acceptance of diversification agenda in the early 1980s.

Initially, The ITC's Indian management had always kept BAT informed of all major strategic decisions. But, the changing management style during the times of Kishan L Chugh, however, has taken a stand not to involve parent company executives in the operational matters. Chugh however chose not to inform BAT about many strategic decisions; one such was ITC's tie-up with Peregrine, global financial services major in 1993. BAT, which was also a global player in financial services, viewed this move with concern. Though, the venture did not work out eventually, Chugh's relations with BAT soured. In September 1993, ITC launched its $91.8 mn GDR issue, managed by Merrill Lynch and Peregrine. While the issue had in principle been cleared by BAT, it took place with no prior intimation to BAT.

According to many insiders, the ITC's management under the leadership of Chugh's was radically different from that of earlier Indian chairman. Both Haskar and Sapru believed in decentralized decision-making and encouraged debates and disagreements. K.L Chugh, on the other hand, was a hands-on executive and tried to keep decision making centralized. There were instances wherein some of Chugh's trusted lieutenants had been encouraged to bypass their bosses and report directly to the chairman.

Gradually, Chugh's autocratic style began to create problems within the organization. By 1995, ITC's main executive body, the committee of directors had virtually become defunct and non-functional. Notwithstanding, these problems, the chairman and his associates continued to consolidate their position helped by the company's strong financial performance.

In a board meeting in November 1994, BAT proposed a nomination committee to screen future board appointments. The Indian management under Chugh saw ulterior motives behind this move. In a February 1995 board meeting, the difference between Chugh and BAT deepened when the Indian chairman wanted to include his associates in the nominations committee while BAT strongly opposed the move.

The main conflict between BAT and Indian management of ITC seemed to be over BAT's intention of acquiring a 51 percent stake in ITC. The ITC's management explained that they had opposed BAT's move only because they did not want ITC to be reduced to being just a tobacco company. In a shrewd move, the management played 'swadeshi' card posing as an

Indian professional management making valiant efforts to ward off an ‘MNC marauder’. In the process the incumbent management team of ITC had received favorable publicity in the media.

All of a sudden in March 1995, a press release issued by the UK-based parent company of ITC, British American Tobacco (BAT) shocked the Indian corporate world. Expressing a lack of confidence in K. L. Chugh, the chairman of its Indian subsidiary, ITC, the press release demanded his resignation. The incident took place soon after Chugh had accused BAT of trying to forcibly increase its stake in ITC to gain majority and that BAT was not in favour of ITC’s diversification into the power generation business.

Subsequently, Chugh was called for a meeting with BAT management team in London. During the meeting, BAT made clear its intensions to increase its equity stake in ITC. It also demanded Chugh’s resignation. Chugh asked for a week’s time to put in his resignation and returned to Delhi. Instead of complying with BAT’s wishes, Chugh held a meeting with his close associates. Thereafter, Chugh presented his case before the Indian media. The Indian management led by Chugh advocated that BAT does not want to see ITC as a multinational competing in the global marketplace, and wants to confine ITC’s activities to just tobacco and finance. These views have been backed by the media and Indian financial institutions too had come to the rescue of ITC’s management, and condemned the BAT’s approach to acquiring control of ITC.

BAT seemed to have been completely taken aback by these actions, but quickly realized that it would not be able to put down Chugh easily. Consequently, in May 1995, BAT chairman met Chugh to assure him that it did not have any takeover plans and that it would support ITC’s diversification efforts. BAT had apparently reconciled to the fact that it cannot secure the Indian chairman’s resignation as he enjoyed the support of financial institution nominees on the board and executive directors.

However, in June 1995, BAT once again openly accused Indian management team of financial irregularities. BAT’s CEO even demanded ITC chairmen’s resignation. BAT alarmed at the manner in which Chugh had apparently ‘departed from the standards of professional management’. The BAT claimed that a special audit committee, set up by the board to investigate BAT's charges of financial bungling by ITC, had proved the irregularities by ITC and its subsidiary, ITC Global, in Singapore. The audit report also highlighted many incidents of mismanagement. These include ITC showing an income of Rs25 crore from the sales of Sundrop brand of sunflower oil to a subsidiary company, ITC Agro Tech Ltd, although the brand was not registered with ITC. The company's international business division (IBD) understated losses in its aquafood export operations. The losses were Rs32 crore and not Rs.13 crore as stated. ITC overstated export earnings in 1992-93 by the book entry of income from transactions in 1993-94. The accounting policy of IBD and ITC Global were inconsistent. The audit report showed the nexus between ITC Global, IBD and the EST group of New York. Undue preference was given to EST by way of credit, cash and trade advances by IBD, so that EST can keep up its financial commitments to ITC Global.

Alongside, BAT also emphasized that its main concern was not acquiring a majority stake in ITC, but restoring professionalism to ITC's management. Guruswamy Mohan (1995) described that BAT's frontal attack came on the eve of the EGM convened on 24th March 1995 to approve ITC's diversification into the power sector (deemed to be Chugh's pet project). The venture implied a considerable financial commitment from BAT. The parent company categorically stated that it would approve the diversification only if Chugh resigned.

Finally, in September 1996, Chugh decided to resign citing irresolvable differences of opinion with BAT. The move came after Chugh had been under three-day question hour by a special audit committee probing FERA violations and the loss making export transactions. The committee gave Chugh a clean chit and BAT did not press further. Chugh reported to have been given a handsome severance package as well. The media considered the peace making moves as efforts by the two sides to avoid having to wash dirty linen in public.

Though BAT has succeeded in putting down Mr Chugh and his team, but it did not have the total freedom to nominate the successor because of the financial institutions which held 38 percent stake in the company. The ITC's nominations committee has been entrusted to decide on the future management structure and the chairman. The committee consisted of two BAT representatives and five institutional nominees.

The Indian Financial Institutions had decided to look for suitable person to fill the vacancy within the country. BAT had suggested to split the chairman post of chief executive officer into a non-executive chairman and a separate managing director. But the Indian Financial Institutions had disagreed with BAT's proposal to split up the chairman's post in ITC.

BAT Industries of the UK was likely to favour a complete reorganization of the ITC Board which was to include transfer of some of the Indian directors overseas. It proposed a plan in the final round of meetings with financial institutions that the existing members of the ITC Board lack requisite experience to head ITC Limited.

In midst of all these developments, the tobacco division of ITC Ltd had recorded a 63 percent market share in volume in 1995-96 (60 percent in 1994-95). This performance of ITC has silenced the representatives of BAT who had proposed to appoint their representative as chairman of ITC. The Indian financial institutions had upheld the performance of the company in recommending an Indian candidate for the post, so as to not disturb the continuity.

At last, Mr Yogesh Chander Deveshwar has been appointed as the chairman and chief executive officer of the company. The appointment has been a critical victory for the Indian financial institutions (FIs) who collectively held 38 percent stake in ITC. However, the BAT did not support the choice and had threatened to withdraw active support to ITC's activities. BAT has suggested bifurcation of the ITC board with the chairman taking charge of the overall policy matters of ITC and the vice chairman to look after the day-to-day operations. This was opposed by the financial institutions. The Indian chairman’s choice was strongly supported by the board with two nominees from BAT dissenting.

Thus the management of the ITC Ltd, its largest shareholder, BAT Industries (31.5 percent stake), and the Indian financial institutions had made a temporary reconciliation. They decided to work together as a team to address the various issues which dogged the company in recent times. The BAT, which was harping on gaining management control in the company, had decided to adopt a wait and watch policy, though it was being rumoured during the first half of 1996 that foreign institutional investors (FIIs) had acquired 3.5 percent of ITC's equity on behalf of BAT.

6.2.3 ITC-FERA Violation Story

A majority of ITC’s legal troubles could be traced back to its association with the US based entrepreneurs - Suresh Chitalia and Devang Chitalia (Chitalias). The Chitalias were ITC’s trading partners in its international trading business and were also directors of ITC International, the international trading subsidiary of ITC. In 1989, ITC started the ‘Bukhara’ chain of restaurants in the US, jointly with its subsidiary ITC International and some Non-

Resident Indian (NRI) doctors. Though the venture ran into huge losses, ITC decided to make good the losses and honour its commitment of providing a 25% return on the investments to the NRI doctors. ITC sought Chitalias' help in this regard.

Accordingly, the Chitalias bought the Bukhara venture in 1990 for around $1 million. Investors were paid off through the Chitalias New-Jersey based company, ETS Fibers, which supplied waste paper to ITC Bhadrachalam Limited. To compensate the Chitalias, the Indian Leaf Tobacco Division (ILTD) of ITC transferred $4 million to a Swiss bank account, from where the money was transferred to Lokman Establishments, another Chitalia company in Liechtenstein. Lokman Establishments made the payment to the Chitalias. This marked the beginning of a series of transgressions that eventually resulted in the company being charged for contravention of FERA regulations.

During the 1980s, ITC had emerged as one of the largest exporters in India and had received accolades from the government. This was a strategic move on ITC's part to portray itself as a good corporate citizen' earning substantial foreign exchange for the country. In the early 1990s, ITC started exporting rice to West Asia. When the Gulf war began, ITC was forced to withdraw rice exports to Iraq, which resulted in large quantities of rice lying waste in the warehouses. ITC tried to export this rice to Sri Lanka, which however turned out to be a damp squib because the rice was beginning to rot already. There were discussions in the Colombo parliament as to the quality of the rotting rice. This forced ITC to import the rice back to India, which was not allowed under FERA.

There were a host of other such dubious transactions, especially in ITC's various export deals in the Asian markets. The company, following the Bukhara deal, had set up various front companies (shell or bogus companies) with the help of the Chitalias. Some of the front companies were Hup Hoon Traders Pvt. Ltd., EST Fibers, Sunny Trading, Fortune Tobacco Ltd., Cyprus, Vaam Impex & Warehousing, RS Commodities, Sunny Snack Foods and Lokman Establishment, the one involved in the Bukhara deal. These front companies were for export transactions. It was reported that ITC artificially hiked its profits by over-invoicing imports and later transferring the excess funds as export proceeds into India. Critics pointed out that ITC did all this to portray itself as the largest exporter in the country.

In 1991, ITC asked all its overseas buyers to route their orders through the Chitalias. The Chitalias over-invoiced the export orders, which meant they paid ITC more than what they received from overseas buyers. For instance, in an export deal to Sri Lanka, ITC claimed to have sold rice at $350 per ton – but according to ED, the rice was actually sold for just $175 per ton. ITC compensated the difference in amount to the Chitalias through various means including under invoicing other exports to them, direct payments to Chitalia companies and through ITC Global Holdings Pte Ltd. (ITC Global), a Singapore-based subsidiary of ITC. ITC Global was involved in a number majority of the money laundering deals between ITC and Chitalias.

However, by 1995, ITC Global was on the verge of bankruptcy because of all its cash payments to the Chitalias. It registered a loss of US $ 16.34 million for the financial year 1995-96, as against a profit of US $1.7 million in 1994-95. The loss was reportedly due to the attrition in trade margins, slow moving stock and bad debts in respect of which provisions had to be made.

It was also reported that ITC Global incurred a loss of $20 million on rice purchased from the Agricultural Products Export Development Authority (APEDA), which was underwritten by the Chitalias. By the time this consignment was exported to S Armagulam Brothers in Sri Lanka through Vaam Impex, another ITC front company, there was an acute fall in international rice prices. The consignee (S Armagulam Brothers) rejected the consignment because of the delay in dispatch. Following this, ITC bought back that rice and exported it to Dubai, which was against FERA regulations.

This resulted in huge outstanding debts to the Chitalias, following which they turned against ITC and approached BAT complaining of the debts and other financial irregularities at ITC in late 1995. BAT, which was not on good terms with the ITC's Indian management, reportedly took this as an opportunity to tarnish the reputation of Chugh, who was the then chairman and compel him to resign. As mentioned earlier, BAT appointed a renowned audit firm Lovelock and Lewes to probe into the irregularities at ITC. Though the audit committee confirmed the charges of financial irregularities at ITC during the early 1990s and the role of the Chitalias in the trading losses and misappropriations at ITC during the year 1995-96, yet it cleared Chugh of all charges because as he agreed to resign. However according to industry sources, though the Chitalias were on good terms with ITC, it was BAT, which instigated the Chitalias to implicate the top management of ITC. BAT reportedly wanted to 'step in as a savior' and take control of ITC with the active support of the FI nominees on the board, which had supported ITC before charges of unethical practices surfaced.

Meanwhile, the Chitalias filed a lawsuit against ITC in US courts to recover their dues. They alleged that ITC used them to float front companies in foreign countries in order to route its exports through them. They also alleged ITC of various wrongdoings in the Bukhara deal. These events attracted Enforcement Directorate of India's (ED) attention to the developments at ITC and it began probing into the company's operations. ED began collecting documents to prove that ITC had violated various FERA norms to pay the NRI Doctors.

6.2.4 FERA Violations

The ED found out that around $ 83 million was transferred into India as per ITC's instructions on the basis of the accounts maintained by the Chitalia group of companies. According to the ED, the ITC management gave daily instructions to manipulate the invoices related to exports in order to post artificial profits in its books. A sum of $ 6.5 million was transferred from ITC Global to the Chitalias' companies and the same was remitted to ITC at a later date. Another instance cited of money laundering by ITC was regarding the over-invoicing of machinery imported by ITC Bhadrachalam Paperboards Ltd., from Italy. The difference in amount was retained abroad and then passed to the Chitalias, which was eventually remitted to ITC.

The ED issued charge sheets to a few top executives of ITC and raided on nearly 40 ITC offices including the premises of its top executives in Kolkata, Delhi, Hyderabad, Guntur, Chennai and Mumbai (Financial Express, 1996). The charge sheets accused ITC and its functionaries of FERA violations that included over-invoicing and providing cash to the Chitalias for acquiring and retaining funds abroad, for bringing funds into India in a manner not conforming to the prescribed norms, for not realizing outstanding export proceeds and for acknowledging debt abroad.

6.2.5 Overview of FERA Violations by ITC

- ILTD transferred $4 million to a Swiss bank account. The amount was later transferred to Lokman Establishment, which in turn transferred the amount to a Chitalia company in the US.
- ITC also made payments to non-resident shareholders in the case of certain settlements without The permission of the RBI. This was against Sections 8(1) and 9(1)(a) of FERA;

- ITC under-invoiced exports to the tune of $1.35 million, thereby violating the provisions of Sections 16(1)(b) and 18(2);
- ITC transferred funds in an unauthorized manner, to the tune of $0.5 million outside India by suppressing facts with regard to a tobacco deal. This was in contravention of Section a (1) read with Section 48;
- ITC acquired $0.2 million through counter trade premium amounting to between 3 and 4 per cent on a total business of 1.30 billion, contravening Section 8(1);
- The company had debts to the tune of 25 million due to over-invoicing in coffee and cashew exports during 1992- 93 to the Chitalias, contravening Section 9(1)(c) read with Section 26(6);
- G. K. P. Reddi, R. K. Kutty, Dr. E. Ravindranath and M. B. Rao also violated the provisions of Sections 8(1), 9(1)(a), 9(1)(c), 16(b), 18(2) and 26(6) read with Section 68 of FERA.

The ED also investigated the use of funds retained abroad for personal use by ITC executives. Though the ED had documentary proof to indicate illegal transfer of funds by top ITC executives, nothing was reported in the media. The top executives were soon arrested. In addition, the ED questioned many executives including Mr. Ashutosh Garg, former chief of ITC Global, Mr. S. Khattar, the then chief of ITC Global, the Chitalias, officials at BAT and FI nominees on ITC board.

Meanwhile, the Chitalias and ITC continued their court battles against each other in the US and Singapore. ITC stated that the Chitalias acted as traders for ITC's commodities including rice, coffee, soyabeans and shrimp. ITC accused the Chitalias of non-payment for 43 contracts executed in 1994. ITC sued the Chitalias seeking $12.19 million in damages that included the unpaid amount for the executed contracts plus interest and other relief. Following this, the Chitalias filed a counter-claim for $55 million, accusing ITC of commission defaults (trading commission not paid) and defamation.

In August 1996, the Chitalias indicated to the Government of India and the ED their willingness to turn approvers in the FERA violation case against ITC, if they were given immunity from prosecution in India. The government granted the Chitalias, immunity under section 360 of the Indian Criminal Procedure Act, following which the Chitalias were reported to have provided concrete proof of large scale over-invoicing by ITC mainly in the export of rice, coffee and cashew nuts. In another major development, a few directors and senior executives of ITC turned approvers in the FERA violation case against the company in November 1996.

The same month, the High Court of Singapore appointed judicial managers to take over the management of ITC Global. They informed ITC that ITC Global owed approximately US $ 49 million to creditors and sought ITC's financial support to settle the accounts. Though ITC did not accept any legal liability to support ITC Global, it offered financial assistance upto $26 million, subject to the consent and approval of both the Singapore and Indian governments.

In December 1996, most of the arrested executives including Chugh, Sapru, R. Ranganathan, R K Kutty, E Ravindranathan, and K.P. Reddi were granted bail. ITC sources commented that BAT instigated the Chitalias to sue and implicate its executives. BAT was accused of trying to take over the company with the help of the financial institutions (FIs), who were previously on ITC's side. In November 1996, BAT nominees on the ITC board admitted that BAT was aware of the financial irregularities and FERA violations in ITC. However, BAT authorities feigned ignorance about their knowledge of the ITC dealings and charges of international instigation against ITC.

Thus ITC landed in a mess due to gross mismanagement at the corporate level. Many agreed that poor corporate governance practices at ITC were principally responsible for its problems. They remarked that nominees of the FI and BAT never took an active part in the company's affairs and remained silent speculators, giving the ITC nominees a free hand. It is nevertheless difficult to believe that FIs and BAT nominees had no idea of these financial wrongdoings and unfair practices. Apparently, the board members of ITC, did not ask for more disclosures and information. Few industry critics also commented that ITC followed a highly centralized management structure where power vested in the hands of a few top executives.

6.3 The Aftermath – Setting Things Right

ITC Ltd, the tobacco major with sales of Rs. 5000 crore, had descended from its pedestal as one of the best managed corporates in India, with the arrest of its top executives for Foreign Exchange Regulations Act (FERA) violations. The dramatic turn of events from 1996 to 98 had worsened the reputation of ITC. Alarmed by the growing criticism of its corporate governance practices and the legal problems, ITC took some drastic steps in its board meeting held on November 15, 1996. ITC inducted three independent, non-executive directors on the Board. ITC also suspended the powers of the Committee of Directors and appointed an interim management committee. This committee was headed by the Chairman and included chief executives of the main businesses to run the day-to-day affairs of the company until the company had a new corporate governance structure in place.

Surprisingly, BAT had worked with financial institutions (FIs) in revamping the ITC board. The government was also unhappy with the role of the Indian management at ITC. The BAT had put forward a proposal to form a new committee with senior ITC executives at vice presidential levels to handle the daily affairs of the company. ITC also appointed a chief vigilance officer (CVO) for the ITC group, who reported independently to the board. ITC restructured its management and corporate governance practices in early 1997. The new management structure comprised three tiers- the Board of Directors (BOD), the Core Management Committee (CMC) and the Divisional Management Committee (DMC), which were responsible for strategic supervision, strategic management, and executive management in the company respectively.

However, the company's troubles seemed to be far from over. In the last three months of 1997, ITC's share price underwent dramatic ups and downs. In October, it reached a high of Rs 652.90. Later, it fell by more than Rs 100 to Rs 525. It increased against the next month to Rs 601.50 after reaching a low of Rs 488.30. This was repeated in December, when it zoomed to Rs 648 and then touched a low of Rs 526. ITC's half yearly results were announced on November 21, 1997. On November 20, the share price had increased from Rs 489.70 to Rs 505.40 on NSE and from Rs 492.25 to Rs 506 on BSE. A whopping 287 lakh shares changed hands on NSE while BSE reported 111 lakh share trades, the highest ever in the stock's history.

In the second week of November 1997, the Kerala High Court ordered CBI to investigate a fraudulent transaction involving ITC shares on a petition filed by a Kochi based investor. According to the investor, when the market had reopened for trading at 1200 hrs on Thursday, November 6, it was found that a transaction for 100 ITC shares had been entered on NSE at the rate of Rs 615 per share where the market price was only Rs 558. By recording the transaction at the rate of Rs 615, interested parties had apparently attempted to ward off the selling pressure on the shares.

Following these incidents, The Securities and Exchange Board of India (SEBI), decided to conduct detailed investigations. Though these investigations failed to produce concrete evidence of ITC’s involvement in insider trading, speculations about ITC’s hand in the volatile share price movements remained alive.

In the post-FERA violation developments, the ITC decided to retain interests in tobacco, hospitality and paper. ITC either sold off or gave up the controlling stake in several non-core businesses. It had shelved off power sector diversification agenda. In December 1997, ITC Classic was merged with ICICI at a swap ratio of 15:1. ITC agreed to sanction Rs 350 crore as interest free advance to ITC Classic and buy its assets. ITC also settled all of ITC Classic bad debts. Many of ITC Classic’s employees were absorbed by ICICI. In 1999, ITC consolidated most of its investment holdings into a single company Russel Credit. Two subsidiaries, Summit Investments and Sage Investments were merged with Russel Credit in February 1999. In May 1999, ITC sold off ITC Classic’s home finance business to the K K Birla group for Rs 10 crore.

Likewise, ITC divested its 51 percent stake in ITC Agrotech to ConAgra of the US, the world’s fourth largest company in the food business. ITC Zeneca, the seed manufacturing company and ITC Palm Tech were also merged with the new agri-business entity. Tribeni Tissues (which manufactured newsprint, bond papers, carbon and thermal paper) was merged with ITC.

Notably, the ITC's board had adopted a three tier governance strategy and restricted the total number of executive directors on the board to a maximum of five. The strategy also envisaged the management of ITC's businesses by the respective chief executive officers while the overall supervision of ITC as a whole was to be taken care by the executive directors. Through this three-tiered interlinked governance process, ITC claimed to have struck a balance between the need for operational freedom, supervision, control and checks and balances. Each executive director was responsible for a group of businesses/corporate functions, apart from strategic management and overall supervision of the company.

In 1999, the company had adopted formal corporate governance framework based on international norms of transparency and good governance. The governance policy equally provided freedom of executive management to respond to the dynamics of a fast changing business environment whilst adhering to the internal controls and ethical code of conduct. The following section deals with the governance framework at length.

6.4 Definition and Purpose of Corporate Governance:

ITC defines Corporate Governance as a systemic process by which companies are directed and controlled to enhance their wealth generating capacity. Since large corporations employ vast quantum of societal resources, they believe that the governance process should ensure that these companies are managed in a manner that meets stakeholders aspirations and societal expectations.

6.4.1 Core Principles

ITC's Corporate Governance initiative is based on two core principles. These are:

(i) Management must have the executive freedom to drive the enterprise forward without undue restraints; and

(ii) This freedom of management should be exercised within a framework of effective accountability.

ITC believes that any meaningful policy on Corporate Governance must provide empowerment to the executive management of the Company, and simultaneously create a mechanism of checks and balances which ensures that the decision making powers vested in the executive management is not only misused, but is used with care and responsibility to meet stakeholder aspirations and societal expectations.

6.4.2 Cornerstones of Corporate Governance Policy

From the above definition and core principles of Corporate Governance emerge the cornerstones of ITC's governance philosophy, namely trusteeship, transparency, empowerment and accountability, control and ethical corporate citizenship. ITC believes that the practice of each of these leads to the creation of the right corporate culture in which the company is managed in a manner that fulfíls the purpose of Corporate Governance.

Trusteeship

ITC believes that large corporations like itself have both a social and economic purpose. They represent a coalition of interests, namely those of the shareholders, other providers of capital, business associates and employees. This belief therefore casts a responsibility of trusteeship on the Company's Board of Directors. They are to act as trustees to protect and enhance shareholder value, as well as to ensure that the Company fulfills its obligations and responsibilities to its other stakeholders. Inherent in the concept of trusteeship is the responsibility to ensure equity, namely, that the rights of all shareholders, large or small, are protected.

Transparency

ITC believes that transparency means explaining Company's policies and actions to those to whom it has responsibilities. Therefore transparency must lead to maximum appropriate disclosures without jeopardising the Company's strategic interests. Internally, transparency means openness in Company's relationship with its employees, as well as the conduct of its business in a manner that will bear scrutiny. We believe transparency enhances accountability.

Empowerment and Accountability

Empowerment is an essential concomitant of ITC's first core principle of governance that management must have the freedom to drive the enterprise forward. ITC believes that empowerment is a process of actualising the potential of its employees. Empowerment unleashes creativity and innovation throughout the organisation by truly vesting decision-making powers at the most appropriate levels in the organisational hierarchy.

ITC believes that the Board of Directors are accountable to the shareholders, and the management is accountable to the Board of Directors. They believed that empowerment, combined with accountability, provide an impetus to performance and improve effectiveness, thereby enhancing shareholder value.

Control

ITC believes that control is a necessary concomitant of its second core principle of governance that the freedom of management should be exercised within a framework of appropriate checks and balances. Control should prevent misuse of power, facilitate timely management response to change, and ensure that business risks are pre-emptively and effectively managed.

Ethical Corporate Citizenship

ITC believes that corporations like itself have a responsibility to set exemplary standards of ethical behaviour, both internally within the organisation, as well as in their external relationships. They believe that unethical behaviour corrupts organizational culture and undermines stakeholder value.

6.4.3 The Governance Structure

Flowing from the philosophy and core principles, Corporate Governance in ITC shall take place at three interlinked levels, namely -

1. Strategic supervision by the Board of Directors
2. Strategic management by the Corporate Management Committee
3. Executive management by the Divisional Chief Executive assisted by the Divisional Management Committee

It is ITC's belief that the right balance between freedom of management and accountability to shareholders can be achieved by segregating strategic supervision from strategic and executive management. The Board of Directors (Board) as trustees of the shareholders will exercise strategic supervision through strategic direction and control, and seek accountability for effective strategic management from the Corporate Management Committee (CMC). The CMC will have the freedom, within Board approved direction and framework, to focus its attention and energies on the strategic management of the Company. The Divisional Chief Executive, assisted by the Divisional Management Committee, will have the freedom to focus on the executive management of the divisional business.

The 3-tier governance structure thus ensures that:

(a) Strategic supervision (on behalf of the shareholders), being free from involvement in the task of strategic management of the Company, can be conducted by the Board with objectivity, thereby sharpening accountability of management.

(b) Strategic management of the Company, uncluttered by the day-to-day tasks of executive management, remains focused and energized; and

(c) Executive management of the divisional business, free from collective strategic responsibilities for ITC as a whole, gets focused on enhancing the quality, efficiency and effectiveness of its business.

6.4.4 Roles

The core roles of the various entities at the three levels of Corporate Governance are as follows:

6.4.5 Board of Directors (Board):

The primary role of the Board of Directors is that of trusteeship to protect and enhance shareholder value through strategic supervision of ITC, its wholly owned subsidiaries and their wholly owned subsidiaries. As trustees they will ensure that the Company has clear goals relating to shareholder value and its growth. They should set strategic goals and seek accountability for their fulfillment. They will provide direction, and exercise appropriate control to ensure that the Company is managed in a manner that fulfills stakeholder aspirations and societal expectations. The Board must periodically review its own functioning to ensure that it is fulfilling its role.

The ITC Board will be a balanced Board, consisting of Executive and Non-Executive Directors, the latter including independent professionals. Executive directors, including the Executive Chairman, shall not generally exceed 1/3rd of the total strength of the Board. The Non-Executive Directors shall comprise eminent professionals, drawn from amongst persons with experience in business / Finance / Law / Public enterprises. Directors shall be appointed / re-appointed for a period of three to five years, and in the case of Executive Directors up to the date of their retirement, whichever is earlier. The Board shall determine from time to time the retirement age for both Executive and Non-Executive Directors. The Board shall specify the maximum number of company Directorships which can be held by members of the ITC Board.

Non-Executive Directors are expected to play a critical role in imparting balance to the Board processes by bringing an independent judgment to bear on issues of strategy, performance, resources, standards of company conduct, etc.

The Board shall meet at least six times a year and as far as possible meetings will be held once in two months. The annual calendar of meetings shall be agreed upon at the beginning of each year. As laid down in the Articles of Association of the Company, the quorum for meetings shall be one third of members and decisions shall be taken by simple majority, unless statutorily required otherwise. Meetings shall be governed by a structured agenda. All major issues included in the agenda shall be backed by comprehensive background information to enable the Board to take informed decisions. Agenda papers, as far as practicable, shall be circulated at least three working days prior to the meeting. Normally items for the Board Agenda, except those emanating from Board Committees, should have been examined by the CMC. Minutes shall be circulated within 15 working days of the meeting and confirmed at the next meeting. Board decisions shall record the related logic as far as practicable.

The Board shall have the following Committees whose terms of reference shall be determined by the Board from time to time:

- Audit Committee: To provide assurance to the Board on the adequacy of internal control systems and financial disclosures. The Head of Internal Audit will act as co-ordinator to the Audit Committee, but will be administratively under the control of the Director accountable to the Board for the Finance function.
- Compensation Committee: To recommend to the Board, compensation terms for Executive Directors and the senior most level of management below the Executive Directors.
- Nominations Committee: To recommend to the Board nominations for membership of the CMC and the Board, and oversee succession for the senior most level of management below the Executive Directors.
- Investor Grievances Committee: To look into redressal of shareholder and investors grievances, approval of transmissions, sub-division of shares, issue of duplicate shares, etc.
- Sustainability Committee: The role of the Sustainability Committee is to review, monitor and provide strategic direction to the Company's sustainability practices towards fulfilling its triple bottom line objectives. The Committee seeks to guide the Company in integrating its social and environmental objectives with its business strategies.

The composition of these Committees will be as follows:-

Audit Committee includes Directors of the Company, as may be decided by the Board, with at least 3 members all being Non-Executive Directors with majority of them being independent; and the Director accountable to the Board for the Finance function, Head of Internal Audit and representative of External Auditors as Permanent Invitees with the

Company Secretary as the Secretary. One of the Independent Directors is to be determined by the Board.

Compensation Committee comprises of Non-Executive Directors as may be decided by the Board, with the Director accountable to the Board for the HR Function as the Secretary. One of the Independent Directors, to be determined by the Board.

Nominations Committee consists of the Executive Chairman and all the Non-Executive Directors and Executive Chairman.

Investor Grievances Committee comprises of Directors of the Company, as may be decided by the Board, with the Company Secretary as the Secretary. One of the non- Executive Directors, to be determined by the Board.

The Sustainability Committee presently comprises the Chairman of the Company and five Non- Executive Directors, three of whom are Independent Directors. The Chairman of the Company is the Chairman of the Committee.

Normally meetings of the Board Committees shall be convened by their respective Chairman. However, any member of the Committee may, with the consent of the concerned Chairman, convene a meeting of the Committee. The Chairmanship of Board Committees shall be for two years at a time. Signed minutes of Board Committee meetings shall be tabled for the Board's information as soon as possible. However, issues requiring Board's attention / approval should be tabled in the form of a note to the Board from the Committee Chairman.

In the event there are no issues to be brought before the Board by the Audit Committee, the Chairman of the Audit Committee shall submit 'NIL' reports to the Board.

6.4.6 Corporate Management Committee (CMC)

The primary role of the CMC is strategic management of the Company's businesses within Board approved direction / framework. The CMC will operate under the superintendence and control of the Board. The composition of the CMC will be determined by the Board (based on the recommendation of the Nominations Committee), and will consist of all the Executive Directors and three or four key senior members of management. Membership of the CMC shall be reviewed by the Nominations Committee annually. The CMC shall be convened and chaired by the Executive Chairman of the Company. The Company Secretary shall be the Secretary of the CMC. The quorum for meetings will be 50% of the members, subject to a minimum of three members. Decisions will be taken by simple majority. Minutes of CMC meetings shall be tabled before the Board for its information. However, issues arising from CMC Meetings and requiring Board's approval / attention should be tabled in the form of a note from the relevant Executive Director. Agenda items shall be backed by comprehensive notes from the concerned member / invitee, along with DMC approval where applicable. Agenda papers, as far as practicable, shall be circulated at least three days prior to the meeting. The CMC shall normally meet once a month.

6.4.7 Executive Chairman of ITC

The Executive Chairman of ITC shall operate as the Chief Executive for ITC as a whole. He shall be the Chairman of the Board and the CMC. His primary role is to provide leadership to the Board and CMC for realising Company goals in accordance with the charter approved by the Board. He shall be responsible for the working of the Board, for its balance of membership (subject to Board and Shareholder approvals), for ensuring that all relevant issues are on the agenda, for ensuring that all directors are enabled and encouraged to play a full part in the activities of the Board. He shall keep the Board informed on all matters of importance. He shall preside over the General Meetings of shareholders. As Chairman of the CMC he will be responsible for its working, for ensuring that all relevant issues are on the agenda, for ensuring that all CMC members are enabled and encouraged to play a full part in its activities.

6.4.8 Executive Director:

a) As a member of the CMC, he should contribute to the strategic management of the Company's businesses within Board approved direction / framework.

b) As Director accountable to the Board for a business (Line Director), assume overall responsibility for its strategic management, including its governance processes and top management effectiveness.

c) As Director accountable to the Board for a wholly owned subsidiary, or its wholly owned subsidiary (Line Director), act as the custodian of ITC's interest and be responsible for their governance in accordance with the charter approved by the Board.

d) As Director accountable to the Board for a particular corporate function (Line Director), assume overall strategic responsibility for its performance.

6.4.9 Divisional Management Committee (DMC):

Executive management of the divisional business aims to realize tactical and strategic objectives in accordance with CMC / Board approved plan. Composition of the DMC shall be determined by the Line Director with the approval of the CMC. The Divisional CEO shall convene and chair the DMC meetings. If the Divisional CEO, for any reason, is not in a position to convene a required DMC meeting, he shall in writing delegate the power to convene and chair the required meeting to one of the DMC members identified by name. Such delegation should be either for a specific meeting or for meetings to be held during a specific period of time. It cannot be a general, open-ended delegation. The key functions of the Division shall be represented on the DMC. Normally the Divisional Financial Controller, in addition to being a member, shall act as the Secretary to the DMC and will be responsible for circulation and custody of agenda notes and minutes. The DMC shall generally meet at least once a month to review Divisional performance and related issues. Quorum for meetings shall be 50% of the members subject to a minimum of three members. Decisions will be taken by simple majority. Minutes of meetings shall be tabled before the CMC for its information. Agenda items shall be backed by comprehensive notes from the relevant member / invitee. Agenda papers, as far as practicable, shall be circulated at least three days prior to the meeting.

6.4.10 Divisional CEO:

The Divisional CEO shall function as the Chief Operating Officer with executive responsibility for day-to-day operation of the Divisional business, and shall provide leadership to the Divisional Management Committee in its task of executive management of the Divisional business.

The corporate governance policy also adhere a Code of Conduct, which is adopted by the Board of Directors, is applicable to Directors, senior management and employees of the Company. The Code is derived from three interlinked fundamental principles in ITC's policy, viz. good corporate governance, good corporate citizenship and exemplary personal conduct in relation to the Company's business. The Code covers ITC's commitment to sustainable development, concern for occupational health, safety and environment, a gender friendly workplace, transparency and auditability, legal compliance and the philosophy of leading by personal example.

6.5 Conclusion

Thus, the period of 90s and the entire BAT-ITC tussle, FERA violations turned into a learning experience for ITC Ltd. During this time, the ITC found itself trapped in meeting the expectations of various stakeholders which ultimately led to certain corrective actions from the company's management. All these governance norms with regard to the Board of Directors, Board Committees and their structures follow the recommendations of National and International Committees on corporate governance.

CHAPTER 7

7

Institutionalization of Corporate Governance at ITC: a Social Science Analysis

This chapter deals with the empirical context of the study on corporate governance. In this study, the investigations and observations were carried out focussing on particular company i.e. ITC Ltd with special emphasis on corporate governance practices. The scope of the present investigation was restricted to governance and stakeholder relationships as the universe, and data was collected from two main sources. Firstly, it was secondary sources such as Annual reports, codes, documents and reports. Secondly, the data was also collected through primary sources through fieldwork. The primary data was also collected from the key stakeholders of ITC's organizational structure with the help of formal and structured interview schedule.

This chapter aims to illustrate the data obtained through the selected methodology, by explaining what it signifies, summarizing and then exploring whether it provide answers to the research questions posed and identified in this study.

Section I describes the corporate governance practices of ITC which is reflected in distribution of rights and responsibilities among different participants in the organisation such as the Board, management, Shareholders and other Financial Stakeholders, and the rules and procedures laid down and followed for making decisions. The focus is on quality of governance practices that addresses the requirements of the shareholders and regulators. Similarly, Section II illustrates a wide spectrum of issues on stakeholder management that embodied the questionnaires and interviews which were conducted to collect data. This section highlights the linkages between company and stakeholders namely, shareholders, employees, suppliers, customers and community.

Section I

This section is an assessment of the ITC's compliance with statutory regulations as laid out in Clause 49 of the Listing Agreement. The focus, however, is on substance over form, and to that extent, compliance with regulations is only the starting point of analysis. Besides regulatory compliance, the section also highlights governance practices which are reflected in various corporate documents like Board Notes, Agenda Papers, Minutes of Meetings, Statutory Returns submitted to the Registrar of Companies, the Stock Exchanges, and the Securities and Exchange Board of India (SEBI), Annual Reports, etc. Additionally, the section also illustrates the views of key officials of the company namely, Internal Audit department, Top management and other senior management.

The central issues analysed in this section are: Shareholding Structure, Governance Structure and Management Processes, Board Structure and Processes, Board Committees and Procedures. All these issues will be discussed in depth in the pages to follow, based on the analysis and responses received.

7.1 Material Information: Shareholding Pattern

The analysis of organisation's shareholding structure enables to understand its ownership pattern, identify the dominant shareholder(s), evaluate the extent of cross-holdings, and identify the extent of shares held by its promoter/promoter groups. The analysis is based primarily on the study of the Distribution Schedule furnished to the Stock Exchanges and offer documents relating to any public or rights issues that a the company have made in the recent past. The table 7.1 illustrates the shareholding pattern in the ITC Ltd.

Table 7.1 Shareholding Pattern (2002-2011)

Shareholders	Year					(in Percentage)				
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Banks, FIs, Insurance companies, MFs	35.43	38.3	34.9	33.8	36.1	37.0	37.6	37.74	37.1	35.8
Foreign Institutional Investors	11.2	9.6	14.7	17.4	14.3	12.7	14.0	13.6	13.4	14.0
Overseas corporate bodies	32.7	32.5	32.4	32.4	32.1	32.1	32.0	32.0	31.6	31.1
NRIs	0.75	0.7	0.63	0.60	0.64	0.60	0.62	0.58	0.55	0.56
GDRs	4.35	3.90	3.90	2.98	1.83	1.48	0.72	0.56	0.39	0.33
Indian Public	15.2	14.9	13.3	12.7	14.8	15.8	15.0	15.4	11.6	11.5

Note: FIs is Financial Institutions and MFs is Mutual Funds

The above table illustrates that highest shareholders of the company are Banks, Financial Institutions, Insurance Companies and Mutual Funds followed by overseas corporate bodies.

The GDRs are the lowest shareholders with 0.56 percent of shares. The shareholding percentage for the GDRs has declined from 4.35 in 2001 to 0.33 in 2011 and NRIs has also declined from 0.75 in 2002 to 0.56 in 2011. The shareholding of Banks, Financial Institutions, Insurance Companies and Mutual Funds has gone up from 35.43 to 37.74 in 2009, however remained at 35.8 % in 2011.Similarly, the Foreign Institutional Investors has increased from 11.2 in 2002 to 14 % in 2011. For Overseas Corporate bodies and Indian public the percentage of shareholding has not changed significantly over the years.

It is clear that Banks, Financial Institutions, Mutual Funds, Insurance companies, overseas corporate bodies and Foreign Institutional Investors are key shareholders of the company. The ownership pattern of the company describes concentrated structure in which banks and FIs are key actors than diffused ownership in which more equity ownership is held by the general public and other minority shareholders. Table 7.2, however, illustrates the top 10 major institutional investors in the company and changes in their shareholding patterns during the study period.

Table: 7.2 Top 10 Institutional Investors in ITC Ltd.

Particulars	**Years (in Percentage)**									
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Tobacco Manuf. Association of India	26.9	26.7	26.7	26.6	26.4	26.3	26.3	26.3	26	25.6
Unit Trust of India Ltd	11.7	11.7	9.8	11.1	11.8	11.9	11.9	11.8	11.7	11.5
Life Insurance Corporation of India Ltd	10.4	13.5	11.3	10.61	11.74	12.7	13.65	13.61	13.72	12.92
Middleton investment Co. Ltd.	4.4	4.37	4.36	4.35	4.32	4.31	4.3	4.29	4.25	4.19
Citibank, New York	4.35	3.9	3.9	2.98	1.83	1.48	1.39	-	-	-
New India Assurance Co. ltd.	2.99	3.01	2.86	2.65	2.6	2.49	2.36	2.3	2.24	2.16
Oriental Insurance company Ltd	2.46	2.43	2.17	2.05	1.97	1.98	1.94	1.9	1.85	1.71
General Insurance Corp. India ltd.	2.22	2.38	2.05	1.97	1.98	1.99	1.99	1.96	1.92	1.88
National Insurance Comp. Ltd	2.03	2.02	1.93	1.88	1.84	1.83	1.79	1.73	1.72	1.69
Rothmans Intl. Ltd	1.4	1.39	1.39	1.39	1.38	1.37	1.37	1.37	1.35	1.33
ICICI Prudential Life Insurance Ltd.	-	-	-	-	-	-	-	1.39	1.39	1.83

Source: Compilation from the Annual Audit Reports of the Company

The Tobacco Manufacturers Association of India a wholly owned subsidiary of BAT, the Life Insurance Corp of India Ltd and Unit Trust of India are the 3 major shareholders in the company. Together, they control more than 60 % of shareholding owned by the Banks, MFs and FIIs. Alongside, the company also provides the details on the director ownership or management shareholding in the annual reports. Table 7.3 illustrates the director ownership in ITC Ltd during the last 10 years.

Table 7.3 Director's Shareholding in ITC Ltd (2002-2011)

Sl.No	Year	No. of Shares held individually or jointly
1	2002	5652
2	2003	8169
3	2004	44296
4	2005	51248
5	2006	2120320
6	2007	2547474
7	2008	2604230
8	2009	2050415
9	2010	4491930
10	2011	10259044

It is clear from the above tables, that ITC transparently disclosed the ownership structure in the Annual financial reports and reports submitted to the Securities authorities. The shareholding pattern reflects the extent to which dominant shareholders are easily identifiable, shareholding by the parent company, extent of institutional shareholding and pattern of retail shareholding. However, the major shareholding of the company is controlled by the Banks, FIs, MFs and Parent company, which illustrates concentrated nature of ownership and in-sider, based corporate governance system.

7.2 Governance Structure and Management Process

The ITC's governance structure and management process ensures that the powers are exercised in accordance with established procedures and in harmony with the broad policy guidelines and strategic objectives formulated by the Board. The ITC's board is unitary board which include both executive and non-executive directors and make decisions as a unified group. All statutory and other significant and material information are placed before the Board to enable it to discharge its responsibility of strategic supervision of the Company as trustees of the Shareholders.

In ITC, there is no separation of power between the CEO and Chairman of the Board. ITC's board is chaired by the Executive Chairman, who is selected for a term of 5 years. The company adopted Divisional Management Structure, with a clear distinction of powers and responsibilities between Board of Directors and Executive Management across the divisions and strategic business units. The following paragraphs describe the governance structure and management process at ITC.

The three-tier governance structure ensures that

- Strategic supervision by the board
- Strategic management by the executive management
- Executive management of a Division or Business

The core roles of the key entities flow from this structure. The core roles, in turn, determine the core responsibilities of each entity. In order to discharge such responsibilities, each entity is empowered formally with requisite powers. As the previous chapter describes the roles and responsibilities of the key actors in the ITC's three tier governance structure, the analysis in this section is limited only to core powers of the Board of Directors, Executive Management and Divisional Management.

7.2.1 Core Powers of the Board of Directors

The Board of Directors has the power to decide Entry into / exit from businesses / product lines / major activities, including purchase, sale, lease, license, franchise, mergers & acquisition, etc. except to the extent delegated to the CMC. They will approve integrated business plans, annual reporting plans and budgets, long term plans including broad business specific strategies, investments, capital budgets, revenues and profits. The Board of Directors also monitor the human resource strategies, manpower plans and issues that form an integral part of such plans, both at Divisional as well as Corporate levels.

TheBoard shall approve a consolidated capex plan for the Company as a whole based on the Division-wise business plans, promotion or closure of companies, joint ventures, partnership firms, divisions and subsidiaries in in India or abroad. They also has the statutory power to decide investment / Disinvestments in Equity/ Preference Capital in any entity, including those carrying options convertible to equity, other than stock-in-trade investments by investment subsidiaries of the Company.

Through Nominations Committee, the Board has the power to recommend for appointment of Chairman, Managing Director and other Directors on the Boards of Subsidiary and Associate companies. It also appoints CMC members and prescribes performance criteria for Executive Chairman (based on the recommendations of the Remuneration Committee) and for the Executive Directors, Divisional CEOs and Grade 'A' managers (based on the recommendations of the Nominations Committee). It evaluates their performance based on the recommendations of the Remuneration Committee and Nominations Committees respectively.

The Board is entrusted with the responsibility of formation of Board Committees and determination of their Charters / Terms of Reference. The board reviews Register of Contracts between ITC and BAT (including BAT subsidiaries/ associate companies), between ITC and the Financial Institutions represented on ITC Board and between ITC and its subsidiaries / associate companies – except those entered into by the Company in the normal course of business and hence may be exempted by the Board from time to time.

Similarly, the Board of Directors review quarterly performance against plan, including business-wise financials in respect of revenue, profits, cash flow, balance sheet, investments and capex. It oversee the Treasury policy, Internal Audit findings and External Audit Management Reports, Policy on Shareholder Disclosures, changes in the portfolio of Executive Directors, Status of Safety, security and legal compliance etc.

During board meetings, the board calls for a comprehensive presentation by various divisions on their business performance and related issues. It takes into account of appointment, retirement/resignation of senior management and reviews their performance, provides inputs for succession planning and management development. It also seeks timely information on employee practices, information on strikes, lockouts, retrenchment, fatal accidents in the company.

In addition, the Board is also vested with following powers:

- Letters of Comfort / Letter of Awareness etc. on behalf of any entity
- Delegation of powers for issue of Powers of Attorney for the Company's business
- Donations (other than political) in excess of CMC's limit but within overall statutory limit
- Use of Company's existing Brand Names/ Trade Marks for new products or services
- Individual compensation and other terms and conditions of service of managers in Grade 'A' (through the Remuneration Committee)
- Retirement age for all employees
- Loans and sale of assets to managers in Grade 'A' and Directors, except those extended under policies approved by the Board
- Review the status of business risk exposures, its management and related action plans.
- Monitor defaults in payment of interest and repayment of principal on any public deposit, dues to any major creditor or Financial Institution.
- Covenants (in loan agreements) which impinge upon the composition of the Board or the equity structure of the Company.
- All Write offs / disposals (fixed assets, inventories, receivables, advances, etc.) on a half yearly basis.
- Any possible product liability claims of a substantial nature.

7.2.2 Core Powers of the Corporate Management Committee

The CMC recommends to the Board of Business Plans, both Divisional and Integrated, including strategies, investments, revenues, costs, profits, etc. In case of any departure from approved plans, the CMC approves afresh and updates the Board through the review process. It sets up policies, systems, control manuals and any other framework which aims at exercising operational and risk management controls.

The CMC approves for each Division a flexible capex budget, within the Board-sanctioned capex budget for the Company as a whole, up to an identified amount towards purchase of unforeseen and emergent capex items. It has power to approve itemised expenditure within the flexible budget which is delegated to the DMC, provided the total flexible capex budget for that financial year is not exceeded and provided that the value of individual items does not exceed Rs. 20 lacs. The CMC is also authorised to sanction additional capex / cost overruns up to 10% of the consolidated capex plan approved by the Board for the Company as a whole.

It oversees the divisional / functional organisational structures covering all management positions. It has the powers to appoint DMC members based on the recommendations of the Line Director. The CMC can approve inter divisional transfer of fixed assets exceeding Rs. 100 lacs in written down book value and Write off / disposal of fixed assets.

The CMC approves recruitment, dismissal, promotion, increments, rewards, compensation and succession at all senior and middle levels of management. It oversees the Manpower Planning in the company in terms of Inter-functional transfers, Inter –divisional transfers, redeployment and re-fitment of management staff at senior levels. It monitors residual issues of Human Resources Policy with regards to declaration of lockouts, layoffs and retrenchment. It also permits company managers to accept Directorship in other companies. In addition, the following are some of the powers of CMC which is directed by the Corporate Governance Policy manual of ITC.

- Issue of Bank Guarantees and Corporate Guarantees on behalf of and for the Company
- Form any Task Force / Committee for specific objectives / assignment
- Investment of short term cash surpluses in bank deposits, treasury bills and Government securities
- Donations in cash or kind (other than political) exceeding Rs. 1 lac in individual value but not exceeding Rs. 50 lacs
- Taking on record of resignations of managers
- Consent under specific rules of Pension/Superannuation Funds to retiring (normal as well as premature) / resigning managers
- Succession planning for all management staff at senior levels
- Separation schemes for management staff, non-management staff and workmen

The CMC meets normally at least once a month for a review of various issues at the company level and give recommendations to the Board for its own review. The table 7.4 illustrates the number of CMC level meetings held during 2002 to 2011.

Table 7.4 Executive Committee Meetings (2002-2011)

Year	Number of Executive Committee Meetings held
2002	30
2003	34
2004	30
2005	38
2006	32
2007	33
2008	35
2009	36
2010	43
2011	39

During the meetings, the CMC would review Business-wise performance against approved plans of revenue, costs, profits, balance sheet, borrowings and investments, including strategy implementation. It also reviews the performance of corporate departments and functions, Internal Audit findings, Management Report of External Auditors. It monitors the implementation of Human Resource Plans and policies including Human Resource Development, status of safety / security, status of Risk Management and Statutory Compliances.

7.2.3 Core Powers of Divisional Management Committee

The Divisional Management Committee (DMC) approves business plans for consideration of CMC, including business strategy, functional strategies, related action plans, revenues, costs, profits, investments, etc. It recommends policy and control system manuals relating to major areas of risk management for the approval of CMC.

The DMC has control over the pricing of Division's products. However, in case of ITD, the DMC only recommends pricing of its products for the approval of the CMC. However, in the case of non-ITD Divisions the DMC may delegate this power to manager (s) of adequate seniority. Likewise, the DMC approves Pricing policy for Division's products relating to discounts/ rebates/ allowances etc. The DMC may delegate the power to grant discounts/ rebates/ allowances etc. to designated managers up to specified limits.

The DMC approves, within the CMC-sanctioned flexible capex budget, expenditure towards individual items, provided value of individual items does not exceed Rs. 20 lacs. It also monitors inter – Divisional transfer of assets not exceeding Rs. 100 lacs and recommend Write off / disposal of fixed assets, finished goods , raw materials, spares, inventories, advances, receivables, claims, etc. for the approval of CMC. The DMC reviews organisational structure, covering all management positions for recommendation to CMC through the Line Director.

The DMC is entrusted with the responsibility of implementation of Human Resource Development Plans, and practice of HR policies and procedures. It sanctions for recruitment (including promotion from non-management to management), and confirmation on completion of probation (by way of ratification) of management staff below Grade 'D'. The DMC is entrusted to execute long term agreements with employee unions. It approves promotions from non-management to management based on the recommendation of Selection Board and with the concurrence of the DMC member's in charge of HR and the concerned function. DMC proposes succession planning for all management staff up to and including Grade 'D' and transfers within the divisions of management staff . It also circulates the copies of meeting agenda and monthly performance report to the Line Director.

From time-to-time the DMC reviews the following in respect of Divisional business at their monthly meetings, and such a review will form the basis of their recommendations to the CMC for its own review:

- Business performance against approved plans of revenue, costs, contributions, profits, balance sheet items, cash flow, investments etc.
- Review of implementation of business strategies and activity and related action plans
- Implementation of Capex Plans and Projects
- Review of Internal and External Audit findings
- Status of safety/security
- Status of Risk Management and related action plans
- Status of tax and legal issues

The above paragraphs clearly illustrate governance process and division of powers and responsibilities among the key actors and across the divisions. ITC's governance policy fosters a well-defined management structure that best suits the growing needs of the company. It also enables the three tier of management to focus on three major functions – Supervision, Management and Control. The three tier system strengthens the internal controls, checks and balances.

The Corporate Governance policy also stipulates that matters which require urgent board approval/sanction and cannot wait for the next board meeting may be decided by way of circular resolutions where so permitted by the Indian Companies Act. Such resolutions along with detailed notes shall be forwarded to all members of the board by the Company Secretary with the prior approval of the Executive Chairman and the same shall be tabled at the next board meeting for ratification.

Similarly, the policy offers flexibility to deal with matters which require urgent CMC/DMC approval/sanction. Such matters can be handled through circular resolutions along with detailed notes which should be forwarded to all members by the secretary to the CMC/DMC with the prior approval of the Executive Chairman/Divisional CEO respectively and the same shall be tabled at next CMC/DMC meeting for ratification.

7.3 Board Structure and Process

In terms of the Company's Corporate Governance Policy, all statutory and other significant and material information are placed before the Board to enable it to discharge its responsibility of strategic supervision of the Company as trustees of the Shareholders.

To reiterate, ITC's Board is a balanced Board, comprising of Executive and Non-Executive Directors. The Non-Executive Directors include independent professionals. Executive Directors, including the Chairman, do not generally exceed one-third of the total strength of the Board.

In terms of the Corporate Governance Policy of the Company, all Directors, including Independent Directors, are appointed / re-appointed for a period of three to five years or a shorter duration in accordance with retirement guidelines as determined by the Board from time to time. However, No maximum tenure for Independent Directors has been specifically determined by the Board.

According to ITC's Corporate Governance Policy the Non-Executive Directors, including Independent Directors, are drawn from eminent professionals with experience in business / finance / law / public enterprises. Directors are appointed / re-appointed with the approval of the Shareholders for a period of three to five years or a shorter duration in accordance with retirement guidelines as determined by the Board from time to time. The initial appointment of Executive Directors is normally for a period of three years. All Directors are liable to retire by rotation unless otherwise approved by the Shareholders.

One-third of the Directors who are liable to retire by rotation, retire every year and are eligible for re-election. In terms of the Articles of Association of the Company, the strength of the Board shall not be fewer than five not more than eighteen. The table 7.5 illustrates the composition of ITC's board from 2002 to 2011.

Table 7.5 Size of the Board (2002-2011)

Year / Composition	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Executive Chairman & Directors	4	4	4	4	4	4	4	3	4	4
Non-executive Independent Directors	3	3	3	3	3	4	6	5	6	6
Non-executive Nominee (representative) Directors	7	6	5	5	5	5	5	5	5	6
Total Strength	**14**	**13**	**12**	**12**	**12**	**13**	**15**	**13**	**15**	**16**

It is evident that the ratio of Non-Executive Directors to Executive Directors is more than fifty percent during the study period. ITC's board composition is in line with the Clause 49 regulations which mandate more than 50% of Non-Executive Directors in case the Board has an Executive Chairman. Similarly, the presence of the Non-Executive Independent Directors has been increased over the years. Apart from receiving remuneration, the independent directors do not have any material pecuniary relationships or transactions with the company, any of the directors of the company, or management, the company's holding company or any of the company's subsidiaries.

Categorically, the Non-Executive Nominee Directors consists of 37.5% of ITC's board representing the Indian Financial Institutions, Insurance Companies, Mutual Funds. These directors are also treated as Independent Directors, as they are appointed by Public Financial Institutions (PFA). According to Section 4A of the Companies Act, 1956 or Section 2(d) of the Banking Companies (Acquisition and Transfer of Undertaking) Act, 1970 or the Banking Companies (Acquisition and Transfer of Undertaking) Act, 1980), representatives of PFIs which invested in shares or lent money shall be treated as independent directors. Alongside, the ITC board also has two Nominee Directors representing its Parent company.

The Non-Executive Directors are entitled to remuneration by way of commission for each financial year, up to a maximum of Rs.6,00,000/- individually, as approved by the Shareholders. Non-Executive Directors' commission is determined by the Board based on Company performance and regulatory provisions and is payable on a uniform basis to reinforce the principle of collective responsibility. Non-Executive Directors are also entitled to sitting fees for attending meetings of the Board and Committees thereof, the quantum of which is determined by the Board, within the limit approved by the Shareholders. The sitting fees, as determined by the Board, are presently Rs.20,000/- for attending each meeting of the Board, Audit Committee, Compensation Committee, Nominations Committee and Sustainability Committee and Rs.5,000/- for each meeting of the Investor Services Committee. The Non-Executive Independent Directors are entitled to get stock options of the company, through shareholders' resolutions during the annual general meetings. Alongside, the Non-Executive Directors are also entitled to have coverage under Personal Accident Insurance.

The remuneration of Chairman and other Executive Directors is determined by the Compensation Committee comprising only Non-Executive Directors. The recommendations of the Compensation Committee are considered and approved by the Board subject to the approval of the Shareholders. The Chairman and Executive Directors are entitled to Performance Bonus for each financial year up to a maximum of200% and 150% of their consolidated salary, respectively, and as may be determined by the Board on the recommendation of the Compensation Committee, based on qualitative and quantitative assessment of Company performance.

The Board of Directors meet at least four times during the year. The interval between such meetings shall not be more than four months between any two consecutive meetings. The table 7.6 illustrates the number of board meetings conducted during 2002-2011.

Table 7.6 Board Meetings (2002-2011)

Year	Number of Board Meetings held
2002	8
2003	7
2004	7
2005	8
2006	7
2007	5
2008	7
2009	5
2010	6
2011	7

It can be observed that on an average Board of directors met 6 times every year during 2002-11. The board of directors shall inform the company about the changes in their membership/ chairmanship in the committees aforesaid. None of the ITC's Directors have membership of more than ten Audit committee and/or Shareholders' Grievance committee of any Public limited company including the company and there is no Director having chairmanship of more than five Audit committee and/or Shareholders' Grievance committee of any Public limited company.

7.4 Board Procedures

The ITC's Governance Policy requires the Board to meet at least six times in a year. The intervening period between two Board meetings should be well within the maximum gap of four months prescribed under Clause 49 of the Listing Agreement with Stock Exchanges. However, it is illustrated in the table 7.3 the company's board has met on an average of 6 times in a year during 2002-2011. The annual calendar of meetings is broadly determined at the beginning of each year.

7.4.1 Board meetings agenda

The board meetings are governed by a structured agenda. The Board members, in consultation with the Chairman, may bring up any matter for the consideration of the Board. All major agenda items are backed by comprehensive background information to enable the Board to take informed decisions. Agenda papers are circulated at least seven working days prior to the Board meeting.

7.4.2 Information placed before the Board

The Board members make available the relevant information. In addition, to matters required to be placed before the Board under the Governance Policy of the Company, the following are also tabled for the Board's periodic review / information / approval:

- Internal Audit findings and External Audit Management Reports (through the Audit Committee)
- Status of safety and legal compliance
- Risk management processes
- Succession to senior management (through the Nominations Committee)
- Show Cause, demand, prosecution and adjudication notices, if any, from revenue authorities which are considered materially important, including any exposure that exceeds 1% of the Company's Net worth, and their outcome.
- Significant court judgement or order passing strictures, if any, on the conduct of the Company or a subsidiary of the Company or any employee, which could negatively impact the Company's image
- Product liability claims of a substantial nature, if any.
- Default, if any, in payment of dues to any major creditor
- Write-offs / disposals (fixed assets, inventories, receivables, advances etc.) on a half-yearly basis.
- All other matters required to be placed before the Board for its review / information / approval under the statutes, including Clause 49 of the Listing Agreement with Stock Exchanges

Alongside, during personal interviews a permanent invitee in the CMC has added that Board of directors takes a periodic review of Human Resource developments in the company. The Board oversees all significant development in Human Resources/ Industrial Relations front such as signing of wage agreement, implementation of Voluntary Retirement Scheme, fatal or serious accidents, dangerous occurrences, significant labour problems and their proposed solutions.

Similarly, a senior manager in the secretarial department expressed that board of directors are informed on Non-compliance of any regulatory, statutory nature or listing requirements and shareholders service such as non-payment of dividend, delay in share transfer etc. He also expressed that decisions made by the Board are clearly documented and circulated to the shareholders and other stakeholders. The board also seeks independent and professional advice in case of need.

7.4.3 Post-meeting Follow-up System

The Governance processes in ITC also include an effective post-meeting follow-up, review and reporting process for action taken / pending on decisions of the Board, the Board Committees, the CMC and the Divisional / SBU Management Committees.

The Board of directors of ITC have an explicit commitment to foster openness in the organisation. It is reflected in the ITC Code of Conduct, which is derived from three interlinked fundamental principles, viz. good corporate governance, good corporate citizenship and exemplary personal conduct in relation to the Company's business. The Code covers board's commitment to sustainable development, concern for occupational health, safety and environment, a gender friendly workplace, transparency and auditability, legal compliance and the philosophy of leading by personal example.

Similarly, the Board is equipped to perform its role of business assessment through inputs from time to time. Directors are fully briefed on all business related matters, risk assessment & minimisation procedures, and new initiatives proposed by the Company. Directors are also updated on changes / developments in the domestic / global corporate and industry scenario including those pertaining to statutes / legislation and economic environment.

The Board have a Policy to prevent Insider Trading which, inter alia, prohibits purchase / sale of securities of the Company by Directors and employees while in possession of unpublished price sensitive information in relation to the Company.

7.5 Board Committees

Currently, the ITC's board has Five Committees – the Audit Committee, the Compensation Committee, the Investor Services Committee, the Nominations Committee and the Sustainability Committee. The terms of reference of these committees are determined by the Board from time to time. The respective chairman of the committee convenes the meetings of these committees.

Evidently, various matters requiring the Board's attention / approval, as emanating from the Board Committee meetings, are placed before the Board by the respective Committee

Chairman. The role and composition of these Committees, including the number of meetings held during 2002-2011, are provided in Table 7.6

7.5.1 Audit Committee

The Audit Committee of the Board provides reassurance to the Board on the existence of an effective internal control environment. It is empowered, pursuant to its terms of reference, to investigate any activity within its terms of reference and to seek any information it requires from any employee. It can also obtain legal or other independent professional advice and to secure the attendance of outsiders with relevant experience and expertise, when considered necessary.

The Audit Committee primarily oversee the ITC's financial reporting process and the disclosure of its financial information to ensure that the financial statements are correct, sufficient and credible. It recommends appointment and removal of external auditors, fixation of audit fee and approval of payment of fees for any other services rendered by the auditors. It also reviews financial statements before submission to the Board, focusing primarily on:

- Any changes in accounting policies and practices and compliance with Accounting Standards
- Compliance with Stock Exchange and legal requirements concerning financial statements
- Related party transactions

The audit committee review the internal control systems, especially, adequacy of the internal audit function, including the structure of internal audit department, staffing and seniority of the official heading the department, reporting structure, coverage and frequency of internal audit.

It discusses with the external auditors, before the audit commences, on nature and scope of audit, as well as after conclusion of the audit, to ascertain any areas of concern and review the comments contained in their management letter;

The audit committee also review the Company's financial and risk management policies; and monitor reasons for substantial defaults, if any, in payment to shareholders (in case of non-payment of declared dividends) and creditors.

During 2002 to 2011, the ITC's audit committee on an average comprised of 4 Non-Executive Directors, where in majority of are Non-Executive Nominee Directors. Till 2007, the board was chaired by Nominee Director who represents an Indian bank. However, after that the committee has been chaired by the Non-Executive Independent Director till 2011. The following table illustrates the composition of Audit committee.

Table 7.7 Composition of Audit Committee (2002-2011)

Year / Composition	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Executive Directors	0	0	0	0	0	0	0	0	0	0
Non-executive Independent Directors	1	1	1	1	1	1	3	3	4	4
Non-executive Nominee (representative) Directors	6	4	3	3	2	2	0	1	2	2
Total Strength	**7**	**5**	**4**	**4**	**3**	**3**	**3**	**4**	**6**	**6**

Along with the above Non-Executive Directors, the Executive Director representing Finance function, the Chief Financial Officer, the Head of Internal Audit and the representative of the Statutory Auditors are Invitees to the Audit Committee. The Head of Internal Audit is the Co-ordinator and the Company Secretary is the Secretary to the Committee. The representatives of the Cost Auditors are also invited to meetings of the Audit Committee whenever matters related to cost audit are considered. All members of the Committee are financially literate; the Chairman of the Committee, is an accounting and financial management expert.

During the period 2002 to 2011, an average of 9 Audit committee meetings per year have been conducted. The 7.8 table illustrates this:

Table 7.8 Audit Committee Meetings during 2002-2011

Sl. No.	Year	Number of Audit Committee Meetings held
1	2002	7
2	2003	10
3	2004	10
4	2005	9
5	2006	9

6	2007	9
7	2008	8
8	2009	9
9	2010	9
10	2011	9

Thus, ITC's audit committee ensures that efficiency and effectiveness of domestic and overseas operations are maintained. A senior general manager in the Internal audit function of ILTD remarked that ITC's audit committee regularly seeks information on division/company assets and monitors adequacy of internal financial controls to enable compliance with all relevant statutes.

7.6 Remuneration Committee

The Remuneration Committee of the Board, under the nomenclature 'Compensation Committee', recommends to the Board the compensation terms of Executive Directors and the senior most level of management immediately below the Executive Directors. This Committee also has the responsibility for administering the Employee Stock Option Schemes of the Company.

During 2002 to 2011, the Compensation Committee has 5 Non-Executive Directors, comprising of Independent and representative (nominee) directors. However, the Chairman of the Committee has been an Independent Director during 2002 to 2011. The table 7.9 illustrates the composition of Remuneration Committee.

Table 7.9 Composition of Remuneration Committee (2002-2011)

Year / **Composition**	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Executive Directors	0	0	0	0	0	0	0	0	0	0
Non-executive Independent directors	1	2	2	2	2	2	3	3	4	4
Non-executive Nominee (representative) directors	5	3	3	3	3	3	2	2	1	1
Total Strength	6	5	5	5	5	5	5	5	5	5

The Remuneration Committee oversees the ITC's remuneration strategy which aims at attracting and retaining high calibre talent. The Remuneration policy, therefore, is market-led and takes into account the competitive circumstance of each business so as to attract and retain quality talent and leverage performance significantly.

During the period 2002 to 2011, an average of 3 Remuneration committee meeting per year have been conducted. This can be illustrated in the following table 7.10.

Table 7.10 Remuneration Committee Meetings during 2002-2011

Sl. No.	Year	Number of Remuneration Committee Meetings held
1	2002	3
2	2003	4
3	2004	4
4	2005	2
5	2006	5
6	2007	3
7	2008	4
8	2009	2
9	2010	3
10	2011	5

To reiterate, remuneration of the Chairman and other Executive Directors is determined by the Board, on the recommendation of the Compensation Committee comprising only Non-Executive Directors; remuneration of the Directors is subject to the approval of the Shareholders. A senior team member of Human Resources at the corporate headquarters noted that ITC's Chairman and other Executive Directors are entitled to performance bonus for each financial year up to a maximum of 200% and 150% of their consolidated salary. However, such remuneration is linked to the performance of the Company in as much as the performance bonus is based on various qualitative and quantitative performance criteria.

7.7 Nominations Committee

The Corporate Governance policy of ITC accords that the Nominations Committee of the Board recommends Executive Directors' appointment to the Board, appointment to the CMC and the senior most level of executive management below the Executive Directors.

During 2002 to 2011 the Nominations Committee comprised of the Chairman of the Company and all Non-Executive Directors, including Independent and Nominee Directors. The Chairman of the Company has been the Chairman of the Committee during this period.

Table 7.11 Composition of Nominations Committee (2002-2011)

Year / Composition	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Executive Directors	1	1	1	1	1	1	1	1	1	1
Non-executive Independent Directors	3	3	3	3	3	4	6	3	3	4
Non-executive Nominee (representative) Directors	7	6	5	5	6	5	5	3	3	4
Total Strength	**11**	**10**	**9**	**9**	**10**	**10**	**12**	**7**	**7**	**9**

During the period from 2002 to 2011, an average of 1Nominations committee meeting per year has been conducted. This is illustrated in the following table 7.12.

Table 7.12 Nominations Committee Meetings during 2002-2011

Sl .No.	Year	Number of Nominations Committee Meetings conducted
1	2002	3
2	2003	0
3	2004	2
4	2005	1
5	2006	2
6	2007	1
7	2008	0
8	2009	0
9	2010	4
10	2011	5

The above table reflects that Nominations committee meetings have been more frequent in the years that coincide with the Board rotation and new appointments. For example in 2011, the committee met more number of times as 2 new Executive Directors and 5 Non-Executive Directors have been appointed to the ITC board. The committee however, did not meet even once during 2003, 2008 and 2009.

7.8 Investor Grievance Committee

The Investors Grievance Committee of the Board, under the nomenclature 'Investor Services Committee', oversees redressal of shareholder and investor grievances, and approves sub-division / consolidation / issue of duplicate share certificates, transmission of shares and issue & allotment of shares upon exercise of Options by employees under the Company's Employee Stock Option Schemes.

During 2002 to 2011 the Investor Services Committee comprised on an average of 3 Directors wherein majority were Non-executive directors. The committee has been chaired by non-executive Independent Director during this period. The table 7.13 illustrates the composition of Investor Grievances Committee.

Table 7.13 Composition of Investor Grievance Committee (2002-2011)

Year / Composition	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Executive Directors	1	1	1	1	1	1	1	1	2	1
Non-executive Independent directors	1	1	1	1	1	1	2	3	3	3
Non-executive Nominee (representative) directors	1	1	1	1	1	1	0	1	1	2
Total Strength	**3**	**3**	**3**	**3**	**3**	**3**	**3**	**5**	**6**	**6**

The study observed that during the period 2002-2011, an average of 35Investor Grievance Committee meetings per year has been conducted. This is illustrated in table 7.14.

Table 7.14 Investor Grievance Committee Meetings during 2002-2011

Sl.No.	Year	Number of Investor Grievance Committee Meetings held
1	2002	29
2	2003	47
3	2004	37
4	2005	46
5	2006	33
6	2007	33
7	2008	29
8	2009	29
9	2010	32
10	2011	40

The Investor Grievances Committee plays a crucial role in terms of investor service and shareholder value creation. The committee also monitors the number of shareholder complaints received and suggest mechanisms to solve the shareholder problems.

7.9 Sustainability Committee

ITC is one among the pioneering Indian companies which has sustainability committee at the board level. The sustainability committee has been created in 2007, to review, monitor and provide strategic direction to the Company's sustainability practices towards fulfilling its triple bottom line objectives. The Committee seeks to guide the Company in integrating its social and environmental objectives with its business strategies.

The Sustainability Committee comprises of the Chairman of ITC and five Non-Executive Directors, two of whom are Independent Directors. The Chairman of the Company is the Chairman of the Committee. The table 7.15 illustrates the composition of the Sustainability committee during 2009 to 2011.

Table 7.15 Composition of Sustainability Committee (2002-2011)

Year / Composition	2009	2010	2011
Executive Directors	1	1	1

Non-executive Independent directors	2	2	2
Non-executive Nominee (representative) directors	2	3	3
Total Strength	5	6	6

During this period, the committee has met to discuss on the sustainability issues once in the year 2010 and twice in 2011. Consider the table 7.16:

Table 7.16 Sustainability Committee Meetings during 2002-2011

Sl.No.	Year	Number of Sustainability Committee Meetings held
1	2009	0
2	2010	1
3	2011	2

The sustainability committee earmarks ITC's commitment to People, Planet and Profit as key components of responsible corporate citizenship and sustainable business practice, therefore accorded the highest priority. A senior official in the Corporate Sustainability wing quoted that "ITC is committed to Best Practices in sustainable development across the business operations and creation of sustainability committee is an attempt to fully demonstrate this commitment. In addition to complying with applicable laws and regulations, it gives us an opportunity to establish procedures for assessing the economical, societal and environmental effects of our present and future activities".

Section II

This section deals with the presentation and analysis of the data collected from various key stakeholders of the company. It is based on the in-depth interviews, focus group discussions and observations made during the field study. This section examines the linkages between company and its shareholders, employees, suppliers, customers and local community. It reflects how managers perceive their relationships with stakeholders and vice versa. It also describes the instrumental logic that governs such linkages and relationships between the company and its stakeholders.

7.10 Shareholder Relations

As one of India's foremost private sector companies, ITC has performed consistently since the inception of the Company, and has rewarded the shareholders with uninterrupted dividends and issue of bonus shares from time to time.

As trustees of shareholders, the board of directors believe that it is the key responsibility to protect and enhance their wealth. Their primary expectations remain centred around continued profitability and growth, communication and investor servicing.

The ITC Chairman addresses and provides clarifications to the shareholders at least once a year at the Annual General Meeting to consider and approve the report of the Directors, the Annual financial statement with the notes and schedule thereto, declaration of dividends, any other returns or resources intended for distribution, the appointment of Directors, appointment of auditors and other important matters, requiring shareholder approval. The annual general meeting is the principal forum for face-to-face interaction with shareholders, where the entire board is present. The chairman addresses the shareholders on issues of relevance to the company and provides clarification to shareholders on behalf of the Board. The Board encourages open dialogue with all its shareholders-be it individuals, corporate or foreign investors.

ITC has set up ‘Share and Debenture Transfer Committee’ to approve share transfers on a weekly basis. The processing activities with respect to requests received for share transfers are generally completed within three working days from the date of receipt of request. During 2002 to 2011 the Committee met on an average of forty times to attend to Shareholder / Investor complaints, queries and other correspondences. Table 7.17 provides some descriptive statistics regarding the Investor grievances redrassal situation in the company during 2002-2008.

Table 7.17 Shareholder Complaints and Redressal (2002-2008)

S.No	Year	Complaints Received	Redressal done	Complaints Pending
1	2002	294	294	0
2	2003	917	917	0
3	2004	274	274	0
4	2005	38	38	0

5	2006	14	14	0
6	2007	13	13	0
7	2008	5	5	0

Thus, the company has maintained vital channels of communication with the shareholders. The company also takes periodic feedback from the shareholders through shareholder satisfaction survey. The survey covers a wide range of items, such as Transfer/ Demat of shares, responses to queries/complaints, interaction with company/R&T Agent personnel, quality and contents of annual report, promptness in confirming Demat /Remat requests, quality of response, timely receipt of Annual Report, quality of financial and non-financial information in the Annual Report and overall quality of Annual Report.

During the field study, a manager in the in-house Investor Service Centre explains that the company has been accredited with ISO 9001: 2008 certification for investor servicing, share registration and other related activities. The company also takes shareholder views on conduct of the Annual General Meeting, timely receipt of dividend warrants, presentation of information on Company's website etc. He also noted that ITC's experience and overall rating of our investor service has been very good over the years.

7.11 Employee Relations

ITC's human resource management systems and processes are committed to create a responsive, customer-centric and market focused culture that enhances organisational capability and vitality. These unique employee value propositions which are supported by the company's strong corporate equity enable a sustained engagement for the company.

The overall responsibility of managing human resources is the overall responsibility of the Divisional Chief Executives, through the members of their Divisional Management Committees, Human Resources and EHS Functions. They ensure that employment and EHS practices in all Units are in accordance with the governance policy and statutory provisions governing labour practices and decent work. The Corporate Human Resources and EHS functions are responsible for reviewing and updating standards and guidelines on labour and EHS policies, employment practices, and for providing guidance and support to all concerned.

During 2010 to 2011, the company's full-time direct employees numbered over 28,500 of which nearly 2,278employees in the Leaf Tobacco business were engaged on a seasonal basis due to the nature of the Business. Out of this 28,500 employees, 12,000 belong to the unionised cadre. The remaining are frontline staff, supervisory staff, management staff, lady confidential secretaries and administrative assistants. The Company permits freedom of association and does not discourage or discriminate against employees who are members of trade unions. The Company follows a policy of dealing with recognised unions and has a robust collective bargaining process through which it discusses and negotiates monetary and non-monetary aspects of employment impacting unionised employees. Evidently, the harmonious employee relations at all the operating units are a reflection of the Company's approach to employee engagement focussing on a collaborative approach and mutuality of interests.

The birth of trade unionism in ITC has started in 1938, when workers at all the cigarette factories formed registered unions. The presence of workers unions were recognized at Monghyr initially, later on followed by other factories. However, the management acknowledgement of union was superficial, thus many unions had remained only with title but no weight. There were no productive reasons for their existence.

This protracted response from ITC's factory management had trigged serious response from the workers unions, wherein representatives of four units met in January 1940 at kiddorepore cigarette factory. The workers unions had decided to force the management on the issue of Union recognition and therefore staged a strike in all factory locations of ITC. Eventually, this strike gained political support and soon became a violent revolt against the factory management. However, the four months strike had collapsed after the government's intervention. The strike was called off in view of grave situation that arose in the European conflict. The central worker's council of ITC factories had extended the support to management and promised to put forth all energy for the defence of India and the Empire and for the efficient prosecution of war. In the late forties ITC, finally accepted the need to confer both formal and real recognition to representative trade unions in its units.

It seems extraordinary in the context of outstanding industrial relations today and the genuinely amicable relationship that exists at present between labour and management that union should have had such a hard time to gain recognition when they first started. The 1940 strike was an eye-opener to both management and labour, a period when both sides took stock. While managers were forced to realize that demands of labour were to be taken seriously, workers for the first time began to recognize the power of a union.

The company enters into Long-term comprehensive agreements on the whole contract of employment of workers. The first such long-term agreement was signed at the Bangalore factory in 1952, and followed by all the other units in the country by 1953. Job evaluation was attempted at the Bangalore and Saharanpur factories in the mid-fifties in consultation with the unions. New wage patterns were introduced to protect differentials, the battle cry of the British trade unions, these were found dis functional in the Indian context and soon discarded. Lessons learnt from one factory were translated to other.

The table 7.18 provides information about the trends in employment in ITC and its Divisions and SBUs.

Table 7.18 Trends in Employment in ITC and its Divisions and SBUs

Sl.No.	Year	Full-time direct employees	Seasonal employees	Unionised employees
1	2004	15692	NA	10605
2	2005	20362	NA	136570
3	2006	20000	2300	NA
4	2007	21000	2100	12000
5	2008	25000	2300	12000
6	2009	26200	2100	12600
7	2010	26200	2279	12600
8	2011	28500	2278	12000

The above table illustrates that, the newer businesses, and the growth of the traditional businesses since 2006, have facilitated a significant increase in net employment.

The company has organized several customised training and development at Corporate and Divisional levels aimed at developing functional, behavioural, leadership and management capabilities. The company’s learning and development approach had elements beyond training, with the objective of increasing knowledge of systems and procedures, providing opportunities for on-the-job learning, encouraging employee participation, etc.

A senior Vice President of HR at ITC PSPD division quoted: “The on-going core programmes were revitalised to reflect the emerging learning and capability requirements. Business HR teams work closely with the Corporate HR team in designing and implementing Learning and Development initiatives. Employee training at the factory level is undertaken after assessment of skills gaps or after evaluation of emerging technology or skills needs. The process is proactive and well- structured”.

In 2010-11, close to 110,000 person-days of formal training were organised for employees at various levels. In addition, on-the-job learning opportunities were provided to a cross-section of employees supported by inputs from peers and superiors. The Company, on an average, provided 2 person days of training per employee. Table 7.19 illustrates the total number of trainings provided across various categories, during 2006-2011.

Table 7.19 Total number of Trainings provided across various categories (20006-2011)

Employee category	2011	2010	2009	2008	2007	2006
Unskilled	13750	12000	9750	9750	5625	5000
Semi-skilled	37070	32352	26286	26286	15165	13480
Clerical, skilled, and highly skilled	21450	18720	15210	15210	8775	7800
Management	31680	27648	22464	22464	12960	11520
Non-management	5610	4896	3978	3978	2295	2040
Total	110000	96000	78000	78000	45000	40000

7.12 Occupational Health and Safety

At ITC, primary importance is placed on the Occupational Health & Safety of employees. This is ensured through strict adherence to Corporate Environment, Health and Safety Guidelines incorporating best International Standards and Practices.

The company has also established **Zero accident systems** in all units. Any incident /accident undergo detailed investigation for identifying root causes and corrective / preventive measures.

The company achieved excellent results in safety performance during the period 2002 to 2011 . Over the years the number of Lost Time Accidents (LTA) to ITC employees has been brought down to 12, close to half the LTAs in comparison to the previous year. Injury rate, the frequency of injuries in relation to total time worked has been brought down considerably. The injury rate has been consistently reduced; an improvement of 44% in comparison to 2009-10, despite significant growth in all businesses. Table 7.20 illustrates it below:

Table 7.20 Lost Times Accidents and Injury rate

Year	**Lost Times Accidents**	**Injury rate**
2002	33	0.22
2003	35	0.2
2004	27	0.17
2005	37	0.21
2006	16	0.09
2007	14	0.08
2008	20	0.09
2009	15	0.06
2010	23	0.09
2011	12	0.05

All the Units are provided with occupational health centres with adequate medical staff to monitor occupational health and provide immediate relief, when required. Also, at least 2% of total employees in each Unit are trained to provide first aid.

In 2010-11, over 12,430 employees underwent preventive medical examinations, to identify symptoms of any occupational illness and there were no occupational related illnesses reported from Units. Table 7.21 illustrates the total number of preventive medical check-ups specifically conducted in ITD, ILTD, PSPD and ABD division.

Table 7.21 Number of Preventive Medical Check-ups conducted in ITD, ILTD, PSPD and ABD

Year	**ITD, ILTD, PSPD, ABD**
2002	689
2003	683
2004	899
2005	1157
2006	1220
2007	1200
2008	1462
2009	17260
2010	1620
2011	1864

Similarly, the company remained committed to the various programmes and interventions introduced in response to the serious threat posed by HIV/AIDS. During 2010-11, the company conducted 123 awareness programmes for the employees and communities around its units. The interventions covered a total of 14,935 people of which 13,306 were employees while the balance were members of the local community.

The descriptive statistics and information provided above, gives a detailed picture of workers-management relations in the ITC. However, these issues are only limited to the statutory aspects of worker-management relationships and adoption of best practices. The present study also examined the issues of corporate governance and its implications for strengthening worker-management relationships. This data has been collected through interview schedule and focus group discussions with the employees and managers.

The study observed that the employees are governed by a set of certified standing orders and also by the terms and conditions agreed to between the Management and the Union in the long term settlements that are negotiated between the two parties and signed before the labour commissioner. The long term settlements are usually for a period of 3 and half years. They are statutory, in the sense that, they fall within the purview of the Industrial Disputes Act, 1947. The standing orders govern issues of discipline and disciplinary proceedings. The long term agreements govern wages, working hours, leave, promotional policies, job descriptions, crewing/manning of the various machines incentives, production norms, work practices and also lists likely changes in technology in the future which could have a bearing on the employees in terms of work load and work practices.

The HR managers interviewed across the divisions opined that the employee relations at ITC are based on participatory management systems. They perceive that employee representation is essential and the relations with employees are based on mutual trust and reciprocity between management and Union representatives. Management has established a fairly good system of relations with Unions and workers all across the units that are studied in the present work.

The workers union representatives and workers also noted that the labour relations in the company are fairly satisfactory. During a focus group discussion with technical staff union, workers union and staff union representatives at the ILTD-Chirala Factory, the representatives had quoted that "Company provides good deal of benefits to the workers. They look after the health and safety issues of workers. If workers need any medical treatment, company takes care of that. Company provides all possible health allowances to workers. However, in case of their family members, the company pays half of the cost and remaining are to be incurred by the workers.

The elected representatives of the Union represent worker’s issues before the management. There are no ‘Workers Councils’ in any of the plants/divisions that are covered by this work. The workers described that management’s response on issues related to workmen is dependent on how effectively the Union representatives espouse the cause of the workmen and how much pressure is brought about to sort out or solve the issues. This is also dependent on the subjective view of the Union leadership, which may at times vary with the opinion of the worker (s) with a grievance. Therefore, workmen either individually or in a group may directly approach/raise an issue with the management bypassing the Union. The ITC management is not averse to this kind of approach. The workers in ITD- Bangalore factory said that management often encourages the same, if it perceives some advantage to itself.

Along with union office bearers there are certain committees of workers that are also recognized by the management. There are safety committee and Health committee, consisting of operational head of plant and 2 workers representatives and 3 worker representatives and 3 management representatives respectively. Prior to 1990 these representatives are nominated but post 1990 there were also been elected by workers. The workers Union representatives have noted that these committees play a crucial role in strengthening management and workers consultations and arriving at mutual consent.

To reiterate, the HR policies and IR practices are adopted related to workers issue and are decided in terms of the long term tripartite agreements. These Memorandums of Settlements or LTA govern employee management relations and in a way guide the course of action for the period of 3 to 4 years. The collective bargaining systems are built on fairness and slight approach. There is an enterprise level bargaining system and central bargaining is not found in ITC.

At ITD-Bangalore factory, the Long Term Agreements are based on productivity. These agreements specify the productivity index along with wage improvements. Companywide system of "Productivity Based" annual bonus schemes are practiced instead of traditional profit related bonus. According to these schemes if productivity index goes up wages also goes up in the same fashion. These LTA consist of throughing patterns, job incentives, job descriptions, job responsibilities, personnel policies, bonus, etc. Both management and unions discuss on the issues included in LTA and mutually accept and abide by that. The workers at ITD-Bangalore factory expressed that these agreements would help to increase productivity of the firm. As productivity increases there is a subsequent increase in wages of the workers. So this leads to mutual benefits – productive increase for management and wage increase for the workers.

The workers were informed about the changes regarding work environment and other key changes taking place in the factory and in the overall industry. At ITC-PSPD, Bhadrachalam factory, the management has recently taken initiatives by installing notice boards in the factory premises where they display cuttings, clippings of changes in paper industry, etc. The company keep workers informed about changes in technology, developments and changes in industry, induction of new technological equipments, etc.

The workers at Bhadrachalam plant also described that the Unions would be consulted before any changes in the technology and work environments. Workers voice must be heard before introduction of new technology in the plant. They had noted that while installing the 5th paper machine, workers were asked to express consent for the new technological development. Workers thus always have a right to express their views and bargain with management in this regard. Workers bargain with the management regarding the issues like number of workers per machine. The management also see that average number of men to machine prevails even with the introduction of new machinery. They were also provided necessary training to work with new technology implements.

A senior worker union representative, expressed that workers have right to express their grievances with regard to changes in work environments. He noted that there was large scale resentment from workers when factory shifted from Coxtown to Devanahalli in 1998. The management addressed workers issues of transportation and subsequently increased wages to workers. Thus, workers have always given right to voice and express grievances in this regard.

A general manager at ILTD-Chirala factory has noted that the company provides opportunity for workers to express their interests regarding job loss, men per machine, etc. when the new machine is incorporated. The company also provides training to workers and equip them with skills before the installation of the new machinery. Workers are sent abroad many a times to acquire new skills to deal with ever changing technology. An assistant HR Manager at ITD-Bangalore also expressed that though approval of worker is important with regard to certain key issues but the range of these issues are again subjected to management's discretionary power. Management does acknowledge these issues of workers interest.

The company fosters a culture of openness to the workers. It considers workers are central to their business of creating a competitive brand. In 2005, the company carry out employee involvement survey and notably ITC is the first one to conduct this survey in an organized unionized industry set up. A workers union representative in ITD-Bangalore factory said that the factory production was even stopped for a day to enable employees to complete the survey.

The company does deal with a fair amount of openness with the Employees. ITC recognized that the artificial barrier of "workers" and "managers" needed to be diluted, and was an early company that started to reward and promote large number of workers to managerial levels - for growth from within. A senior vice president of HR in ITC-ITD commented that with regular sharing information and plans with unions, the company reduced "we-they" differentials, and gains of productivity sharing became an accepted principle.

The data collected from the field illustrated that management fosters transparency in providing information to employees regarding changes in the business environment, through in-house Magazines, Notices, and Newspaper clippings displayed in the notice boards, and by the word of mouth, through communication from Shop-floor level Managers. Union representatives in ILTD-Chirala factory added that the management at times use the Union leadership (if willing) to disseminate the information. Most of the information passed on is "alarming" in nature and tries to give the impression that the industry is under constant threat and of impending doom. They feel that it is clever ploy of the Management to use 'Transparency' to lower the expectation of the 'Employees' in terms of wages and other benefits/amenities.

The study also observed that concept of 'Employee Empowerment' was not just a slogan, as there has been a lot of activity in this direction, in terms of making workers part of the decision making process in the production processes and other issues in the company. At ITD-Bangalore factory, the workers involvement is mainly brought about by conducting 'Kaizan Workshops' in which the Employees are nominated to participate. Workers also stated that the company has also been holding competitions like 'innovation to implementation', both intra-factory and inter-factory where employees are encouraged to give their ideas and implement them in both the production and non-production processes.

Similarly in ITC-PSPD Bhadrachalam unit, the management is encouraging workers to participate in decision making through Total Productivity Maintenance (TPM) and implementation of 5S production techniques. Likewise the study also observed that in ILTD-Chirala Unit, the management encourages employee participation through Alochana schemes, Kaizen workshops, Group meetings and creation of process implementation teams.

However, the workers perceive that these efforts are mainly directed towards improving efficiencies and reducing costs to the company, by direct participation and involvement of the employees. However, the company spares no expense in this kind of activity, since in the long run the savings towards cost to the company, can be huge. Union representatives at ITD-Bangalore factory criticized the ad-hoc and need based training support to the technical staff, and said that there is no structured effort in the direction of investment in improving skills of employees. One senior trade union leader quoted that "so far as considering the Employees as key constituents is concerned, there is more lip-service to this concept than reality".

The study also observed that there are no stock-options available to the employees in ITD and ILTD divisions. However, in ITC-PSPD some employees held shares of the company, however it was on their individual capacity and they are in possession of these shares through investment in the stock market.

Importantly, most workmen are unaware of the existence of the Corporate Governance policy of the company. Only a handful may be aware that such a document or policy exists. Majority of workers have expressed that though company promotes openness regarding issues of labour management and bargaining systems but it does not really generate awareness of Corporate Governance. The workers across the divisions too, are not really bothered about the Corporate Governance practices in the company. They pay less attention to policies of Corporate Governance, Sustainable development and employee empowerment.

The management maintains a categorically different stand and said that workers have benefitted by governance framework. The Board of Directors oversee the key human resource developments in the company and provides strategic direction to management with regard to workers issues. A HR manager explained that due to new corporate governance developments at the company, they need to obtain approval from the line director or DMC to remove any fulltime employee of the company.

On the whole this represents a stable industrial relation systems and mutually enforceable relationship between ITC management and workers. Alongside, it has been observed that employee and management relationships vary across the units studied in the present research endeavour. The study observed that employee relationships at ITC-ITD Bangalore Unit are marked by the presence of active unions and matured union-management bargaining systems based on productively agreements. Similarly, in ITC-PSPD Bhadrachalam plant, the employee and management relations are distinctive - with cooperative ties, informality, moderately active unions and community wellbeing. Likewise, the employee relations in the ITC-ILTD Chirala unit are based on conventional Industrial Relations and prevalence of craft based unionism. The workers unions are moderately active and cooperative ties are established with management due to patronism and transparent relationships.

7.13 Community Relationships

The community engagement process has evolved over 100 years of the organization's existence, based on mutual trust and respect developed over the years. ITC managers who were covered in the sample of the study believed that their corporate strategy embraces societal development as an integral part of wealth creation for stakeholders to ensure long term sustainability of its businesses.

All ITC units covered in the study continuously interact with communities surrounding their operations. Community need assessment surveys by competent agencies are conducted in and around the operating units and for green field projects to understand the stakeholders' expectations.

ITC's sustainability efforts are augmented by its dedicated programme 'Mission SunehraKal', a prime vehicle for implementing social development initiatives. Mission SunehraKal empowers rural communities by helping them adopt sustainable practices that enable them to be economically competitive and socially secure. These endeavours are aimed at (a) diversifying farming systems as a strategy for sustainable agriculture and climate change mitigation by broad-basing the farm based livelihoods portfolio of the poor and (b) expanding off-farm income opportunities to reduce the disproportionate dependence of rural households on land. This deep engagement with rural communities has enabled ITC to contribute to the creation of sustainable livelihoods by building community assets.

The company identified that social forestry, integrated watershed management, livelihood support, as well as Infrastructure needs, health & sanitation, primary education, women economic empowerment and skill development are the priority concerns raised through the need assessment surveys. Based on this, various social interventions are planned and implemented. The details are provided in the following pages of this chapter.

7.13.1 Social & Farm Forestry

ITC has institutionalized its intervention by creating village-level natural resource management committees comprising local farmers. In 2002 — ITC's afforestation programme has resulted in the planning of 20 million saplings. Till 2006-07, under the ITC's afforestation programme, 119 million saplings have been planted. In a span of 15 years, nearly 318 million saplings have been planted in 77,000 hectares, generating employment potential for 7,60,000 people. By 2009-10, 100 million saplings were planted over 100,000 hectares of private wastelands, benefiting 1.2 million people.

The study has observed that ITC-PSPD Bhadrachalam unit has been implementing this program in 5 mandals of Khammam district. The division has been working with a NGO partner - SINARD, to identify poor tribals with wastelands and organises them into self-supporting forest user groups. In the Kottapalli and Palamadugumandal of Khammam district, ITC-PSPD along with partner NGO have trained the user group leaders to follow best silvicultural practices to grow high quality timber as a viable cash crop, and other local species that meet domestic, fodder, fuel and nutrition requirements. ITC-Bhadrachalam unit provides a comprehensive package of support and extension services to tribal farmers in terms of loans, land development, planting of saplings, plantation maintenance, marketing and funds management. The social development manager has described that ITC is helping the farmer produce a quality that attracts the best price. After the first harvest, the farmer returns the loan to his forest resource user group, in the process, creating a village development fund large enough to sponsor aspiring timber growers or meet other village development needs.

ITC provides valuable extension support to farmers by teaching tribal people about silvicultural practices. ITC also donates high-yielding, disease free clonal planting stock developed through Tree Improvement research at its Bhadrachalam unit. Inter-cropping on plantations also encouraged to ensure income to farmers during the gestation period of these plantations.

At the heart of this comprehensive greening project, as explained by the deputy manager Plantations and R&D, is ITC's state-of-art research centre, which has been consistently striving for productivity improvement of several tree species in order to give attractive land-use alternatives to traditional farmers and Tribal population. So far 107 high-yielding, fast-growing and disease-resistant `Bhadrachalam' clones of Eucalyptus and 12 clones of Subabul have been produced on a commercial scale with productivity more than thrice that of the normal seedlings. Table 7.22 illustrates the significant milestones achieved in this community development initiative.

Table 7.22 Community Development Initiatives

	2008-09	2009-10
Coverage		
No. of Villages	454	480
No. of Beneficiaries	16061	19376
Plantation Area (Ha)	14360	16471
Economic Impact		
Harvest Area	1766	1860
Income to farmers (Rs. in lakhs)	814	850
Village Development Fund	78	90

The social forestry initiative has not only enabled the ITC Bhadrachalam unit to procure timber exclusively from sustainable sources but also benefitted 1.2 million people through incremental employment. Additionally, it helps forest conservation by reducing pressure on public forests. Apart from the obvious benefits of increasing the forest cover, this effort also directly contributes to in-situ moisture conservation, groundwater recharge and significant reduction in top-soil losses due to wind and water erosion. The tribals also said that they now have increased access to their own biomass under ITC's social forestry programme, which helps to meet most of their in-house fuel wood requirements.

7.13.2 Integrated Watershed Development Programme

ITC-ITD, Bangalore factory has initiated a comprehensive watershed development programme in Chitkala, Dodjala and Betalsur village panchayats in Bangalore Rural District, Karnataka with an objective to soil-water retention and the reversal of land degradation. In partnership with Govt. of Karnataka, ITC is helping build cost-effective percolation tanks to protect farmlands from acute moisture stress and high soil erosion. The company have formed village-level water user groups, and engaged in capacity building, planning, implementation and maintenance of micro watershed projects.

ITC's watershed development project seeks to achieve two critical objectives: water conservation and soil enrichment. The company enables water shed committees to plan and build water harvesting structures like contour bunds, check dams, percolation tanks and farm ponds. Trained farmers use their knowledge of the terrain to identify locations for building water structures and develop the related micro plans. ITC contributes 75% of the cost, the balance 25% being mobilised by the user groups. The rich silt excavated from percolation tanks is used to enhance soil fertility. User groups raise regular contributions from the farmers to meet the maintenance cost of these water harvesting structures. So far ITC's Soil and Moisture Conservation Programme covers 31,976 hectares of rain fed agricultural land and generates employment during the lean season. ITC's conservation projects include construction of surplus weirs to channel water flow from percolation tanks and excavation of farm ponds for rain water harvesting.

Table 7.23 Integrated Watershed Development Programme

Activity	Unit	2008-09	2009-10	Cumulative till 2011
Coverage				
Area Treated	Ha	22349	28301	39169
Critical irrigation area	Ha	21492	22993	25330
Total watershed area	Ha	43841	51294	64498
Command area				
Minor Structures	No.	1587	1755	1983
Major Structures	No.	948	1058	1246
Total Structures	No.	2535	2813	3229

The programme manager had described that the company has built 1782 small and large water harvesting structures which caters to irrigation needs of over 16,500 hectares of land in Andhra Pradesh, Karnataka and Tamil Nadu.

7.13.3 Livestock Development

ITC is assisting farmers to crossbreed their low milk-yielding cattle with high-yielding breeds to significantly enhance the milk yield. The ITC- supported Artificial Insemination technician provides doorstep service to the farmer, helping produce high milk-yielding cross breeds India has the largest cattle population in the world.

ITC-ITD Bangalore unit, ITC-PSPD Bhadrachalam unit, ILTD-Chirala Unit has spearheaded Livestock Development programme in a systematic way to increase milk yield, among the local communities with appropriate extension and support services. In collaboration with BAIF Development Research Foundation, a national NGO specializing in livestock development, ITC assists small and landless farmers to cross-breed their low milk-yielding cattle with high-yielding breeds like Jersey and Holstein-Friesian. The company has identified diploma and degree holders in agriculture and animal sciences among the local community and encouraged them to become para-workers or artificial insemination technicians to enhance livestock management skills in rural areas. These technicians provide service to the farmers' right at their doorstep. ITC also promotes low- cost "complete feed," helping reduce the pressure on invaluable forest resources and pastures. The following are some significant results achieved by the company in this social development initiative.

Table 7.24 Livestock Development

Activities	2008-09	2009-10	Cumulative till 2011
Cattle Development Centres	121	161	210
No. of AIs	277054	407609	574987
No. of Cross breed calves	68352	104233	151284
Vaccination & Health	NA	177701	216313

The manager, social development initiatives in south expressed that ITC targets to increase yields 7 to 9 times from the current levels. He also said that dairy farming requires low investment and has the potential to create attractive livelihood opportunities for the economically challenged sections of rural India, provided livestock can be genetically upgraded through systematic and scientific animal husbandry.

7.13.4 Women's Empowerment

ITC believes that economic empowerment of women transforms them into powerful agents of social change. ITC's interventions leverage micro-credit and skills training to generate alternate employment opportunities. The Increased income in the hands of rural women means better nutrition, health care and education for their children. The study observed that all three selected divisions have been partnered with various NGOs, to organize village women into Self Help Groups or Micro-Credit groups. These group members make monthly contributions to create a savings corpus which would be used to extend soft loans to group members, thereby eliminating the stranglehold of the local moneylender. The system of mandatory contribution further strengthens the savings habit, leading to capital augmentation among the poor families.

ITC provides training to group members to handle bank accounts and understand the nuances of government development programmes. These empowered groups function autonomously and take their own decisions, including sanction of loans to fellow-members and collection of repayments. The company provides further support through seed money for self- employment activities to well-managed micro-credit groups with no default records. These venture funds provided by ITC have already spawned hundreds of women entrepreneurs. This is illustrated in Table 7.25.

Table7. 25 Women Empowerment Initiatives

Activity	Unit	2008-09	2009-10
Micro credit programme			
SHGs (Cumulative)	No	1023	1035
Members (Cumulative)	No	10614	14278
Savings (Cumulative)	Rs. in Lakhs	135	179
Livelihoods			
Self Employed	No.	18428	23797
Micro Enterprises	No.	4257	5898
Credit			
Internal Loans	Rs. in Lakhs	198	306
External Loans	Rs. in Lakhs	300	398
Skills Training	No. of women	1877	2472

The study observed that earnings of SHGs range from Rs 70 to Rs 150 per day which not only supplement household incomes but also significantly enhance their self-esteem. ITC also conducted skills training to enhance employability. These SHGs are engaged in Pickle-making, fish-processing, vermin-composting, spice processing and agarbatti-rolling in rural areas and chikankari, garment-sewing, driving and computer-aided secretarial training in semi-urban areas.

7.13.5 Primary Education

The study also identified that all the Three ITC's divisions and units provides critical support to state- run village schools, improving school buildings and supplying books, satchels and uniforms to students. The ITC's education support initiatives are aimed at overcoming the lack of opportunities available to the poor. ITC believes that the extensive network of government-supported schools must be made more attractive to children. Various units of the company, therefore provides critical support to state- run schools to maximize enrolment and minimize dropouts.

The ITC-ILTD and ITC-PSPD community initiatives include improving school buildings, constructing toilets, providing electricity connections and supplying fans and lights. The units also provides students with uniforms, satchels and books. ITC has financed the establishment of Supplementary Learning Centres to help poor students cope with their lessons and improve their scholastic abilities, thereby preventing dropouts. This programme also benefitted educated local youth who serve as tutors at these centres. Table 7.26 illustrates the various types of initiatives undertaken by the company.

Table 7.26 Primary Education and Health & Sanitation Initiatives

Activity	2008-09	2009-10	Cumulative till 2011
Primary Education			
Learning centres	1885	2380	2523
Rural Libraries	304	304	357
Roaming Laptop	196	260	315
Govt. schools infra support	339	577	741
Children covered	183457	228872	353865
Health and Sanitation			
Sanitary toilets	NA	2937	3220
Backyard Horticulture	NA	23614	23614
Health camps	NA	309	314
Beneficiaries	NA	21780	22819

The company has partnered with many NGOs to conduct teacher training programmes to raise the standard of teaching in government run primary schools. ITC also helps NGOs to organize summer camps, sports and other extra-curricular activities as part of the overall development inputs for children. The dramatic improvement in the academic performance of these children has made such centres very popular with parents in the field area.

Thus the company has been engaged in Community Development through capacity building /strengthening local institutions, village level bodies, Self Help Groups, supplementary education programs, training, awareness creating, capacity building measures, infrastructural support etc. This reflects the significant role of the corporate organization and its commitment to the society. This not only reflects the social role of the company but also highlights the new era of collaboration between private business, government, people and civil society organizations. The study also observed that strategic collaborations constitute a win-win situation for both the company and NGO in terms of aligning its vision, objectives, core values, and to formulate action agenda for Sustainable Development. The framework of ITC's community development interventions are rightly grounded and provide an alternative methodology of social responsibility. Unlike philanthropic activities this model lays greater emphasis on participation, long term sustainability and up-liftment of community through collective efforts. This is indeed, a positive value addition to the company image and position in ever changing competitive landscape.

7.14 Farmer (Supplier) Relationships

Since ITC's principal raw materials are agri-based, farmers have always been an integral and important part of our value chain. A large part of ITC's R&D efforts are dedicated to provide expertise and support to improve agri-quality and productivity. ITC has partnered with farmers not only to procure customized and quality raw materials, but also to ensure them better price, assured markets and improved productivity.

The farmers are an important value chain partner for ITC and the company continuously tries to engage with them through a large gamut of interventions. The study covers at length of one such intervention, namely E-Choupal in Madhya Pradesh and Maharashtra.

The E-Choupal was introduced by ITC in June 2000 so as to set up a direct link with rural farmers for procurement of products like soybeans, wheat, coffee, oilseeds etc. which it requires for the ITC-Agri Business Division. Prior to this intervention, ITC-ABD have bought soybean from traders (operating in the mandis) and processed the beans to produce edible oil for sale in the Indian domestic market and DOC (de-oiled cake) for export. Since ITC-ABD did not have any direct contact with the farmers, it commissioned certain traders (called commission agents) to buy soybean from the mandis on its behalf. The company was dependent on its agents' knowledge about local farmers and their produce. During the field study ITC procurement managers revealed that the distortion of quality undertaken by the agents made the company to pay a high price for a lower overall quality of soybean, which upon processing yielded less oil and more contaminated DOC.

Given the backdrop of these problems, ITC took the initiative to introduce E-Choupals through which the farmers could directly negotiate the sale of their produce with the company without further involvement of intermediaries. As part of this model, ITC-ABD provided a PC to every large village (or to a cluster of smaller villages). It has enabled these farmers to check market prices of their produce and sell it at a favorable price, bypassing the traditional ‘mandi auction system’. The farmers were able to increase their profits, and the same time ITC was allowed to procure at a lower cost by eliminating the logistical inefficiencies. This electronic market place - E-Choupal offered farmers and village community five value creating services:

- Information: regarding weather, market prices in local languages
- Knowledge: on farming methods specific to crop and region
- Purchase: farmers can buy seeds, fertilizers, pesticides
- Sales: farmers sell their crop to ITC centers or the local market
- Development work: for NGOs, SHGs etc.

Through E-Choupal, farmers can use the computer to access daily closing prices on local *mandis*, as well as to track global price trends or find information about new farming techniques - either directly or, because many farmers are illiterate, via the *sanchalaks*. The farmers in the Sehore district of Madhya Pradesh use the e-Choupal to order seed, fertilizer, and other products such as consumer goods from ITC or its partners, at prices lower than those available from village traders.

The innovative idea thus, provides farmers a unique experience through information access and interactive applications to co-create value.This also had opened a two way distribution model that connects farmers to end consumers and FMCG companies with rural markets. The ITC's 6,500 e-choupals network has already reached 4 million farmers across 13 states covering 40,000 villages – making it corporate India's most ambitious rural ICT initiative ever.

The benefits of E-Choupal are multidimensional. During the study, extensive discussions with ITC officials and farmers were conducted to analyze the benefits of this Web based supply chain model. Many Farmers have revealed that they have been benefited from more accurate weighing, faster processing time, prompt payments, and accessibility to a wide range of information - including accurate market price knowledge, market trends, which help them decide when, where, and at what price to sell. Today these farmers are selling directly to ITC through an E-Choupal, receiving a higher price for their crops than they would receive through the mandi system, on average about 2.5% higher. The total benefit to farmers includes lower prices for inputs and other goods, higher yields, and a sense of empowerment.

Thus began in the year 2000, experimentation with Soya procurement, the ITC-ABD however then applied for Wheat sourcing in 2001 and Coffee and Shrimp in 2002. The E-Choupal movement grew at an impressive rate from 2002 to 2007 adding 30 new villages every single day. Today E-Choupal covers a network of 6,500 choupals in 13 states covering 40,000 villages and 4 million farmers. The E-Choupal developments can be categorized in five well-thought out phases.

- Phase I: Choupal Model – Procurement model – Soya bean, Wheat, Shrimp and Coffee.
- Phase II: Platform for trading Agricultural commodities and FMCG flow into rural markets.
- Phase III: Choupal Sagars- Rural hyper markets attached to the Warehouses and Procurement hubs in the supply chain
- Phase IV: Choupal Fresh – linking directly to market- from Farms to Urban markets
- Phase V: Services- Health care, Education, Insurance, E-Governance

During the personal interview, the chief executive of ITC-ABD noted that over the years ITC E-Choupal has gone through three stages of evolution. It started with a sourcing strategy (supply chain management) then became a selling strategy (marketing) which eventually resulted in an engagement (value co-creation) model. In each of these stages, ITC had to build even more sophisticated IT systems and analytics.

The study also observed that the average price of soybean in the mandis have increased by 1-3 percent after the introduction of the E-Choupals. The soybean growing farmers also noted that the increase in price triggered increase in the overall quality of soybean over time. The company officials said that the oil and protein content of the seed has increased over the 5 years, attributing to the information dissemination by E-Choupals on farming techniques and weather forecasts which led to an improvement in unobservable aspects of quality.

However, the ABD managers described that the immediate benefit to ITC through this intervention was the improvement in procurement efficiency of soybeans resulting from the creation of a direct marketing channel and a reduction in its transaction costs. The presence of a hub, however, is likely to exert two opposing forces. On one hand, direct buying by ITC is expected to divert a part of the sales away from the mandis, leading to an upward pressure on price, the Competition effect. On the other hand, scientific testing of quality performed at the ITC hubs might induce farmers to put downward pressure on the price offered in the mandis, the Composition effect. If farmers with good quality soybean have a greater tendency to sell directly to the private company, the effect of the hub on the mandi price is a priori ambiguous, and is ultimately an empirical question. The study also revealed that the traders are losing some of their traditional monopsony power and facing a shrinking market. The farmers explained that on numerous occasions they have had arguments with the local traders in the agricultural mandis.

The ITC initiative is part of an overall institutional change in the supply chain &marketing environment. Thus a change in the procurement strategy of ITC-ABD has had significant spillover effects on the movement of prices across agricultural markets in Madhya Pradesh and Maharashtra.

Similarly, the ITC-ILTD, which has pioneered the cultivation of Flue-cured Virginia tobacco in India, has built an enduring partnership with several thousand farming communities in Andhra Pradesh and Karnataka. This partnership is the bulwark of ITC’s core initiatives in sustainability.

The division has been actively engaged with farmers and collaborated with key public institutions such as the Tobacco Board and the Central Tobacco Research Institute (CTRI). The R&D at ILTD has steadily upgraded through improved varieties, upgraded crop and curing practice and post-harvest product management.

The division established cooperative ties with farmers through extensive networking and information sharing. The division has strengthened its relationships with farmers through day to day crop development activities to assisting them at the auction platforms. During the study a senior marketing manager explained that the company staff, specially the crop development team to buying team provides assistance to farmers to enhance the crop quality. The study also noted that farmers are also oriented on customer value creation through elimination of hazardous Non-Tobacco Related Material during the cultivation.

The tobacco growing farmers interviewed in the Prakasham district, revealed that the company managers provide inputs to them on Integrated Farm Management, Integrated Pest Management, Integrated watershed development, Vermiculture etc. to create sustained value in farming activities. They indeed referred ITC-ILTD as “Talli Company” (Mother Company). They said the company has provided them training, assisted in post harvesting storage facilities, modernized the tobacco curing barns and introduced them to sustainable agricultural practices in tobacco cultivation that increased their yield by 30%. They also said that there were instances in the past, during the adverse market scenario and at the time of fallout of tobacco prices, the company had come to their rescue, supported them with better prices for their yield.

7.15 Customer Relations

The company primarily focuses on understanding customer’s needs and aspirations and meeting consumer satisfaction by creating products and services of a high quality along with cost competitiveness and on time delivery thereby developing strong long-term customer relationships.

The study observed that all three business divisions have various mechanisms to capture the needs and expectations of the customers through market surveys, personal contacts/ visits, events, customer satisfaction surveys, joint development & improvement projects, key account management etc. the following reflections on the customer relationships are based on the discussions with the marketing management team at ITC-ILTD division in Guntur.

ITC-ILTD have global footprint in delivering products and services across the scale and scope of Indian tobaccos. The division perpetually engages with customers, helping them to take informed decisions, by providing key inputs such as progress on the crop and market, price movements, market dynamics and opportunities. A senior marketing manager described that periodic crop report which ITC sends to its customers is perhaps one of the most recognized, authentic and eagerly anticipated document. The division is also engaged with many global buyers in collaborative initiatives spanning crop development and extension services, R&D, processing, logistics and social responsibility.

The division practices a unique concept of dedicated key account management, wherein each customer / market is handled by one individual with the support of a team which is adept in operating in global markets. A key account manager of ILTD noted that the division has a mandate to deliver products and services in line with customer expectations, and responding to their needs with a minimal lead time. The division takes the customer feedback through customer satisfaction survey which rates the performance with regards to efficiency, product and process quality etc.

The division also nurtures the customer focus across the organisation. The employees are sensitized on positive customer orientation during the workshops and also at the shop floor meetings. Before the commencement of the season, the export team visits the plant to conduct orientation programmes for the workers on the basis of previous year's customer feedback. The workers are clearly instructed to eliminate the N.T.R.M during the work process which is a step to enhance customer satisfaction.

The customers of ITC-ILTD are fairly satisfied with the relationships and management practices of the division. During the personal discussions, a senior Vice-President of American Merchant Tobacco company which exports to blue chip clients in US, Middle East and Japan, noted that ITC-ILTD is an extended enterprise for customers. Every month the division shares information regarding markets, crop development initiatives, research activities, price trends, demand and supply conditions which have been extremely useful. Besides that the agronomy practices of the division are best of its kind that enables the customers to have long-term relationship.

This chapter has provided the empirical findings regarding the Corporate Governance and Stakeholder relations and next chapter brings out the summary and conclusion of the present study.

CHAPTER 8
Summary and Conclusions

8

This chapter puts forth the findings drawn from the analysis of a wide range of data presented in the earlier chapter. The primary data forming the basis of this study has been derived from the responses of the employees, managers, local community members, suppliers and customers. The present chapter is divided into two parts namely summary of the study and conclusions.

Part I

The part I bring together three central themes of the study. Firstly, it reviews the Corporate Governance Policy and Practices of the selected company during the study period. The study however, emphasized that these practices are by no means faultless. The governance practices have been and will continue to be, criticized by unhappy stakeholders – employees, investors, customers, suppliers, communities, and others from time to time. But the experiences of ITC and its divisions reveal efforts undertaken to become more effective in their interaction with their stakeholders and thereby attribute specific meaning to governance and stakeholder management.

Secondly, this chapter describes the key findings of the study, emphasizing the descriptive, instrumental and normative aspects of corporate governance at ITC and its implications for better stakeholder relationships. The chapter aims at linking of data to the propositions developed at the outset of this research study and justify / negate the descriptive scenarios, which were illustrated in the first chapter.

Thirdly, the chapter examines the implications of the corporate governance policy and practices at the case company in terms of its advantages, disadvantages and future possibilities.

To reiterate, the present study is primarily a study of the particular case company in terms of its nature, historical background, physical setting and understanding of corporate governance and stakeholder relations in the context of organizational, capital market and product market environments. The study is a mix of exploratory, descriptive and explanatory design (though largely based on descriptive method) to understand what is the meaning of corporate governance, how managers perceive about managing firm and stakeholders interests and how specific stakeholder relations lead to strategic outcomes that are essential for competitive advantage for the firm.

The study noted that the Corporate Governance Policy is the apex level instrument guiding conduct of the affairs of the Company. The core powers are divided in a manner to uphold functional dependence, delegation of powers and maintaining a right balance between freedom of management and accountability to shareholders.

The study revealed that the company has transparent shareholding distribution, wherein the major shareholders are clearly identifiable. The Institutional Investors and parent company controls major shareholding whereas 'Private Corporate Bodies' hold a very small portion of ITC's shares, and there is no apparent evidence of cross-holdings.

The study also noted that ITC follows a three-tier governance structure, which incorporates: 1) Strategic Supervision by the Board of Directors (BOD), 2) Strategic Management by the Corporate Management Committee (CMC), and 3) Executive Management by the Divisional CEO assisted by the Divisional Management Committee. The role, responsibilities, and delegation of powers of each of these committees is clearly defined in the Corporate Governance Policy of ITC, and adhered to rigorously. On an average, at least one CMC meeting is held every month. The data also revealed that there have been occasions where several CMC meetings have been held within a short span of time, typically to discuss the business plans of each division. The agenda papers for each of the meetings provide extensive details on each of the issues, and policy guidelines are referred to for every decision. In addition, the Board is kept informed of all major activities. The information supplied is comprehensive and is quite relevant in content and presented to support decision-making. Overall, the decision making process at ITC is well structured, with the delegation of powers being adequate.

The analysis revealed that ITC's current BOD consists of 16 members. Four of them are Executive Directors (including the Chairman), two represent BAT, and the balance ten is Non-Executive Independent Directors of whom 6 members represent Financial Institutions as Nominees or representatives. The frequency of Board meetings, timeliness of circulation of agenda papers, and quality of presentations made to the board in the case of critical issues, are transparent and facilitates board-level decision making at ITC. However, a careful observation of the composition of Board of Directors reveals following interesting dimensions.

The company broadly categorize Non-executive Directors who represent the Financial Institutions as Independent Directors. This is true, so much so that Nominee Director appointed by an Institution, which is a Public Financial Institution as defined in Section 4A of the Companies Act, 1956 or a corresponding new bank as defined in Section 2(d) of the Banking Companies (Acquisition and Transfer of Undertaking) Act, 1970, which has invested in shares or lent money shall be treated as an Independent Director. However, independence of these Nominee Directors is a questionable assumption, as they effectively represent their own institutions on the company boards.

The presence of Institutional Nominees is certainly the most distinctive feature of the Indian Corporate Governance system. Banaji and Mody (2001) study on Corporate Governance in India has criticized the Nominee Director system and felt that there was no point in having Institutional Nominees if they were not effective. In contrast, the Nominee Directors in ITC played an active role, especially during the time of Corporate Governance issues in 1996-97, wherein they had supported the ITC's Indian management to successfully counter BAT's take over plans.

In addition to that, ITC Board meetings always consider a Statutory Compliance Report signed by each of the Divisional/ SBU Chief Executives and Divisional/ SBU Financial Controllers. The board also review the quarterly report from chief executives of subsidiaries, covering key business trends, status of borrowings, strategic investments, and update on important developments and performance. According to the study, ITC's Board of Directors lays adequate emphasis on issues like monitoring and evaluating strategy, ensuring adherence to legal requirements, monitoring division-wise performance, and determining remuneration for key Managers and Directors.

ITC has five Board Committees in operation: Audit Committee, Compensation Committee, Investor Services Committee, Nominations Committee and Sustainability Committee.

Apart from the statutory functions, the study revealed that ITC's Audit Committee also emphasises "Systems Audit" which evaluates the existence, adequacy and effectiveness of systems and control mechanisms, compliance with statutory provisions, quality of assets/quality of profits, nature of risks, and quality of risk management systems. The Audit Committee also approves the annual audit coverage of the divisions and strategic business units (SBUs), which is a major positive step in the Company's Corporate Governance practices.

The data illustrated that ITC's Board Committees comply with the Statutory and Non-statutory recommendations governing the composition and functioning of Board Committees. Significantly, ITC has gone beyond the mandatory requirements, and in fact, some of its Board Committees, like the Audit Committee, were formed much before they were made mandatory. Similarly, the presence of Sustainability Committee, also illustrates the company's commitment to address the challenges pertaining to People, Profit and Planet.

ITC prepares its accounts in accordance with the Indian GAAP. A careful study of Company's Annual Accounts from 2002 to2011 illustrated that ITC has been complying with the Statutory Disclosure requirements. However, the study observed that the company can make further improvements in its disclosures with respect to some balance sheet items, like loans and advances and contingent liability.

The study thus, reflects that ITC has a transparent shareholding structure, a well-structured decision making process (with adequate delegation of powers) and sound Board structure and process. Further, the composition of the Board as well as the Board Committees, frequency of meetings, quality of agenda papers and the Board's involvement in the decision making process satisfy the requirements of good Corporate Governance. The analysis also reflects conformity with the provisions of Clause 49 of the Listing Agreement. The company nevertheless can further improve the governance practices by incorporating worker's representatives at the board level, at least in the Board Committee on Sustainability. If workers are given place at the Board level, it would indeed pave a way for the next practices in the Indian Corporate Governance Norms and act as an exemplar for worker's participation in governance.

The study revealed that ITC has set up an in-house Investor Services Centre in accordance with the SEBI (Registrar to an Issue and Share Transfer Agent) Regulations, 1993. The Internal Standards that the Centre has set for itself, and complied with are more stringent than the statutory requirements. The Company suo moto seeks confirmation on a quarterly basis from the SEBI, the Stock Exchanges, the National Securities Depository Limited (NSDL) and the Central Depository Securities Limited (CDSL) that there are no pending complaints against it and places such confirmations before the Investor Services Committee of the Board. The study also illustrated that ITC is responsive to investor needs, and often goes beyond minimum statutory compliance and has taken several proactive steps in the interest of investors. The shareholder satisfaction survey's track record in terms of servicing of investors is also very satisfactory.

The study observed that corporate governance developments have greatly enabled the employee relationships in the company. The Board of Directors takes into account of appointment, retirement/resignation of senior management and reviews their performance, provides inputs for succession planning and management development. The Board of Directors also seeks timely information on employee practices, information on strikes, lockouts, retrenchment, fatal accidents in the company.

It is observed in the study that planning and implementation of Human Resource Development agendas and practice of HR policies and procedures are carefully reviewed by the Board of Directors of the company. The Governance policy standardized the internal employee relations, wherein recruitment (including promotion from non-management to management), and confirmation on completion of probation (by way of ratification) of management staff is included. The Line Directors are found to be observant of overseeing long term agreements with employee unions, the succession planning, inter/intra divisional transfers of employee etc.

However, the study revealed that workers awareness is limited regarding Corporate Governance issues in the company. Though Company fosters openness regarding issues of labour management and bargaining systems but it does not really generate awareness of Corporate Governance. The workers too, are not really concerned about the CG issues. They pay less attention to policies of CG, Sustainable Development and Employee Empowerment. They believe that whatever employee practices currently are achieved are through struggles and joint consultations with management, not because of Corporate Governance Policy.

The study also found that the Corporate Governance Policy speaks about the belief that empowerment is a process of actualizing the potential of its employees. However, in real term the empowerment is non-existent as far as the unionized workers are concerned. There is no representation of workers in any of the levels of Corporate Governance Hierarchy. Similarly, the Corporate Governance Policy speaks about ITC (Board) being trustees to ensure that the company fulfils its obligation and responsibility to its stakeholders. It also states that the ITC

Board represents a coalition of interests, namely those of the shareholders, other providers of capital, business associates and employees. However, there is no explicit statement of policy to say that it recognizes the Rights of Labour, to be found anywhere in the document.

On the whole this represents a stable industrial relation systems and mutually enforceable relationship between ITC management and workers. The principles like employee empowerment do exist but restricted only to particular circumstances. In reality, the ITC is in a process of generating wealth to the employees so as to construct its image, brand positioning, etc. in an ever changing competitive environment. It strives to attract and retain talent through various initiatives that focus on providing personal development and growth, a work culture that ensures high levels of performance by developing agility and creativity to speedily embrace change, creating an environment where employees are inspired, engaged and aligned with the Company's Vision, Mission and Core Values.

The study revealed that, ITC's approach to community development based on aligning business performance to the objectives of social responsibility and citizenship will ensure long-term business sustainability and unleash strong drivers that can make national progress more inclusive and equitable. The company has put in place a multidimensional rural capacity building mission, based on specific needs identified and articulated by the communities. PRAs (Participatory Rural Appraisals) are conducted to identify the potential target group, its needs and the existing resource base.

The ITC's methodology of sustainability is noteworthy because it emphasizes on empowerment of communities through organizing them into enduring Self Help Groups, User Groups, Joint Liability Groups and Common Interest Groups. This will inturn increase the ability of women, farmers to overcome poverty and leads to empowerment by addressing not only their individual needs but also focuses on household needs of the rural poor. The study observed that ITC through its Self Help Groups is enabling poor communities to use micro-credit for meeting emergencies, for consumption smoothening and for investing in opportunities etc. Much of this leads to reduce vulnerability rather than providing higher income. However reducing vulnerability is also very important for poverty ridden households who are otherwise completely gullible and cannot make decisions on their own.

The study noticed that the ITC's CSR agenda: Mission SuneharaKal has potential comprehensiveness and a holistic approach for Sustainable Development. Along with Self Help Groups, the mission spearheaded various community development programs like supplementary education, health awareness camps, infrastructural support for development of sanitation and hygienic conditions, animal husbandry, promotion of micro enterprises, which depicts a larger picture and commitment of the company. Though each program is targeted to a specific social issue in the rural hinterland but they independently contribute to the larger / overall development of the village community. The development equilibrium as a whole is what one should focus at contemporary business and society partnerships.

The study described that, community orientation in ITC is largely based on the two CSR models namely, Competency driven model and Customer driven model postulated by Dipankar Gupta (2005). Gupta (op.cit,) opined that the company reaches out to the society by depending on its core competencies. In doing so, it helps to create potential stakeholders, and also adds to evolving higher efficiency standards. The ITC's socio-forestry initiative is an excellent paradigm where CSR and business have created such a harmony. ITC-PSPD linked CSR to corporate strategy and to their unique capabilities in the Paper board and Specialty Paper industry thereby established competitive position in the market place. Likewise, customer driven not only facilitates sustained CSR but also helps in raising consumer standards and expectations. In this process, not only is the consumer benefited, but the company too can hike up the competition in its own market sector. For example, ITC-ILTD's agronomy effort to eliminate the NTRM (Non Tobacco Related Material) in their supply chain has enabled them to work closely with tobacco growing farmers. ITC is engaged with farmers through technical support and awareness campaigns in the tobacco growing villages. This has not only benefited the company to eliminate harmful waste at supply chain level but also enabled them to meet the expectations of blue-chip international tobacco manufactures that source tobacco from ITC ltd.

Thus, the study noted that the ITC's Community Engagement and Social Development Strategy is based on Business Centric Model of CSR. The company establishes long term relationships with the communities through various capacity building initiatives to create self-reliant, empowered institutions that become agents of change and development. ITC also believes that India's rural transformation cannot be brought about by a single player, nor can the efforts of a few enterprises make a decisive difference. Thus, constructive public- private partnerships are imperative to the achievement of inclusive and sustainable growth.

The study illustrated that ITC's relationships with farmers / suppliers have strengthened due to the E-Choupal services. The farmers have seen a rise in their income levels because of rise in yields, improvement in quality of output and a fall in transaction costs. The data collected from the field has revealed that customized knowledge is offered to the farmers despite heterogeneity because of which even small farmers have gained. Currently, farmers can get real-time information despite their physical distance from the mandis.

The study noted that E-Choupal has been most successful initiative to connect rural India and to involve the farmers in learning. The E-Choupal has also attracted attention from the renowned academicians, since E-Choupal innovate the traditional agriculture supply-chain, and generate enough potential to be replicated in the under-developed and developing countries.

Evidently, ITC has been successful in making the farmer feel the sense of ownership and empower him to generate additional revenue by eliminating middleman. The study revealed that participating farmers have been able to enhance their income and eliminate the delay in getting the payment once the product is sold. It has helped in reducing debt burden of the farmers. The E-Choupal has helped the farmers to improve their productivity and get better prices, whereas ITC has benefited by better sourcing of raw materials and building a backbone to market the end products which is vital for the FMCG companies like ITC.

However, critically through E-Choupal initiative of ITC-ABD more or less monopolised agricultural procurement, channels of agriculture related information and products, as well as the rural market for many other services and products in the study areas. The monopolization of the company could be seen not only in channels of information but also in market prices in different mandis, procuring the produce, offering information about best agriculture practices and providing agricultural inputs, like seeds and fertilisers. Thus it is highly questionable whether this model of corporate monopolization can be beneficial for the community.

Alongside, the study also found that E-Choupal system is built around the needs and interests of rich farmers, with some spin-off benefits for those with some degree of purchasing power. This model created a digital divide, yet to realize the genuine trickle-down benefits to weaker sections of the community.

The data collected from the field clearly illustrated that ITC-ABD benefited by improved procurement system of soybeans resulting from the creation of a direct marketing channel and a reduction in its transaction costs. Many critics have pointed out that this may lead to increased reliance on commercial crops, which can decrease local food security both through reduced availability and increased prices. Goyal (2010) noted that such monopolistic control over an entire local agricultural ecology might be beneficial to large farmers, crowding out the small and marginal land-holding farmers. It may promote corporate dependency of local agriculture and mono- culturisation of agro-production systems.

However, the study also observed that success of E-Choupal has given new lessons to the corporate in the India and abroad. The initiative has considerably impacted price received by soybean farmers in the mandis and on their subsequent planting decisions to cultivate soybean. The gains from the noble initiative are manifold to ITC, the farmers and other companies. To reiterate, the idea and practice of E-choupal has been intrinsically business functional. It enabled ITC to assume socially responsibilities because they anticipate a benefit from these actions. The model has enhanced the reputation of the company, facilitated risk management strategy, determined premium price for output, fostered transparent supplier relations. It not only increased ITC-ABD’s competitiveness and market position but also farmer’s income to a considerable extent. Thus, E-Choupal is the private provision of a public good and a business level differentiation strategy.

The study described that ITC values its customers. ITC-ILTD has a feedback procedure, which includes a periodic market research and customer feedback mechanism, to gauge public perception and customer satisfaction. The division also gather information on these aspects during interfaces with customers and public representatives. The study noted that the division carry out at least one customer satisfaction survey or feedback gathering exercise at any given time during the year. The division provides opportunities for its customers to raise grievances through market complaints in the case of products and through feedback forms in the case of services. It has put in place a structured process to redress grievances within specified time limits, including bringing them to the knowledge of superiors. Such grievances also form an integral part of the operations review and pattern analysis, so that corrective action can be taken to prevent the repetition of similar grievance in the future.

Though in a limited dimension, the study also observed that ITC has been committed to energy sustainability and reducing GHG (greenhouse gas) emissions in its operations. The ITC-PSPD Bhadrachalam unit, ITC-ITD Bangalore unit and ITC-ILTD Chirala unit has put in place several initiatives, such as increasing the use of renewable and environment-friendly energy sources, sequestrate CO2 through large- scale plantations, and utilize CDM's under the Kyoto Protocol. The ITC has been 'carbon positive' for the past seven years and also become 'water positive' by mitigating the negative impacts of freshwater depletion due to its operations.

The present study thus, re-approached Corporate Governance issues from the efficiency of internal mechanisms, mutual arrangements between company and stakeholders. It is evident from the above analysis that the ITC has proactively established co-operative arrangements with stakeholders even though it is not mandated by Corporate Governance Regulations in India. The Internal mechanisms like IR /HR practices, supply chain management, customer relations and CSR have efficiently contributed to the overall governance of the company and its divisions. The efficiency and professionalism of these internal mechanisms nevertheless, provides a holistic understanding to ITC’s policy of governance and subsequent practices. However, these are exclusive practices of the case company and perhaps, such a stakeholder orientation cannot be generalized for all other or rather universally mandated for Indian corporates since the Company Law does not make mandatory claims for such a practice in reality.

The study validates Post, et.al, (2002) argument that if good governance constitutes the sine-qua non for corporate success, a success situation which is not only demonstrable with reference to the profit and loss account of the company concerned but by certain indicators that in, aggregate establish a good will and appreciation in stakeholders (public) perception. The study reveals that ITC Corporate Governance has not only enabled a competitive market position and stable growth rate but also created enduring relationships with shareholders, employees, suppliers, communities and customers.

The study also supports Freeman et.al, (2007) thesis that if stakeholders’ view has been incorporated into firms’ core functional and operational areas it will positively relate to firm’s reputation and corporate performance in the long run. The study revealed that stakeholder primacy in core functional areas like investor relations, industrial relations, human resources management, supply chain management, customer relations and community development initiatives has created a reputation capital for the company. These relations indeed, have contributed to gain stakeholder acceptance over the years.

The study substantiates Post, et.al (2002) views that Corporate Governance Policy alone is not sufficient, but other internal systems and institutional arrangements does contribute to manage the interests of stakeholders. The present study described that IR system – HR practices, Customer relations management, Supply chain Management, Investor relations and

Corporate Social responsibility practices of ITC has strengthened stakeholder management practices in the backdrop of strong corporate governance philosophy based on trusteeship, transparency and accountability. The study also validates Freeman and Evan (1990) arguments that postulated the difficulty in having a Corporate Governance Policy that can address broad range of stakeholder issues with appropriate practices at the company level. However if companies are interested in long term value creation, stability and sustainability, they should positively formalize their relationships with stakeholders in the external and internal environment.

The study also supports Mitchell and Agle (1997) arguments that firms often integrate one stakeholder with others to meet the expectations of another key stakeholder. The evidence from the study suggests that ITC's stakeholder management practices foster an integrated approach wherein suppliers were combined with employees to create customer value or employees and customers are integrated to create shareholder value.

The ITC's case thus, envisions a philosophy and practice of governance which is comprehensive. The company developed an integrated understanding wherein managers do not view one stakeholder as more important than others. They understand that satisfaction of every section is a prerequisite to the satisfaction of all sections. Thus, shareholder satisfaction is as much as important and is as dependent on other stakeholder satisfaction and vice-versa. This approach of the company reflects active commitment to all and has a great implication for theory as much as for further empirical (analysis) of Indian business.

The study described that ITC, descriptively view Corporate Governance as a systemic process by which it directed and controlled to enhance their wealth generating capacity. As a large corporation it perceives stakeholder's interests are crucial for competitive advantage. The company therefore instituted governance process and internal mechanisms to ensure that it meets stakeholder's aspirations and expectations.

To reiterate, the ITC's Corporate Governance Policy was a response to its worst shock with the unfolding of India's biggest EXIM fraud in 1996.The tricolour propaganda, Swadeshi slogan and heroic defence by Indian management was lost when enforcement agencies raided at ITC offices throughout India and arrested 2 former Chairmen and 8 Executive Directors under FERA violation charges. These governance as well as financial wrongdoings has questioned the role of ITC's Board and Financial Institutions (FIs)who supported the then ITC chairman K.L Chugh while oppossing BAT's move to raise their holdings to 51% in

1995. Notably, the Nominee Directors of FIs have remained passive and have hardly taken interest in checking the massive corporate fraud, even though collectively they command majority stakes, 35.5% as in the case of ITC. As a result of these changes, ITC's Board of Directors have adopted Corporate Governance Policy framework that guides conduct of the affairs of the company and clearly delineates the roles, responsibilities and authorities of the key entities in its governance structure.

The study observed that Corporate Governance Policy has strengthened internal controls and enabled ITC's transformation over the years from a single product company to a multi-business corporation. Today, its businesses are spread over a wide spectrum, ranging from cigarettes and tobacco to hotels, packaging, paper and paperboards and International Commodities trading. Each of these businesses is greatly different from the others and influences the choice of the form of governance. The study noted that ITC's governance addresses the uniqueness of each of its businesses and yet strengthens the unity of purpose of the company as a whole. The following are some of the implications of Corporate Governance Policy in the selected company.

- Internal Standardization: Checks and Balances
- Stakeholder Confidence and building Trust based co-operative relationships with them which enabled competitive advantage for ITC and its divisions.
- Wider acceptance and change in Reputation
- Achievement of Strategic goals related to diversification and building other businesses whilst creating multiple drivers
- In pursuit of Excellence at an organizational level with a committed policy and value based Corporate Governance system with an emphasis on Trusteeship, Transparency and Corporate Citizenship.
- Commitment beyond conventional notions of Corporate Governance wherein the company practices stakeholder orientation
- Trust based, co-operative relationships enabled competitive advantage for the company

The Indian government amended the Cable TV Act in 1995, culminating in the Ministry of Information and Broadcasting banning cigarette advertisements in 2000. Even surrogate advertising was banned in 2002. These developments have sent early warning signal for ITC and it had realized the need to identify new areas to be competitive, forward looking and sustaining itself in changing regulatory context. The company has identified competitive strengths in the FMCG business and intended to develop them for future competence. The management had communicated with investors and shareholders regarding the kind of activity which ITC would like to pursue in future and challenges to be addressed to be a leader in the Industry. The company has invested in R&D, to produce goods for future competitive environment with the vision to be no longer a tobacco company. Thus other businesses are focussed, strengthened and consolidated so as to reduce the dependence on not-so-desirable core tobacco business.

Today, the ITC has 6,500 E-Choupals covering 40,000 villages and over 4 million farmers, and a social forestry initiative that has greened over 80,000 hectares and created 35 million man days of employment. For long a force in the hospitality sector, it has become a major player in the areas of apparel and foods. The company has transformed when it comes to public perception, as these have become as prominent (if not more) than ITC's cigarette brands, which do not make for a happy discussion at public forums now.

However, still, the company pays its dividends and bonus for its shareholders and employees with tobacco money. Critically speaking many of the new businesses are funded by the earnings from tobacco which raises the uncomfortable question: Does this whole thing amount so far to little more than a corporate social responsibility, or CSR, initiative to make people stop linking ITC to tobacco?

However the answers to these questions are complex. Ever since ITC's first Indian Chairman Mr. A.N. Haksar took charge from BAT in 1969, every leader has tried his best to diversify beyond tobacco, but without much success. The BAT exercised a high degree of control - each division was required to send them massive twenty-thirty page monthly reports covering almost everything. BAT Advisors/Experts came periodically to review all units and had unlimited authority. Mr. Haksar managed to convince BAT to reduce this supervisory role, and gradually decisions were made in India from the earlier highly controlled situation. He was the prime mover to diversify ITC to other areas, especially Hotels, which were expanded after him by Mr. J.N Sapru and Mr. Krishan Chugh, and continuing thereafter. However, the diversification in so many different businesses, including many unique services like E-Choupal was carried out mostly after 2000 under the chairmanship Mr. Yogesh Deveshwar and strategic supervision by the ITC's Independent Board. Today's ITC is India's largest consumer product firm which encourages openness and professional excellence, and a conglomerate of different businesses and activities. This transformation has been carefully orchestrated by the current leadership and appreciated by the stakeholders.

Thus, the study described that there have been many staging posts on the corporate journey of ITC. The company has arrived again at another milestone – this time its centenary in 2012.Over the years, the company has embraced challenges and treated it as a privilege to change. Actuated by past foundations and strengthened by last fifty years, the company has emerged strong and whole. The future perhaps looks bright. What has made it so is the quality of its people and governance, by displaying flexibility and resilience, that has been able to adapt to changes of varying degree brought about by social, economic, and political factors.

The study concludes that it is governance and leadership, which have determined and guided the fortunes of the company. The credit must go to a continuing team of professional managers and philosophy of governance, without which, the ITC story might have been in a different trajectory.

Part II

This section describes the recent developments in the Corporate Governance Regulations and Practices in the India and World to understand contemporary trends. It also highlights changing practices and philosophical understanding of Indian companies on governance, leadership and sustainability.

8.1 International Convergence

The development of Corporate Governance Regulation in India, accords an identifiable process of evolution of global norms that aims at efficiency and transparency. The scope and significance of Corporate Governance in India has increased in the recent times due to the interaction of Indian corporates' with international financial markets and investment community in exploring the domestic as well as global markets for business growth. The quadrilateral of Corporate Governance Committees in India (CII - KM Birla – Naresh

Chandra – N.R. Narayana Murthy) highlighted how issues developed over the years in Indian context in relation with global developments.

The Indian journey represents certain amount of convergence or incidental harmony with international corporate governance models prevailed in advance economies. One such notable development relates to the world wide changes in the regulatory framework of corporate governance. Letza and Kirkbride (2004) opined that traditional regulatory architecture that focus on the choice between Market-based regulation and State-based regulation has been dramatically changing due to the increasing role of self-regulation. This 'blurring boundaries' view has been supported in numerous studies because governance through self-regulatory codes that include a focus on social, ethical and environmental issues is likely to reduce the need for governmental interference and will also contribute to the creation of greater shareholder value. Indian regulatory context positively reflect an identical convergence, as one observe the popularity of self-regulatory codes that however reasonably interplay with other two i.e. Market-based and State-based. Majority of recommendations (not Listing Agreement) have asked for voluntary regulation on part of companies while duly seeking the governmental and market regulators co-operation in achieving the penultimate objectives of Corporate Governance reforms. However, it's a classic interface of Market based (regulations like prohibition of Insider Trading, Listing Agreements, Takeover Code which aims to reduce the fundamental Agency problem), State-based (Company Law Review) and Self-regulation (Voluntary action suggested in various reports) in the Indian Corporate Governance context.

Another aspect which is somewhat similar is to the relationship between three layers Law, where one can postulate convergence of Indian Corporate Governance system in relation to the world. As Hoffman (1998) emphasized in the UK context that at the first level exist bedrock of duties owed by Directors as prescribed in the Common Law, second layer impose number of specific Statutory duties that reinforce the above duties in the Common Law and the final layer specify duties under the Self-regulatory codes. As one applies this to Indian context, the Companies' Act of 1956 has specified certain fundamental duties, liabilities and powers and functions to Directors of the companies which are in turn strengthened by statutory duties set by market regulators. Moreover, Self-regulatory codes adheres duties in the areas not thought suitable for immediate legislation. A classic interplay of these layers constituted the best practices in Anglo-American Corporate Governance systems and Indian experience seems no difference to this.

8.2 Investor Protection and Shareholder Activism

At the outset, it is befitting to explain the uniqueness of Corporate Governance problem in India which may not fully subscribe to widely accepted view that contemporary capitalism is characterized by a conflict between shareholders and management. Banaji (2006) explained that general view on Agency problem has to be drastically modified when applied to markets like India, where shareholding remain concentrated in the hands of family business groups who control the management of 'their' companies. These controlling or 'dominant' shareholders do not face a problem of accountability in the same way that shareholders in the Anglo-American markets do because they are also the managers in the companies they control. In this sense the Classical Agency problem holds no ground in the majority of Indian companies. However, a vast majority of these companies are Public corporations i.e. listed on the local stock exchanges, so here issue of governance becomes, as Varma (1997) described, potentially a conflict between two categories of shareholders - non-controlling and controlling or minority and dominant. It has also been time and again observed that in India (like in many countries), expropriation of minority shareholders and creditors by controlling shareholders is extensive. The controlling shareholders or managers expropriate the returns on investment that actually belongs to other investors who bare the risk of financing the firm. Thus, Corporate Governance reforms in India, to a large extent, aims to set of mechanisms through which outside investors protect themselves against expropriation by the insiders. However a positive trend, in the midst of these transgressions is growing Shareholder Activism and Investor Awareness.

In 2009, an epitome of Shareholder Activism witnessed in Satyam Computer's Ltd which have literally forced Satyam computer services to call off its $1.6 twin deal to acquire Maytas Properties and Maytas Infra, controlled by the sons of the company's chairman. This has subsequently resulted in exposing several wrongdoings at the company and generated heightened interest among several interested parties with regard to investor protection. Another instance of Shareholder Activism in India can be seen in case of Government's decision to part 30 percent of PBT at Gujarat Mineral Development Corporation for socio-economic development. Although the State government proposal passed in the AGM, disappointed shareholders have approached High Court of Gujarat to claim their right over unpaid dividends.

Likewise, shareholders of Bajaj objected the modus operandi of ownership and share transfer between the disputed Bajaj brothers. The shareholders sought Mumbai High Court intervention to critically examine the unfair treatment towards retail investors. The shareholders opposition to the delayed disclosure in case of Solex pharmaceuticals has made the beleaguered promoters of Ranbaxy to reveal ownership issues - who otherwise, maintained a ‘no comment stand’ all the while.

The Shareholder Activism however, may be a positive trend but it should combine with a regulatory re-look at rules governing Corporate Governance to ensure better Investor Protection. The need of the hour is to change regulatory mind set from ‘best practices’ to ‘next practices’. The best practices in reality will only lead to mediocrity in haste. Contrary to that the next practices approach by definition mean ‘amplifying weak signals’. The regulators have to amplify weak signals in Investor Protection, be it legal provisions for quorum at the Annual General Meetings or Takeover code or Insider trading prohibitions or lack of independent Audit function or weak Surveillance mechanisms, thereby prefer either ‘self-regulatory system’ or introducing a new ‘rule based approach’ with effective enforcements. The current politically correct box-ticking approach also needs to transform to an enlightened ethical leadership model for equitable treatment of investors and protection of minority shareholders rights.

8.3 Corporate Governance and Small and Medium Enterprises

The issue of Corporate Governance has been a growing area of management research especially among large and listed firms. In case of SMEs, the application of Corporate Governance, on the face of it, seems to be discrete and indistinct as the structure usually is too small and same actors are engaged in various processes at different levels of the enterprise.

However, Corporate Governance enhances competitiveness of SMEs by playing an important role in management and mobilization of resources. The Corporate Governance system can greatly assist the SME sector by infusing better management practices, effective controls and accounting systems, stringent monitoring, effective regulatory mechanism and efficient utilization of firm’s resources through Independent Directors. SMEs with well-established Corporate Governance structures are able to gain easier access to credit at lower cost since such firms are not only able to repay their debts timely, but also demonstrate an improved performance.

The present study therefore proposes an incentive based governance framework to encourage SMEs firms to adopt good governance practices particularly through tax incentives. A self-regulatory code could be developed with the consultation of SMEs and industry associations to incorporate different features of Corporate Governance for firms at different stages in the business cycle, according to the capabilities of the company and the needs of investors.

8.4 Sustainability Leadership

The concept of Sustainable Leadership includes three dimensions of welfare such as Economic, Environmental and Social - and involves complex synergies and trade-offs among them. It highlights "a Triple Bottom Line” approach that encompasses Profit, People and Planet.

Sustainability Leadership helps to steer business organizations to satisfy the interests of diverse stakeholders who are part of its social, economic and physical environment. A cornerstone of this approach is to take on responsibility for ‘externalities’ – which refers to spill over effects of business operations that have an impact on its broader milieu, either directly or indirectly. These ‘externalities’ for instance, like pollution are the impacts that companies have on the planet, which are not part of immediate business environment. Therefore, earlier thinking is that, business need not be accounted for that. But, Sustainability Leaders understand these externalities and do not wait for Government regulation, stakeholder Law suits, etc., to act on. They proactively respond through well-formulated company policies and demonstrate an overarching commitment through their beliefs, values to deal with these side effects of their business actions. Sustainability Leaders thus, take accountability of social, environmental and social impacts that are not just directly attributed to their business, but also ameliorate problems in the larger interest of human welfare and survival. They consciously embrace choices that serve common interests, knowing that in the long run doing so also serves their own interests. This shift in perspective indeed opens a new path for the collective work to sustain people, organizations, communities, and life on the planet. Sustainability Leadership is therefore beyond the business –to integrate aspects of ethics, individual responsibility and entrepreneurship. It is primarily a mind-set that focuses on long term relationships in contrast to short term transactions. It is a thinking that upholds an organization’s purpose than mere performance.

8.5 Corporate Governance and Stakeholder View

Post, et.al. (2002) stated that adopting stakeholder view of the corporation does not mean that all stakeholders must be included while determining the formal governance structures. But it does imply acceptance of the fact that many classes of stakeholders already have substantial influence on the activities of the corporation with which they are associated, and that this influence usually is legitimate. Thus, insofar as these entities influence the decisions and actions of the corporation, they have a role in governance.

Therefore, a major implication of the stakeholder view of governance is that the formal governance process of corporations should make strenuous efforts to include the views of major stakeholder groups within the framework of analysis and decision making. However, this does not mean that any particular stakeholder group should have a seat or vote on the Board. Freeman and Evan (1990) stated that the Board should make every effort to know what the concerns and interests of critical stakeholders with respect to any significant Board decision are, and to include these stakeholder perspectives in their own decision making. The stakeholder view of Corporate Governance thus implies that a systematic effort should be made to identify critical stakeholders, to specifically recognize and take into consideration of their interests within the formal governance process, and to engage them in an on-going process.

To conclude, the study explores Corporate Governance of the selected case company from a sociological stand point. The study focuses on efficiency of Corporate Governance from the perspective of corporate environment. It tries to substantiate various theoretical standpoints about the given context in which the selected model of Corporate Governance is defined as efficient and differs across the global/national corporate landscape.

The study is oriented to explain the trends in Corporate Governance in case of ITC post hoc. The results of the study primarily explain how the context and history of Corporate Governance of the selected company contribute to contemporary developments.

The study also differentiates from the management theory perspectives which describe that Corporate Governance developments are principally driven by competitive pressures and quest for efficiency. They have attributed little power to historical, political and social factors and their subsequent influence on the company. From the sociological standpoint, the study elaborated that competitive pressures and quest for efficiency are important, but when competition is occurring within a highly structured historical and regulatory context, more at the global level may influence companies to alter strategies and Corporate Governance policies.

Appendix I				
Checklist of Corporate Governance **Employed to understand several governance issues in the case company**				
Sl.No	**Issues**	**Yes**	**No**	**Remarks**
1	**Material Information: Shareholding Pattern**			
	Does the company has a transparent ownership structure			
	Nature of ownership structure			
	Breakdown of shareholding is given			
	Dominant shareholder can be identified			
	Director's ownership is given			
	Management shareholding is disclosed			
2	**Governance Structure and Management Process**			
	Is there any separation of power and position between CEO and Chairman			
	What is the type of the Board in the case company?			
	Indicate the governance structure of the case company			
	Are there clear division of powers and responsibilities between the Board of Directors and Executive Management?			
	Is there a division of powers across divisions and strategic business units of the company?			
	How many times Executive Management Committees meet annually?			
	Do the divisions have autonomy to take certain key initiatives and decisions?			
3	**Board Structure and Process**			
	Size of the Board			
	Composition of Board of Directors			
	Proportion of Executive and Non-executive Directors			
	Number of Independent Directors			
	Number of Non-executive Nominee (representative)Directors			
	Number of Directorships and Chairmanships of the Board of Directors in other entities			
	Retirement age, Term limit, Provisions of rotation of Board members			
	Remuneration of Board members: Stock options, Sitting fees, Incentives			
	Is the Remuneration of Board members approved by shareholders?			
	Is there clear distinction of duties and responsibilities among the Board of Directors of the case company?			

3.2	**Board Procedures**			
	How many times Board of Directors meet annually?			
	Is the information and agenda provided to Board members prior to the meetings?			
	Are the Board members made available of relevant information? If yes, what is the nature of the information generally available?			
	Do the Board members oversee the adequacy of Internal Control Systems?			
	Does the Board take interest in the matters of Human Relations (Resource) Development at the company level?			
	Does the Board have an explicit commitment to foster openness in the organisation?			
	Are the decisions made by the Board clearly documented and understood?			
	Does the Board have accessibility to seek independent and professional advice in case of need?			
	Is there a Code of Conduct for Board of Directors?			
	Does the Board have a Policy to prevent Insider Trading?			
	What are the provisions for Directors' education and training?			
4	**Board Committees**			
4.1	**Audit Committee**			
	Membership of the Committee			
	Chairmanship of the Committee: Independent or Executive			
	Financial expertise of the Audit Committee			
	How many times the Audit Committee meet annually?			
	What is the time gap between each of the meeting?			
	Is there a meeting of Audit Committee before finalising the annual financial results?			
	Is the Head of Finance (CFO) and Company Secretary present in the Audit Committee meetings? If yes, in what capacity?			
4.2	**Remuneration Committee**			
	What is the size and composition of the Committee?			
	Chairmanship of the Committee			
	Is the Committee involved in the succession planning of the top Executives of the company?			
	Number of meetings held annually Is the information regarding Committee disclosed in the annual financial report of the company?			

4.3	**Nominations Committee**			
	What is the size and composition of the Committee?			
	Chairmanship of the Committee			
	Does the Chairman of the Committee participate in AGMs?			
	Number of meetings held annually			
	Was there any new Directors inducted in the Board during the study period? The Committee in practice played an appropriate role in recruitment of new members of the Board.			
4.4	**Investor Grievances Committee**			
	What is the size and composition of the Committee?			
	Chairmanship of the Committee			
	Number of meetings held annually			
	Total number of Investor complaints received during the study period			
	Number of complaints solved and pending?			
5	**Stakeholder Relations: Role of Stakeholders in Corporate Governance of the Case Company**			
5.1	**Shareholders**			
	How the company maintains vital channels of communication with Shareholders and provide timely information?			
	Does the company adhere to equitable treatment of the Shareholders?			
	Does the company provide timely notice to the Shareholders with regard to annual general meetings?			
	Does the company disclose information to Shareholders about the external auditors of the company?			
	Does the company allow proxy voting and Postal ballots for Shareholders to express consent and dissent with regard to key decisions?			
	Does the company have any mechanisms that allow minority Shareholders to influence Board composition?			
	Has there been any case of Insider Trading involving company Directors and management during the study period?			
	Has there been any complaints regarding related party transactions?			
	Does the company inform Shareholders regarding nature and extent of transactions with affiliates, associates and interested parties periodically?			
5.2	**Employee Relations**			
	Does the corporate governance policy of the company explicitly recognise the rights of employees?			

	Are there any specific employee rights for participation on the Board of the company?			
	What are the mechanisms for employee participation in the governance of the company concerned?			
	Are there any mechanisms to protect employee interests in the company?			
	Do the employees have ownership rights through ESOPS or any other means?			
	Does the company inform employees regarding threats, opportunities, risks and financial performance of the company regularly?			
	Does the Board maintain links with Employees? Is there any channels of communication between board and employees that inform board members regarding significant Labour problems. Wage agreements, LTA etc.			
	Nature of industrial relations in the case company			
	Have there any instances of strikes and lockouts, fatal injuries and employee retrenchment?			
	Are appropriate standards of occupational health and safety maintained in the factory premises?			
	What are the initiatives undertaken by the company to realise explicit commitments of the corporate governance policy of the company concerned?			
	Does the company concerned effectively contribute for the employee advancement, mobility and development?			
5.3	**Community Relationships**			
	Does the company make explicit reference to the broader obligations to the Society or to the Community?			
	Does the corporate governance policy have having reference to the Social responsiveness of the company concerned?			
	What is the Division's perception of addressing the community needs?			
	What is the extent of Social orientation displayed by the company?			
	Does the corporate governance framework and perception of top management influence the Social orientation of the company?			
	What are the initiatives undertaken by the company and assistance given to maintain links with the community?			
	Does the company build cross sector partnerships for the better results and achieving corporate objectives?			

	Do the relationships with community create a strategic advantage for the company?			
	What is the magnitude of social development initiatives undertaken by the company during the study period?			
	Does the company have any specific reporting procedures to communicate their Social accountability?			
	Has the company developed proper channels of communication with stakeholders which in turn could facilitate dialogue with the community?			
	What are the mechanisms for negotiating with Stakeholders?			
5.4	**Supplier Relations**			
	How do the company executives treat their Suppliers?			
	Does the company maintain mutually enabling relationships with Suppliers?			
	What are the initiatives adopted by the company for the empowerment of Suppliers?			
	What is the extent of involvement by the company with its Suppliers?			
	Does the company transform the supplier linkages to achieve competitive position in the given area of business activity?			
	Does the company also contribute for the social and economic gains of the Suppliers?			
	How the Supplier linkages/ relationships are understood by the management?			
	What are the Supplier perceptions about their dealings with the case company?			
5.5	**Customer Relations**			
	Who are the major Customers served by the company in particular and industry in general?			
	How the company in general understands Customer focus?			
	How the Customer focus is nurtured in the organisation? Are employees and management aware of the advantages of positive Customer orientation?			
	What are the mechanisms adopted to maintain constant dialogue with Customers?			
	How do the Customers perceive their relations with the company?			
	What makes Customers in general to have continuing transactions with the case company concerned?			
	Are there any specific problems that Customers experience in dealing with the company management?			
6.	**Disclosure and Transparency**			
	The requirements of periodic disclosure specified in any provisions of the case			

	company? Explain to whom these disclosures should be made and with what frequency?			
	Is the company required to make a special filing of the annual report with securities market regulator?			
	Does the annual report necessarily reflect business operations, competitive position, changes in equity and other non-financial matters of the company concerned?			
	Does the company provide information regarding major shareholders and voting rights?			
	What type of information regarding Board members and key Executives is available to Investors in the annual report?			
	Is the company mandatory or voluntarily discloses information regarding related party transactions in their Annual report?			
	Does the company disclose information regarding roles, responsibilities, process and procedures of audit committee in the annual report?			
	Has the company voluntarily disclose information on key issues relevant to employees and other stakeholders that may materially affect the performance of the company?			
	Does the company required to disclose corporate governance policy and structure?			
7	**Miscellaneous**			
	Does the company have a policy of takeover defences?			
	Does the company concerned disclose non-mandatory items in the corporate governance report?			
	Does the company have a code of conduct for top management and employees?			
	What are the internal mechanisms adopted by the company to strengthen/ smooth functioning of corporate governance structure?			
	Has any reporting initiatives adopted voluntarily by the company?			
	Does the company established efficient channels of communication with stakeholders? Specify if any?			
	What is the perception on overall stakeholder orientation of the company?			
	Has the company deviated from the statutory provisions of corporate governance in the recent times?			

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