Corporate Governance – A Practitioner's Perspective

Dr. Mukund Rajan

FORUM
OF FREE ENTERPRISE

"Free Enterprise was born with man and shall survive as long as man survives".

- A. D. Shroff
Founder-President
Forum of Free Enterprise

SHAILESH KAPADIA

(24-12-1949 – 19-10-1988)

Late Mr. Shailesh Kapadia, FCA, was a Chartered Accountant by profession and was a partner of M/s G.M. Kapadia & Co. and M/s Kapadia Associates, Chartered Accountants, Mumbai.

Shailesh qualified as a Chartered Accountant in 1974 after completing his Articles with M/s Dalal & Shah and M/s G.M. Kapadia & Co., Chartered Accountants, Mumbai. Shailesh had done his schooling at Scindia School, Gwalior and he graduated in Commerce from the Sydenham College of Commerce & Economics, Mumbai, in 1970.

Shailesh enjoyed the confidence of clients, colleagues and friends. He had a charming personality and was able to achieve almost every task allotted to him. In his short but dynamic professional career, spanning over fourteen years, Shailesh held important positions in various professional and public institutions.

Shailesh's leadership qualities came to the fore when he was the President of the Bombay Chartered Accountants' Society in the year 1982-83. During his tenure he successfully organized the Third Regional Conference at Mumbai.

Shailesh was member, Institute of Fiscal Studies, U.K.; member of the Law Committee and Vice-Chairman of the Direct Taxation Committee, Indian Merchants' Chamber. He was also a Director of several public companies in India and Trustee of various public Charitable Trusts.

He regularly contributed papers on diverse subjects of professional interest at refresher courses, seminars and conferences organised by professional bodies.

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Editorial Introduction

For the past several decades, corporate governance has been a subject of extensive and intensive debate. This is not surprising in the context of the fact that a number of corporate enterprises are becoming extinct, both in India and abroad. Indeed, many of them during their heydays were acclaimed as very successful, and also enjoying good brand equity. All of them have, in some way or other, compromised and manipulated the essentials of corporate governance. Even sound and strong legal and regulatory framework has often been found wanting in promoting and ensuring required standards of corporate governance.

Yet, the relentless pursuit of good corporate governance practices has to assume primacy in our overall legal and regulatory structure. Moreover, there prevails an inextricable relationship between good corporate governance and sustainable performance of corporate enterprises, both at operational and profitable levels. Indeed, consistent adherence to well-established corporate governance standards inevitably earns concerned corporate enterprises the confidence, goodwill and elevated brand equity, not only from its own stakeholders, but also from the people at large.

Needless to say, corporate governance per se has, over the years, come to acquire multiple underpinnings and nuances. All of those have also been primarily determined by specific provisions of the Companies Act, the SEBI guidelines, the Accounting Standards, issued by the ICAI, the listing agreements with the stock exchanges, etc. Besides, many corporate enterprises have conceptualized and implemented their own codes of conduct and value systems aimed at improving their respective corporate governance frameworks.

Be that as it may, the FORUM has been fortunate that the Key Note address delivered by Dr. Mukund Rajan at the prestigious annual program held during August 2018 at Nasik has dealt with comprehensively on this vital theme of corporate governance. Right at the beginning, he highlights two distinctive elements of corporate governance, namely, ethical and compliance related issues. Given his rich experience as Chief Ethics Officer of the Tata Group, he shared with the participants many interesting developments and insights not only from the Tata Group with which he worked for two decades, but also from what has happened across corporates both from India and abroad.

Amongst various facets of his thematic presentation, he reflects upon why "corporates today operate in an environment of significantly diminished trust".

Indeed, a host of illegal or unethical practices come to the surface be it bribery, corruption, money laundering, insider trading, sexual harassment, failure to protect personal data or mishandling of ecological resources. Evidently, "all the ills of a system of crony capitalism", thus, tend to manifest. He quotes several instances of how even largest companies in the world have suffered erosion (or even extinction) of their position.

Dr. Rajan then goes on to highlight how various policy initiatives are expected to combat the drift, and how even social media networks have started playing their powerful role. In substance, apart from the government's policy changes, citizens in India and around the world "are now beginning to hold corporates and their leaders to a higher standard of conduct than in the past".

Dr. Rajan also covers other important facets of corporate governance such as pressures of urbanization and environmental/ climate issues, including sustainability challenges. It is interesting to witness how corporates are responding progressively to these challenges in various ways by embracing the concept of "circular economy"; appropriate usage of CSR funds; innovation and creation of intellectual property; etc.

Reflecting on other ethical aspects like growing inequality in society, employment creation and skill development, he mentions about how Tatas evolved the concept of 4Es – Education, Entrepreneurship, Employment and Employability. Indeed, there is so much to learn for all those in business and industry – both from philosophical and practical perspectives – from what the Tatas have done over the past many years. Witness, just a few of those initiatives – the Tata Code of Conduct; Tata Brand Equity and Business Promotion Agreement; Leadership of Business Ethics framework!

All in all, this booklet offers significant holistic dimensions to the vital theme of corporate governance. Undoubtedly, the business environment for corporate enterprises would be constantly changing in the years to come, given the rapidity of changes in technology, market structures, consumer behavioral patterns, legislative and regulatory reforms, and so on. We, at FORUM, strongly believe that Dr. Rajan's very perceptive and insightful reflections would not only make valuable and relevant reading, but also stimulate academicians and corporate professionals, students and researchers, and policy makers to undertake further studies on this subject, including formulation of useful case studies.

Sunil S. Bhandare
Editor

Corporate Governance – A Practitioner's Perspective

Dr. Mukund Rajan*

I thought I would speak to you today about corporate governance, from a practitioner's perspective, and as a representative of the corporate sector. How are corporates viewed today, what are they doing right from a governance perspective, and where could they do better.

Corporate governance, as we all understand, refers to the mechanisms, processes and relations by which corporations are controlled and directed. There are elements of both ethics and compliance in corporate governance, and there is, of course, a distinction between ethics and compliance. In simple terms, ethics is about 'doing the right things by stakeholders', while compliance is about

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* *The author is a member of Forum's Council of Management. This text is based on Dr. Rajan's inaugural talk at the residential program on taxation arranged by Forum from 2nd to 4th August 2018 at The Gateway Hotel, Nashik.*

'undertaking actions correctly'. Ethical conduct and practices are based on a company's business principles, mission and values, while a compliance program would be more prescriptive – it would be primarily based on laws, regulations, policies and procedures. So, ethics represents a value-based commitment to the 'spirit' of doing the right thing at all times - even when nobody is looking - while compliance relates to following the 'letter' of the law.

In my last organization, the Tata group, where I served as Chief Ethics Officer, we recognized this difference. By the way, I spent over two decades at the Tatas, so it offers fertile ground for several of my illustrations on various points during this talk. So, we implemented a structure of Company Ethics Counsellors supported by field teams of Local Ethics Counsellors. These were mostly voluntary employees identified by their personality, work and experience profile and their professed commitment to the group's value system. They would be drawn from a variety of functions, such as HR, Administration, internal audit, and so on. This network drives advocacy and training activities on the Tata Code of Conduct, and provides counsel and support to employees facing ethics-related dilemmas.

Compliance Officers, on the other hand, are appointed to typically oversee and administer business areas that are clearly governed or regulated under Company Law or our country's legal system. So, separate from the Ethics Counsellors, we would have Compliance Officers for matters such as Anti-Bribery and Anti-Corruption, or anti-money laundering, or anti-insider trading, or the Prevention of Sexual Harassment. Compliance Officers need to be subject-matter experts who understand how to interpret laws/regulations and also oversee a formal compliance program in the area for which they are responsible.

Ethics and compliance both have their part to play in informing the role of corporates in the world today. I would like to reflect on how corporates are viewed today, from ethics and compliance lenses, and then focus on the two most critical challenges corporates face today, and what they are or should be doing about these. In front of this learned audience, I thought my slant should be more on ethics, rather than compliance which most of you already understand.

Let us start with how corporates are viewed today. The plain truth is that corporates today operate in an environment of significantly diminished trust. A **series of events** around the world over the last decade and a half have served to create this environment. These include the dot com boom followed by the bust around the turn of the century, the Enron fiasco, and the global financial crisis of 2008. We had the unedifying spectacle over the last few years of what was briefly the largest automobile company in the world, Volkswagen, suffering significant brand equity erosion and huge punitive fines of well over $ 15 billion in the aftermath of the discovery that the company had fudged the emissions data of its so-called "clean diesel" vehicles. Most recently, we have concerns that are, again, emanating from the dot com world, about the security of personal data and protection of privacy, with some of the largest companies in the world, like Facebook and Google, being accused of not protecting personal data adequately, or even worse, misusing their access to such data for commercial ends. Exactly a week back, we witnessed the massive drop in Facebook's market capitalisation – it was the largest one-day loss in market value for any company in U.S. stock market history – the social media giant's market capitalization plummeted by $119 billion as its stock price fell by 19 percent. This was on the back of disappointing quarterly performance, projections of slower growth in the future, and higher investments required to deal with the improved safety and security features they have promised to provide their users.

In India as well, this past decade has seen a huge catharsis in Indian society, especially in relation to the subject of corruption. Public consciousness has been ignited, with independent activists, the judiciary, a vigilant media, and the instant scrutiny of social media networks, all playing their role in shining a light on the malaise of corruption. Between the **Satyam scam**, the so-called 2G scam, the coal scam and many other scams, we have seen the largest number of corporate leaders, senior bureaucrats and politicians in post-Independent India's history being sent to jail or hauled up before the courts. In 2012 as we know, the Aam Aadmi Party, a new political party, was in fact founded on the exclusive platform of fighting corruption.

We have worrisome data that suggests the malaise of corruption is still deeply rooted in India. The findings of the EY Asia Pacific Fraud Survey for 2017 revealed that 78% of respondents agree that "bribery and corrupt practices occur widely in India", and 58% of respondents are still willing to work for organizations involved in major bribery or fraud cases. Many Indians are inclined to believe that big Indian corporates have got to where they are by a variety of unethical means, whether by being extremely cut-throat in the way they have dealt with smaller competitors, or by ignoring the impact of their activities on environment, or by trying to extract profits at the cost of communities – all the ills of a system of crony capitalism. Over this past weekend, you even saw Prime Minister Narendra Modi having to explain and defend himself when saying "I am not afraid of standing next to India Inc", because the public perception of big corporates is currently so poor.

The trend therefore in terms of policymaking in India has been to correct this problem of crony capitalism by introducing greater fairness and a level playing field. This can be seen in the decision to introduce public auctions of **spectrum in telecommunications**, and greater objectivity in the allocation of mining rights and the issue of banking licenses. We have also seen this in the government's efforts to address the generation of black money, one of the main reasons advanced for the demonetisation exercise. And with greater financial inclusion, the thrust on digital transactions, the introduction of new regulations such as the Insolvency & Bankruptcy Code, and the move towards the Goods and Services Tax (GST), we can expect that there will be far tighter controls on money laundering and corruption than ever before.

So, compliance will force the issue on some of the problems created by corporates. What has also happened, thanks to social media networks, is that no organization or brand, irrespective of stature or legacy, is now able to escape scrutiny, and no matter how famous you may be or how big your reputation, the sins of the past can now catch up with you even after many years. One illustration of this is the **#MeToo movement**, where large number of women across the world are coming forward with descriptions of harassment and sexual abuse they have faced in the past, sometimes decades earlier, and naming and shaming the men responsible. Another, very different, example from India is the case of the Unilever thermometer factory in Kodaikanal which was shut down as far back as 2001 due to environmental violations. There had been a number of public protests against Unilever's failure at the time to fully clean up the site; then, in 2015, **rapper Sofia Ashraf** released a song condemning the inaction called 'Kodaikanal won't'; this went viral, logging over 4 million views, and forcing Unilever's global CEO, Paul Polman, to confirm the company's commitment to cleaning up the site. Paul Polman, and those of you who know him will attest to this, is one of the most environmentally conscious corporate leaders in the world; it was definitely awkward for him to have to deal with this issue, which was not of his making, but he handled it the right way.

It should be no surprise that more CEOs, as a 2017 study by PWC indicates, are getting fired for ethical lapses than used to be the case. This does not mean that CEOs have become more unethical. Rather, it indicates that as a result of the increased public scrutiny and enhanced governance and regulations, companies have become much more likely to dismiss their chief executive officers over ethical lapses, including issues such as fraud, bribery, insider trading, inflated resumes, and sexual indiscretions.

So, citizens in India and around the world, are now beginning to hold corporates and their leaders to a higher standard of conduct than in the past. Citizens, individuals like you and me, have become hugely empowered by the democratisation of information access, the near ubiquitous access to the information resources of the worldwide web, and the power of instant scrutiny of corporate actions through social media networks. And the scrutiny of corporate conduct is now extending far beyond business performance, to issues of governance, risk management, protection of human rights, fair labour relations, commitment to sustainability, nurturing of diversity and inclusion, and many other issues.

In response to enhanced civil society scrutiny, new legislations and compliance requirements are being drawn up across different markets. Many of these now come with **cross-jurisdictional and extra-territorial impact**. For instance, under the UK Bribery Act, it is entirely possible that Indian companies could be prosecuted in the United Kingdom for corrupt practices in totally different geographies, such as in Africa, merely by virtue of having a small footprint in the United Kingdom. Efforts to enhance financial transparency within the G20 countries are another illustration of the fallout from greater scrutiny. Last week we saw General Elections take place in Pakistan; you will recall that these elections are the result of the collateral damage caused by the leak of the Panama Papers, which led to the exit of former Prime Minister **Nawaz Sharif**.

Corporates, moreover, now need to be increasingly concerned not just about their own compliance across a range of issues, but also that of their vendors and their value chain partners. If an Indian tea company, say Tata Global Beverages, wishes to sell tea in markets across the world, it has to be very concerned about the treatment of labour and the sustainability practices followed in plantations across India, Sri Lanka, Kenya and various other parts of the world from where it sources the tea it sells. When I was in Tatas, we actually faced calls in the UK for a consumer boycott of Tetley products because conditions on some of the tea plantations from which Tata Global Beverages sourced tea were not up to the standards Western audiences expected.

Having established then that there is not only more scrutiny but also an expectation of higher standards of ethical conduct and compliance from corporates, you may wonder whether, in substance, any of this is really new. The greed and hunger for power that typically shape bad corporate behaviour are nothing new, nor is the process of then bringing in regulatory changes and compliance requirements to curb the worst instincts of corporates. But what is new – and this time, it *is* different – is first, the deleterious impact corporates are having on the natural environment, and second, the growing inequality in society they are feeding at a juncture in human civilization when information is widely available and gross differences in society are getting recognized and becoming intolerable. These two issues present ethical challenges that corporates have to deal with, and how they resolve them will have huge implications for the sustainability of the global economic system.

Let's look at the impact on the natural environment first. The scale of the impact corporates are having on the environment is unprecedented. There is a concept called the **Earth Overshoot Day**, which is the date when corporate inspired demand for ecological resources and services in a given year exceeds what the Earth can regenerate in that year. Ideally, we should reach that day on December 31st, so that the Earth is able to regenerate all the resources we consume. However, we are actually reaching that day in the month of August now, which is not only unsustainable but also very frightening. A very specific outcome of the excessive consumption of fossil fuel-based energy sources is of course global warming, which will lead to melting glaciers, sea level rise, inundation of low-lying geographies, changes in cropping patterns, and the spread of all kinds of diseases. If you were a devout Hindu, this perhaps represents the 'Kali Yuga' we are warned about. And if you are a movie buff, perhaps movies like '2012' depict the kind of calamities that could befall us. The truth is, even with the Paris Climate Accord which was agreed in 2015 by the governments of the world and entered into force in 2016, and assuming it is diligently followed through, we will be on track for a 2 degrees celsius rise in temperatures by the turn of the century, which will still have significant adverse implications for humankind. We need to try and cap the temperature rise to as close to 1.5 degrees celsius as possible. The speed with which we are hurtling towards possible disaster means that we are running out of time to find solutions.

The added pressure of **urbanization**, which corporates generally favour as it aggregates citizens in compressed geographies that are easier to serve with products and services, compounds the environmental problem. Over one billion people are expected to migrate to cities across the world over the next decade, demanding housing and new infrastructure, and causing more pollution. The environmental degradation this will create can be gauged from the fact that a majority of the world's urban population already lives in cities with air pollution levels at least five times higher than World Health Organization (WHO) guidelines. By the way, it is worth noting that as per the WHO's ambient air pollution database, 10 of the top 20 most polluted cities in the world are in India. Many of us have already experienced the spate of man-made environmental disasters in Indian cities. Chennai is my home town, and I saw how the **floods of 2015** proved to be great levelers, forcing corporate leaders to emerge from their cocoons. Once the flood waters entered the homes of the rich, carried away corporate jets from the tarmac of the airport in Chennai making escape impossible, and once the power supply was cut, it didn't matter how much wealth you possessed - every Chennai inhabitant was reduced to the same primitive level of lack of hygiene and basic needs.

A further level of complexity is introduced by global environmental issues like ozone depletion, global warming and loss of biodiversity; no single nation can solve these problems on its own, and the collaboration of all countries is required for their resolution, which inevitably poses a huge problem. On an issue like global warming, for instance, it is no good for the United States and the European Union to set carbon emission reduction targets, if the reductions they achieve are nullified by the growth in emissions of countries like India and China; a consensus is required between all countries, to ensure the available carbon budget is distributed rationally.

From a compliance perspective, regulators around the world are still evaluating the extent to which corporates should accurately forecast and disclose to their investors and other stakeholders the part their businesses play in the context of these sustainability challenges. Besides the global reporting frameworks for sustainability reporting, such as the Global Reporting Initiative (GRI) and the International Integrated Reporting Council (IR) framework, there are the recommendations of the Task Force on Climate-related Financial Disclosure (TCFD), led by Governor Mark Carney of the Bank of England, for the reporting of material climate-related risks by businesses in their financial filings. Further disclosure guidelines for corporates can be expected, along with increasing legislation, public pressure and media attention.

The ethical challenge to corporates arises from the fact that some of the solutions to the environmental and sustainability challenge we face can only be found in the long term. Corporates will require courage to set aside short-term advantage in preference to long-term solutions, and will need to invest considerable resources in educating their investors and other stakeholders. This is the conceptual understanding underpinning the establishment of Focusing Capital on the Long Term (FCLT), a global not-for-profit organization dedicated to encouraging long-term behaviours in business and investment decision-making, and co-founded by like-minded organizations like BlackRock, the world's largest institutional investor, Canada Pension Plan, Unilever, and McKinsey & Co.

The focus within the corporate world will therefore need to be on a new model for sustainable growth in the long-term that values both social and natural capital and focuses on development of a circular and sharing economy. The magnitude of challenges ahead of us will also call for collective action to build scale through partnerships and collaborations, and drive excellent execution. The good news is that work on these fronts is happening, and increasing numbers of corporates are awakening to the responsibility they carry. Let me illustrate this.

Enlightened corporates are now putting in place protocols to **value social and natural capital**. Of course, these are relatively new constructs, and require a lot of trial and error before adequate valuation frameworks will emerge. For instance, how do you reconcile the environmental damage caused by industrial activity with the social cost of job loss if polluting factories were to shut down? India is, interestingly, leading the charge on the social dimension, by virtue of the legislation in the new Companies Act on Corporate Social Responsibility or **CSR** spending by corporates. In a first of its kind legislation anywhere in the world, corporates in India that meet a size and scale test are required to spend 2% of their net profits on CSR. This spending is required to be monitored by a committee of the Board of Directors, which includes an Independent Director. This scrutiny is elevating the discourse on CSR at the level of the Board – where earlier CSR spending by Indian companies used to be something undertaken "beyond business", if and when a corporate had the money and inclination, it is now a firm mandate, and a matter of considerable debate and discussion amongst Board Directors, with a focus on the efficiency of spending and the outcomes delivered. In addition, in the more forward-looking corporates, we are seeing the mandate of such Board committees expand, to include the larger subject of sustainability.

Many corporates are also beginning to embrace the concept of the **"circular economy"**, one where resources are circulated within the system releasing minimal waste into the biosphere. A good example in this direction is Jaguar Land Rover's REALCAR (REcycled ALuminium CAR) project which aims to develop a closed-loop process for car manufacturing. The key parameter the company uses to measure its success in this project is the percentage of recycled aluminium used in vehicle manufacture – the company aims to boost the amount to as much as 75% in the near term, thereby lowering its overall carbon footprint.

The challenges of sustainability are forcing more and more partnerships and pooling of resources. Indeed, the CSR legislation in India permits corporates to pool their CSR funds, to achieve greater impact; the space is seen as one where corporates can collaborate, without worrying about losing their competitive edge, and where the contribution they can make offers a win-win for all stakeholders. We see this happening in initiatives like skills development activity, where corporates like Schneider, Siemens and Bosch have willingly joined hands with Tatas to deliver high quality skills development programmes.

Corporates are also leading the charge on innovation and creating intellectual property to find new solutions to problems. A good example of this is the work which yielded solutions to the ozone depletion problem. This problem first emerged with the huge hole in the ozone layer above Antarctica in the 1980s. It was the corporate world that led the development of alternatives to the ozone depleting chloro-fluro-carbons which were being used as refrigerants and coolants in devices like air conditioners and refrigerators. Equally important, the key corporates involved in this action consented to the transfer of technology to developing countries, to speed up their elimination of the use of these substances. The international consensus on this issue was enshrined in the Montreal Protocol on Substances that Deplete the Ozone Layer.

The new challenges of sustainability are spurring corporate innovation and the quest for new business opportunities. Corporates see that by responding to these trends with agility, they will not only be able to remain competitive, mitigate risks, and future proof their businesses, but will also be well positioned to seize the business opportunities that get unlocked as a result. **Significant market opportunities** are being created in sectors ranging from solar power equipment to drip irrigation modules to electric vehicles, all a result of the new focus on sustainability. On an issue like global warming, innovative companies are playing their role in catalyzing rapid progress on decarbonization of power combined with extended electrification, increased productivity of energy-based services through a shift towards more service-based and digital economies, and more efficient urban design. It is quite likely that within the next generation we will witness the elimination of the internal combustion engine, the creation of all pervasive intelligent networks that will monitor and shape all human activity, the elimination of most industries based on fossil fuel usage, and a very substantial overhaul of the architecture of the industrial economies with which we are currently familiar.

In this changing landscape, we are also finding that increasing numbers of consumers are becoming more inclined to buy products or services that align with their own lifestyles and value systems. For them, it is no longer about what you buy, but what you buy into. If businesses are willing to clarify the higher purpose they serve, customers are also willing to reward them with both mind-share and share of wallet. Corporates that offer **purpose-driven brands**, like "Patagonia", whose Mission is to 'Build the best product, cause no unnecessary harm, use business to inspire and implement solutions to the environmental crisis', or "The Body Shop", which commits to 'Enrich, not exploit', are consequently getting very good traction in the market. This is the reason that some of the best corporate marketers in the world are emphasizing the importance of corporates defining their core purpose, or *raison d'être*, and winning customers who are aligned to their mission.

The net impact of all of these trends – new protocols to value social and natural capital, the quest for a circular economy, the prospects of greater collaboration, the thrust on innovation, the adoption of new measurement and reporting frameworks in response to greater awareness and scrutiny of stakeholders, and the growing consumer affinity for purpose-driven brands – is that across the globe, leading companies are beginning to respond to the ethical challenge of responding to environmental change by placing sustainability at the heart of their business strategies. Indeed, the entire sustainability agenda is now becoming a part of mainstream corporate strategy development and the responsibility of the CEO, with Board oversight. We must be hopeful that this solution yields the transformation we need, before time runs out for us.

Let's turn now to the other ethical challenge corporates face, which is concerned with the growing inequality in society. **Oxfam** released their report in 2017 on global inequality, suggesting that 8 persons – yes, eight – own as much wealth as half the world's population. In India, poor access to basic services like water, sanitation and health-care continue to impact hundreds of millions of Indians. The truth is that our country is still home to the largest population of poor in the world. We need livelihoods to be created, yet there is growing concern about job creation, to accommodate the over million young people who enter the job market every month. Many of these young people enter the workforce unskilled or poorly skilled to actually do the jobs that industry offers. With growing automation and the use of machines and robots to replace manual labour, even the many jobs currently held in corporates by individuals will be at risk in the near future. The World Bank President, Jim Yong Kim, put a number to this two years back, when he said that automation could threaten 69% of jobs in the future in India. The largest threat would be to workers employed in sectors like manufacturing, retailing, construction and transport, who are in jobs that are routine, repetitive and can be easily automated. Thus, the automation of checkout processes, or advances in robotics and 3D printing which improve efficiencies in manufacturing, will make existing jobs redundant, or will require a change in the skill sets required to do these jobs.

In such a rapidly evolving employment landscape, the worry is that millions of young Indians with high aspirations, and awareness created by ubiquitous internet access and satellite television programming of what the good life looks like, will become extremely frustrated and fall prey to the various social ills we already see playing out across India, including communalism and religious extremism. I recall a CII National Council interaction with the then SBI Chairman, Arundhati Bhattacharya, where she warned that corporate leaders need to get out of their shells and address these frustrations before the mobs land up at their doorstep and grab what they can.

Fortunately, we have the tools and capabilities today to lift an entire generation out of poverty and towards a much better quality of life. But we need to leverage these through investments in education, infrastructure creation and skills development, and collaborate to achieve scale. **Skill development** in particular needs to become a national effort, similar to the manner in which South Korea's vocational training system for a skilled workforce has led to its transformation from a poor agrarian society to a modern industrial nation. The skills imparted need to be in sync with the aspirations of our young people, to ensure that they don't drop out of the jobs they enter into after their training. Guiding them towards undertaking skilling programmes that match their aptitudes and interests will be a crucial step towards building confidence and ownership. Further, these programmes need to address the unique developmental needs of women, as promoting gender equality and empowering women are critical to our economic prosperity – with only around 25% of our women in the formal workforce, there is a huge need and opportunity to integrate more of them into the workforce. The same also holds true for the scheduled caste and scheduled tribe communities in India; the calls for reservation in the private sector for these and other communities will only grow stronger if corporates do not step up to their responsibilities to provide support to these communities across what we used to describe as the 4Es at Tatas – Education, Entrepreneurship, Employment, and Employability.

The bottom line with inequality, as reflected in issues like land acquisition in India, is this – you need to carry the community with you and demonstrate your commitment to inclusive growth. Though different in order of magnitude, there is also the issue of inequality within corporates. In recent years, questions have been raised about the level of executive pay, and the acceptability of very high pay differentials between the highest paid executives and the lowest paid workers in an enterprise - the case of a company where the pay of the chief executive crossed 5000 times the pay of the lowest paid worker, made media headlines in India. This is an issue on which, of course, Mr. Narayana Murthy of Infosys fame has spoken out in recent years.

Framed differently, the two ethical challenges relating to environmental change and growing inequality are also informing the global debate on the future of capitalism – whether it should be shareholder interest driven, as in the US, or stakeholder interest driven, as in the Nordic countries. For a country like India with a very large poor population, the debate has mostly converged on the role that a welfare-oriented capitalism will play.

Similarly, on the role of the corporate, I can quote an old hand from my alma mater, Oxford University, Professor Colin Mayer. In his book, "Firm Commitment", he argues that the idea that the main function of companies is to boost shareholder value rests on a misunderstanding of the nature of the firm; companies are not owned by shareholders in the way that ordinary goods are owned – they are not just devices for lowering transaction costs or bundling contracts together, but should in fact be viewed as devices for getting groups of people - workers and managers as well as investors - to commit themselves to long-term goals.

The related question that follows is what do corporates that care about these ethical challenges do differently? What lessons do they offer other corporates about ensuring alignment with the needs of the community? I would like to suggest that it is their focus on at least four areas that makes the difference. Leadership and the tone at the top; significant investment in securing employee commitment; visible and well communicated action against transgressions; and finally, robust internal control processes and measures. Let me now spend the next few minutes touching upon each of these four factors, drawing on my experience from working with the Tata group.

The first factor I would like to talk about is the **'Tone at the top'**. The commitment to good corporate governance needs to be visibly demonstrated by the leadership of an organisation. Discussions around a company's ethical health, governance processes, compliance frameworks and risk management need to be elevated to the level of the Board. In fact, at the Tata group, our internal dialogues on ethics when I was there were extended to cover the external Chairmen of our Boards and Audit Committees.

We were also blessed at Tatas by imbibing the business philosophy of our Founder, **Jamsetji Tata**, who held the view that "In a free enterprise, the community is not just another stakeholder in business but is in fact the very purpose of its existence." Jamsetji Tata felt corporates have a responsibility to concern themselves with the quality of life of the communities they serve. If the community is not successful, if the customers, suppliers, lenders and investors in that community are not successful, it is hardly likely that the corporate that serves that community will survive. So, at Tatas, we have learnt over a century and a half that if we do not address inequality in society, it prevents us from becoming a valued member of the community, and a neighbor of choice. **JRD Tata** famously said "The wealth gathered by Jamsetji Tata and his sons ... is held in trust for the people and used exclusively for their benefit. The cycle is thus complete. What came from the people has gone back to the people many times over." The Trusteeship model of ownership does a lot to instill pride in employees, and to engender trust within other stakeholder groups. It is such pride that explains the heroic actions of the employees at the sister hotel of the one we are in just now, the Taj Mahal hotel in Mumbai, during the 2008 terror attacks; not only did the employees stay at their posts till they were evacuated, but they helped their guests to escape the carnage, and in the process, sadly, a number of them also lost their lives.

The tone at the top also plays an important role in securing the commitment of the employees of an organisation to adhere to high standards of ethical conduct. Engaged employees can be the best brand ambassadors of a company. The **focus on people** is the second key factor that helps organisations sustain a culture of ethics and good corporate governance. At Tatas, we defined our Mission as improving the quality of life of the communities we serve globally through long-term stakeholder value creation. While this Mission is one that connects very powerfully with our employees, we saw a need to enhance this emotional connect, and picked on volunteering as a way to sustain our culture of giving back to society. **The images in my presentation** capture the volunteering engagements undertaken by our employees across different geographies, from India to the US and to China. Tata colleagues have consistently been delivering over one million hours of volunteering a year over the past several years in support of non-profits across the world. Through the volunteering programme, we were able to align the organization's core purpose and values with the personal value system of the employees. In fact, we have also urged the Government that one of the important contributions the CSR legislation in the Companies' Act might make in India is to encourage Pro Bono volunteering, and make it count towards the 2% contribution of net profits that corporates are expected to make towards CSR. We felt Pro Bono volunteering can play a role in increasing individual sensitivity towards the value of CSR in nation building.

Let me say on this subject also, that in addition to the obvious social benefits of Volunteering, organisations and the volunteers too gain from the volunteering experience. Some of the benefits for companies and employees include:

Allowing employees to expand their skills, build upon strengths and connect with the community

Increasing employee job satisfaction and morale, respect for the company, and respect for the concept of service

Supporting employee loyalty, creating team building opportunities, enhancing cross-department and management interaction, and reducing employee attrition

And building brand awareness and creating trust and loyalty among consumers and shareholders

The third key factor that I would like to talk about is the importance of **walking the talk** on ethics. Let me share with you one illustration in recent Tata history where this was put to test. I refer to the case of **Tata Finance**, a company that was operating in several areas of financial services in the early 2000s.

A whistle-blower communication, citing irregularities in Tata Finance, revealed that tens of millions of dollars had been lost in misdirected investments, through step-down subsidiaries, in stocks of speculative quality; and many transactions were found to have been done to secure personal profits for some managers. The Tata leadership reacted swiftly to this situation. First, it guaranteed that the interest of each and every public depositor in Tata Finance would be protected – the group's holding company, Tata Sons, publicly guaranteed that all investors would get back their investments in full. Second, action was promised against all those whose guilt was established, howsoever influential they might be perceived to be; in fact, the then Managing Director faced criminal prosecution, and spent some years in jail. Third, we made full disclosures to all the regulatory authorities; our then recently appointed General Counsel looks back to those days, and jokes how stupefied he was by our conduct at the time – he was tasked to meet the Regulators and hand over letters to them that effectively conceded that "we have broken the law, please prosecute us!". We are still fighting cases on matters relating to those days, from 15 years back.

By standing by our investors, prosecuting the guilty, and ensuring transparency and full disclosure in all our actions, the Tata group emerged from a situation where the trust it enjoyed could have been massively eroded, to one where its brand equity and reputation were in fact substantially enhanced.

All these actions were completely in line with the Tata Code of Conduct. Which brings me to the fourth key factor – having robust **internal processes and controls** and providing the relevant tools for employees and businesses to be able to conduct themselves in a value driven manner. The **Tata Code of Conduct** is one such tool, that guides Tata employees by laying down the ethical standards that they need to observe in their professional lives, and reinforcing the group's value system. A key requirement of the Code is the nurturing of an open and transparent environment where employees can freely speak up when there is a violation of the Code. The Ranbaxy case is fresh in our minds, where the whistle blower, Dinesh Thakur, was apparently awarded $ 48 million for the information he provided to the US regulators. Corporates need to value the contribution that whistle-blowers can make and need to go out of the way to show the system that whistleblowing will not backfire and that they actually walk the talk on protected disclosure. Unfortunately, in India the fate of whistle-blowers tends not to be happy. Too many organizations tend to brush this issue under the carpet. This must change, if corporates want to avoid the predicament of companies like Tata Finance, which we were forced to close down, or Volkswagen or Ranbaxy.

Under the Tata Brand Equity and Business Promotion Agreement, all Tata companies are required to adopt the Code in order to be able to use the Tata brand, which is owned by the holding company, Tata Sons. Each Tata company also submits an annual Code of Conduct compliance document to Tata Sons, and we have frameworks and tools to provide feedback to our companies on areas of improvement. The intention is to assess and benchmark Tata companies against each other and against their global peers, and provide feedback to them. We use **4 pillars of assessment** based on our Leadership of Business Ethics (LBE) framework - Leadership, Compliance structure, Communication and training, and Measurement of effectiveness.

The Leadership pillar examines the level of engagement and commitment of the leadership team, including the Board of Directors, in strengthening the practice of ethics in the company.

The Compliance structure pillar looks at issues like whether the ethics structure is appropriately integrated in the company's organisational structure, the availability of reporting channels like an ethics helpline, and the deployment of guidelines around issues like the Prevention of Sexual Harassment. It should also call out especially the fact that we would take seriously issues of corruption and bribery; we specifically guide our companies to deploy processes and procedures to red flag sensitive issues such as sham service contracts, unusual payment patterns or financial arrangements, failure to disclose ownership structures, and refusal by potential value chain partners to incorporate Anti-bribery and Anti-Money laundering clauses in contracts.

The third pillar of assessment is the Communication and training pillar. As the old adage goes, you have got to follow the three Cs – Communication, Communication, Communication! The Tata companies do this through tools like e-learning modules, training workshops, and the conduct of Ethics Weeks and Months.

And finally, the Measurement of Effectiveness pillar examines the monitoring and feedback mechanisms available in the company for continuous improvement. These include tracking the number and types of cases and their average resolution time, and incorporating best practices from within and outside the group.

Such measurement also helps because it is increasingly being expected by sophisticated institutional investors that corporates will make transparent and comprehensive disclosures on ESG issues, relating to Environment, Social and Governance matters. For those of you who have not seen it, this year's letter to CEOs from **Larry Fink**, the head of BlackRock, the world's largest institutional investor, makes for very interesting reading. He says "*To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate.*".

So, in conclusion, I would say that there are a set of ethical challenges before society today, and corporates that care about their ability to deliver sustainable, profitable growth need to embrace their responsibility to address these challenges. Failure to do so can yield horrible consequences for the quality of life of humankind, especially in a poor country like India. The good news, though, is that we have the insights and means available to us to identify the right path for corporates to navigate through these challenges. Practitioners like those of you in the audience will have a critical role to play in enabling this. Our future depends on this.

On that note, good luck to all of you, good luck to all of us!

The views expressed in this booklet are not necessarily those of the Forum of Free Enterprise.

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good".

- Eugene Black
Former President,
World Bank

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FORUM
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The Forum of Free Enterprise is a non-political and non-partisan organisation started in 1956, to educate public opinion in India on free enterprise and its close relationship with the democratic way of life. The Forum seeks to stimulate public thinking on vital economic problems through booklets, meetings, and other means as befit a democratic society.

In recent years the Forum has also been focusing on the youth with a view to developing good and well-informed citizenship. A number of youth activities including elocution contests and leadership training camps are organised every year towards this goal.

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