Unit 2 ❒ Business and Society

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2.0 Objectives

By society we understand a collection of human beings, generally within some identifiable geographical limits. These human beings have common ways of living, thinking, aspirations, beliefs and faith that are again the products of the environment they live in and the institutions they create and depend upon for their sustenance. These people, with their hopes, aspirations, beliefs and faiths, have material needs for satisfying which they depend upon some institutions and practices known as business. Thus, the relationship between business and society is very close. In fact business is an integral part of the society it has to category. Business is organized for satisfying wants of people. Profit is the principal motivating force behind business. Business, carried on by some members of

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society, is a part of soceity. Being a part of soceity, meeting needs and wants of society for profit, business influences society, which, in turn influences business. The types of products to be manufactured, the marketing strategies to be employed, the way business should be organized are all influenced by the social structure and culture of soceity. The social system, on the other hand, is influenced by the way business functions. The organization of business, the way business functions, innovations, transmission and diffusion of information and new ideas, etc., may influence society. Business activities can greatly influence social attitude, tastes, values outlooks, customs, traits, etc. However, it is very difficult and in some cases, almost impossible, to change many elements of the social environment in the short period.

The relation between business and society is very close, but at the same time the basis of relationship being supply of goods and services for profit, there exists potential scope of conflict between business and society. Businesses may have practices which harm society. Hence, over the centuries, there have emerged certain codes and conventions to be followed by both business organizations and society for their mutual benefit. The objective of the study extends to examining the changing relationshp between the two parties having sometimes opposing interests but at the same time dependent upon each other for their sustenance and growth. Adam Smith was sure that if conducted in the right way, business would maximize both its own profit and benefit for soceity, for the two need each other.

2.1 Introduction

The first step in understanding business is to recognize that business is something very specific and limited. Despite widespread belief to the country, business is not the whole of economic life, far less the whole of life...In highlighting the fact that business has boundaries, and that it specifies something particular and distinctive, the classic business pronouncement that 'Business is business' expresses a fundamental truth (Elaine Sternberg 1994). Business is about the provision of quality goods and services within a community in a way that provides long-term financial benefit to the owners. If a business fails in respect of quality, or concentrates too much on short-term profits, it will not survive for long, and owners will ultimately be the losers. But business must both survive and thrive. On the micro level it must focus on owners' profit, but on the macro level it has to address to the wider demands of social justice. It may survive, but it will not flourish unless it attends to the demands of ethics and morality within society.

Social responsibility of business and business ethics have to be understood with reference to the purpose of business cited above. Through economic or commercial activities businessmen satisfy material human wants and other social needs. On the other hand, business depends for its survival and prosperity on society who provide the resources, raw materials,m services and infrastructure that it needs for converting the factors of production into profitable goods and services. Again, in order to be able to create and enjoy the fruits of enterprise business needs protection from soceity. As such, when we speak of business-

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society relationships, we may in fact business and the local community, a country as a whole, or business and a specific group of people (consumers, stock holders, employees etc.). But, when we refer to business and entire society, we think of society as being composed of numerous interest groups, moe or less formalized organizations and a variety of institutions. Each of these groups, organizations and institutions is a purposeful aggregation of people who have banded together because they represent a common cause or share a set of common beliefs and interest in a particular issue. Thus, business must attend to the legitimate demands and interests of all stakeholders. It has obligations not jsut to shareholders, but also to employeees, suppliers, customers, creditors, the wider community and the natural environment, which it may harm through pollution.

2.2 The Macro Environment of Business

Business environment is divided into macro-environment and micro-environment. The macro-environment is created by forces arising from within business units. The macro environment of business inlcudes the conditions that exist around business. Accordingly, environment influences business activities and is also the key concept in understanding business-society relationship and formulation of business ethics. The macro environment has four principal segments: social, economic, political and technological.

The social segment of the environment focuses on demographics, lifestyles of people, social values, beliefs and institutions. The economic segment comprises the economic policy of state-the direction of development, monetary and fiscal policies, balance of payment position of the country and the level of employment and income of people. The political segment of the environment includes primarity the process by which legislations are passed and administered in the country. The business houses also take keen interest in the regulato processes and the changes that occur over time in business regulations and policy towards diffeent industries. Finally, the technological segment represents the total state of technology-based advancements or progres made by the country and also the policy of the country towards research and development for technological development.

● Social Responsibility of Business

In the most simple and traditional way, the social responsibility of business can be interpreted as the responsibility of business in respect of the impact of their actions on society. As business operates within society, it cannot disown responsibility to society. It has to see to it that the harmful effects of its modes and operations upon society are minimized and beneficial effects maximised.

Naturally the idea of social responsibility requires busines to consider its activities in terms of the social system and hold itself responsible for the effects of its acts anywhere in that system.

The social responsibility idea is not entirely new. The classical view is that society

could determine its needs and wants through the marketplace and business could fix the terms of trade depending upon the market forces (the forces of demand and supply). Adam Smith found the role of "invisible hand" of the market in transforming self-interest into social interest. For ensuring rational development through individual effort, Smith suggested a system consisting of six institutions-economic motivation, private property, free enterprise, free markets, competition and limited liability. The role of government should be very small. That government is the best which governs the least, confines the government to political functions only.

Towards the end of the nineteenth century it was realized that industrial development with scant regard for social responsibility and near-absence of any role of State create innumerable social economic problems. In the circumstances, what followed was proliferation of laws regulating business behavior. The legal restrictions gradually came to influence the attitude and activities of the corporate sector. A new era of social responsibility of business dawned in the wake of the arrival of the welfare state. Social responsibility of business is a late twentieth century concept so far as management science is concerned. Of course, in the days of the classical economists the business community used to volunteer in philanthropic activities like helping the distressed during earthquakes, floods and famines. They had an idea, though vague, of their moral responsibility towards people within as well as outside their work places.

During the economic crisis of the 30s in the 20th century there was a transition from the laissez faire to the Welfare State with mixed economy in certain countries. By the 1950s social responsibility of business came to include employee welfare, decent wages, work place safety measures, retriment benefits, enforced upon business by legislation (e.g. factory acts) in many countries.

Thus, the period from 1950s may be considered the modern era in which the horizon of the concept of social responsibility of business considerably expanded and gained popular acceptance. During this period, the emphasis moved from little more than a general awareness of social and moral concerns to specific issues, such as product quality and safety, honesty in advertising, employee's rights, affirmative action, environment protection and transparency in acounting. Under the changed scenario social responsibility came to be identified as more specific responsibility of the corporate sector, and different scholars defined social responsibility of business in different ways keeping in view the multidimensional impact of corporate activities on society. One definition came from Joseph McGuire who laid down, "The idea of social responsibility supposes that the corporation has not only economic and legal obligations, but also certain responsibilities to society which extended beyond these obligations."

The above definition reflects the extent of consciousness of society about the positive role of the corporate sector in protecting and furthering the interest of people around them. Thus the relation between society and business came to the recognized as a two-way one : both are dependent on each other for their survival and growth. "There exists an implicit

or explicit contract between busines and the community in which it operates. Business is expected to create wealth, supply markets, generate employment, innovate and produce a sufficient surplus to sustain its activities and improve its competitiveness while contributing to the maintenance of the community in which it operates".

It would now be pertinent to provide here the four types of responsibilities businesses owe and are supposed to discharge in fulfillment of their duties to soceity. The four responsibilities are economic, legal, ethical and voluntary/discreationary (philanthropic).

● Economic Responsibility

First and foremost, business is an economic entity whose job is to produce goods and services that society wants and to sell them at fair prices. Profiteering is distinguished from normal profit making. Businesses should not do anything that harms the legitimate interests of other players in the economy.

● Legal Responsibility

Second, there are legal responsibilities of business. There are many laws relating to businesses which ought to be obeyed by businesses. If this does not happen many interest groups in society may suffer. Just as there exists almost in every country a legislative framework to protect business, so also thee exists a responsibility on the part of business to respect the legislative framwork for the protection of the non-business sector.

● Ethical Responsibility

Ethical responsibilities of business include those activities and practices that are based upon the values that bind society and are respected by its members. Thus, ethical responsibilities embody the range of norms, standards and expectations that reflect the concern for what consumers, employees, stakeholders and the community regard as fair and just.

Ethical values and beliefs of people of a society also change from time to time along with changes in literacy, living standards and technological developments followed by consumer movements, and aggressive journalism. Ethical responsibilities in this sense continually are under scrutiny and debate by the interested sections of the society as to their legitimacy.

● Philanthropic Responsibilities

Society also expects from business some voluntary/discretionary or philanthropic responsibilities. Strictly speaking, these responsibilities are not legally enforceable. But, the demand for philanthropic services from business actually originate from the common belief of people everywhere that those who own wealth should do something for the weaker sections of the community. Such activities include provision of health and educational facilities for the poor, creation of recreational facilities, undertakin programmes against drug abuse and other social evils.

2.3 Business Ethics

The discipline that has come to be known as "business ethics" is hardly new. Since ancient times philosopheres and social thinkers all over the world have dwelt upon the connection between business and morality. Study on ethics-business relationship has a long history that can be traced at least to the days of Aristotle, who had equated profit with usury. Kautilya, the chief adviser, philosopher and guide of Chandragupta, the founder of the Maurya dynasty, who ruled between 317-293 B. C, in his masterpiece, Arthasasthra, not only dealt with the science of economics but also provided directives for consumer protection, employer-employee relationship and even trading practices. Again, the inscription of Bible that 'it is easier for a camel to pass through the eye of a needle than a rich man to pass throuhg business was never seen as a virtue.

Commerce depends upon the participation of the majority of a socieyt. Thus, for its very existence it depends upon some common understanding among vast majority of the participants. The common grounds of understanding are based upon ethical values. Ethics is about right and wrong in human conduct. Ethics is about values, choices, delemmas and character. All these elements assist us to make fundamental decisions. Values are core beliefs about what is intrinsically desirable. They underlie the choces made in work decisions just as they underlie the choices made in one's private life. They give rise to ideals that are called ethics or morals. The two terms are sometimes confused, though they are synonymous. While ethics is derived from Greek with its root being 'Ethikas', moral is derived from Latin. They are interchangeable terms referijg to ideals of character or conduct, for distinguishing between right and wrong.

The actual decisions we reach will be the result of how our values can be best realized in a particular situation. But once we start talking about valuesk we have to face the fact that in a present day society there is practically no essential agreemnt on values. We live in a multi-cultural and pluralistic society. In the past, people lived in more cohesive communities. There was a geenral agreement on values, often reinforced by shared culture and religion. Nowadays that form of cohesion has disappeared making room for differences on most issues. Thus, the decison-makers are left with the hard task of prioritizing the issues involved and enquirng about their importance on different sections of coeity. Such ethical enquires requireds the decision maker to consider the facts in the light of important valued. Values shape the way the problems are perceived. They are curcial to our notion that there is a problem to be examined rather than blindly accepted.

When ethical analysis of a problem precedes decison-making, the decision is said to be ethically evaluated. In order to reach an ethical decision, one must define the problem and determine the desired result. The value to be maximized must be identified and all aspects of the problem must be analysed with reference to the values involved. After this, alternatives to each dimension of the problem have to be identified and assessed

for knowing which values to accept and which values to reject. Thus, ethical decisions are decision that result from a reaspmed choice from value alternatives.

● Foundation of Ethical Decision-Making

That the concept of principles or ethics in business is not new has already been shown. But, before the arrival of the nineteenth century and particularly before the great depression of the 1930's, ethics in business decision-making did not attract serious consideration. Traditionally, there have been two broad schools of thought in ethics, which have developed over the years. The two main groups or schools are teleogical ethics and deontological ethics.

● Teleological Ethics

Teleology is that branch of knowledge which deals with ends or purposes. In its purest sense teleogical ethics primarily focuses on the 'ends', the results of the decision rather than the method of getting that result. A typical teleogical view is that the 'ends justify the means'. It implies, the decision maker, before taking decision about the ways or means of doing something has to have the end result or the target to be achieved before him. The end result (the target to be achieved) will justify the means adopted.

● Deontological Ethics

Deontology means the science of duty or moral obligation. In its pureset sense deontology focuses on the means of getting the result. It takes the view that how you get there is as important as to where you get. A deontological view would be more along the lines that there are certain things that one should simpley not do, for example killing people or causing mass destruction for reaching the target or goal. Thus, the menas is as important as the end.

● Forms of Teleological Ethics

In order to deal with different situations, there exist a number of different forms of teleological ethics that have been developed over the years. These include ethical egoism, utilitarianism and Machiavellianism.

The foundation of ethical egoism is based on the principle that "All people are selfish at heart." Ethical egoism suggests that a person should act in a way that maximized his or her own long-term interests. Writers, such as Hobbes, suggested that ultimately we are all genetically programmed to do what is right for us. Under ethical egoism morality means nothing. It would also suggest that we always put our own interest first.

Utilitarianism is based on the idea that a person should act in a way that maximized the good of the greatest number of people. The eighteenth-century philosopher Jeremy Bentham had originally put forward the idea of utilitarianism. But the nineteenth century philosopher John Sturat Mill popularized the concept as the basis of economic thinking that ensures greatest good for the greatest number.

Machiavellianism is the most extreme version of teleogical thinking. Essentially it involves doing what one has to do for getting the job done. Another term that is often used to denote Machiaveliianism is expediency. This view virtually negates the existence of morals.

● Denotological Theories

The word 'deontology' comes from the Greek word for duty. And this type of thinking represents a very different approach from the teleological approach. Denontologists believe that what is crucial are the rules and principles that guide reasoning. Essentially, the means are just as important as the ends. Over the years different writers have put forward different variations of this view. The most notable one is that put forward by Immanuel Kant. Kant's key belief was that one ought only to act such that the principles of one's act could become a universal law of human action in a world in which one would hope to live. Kant's second point was that you should respect everybody as rational and free. In other words, all your decision-making should be made on the basis of respect. Other writers, notably Locke, argued that every body is born with certain natural rights-they cannot be taken away. This should therefore be a fundamental grounding for any ethical decision. Whichover of the above views we take in understanding deontological theiroes, deontology can be summarized thus :

1. There should be rules and morals in soceity that should be fair to everyone during a period.
2. These rules should hold good universally even over the passage of time. A decision made today should not have a predictable adverse effect in the future.
3. All members of society under deontology should be treated with equal respect.

Perhaps the biggest problem with deontological thinking is that it does not take into account exceptions, that is, the issus that fall outside the normal set of rules.

2.3.1 Ethics and Decision Making in Business

With the foundations of ethical decision-making before us the problem now is how to make business decisions. The approach should essentially be a careful combination of the best aspects of the teleological and deontological views. Decision-making in a work situation is a complex task because of the number of influences that effect the decision calculus. It is neither fighting a war nor indulging in pure and simple philanthropic work. Hence, neither teleological approach nor deontological approach can lead business to the right position. Here the problem itself presents the central issue, but consideration is moderated by a number of factors, including the wishes of those who are affected by the problem, the opportunities and costs associated with solving the problem, the knowledge and interests of the persons who ultimately make the decision, and the likelihood of being able to implement the decision as it is intended.

Further, most problems involve two or more values, and a comparison between them is inevitable, such that a greater return to one can be obtained with a loss to the other. Not everything is known about the situation and anticipated consequences cannot be predicted with certainty. Moreover, power to make decision is dispersed over a multitude of people and/or departments. Ideally, the dedcision maker will determine the fundamental values to be maximized and then weigh the probable impact of each alternative. This is why it is incumbent upon organization to clearly communicate those values that are most important, so that at least the most important one can be ultimately considered.

Most work-related decisions have an ethical component. With few exceptions, problems that involve people also involve ethical issues. Decisions that involve conflicts of commitment or obligation have an ethical component. Similarly,m decisions that involve basic freedom and civic responsibilities have an ethical component. Only the simplest, most mechanical of decisions are spread of ethical analysis.

Thus, ethical decision-making is the process of identifying a problem, generating alternatives and choosing from among them so that the alternatives selected maximize the major ethical values while also achieving the goal of maximising owners' value over the long term in production or distribution of goods and services.

2.4 Role of the State in the Business Scneario

In the early days of industrial revolution it was believed that the State has no role to play in guiding and regulating the activities of business. But subsequent developments proved that, most of the post industrial revolution socio-economic problems owed their origin to the conflict of interest between business and soceity. This led to large-scale State intervention in different countries of Europe in the activities of business through rules and legislations pertaining to different aspects of busines activities and also provision for social security of workers and toher weaker sections of soceity. The depression of the 1930s induced the US government to introduce several legislations affecting different aspects of business in the interest of both business and society.

The period that followed war and the depression witnessed gradual removal of barriers to free flow of trade, business and investments across the globe. Globalisation is identified as increasing interdependence and interconnectedness of national economies characterized by increasing movement of goods, service, capital and people across the national boundaries. But rise in the power of corporate sector and free mobility of finance capital led to the erosion of political power of States. With efficiency becoming the universal goal of corporate houses, capital has become free to move across the national boundaries for investment in places that provide the possibility of better returns.

Under the situation, the State is withdrawing itself from its role as the guardian of the society making social responsibility and ethics the orphans. "In this dramatic sea change what is being lost is any viable notion of social responsibility-the institutional capacity for the achievement of a more equitable society".

In terms of industrial relations, the new production system is steadily replacing the rule-based relation by flexible work contracts without any scope for bargaining. To ensure highly competitive labour markets the governments on the other hand, are removing much of the protections accorded to the unions so long.

With the governments of States withdrawing themselves from the role of guardians, the activities of powerful business corporations of developed countries are also creating socio-economic and environmental problems in developing countries particularly. The giant multinational corporations are relocating plants in the developing countries not only for getting the benefits of cheap labour, but alwo for producing hazardous materials there and keeping their respective countries of origin freer from environmental pollution and health hazards.

Another dangerous aspect of their operation is that, they are now in the look out for sites for dumping toxic industrial wastes. The obvious choice for the purpose has been the least developed or the developing countries of the world.

Now who bears the responsibility of protecting the rights to safety of the inhabitants and the workers of these poor and technologically backward countries, that do neither have the guts to reject such financially lucrative offers nor possess the technical competence to judge the long-term evil effects of dumping toxic and even nuclear wastes? The extreme inequalities that are likely to follow the process of strengthening the market forces might ultimately hurt the prospect of acceptance of the principles of market economy. Hence, for the purpose of making the operation of market forces socially acceptable, their ethics and values must be made to conform to the social requirements and factor endowments of the coutrneis concerned. The government of both the developed and the developing coutnreis must co-operate in evolving norms of operation by the business corporations whose operations extend beyond national boundaries. The corporations on their part should play more responsible role in sustaining confidence of the soceity to the new system by striving to ensure social justice and equity. "The new paradigm will need to reflect a new relationship between the means to generate wealth and the strategies to distribute wealth. It will be founded on an understanding of ethics and values in the contemporary world with recognition of the limits and risks of executive action. If the past teaches anything about corporate social responsibility, it is that the risk of doing nothing far outweigh the risk of doing something".

2.5 Corporate Governance

● The Concept and the structure

Business corporations being very important economic agents for change and development, it is expected that they will function in a manner that protects the interests of both stakeholders and society. That means they must be socially responsive. The mechanism which is looked upon for ensuring business houses operate in a socially responsive manner is known as corporate governance.

Corporate governance is the overall management of activities of a corporation. It is concerned with the formulation of long-term objectives and plans and the proper management structure to achieve them. At the same time, it involves making sure that the structure functions to maintain the corporation's responsibility to its variosu constituencies of stakeholders and society.

The mechanism to ensure corporate governance is provided by four factors, namely, (i) the ownership structure of a corporation, (ii) the financial structure of the corporation, (iii) the functioning of the board of directors of the corporation, and (iv) the institutional environment within which the corporation operates.

The **ownership structure** of a corporation determines, to a considerable extent how a corporation is managed and controlled. The ownership structure can be either dispersed among individuals and institutions or can be concertrated in the hands of a few large shareholders.

Large sharehoders tend to be active in corporate governance either through their representatives on boards or though their active participation in annual general meetings. Large share holding exemplifies the success of Tata, Birla and Reliance. On the other hand, dispersed shareholding gives the board and the top managers wider latitude in decision-making. Our corporate sector is characterized by the co-existence of state-owned private and multinational enterprises, The shares of these enterprises are (other than the public sector) held by institutional as well as small investors, In UK and USA share holding is dispreased among individuals and institutional investors, whereas in Japan and Germany shareholding is concentrated in a few hands.

Financial structure, that is, proportion between debt and equity, influences the quality of governance of a corporation. The lenders (the suppliers of debt capital) being interested in short term gains remain very much alert about present functioning and treis to influence decision making to their advantage. Whereas the equity holders can sacrifice short-term gains for long-term accretion in value of their holdings. Hence, for the shake of better governance, it is very necessary to maintain a balance between the two different interest groups through an appropriate capital structure.

The **board of directors** is responsible for settings strategies and styles in selecting top executives of a corporation. The boards are permitted to vary in size, composition and structure so as to best serve the interest of the corporation and the shareholders. Board members may include both inside and outside directors, specialists from different walks of life. But what is necessary for the sake of good governance is their commitment to the mission and vision of the corporation.

The **institutional environment,** provided by legal, regularity and political forces significantly influences the quality of corporate governance. Because, upon it depends, the welfare of all the interest groups. Hence, the interested parties can charge the board for non-performance and mis-performance.

● The Context

Corporate governance has become a special aspect of political and economic debate in our era. in recent years American managers, consultants and academics were asking themselves why Japan was overtaking them in global competition. The situation alerted company owners in developed countries about the desirability of effective corporate governance as the most important tool for competitieness and success in the long run. In fact, the imporance of corporate governance has been highlighted by international agencies like the OECD and the World Bank.

● The Circumstance-problem

Other than getting regurn from investment, another important reason that motivates the investors to provide ownership capital to business corporations is the right to vote in the geenral meetings of the shareholders on important issues that affect their interst. Creditors (the suppliers of fixed earning capital) also enjoy rights and legal protection that include the right to seize assets that serve as collateral for loans and the right to liquidate the firm when it does not repay debt, amongst others. However, the rights given to both the shareholders and creditors are very difficult to enforce for a variety of reasons. Sharehodlers, for instance, are spread over a wide area and hence they cannot always assemble in the meetings to exercise their rights. Moreover, generally such rights cannot be exercised by mail; they are required to show up at the meeting and vote. Thus, it is the minority shareholders, who fulfill the quorum, vote and determine policy - changes of the organization. Further, even when shareholders elect the board, the directors do not always represent their interests and passively go by the briefing given in advance by the managers. Again it is also very difficult on the part of the creditors to vindicate their legal position effectively as bankruptcy proceedings generally take very long time to complete. The problem of unpaid bad loans (non-performing assests) has been the headache of banks and other financial institutions in India.

As a social entity a corporation derives its legitimacy from its ability to fulfill social needs. It is therefore, accountable to society. No institution, however mighty it is, can ignore its responsibility towards society from which it derives its ultimate strength and sustenance. Thus the importance of governance continued to assume growing importance in the business. Corporate governance encompasses the structural and behaviral issues of the corporate board as to how it should respond to its sharehodlers, financiers, government and employees. In a wider sense, it means how the corporate board should respond to regulatory and environmental aspects. In practice there is no clear-cut definition of corporate governance. According Milton Friedman "Corporate governance is to conduct the business in accordance with owners' or shareholders desire, which generally will be to make as much money as possible, while conforming to the basic rules of soceity embodied in law and social customs". Apparently, in the present day concept, Friedman's definition is too narrow in scope. Over the period of time the definition of corporate governance has been widened. It now encompasses the

interest of not only the shareholders but also other stakeholders. According to Sir Adrian Cadbury (1992) corporate governance is the system by which compoanies are directed and controlled. There is considerable debate on what actually constitutes corporate governance. But its key elements concern the progress of corporate performance via supervision or monitoring of management performance and the accountability of management to shareholders and other stakeholders.

2.5.1 Institutional Investors and Corporate Governance

Highly concentrated ownership of corporate securiteis can be observed, in the countries, where the legal protection system does not adequately protect the rights of individual shareholders. In these countries the highly concentrated owernship of corporate securiteis is looked upon as the only way to protect the interest of institutional investors through greater bargaining power. With the rights concentrated in the hands of a small number of large investors, concerted action for protection and vindication of rights becomes easier than when the rights remain widely dispersed. Thus, the practice of heavily concentrated shareholding for dominant control gained popularity through out the world. In the countries where large shareholdings was less common, such as in UK and USA, hostile takeovers have taken place for consolidation of ownership and acquisition of controlling interest. Jensen takes the view that the takeovers of 1980s in US were caused by a failure in the internal governance mechanism of corportations. Ever since the 1930s, management incentives had become weaker as corporations had become larger and shareholding became more widespread. Boards, which were supposed to be the guardians of shareholder rights, mostly sided with management and were ineffective in carrying out their duties. At the end of the 1980s, the takeover and merger wave ended, and the corporate governance system became more assertive and sensitive to stock market reactions. The underlying substance of this transformation has been that US managers have become much more focused on stock prices, The corporate governance mechanism that had driven this focus has evolved over time from the leverged hostile takeovers and buyouts of the 1980s to the incentive based activist boards of directors and the shareholders in the 1990s.

Other than large shareholding and concentration of ownership through acquisition and takeover large creditors such as banks and financial institutions have also come to dominate corporate decision making in a big way all over the world. The business houses look upon the banks and financial institutions as the ultimate source of liquid cash for meeting all eventualities. The dependence of corporate houses on banks and financial institutions as directos in the boards of corporate houses. This is the case for instance in the USA where one-third of large firms have bankers on the board. In the bank-based financial systems, such as in Germany and Japan, the percentage is much higher. In Japan over 50 per cent of large firms have a banker on the board, and in Germany the figure is 75 per cent. With bankers on the board the business houses get easier access to liquidity from time to time and at the same time have the careful surveillance of the financier over

the management of finance of the business houses. However, as creditors, the interest of banks and financial institutions may clash with the interest of the shareholders. For example, an increase in return to creditors would mean a corresponding decrease in return to the shareholders. The clash in the interest of creditors and shareholders can be moderated and even avoided if the banks and financial institutions can be persuaded to take equity stakes in the firm side by side with the supply of credit. In this context, the mutual funds may be the most appropriate alternative in the countries like India.

In the last two decades, various stakeholders in the industrially developed countries have agiatated for more active, independent and accountable boards. The common demand in all these agitations is more voice for institutional investors. The rise of institutional investors in these countries governance they have. The Cadbury Report also ntoed that, Because of their collective stake, we look to the institutions in particular, with the backing of the Institutional Shareholders' Committee, to use their influecne as onwers to ensure that the companies in which they have invested comply with the Code', By virtue of the size of their holdings, the institutional investors have the potential to exercise considerable control over the actions of boareds of directors, which the small investors do not have.

Over the last few decades, the share markets allover the world have withnessed a shift towards increased institutional ownership of corporate securities. This has resulted from a growth in public and private pension funds in developed countries and development finance institutions and mutual funds in the developing countries. These institutions generally invest in companies or sectors that are offering higher than the general market rate of return and have under-priced stock. If the company where the institutional investor has invested does not perform well, the institutional investor can exert pressure through its large shareholdings for actions to be taken that ae likely to improve earnings. Moreover, with big investments, the institutional investors find it inconvenient to sell large blocks of shares without depressing share prices. Thus, their possible retention of holdings acts as threat against under performance of the baord. Institutional investors also believe taht the compoositon of the boards is an important factor affecting performance of companies. As a result, they seek increased outside representation on boards. This, they believe, improves the board's effectiveness in being more responsive to shareholders and improves overall performance.

2.5.2 Corporate Governance in India

Corporate governance is an area where Indian companies fare poorly. In India corporate governance follows the British model, the primary aim of companies being looking after the interest of owners or sharehoders. In India, the Companies Act has specifically enecouraged the dispersal of owership. Traditionally, the individuals were the principal owners of corporations. But in course of time the financial institutions, particularly the development banks and mutual funds, enhanced their stakes in the ownership of securities of companies. Eminent persons chosen from different walks of life constitute the Board of

Directors, from whom one is chosen as the Chairman. There is no provision in the Indian Companies Act for nomination of non-executive directors on the board.

The Indian Companies Act requires that there shall be at least three directors in a public company and two in a private company. The board of directors shall meet at least four times a year and once in every four months. The company in the geenral meeting of the shareholders must appoint the directors. Howver, in order to ensure representation of small investors in the board of directors of companies, it has been provided under section 252(1) of the Companies Act by the amendation of the Act in 2000 that, in companies with paid-up capital of rupees five crore and above and one thousand and above small share holders there may have a director elected by such small sharehodlers in the manner as may be prescribed. Indian Companies Act contains elaborate provisions for conduct of the board and here there is little chance of misunderstanding between the board and the shareholders. The government can nominate a director to the board of directors of a company coming within the purview of the Industries (Development and Regulation) Act 1951. Certain statutory corporations, particularly the development banks and non-banking financial institutions, are also empowered to nominate directors to the boards of directors of companies whre they have considerable investments. Further, by the insertion of section 192A in the Companies Act by an Amendment of the Act in 2000, it has been provided that under certain circumstances the Central Government may requre a company to pass a resolution only through postal ballot. The company may also in some cases ascertain the opinion of the shareholders through postal ballot. The provisions will no doubt go a long way in further strengthening the basis of shareholders' rights in the management of companies ensuring better governance.

On the other hand, the nominee directors of the financial institutions, particulalry those of the mutual funds, can play the important role the non-executive directors are expected to play in the governance of companies. In a very organized manner these institutions can represent the interest of a large number of shareholders spread throughout the country and sometimes abroad. These institutional investors not only represnet the interest of their subscribers or creditors, but they also represent the interst of the government and its long-term policies. Today, large numbers of Indian boards of directors have one or more nominees of financial institutions because of their loan exposures or equity investments or both. But, barring few cases where LIC and UTI played very active role, in most cases the nominee directors remained passive in the decision-making process. Because the other financial institutions, such as the commercial banks, attach utmost importance to the management of funds in commercial activities. Professor Dr. Lord M. Desai of the London School of Economics is not impressed with the quality of corporate governnance in India. He says, 'Indian companies have to stop being a part of the insider treaidng rackets.'

2.5.3 Unique Role of Mutual Funds in Corporate Governance

The small investors can exert little influence over the corporate boards : naturally they look upon the mutual funds as their only authorized activist. On the other hand, as the

protectors of interest of small savers, the mutual funds evince keen interest in the efficient governance of corporations they invest in. Being the trustees of the funds, they are also expected to act more independetly in protecting the interest of small suppliers funds than the other investment institutions. Hence the role of mutual funds in corporate governance has to be specially mentioned.

The mutual funds in India are governed by various provisions of the Indian Companies Act, 1956, the Indian Trusts Act, 1882, the SEBI Mutual Funds Regulation 1996 and the Indian Registration Act 1908. Separate authoriteis, such as Sponsor Company, Asset Management Company, Trustees and Custodian deal with every function of the organization from the formulation of schemes for collection of funds to the ultimate investment of funds and distribution of certificates, leaving little chance for development of vested interest at any stage. Hence, the mutual funds, with theiur unique organizational and management practices as well as immense trust of small investors in them, can provide leadership on promoting ideal corporate governance practice in a country like India in a number of ways. In the first place, as the trustees of investors' money, the mutual funds can try to maximize the value of theor investments by encouraging better management through changes in the board of directors of the company in which they have invested. Secondly, instead of considering themselves as the mere onlookers, the mutual should consider thremselves as responsible investors of funds. Thridly, they can also popularize the view that 'compliance of law is necessary, but not a sufficient, condition for good corporate governance. It demands compliance of law for maximization of the value of investors' wealth. Fourthy, mutual funds can devise a set of guidelines for their nominees on the corporate boareds. In case of merger, inter-corporate investments, joint ventrues, appointement of Charman/Managing Directro etc., information from third parties may be of immense importance. Sixthly, mutual funds can take active interest in strategic planning of companies. The purpose of good corporate governance being maximization of shareholders' wealth, the board must always be on the lookout for opportunities to take advantage of the emerging the developments through strategic planning and corporate restructuring. Lastly, because of their unique position in the governance of companies, the mutual funds can try to convince others on the board as well as the shareholders of the concerned company about the desirability of implementing the Code of Best Practices listed by the Cadbuty Committee for good governance. But the mutual fund industry has not been free from scandals in countries like India.

● The Cadbury Committee

The committee appointed in UK in 1991 under the Chairmanship of Sir Adrian Cadbury (Cadbury Committee 1992), to study and report on the accountability aspect of corporate governance, stressed upon improved inforamtion to sharehoders, continued self-regulation and strengthening of the independence of the auditors. In brief, the Code of Best Practices of Cadbury Committee included the following : (1) all listed companies should establish an audit committee comprising of at least three non-executive directors. The primary brief

of audit committees is to review the financial statements and the findings of the external auditors. Thus, non-executive directors have been looked upon as the best authority for examining account related matters. (2) In the second place, there should be a remuneration committee for determining executives' pay. (3) In the third place, directors should not be appointed for more than three years without shareholdrs' approval, the roles of chairman and highest paid executive officers should be disclosed and the computation of performance related pay fully explained. (4) Further, to emphasize the importance of independent directors in setting executive directors' remuneration, the Committee suggested appointment of a remuneration committee consisting wholly or mainly of non-executive directors. (5) Finally, in order to address accountability issues relating to internal links between parents and subsidiaries, recommendations were also made concerning the need to produce statements on the effectiveness of internal financial control and the business as a going concern. Thus, the Cadbury Committee assigned vital role to the outside non-executive directors in ensuring effective functioning of the board for achieving highest standard of governance. It would not be out of place to mention here that by the insertion of section 293A in the Indian Companies Act by the amendment of the Act in 2000, provision has been made for constitution of Audit Commeittee by the board for examining accounts related matters in every company with paid-up capital of rupees five crore and above in the lines suggested by the Cadbury Committee.

2.5.4 Corporate Governance and Globalisation

Globalisation forced governments to confront conflicting policies. One set of market forces presses for reduced government intervention in economic affairs. Yet, political and economic demands grow for increased state oversihg of economic institutions and processes as globalisation gives rise to an environment which exposes domestic firms to greater risks and competition. For several years the corporate sector was not sure about whether the benefits of globalisation would execeed its disadvantages. In the reform era, initially there was crisis. What has been striking as the fallout of the crisis is the absence of a clear, systematic pattern of structural changes and outcomes at the national and international levels. First, despite the extraordinary conditions favouring reforms and libralisation in the Asian economies, no consistent trend of liberalization has emerged. Japan, Korea, Taiwan, Thailand and Malaysia have been struck by the crissis in different ways and have adopted different policy measures to stabize ther political and economic systems. But it is now felt by many in the Asian countries that globalisation has been good for corporate government on the whole.

A succession of bankruptcies (some in the USA and some in Europe) around 2002 has been attributed to bad corporate governance. Can just good audit and accounting standards ensure good governance?

2.6 Summary

Business, being a part of society, has to take care of the social values that evolved over time. In many cases the values have been codified and represented in the political system. Business thrives and developes on the support of society, while society depends on business for meeting its material needs. So business has to develop its objectives, policies and strategies keeping the values, needs as well as the institutional structure of society before it. Corporate governance is corporate management for the attainment of corporate goals which do not contradict with wider social interests in the coutnry. Society looks upon the qualty of governance of corporations for the fulfillment of its hopes, aspirations and needs. The basic policy tool of corporate governance is the board of directors. Once a board has put its policy criteria in place, evaluation of CEO’s performance becomes a matter of systematic reporting of company performance against theose criteria.

2.7 Exercise

Essay type questions :

1. State what do you understand by business ethics, and examine the importance of ethics in business in our times.
2. What do you understand by social responsibility of business? Trace the process of the evolution of the concept of social responsibility of business.
3. Explain teleogical and deontological concepts of ethics. State how ethical decisions are made in business.
4. State what do you visualize about the role of the state in decision-making in business in the context of globalisation.
5. Write an essay on corporate governance in India.
6. Examine the role of institutional investors in ensuring efficient governance of corporations.
7. Examine the principal recommendations of the Cadbury Committee on corporate governance.

Short answer typem questions :

1. Law is ‘codified ethics’. Explain.
2. Mention the four different types of ethical responsibilities of business.
3. State briefly the different forms of teleological ethics.
4. Mention what do you understand by deonotological ethics.

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5. Explain the relation between business ethics and corporate governance.

6. State the role of mutual funds in ensuring good corporate governance.

7. Write a note on corporate governance and globalisation.

8. Is society a stakeholder in business? Giver reasons for your answer.

Objective type questions :

Select the correct answer :

1. Social responsibility of business followed—

   (a) Technological development

   (b) Political development

   (c) Production of goods and services for exchange

   (d) The ideas of Adam Smith.

2. Utlitarism means—

   (a) Maximum good to minimum people

   (b) Minimum good to all people

   (c) Utility for self only

   (d) Maximum good for the greatest number of people.

3. In the present boundary less world–

   (a) State has no role to play in ensuring social justice

   (b) Each state independently has greater role in ensuring social justice

   (c) States have a greater role to play jointly in ensuring social justice to all

   (d) None of the above is correct.

4. Securing good corporate governance is easier–

   (a) When there is concentrated ownership of securities

   (b) Where ownership is widely dusoersed

   (c) Where full ownership is in the hands of government

   (d) Where ownership is in the hands of creditors, that is, suppliers of loan capital.

5. Large institutional holding of shares emerged in different countries because of

   (a) Failure of individual small investors to protect their interst

   (b) Governments of different coutnreis encouraged shareholding by institution investors

   (c) The companies preferred larger institutional holdings

   (d) None of the above is correct.

6. Recent accounting frauds and failures of giant companies are the results of

   (a) Liberalisation

   (b) Absence of good corporate governance

   (c) Failure of accounting system

   (d) Concentraion of share holding in few hands.

Answer of objective type questions- Nos. 1(c), 2.(d), 3. (c), 4. (a), 5(a), 6(b).

2.8 References

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