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Research Article

CORPORATE GOVERNANCE AND CSR COMPLIANCE: AN ANALYSIS OF THREE BLUE CHIP COMPANIES

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ABSTRACT

This study analyses the corporate governance (CG) practices of three prominent Indian manufacturing companies, based on four variables namely, Corporate Governance Practices, Corporate Governance Structure, Board Meetings and Corporate social Responsibility Activities. Three companies namely HUL Ltd., Reliance Industries Ltd., TCS Ltd., were chosen, as they represent significant compliance of Corporate Governance practices and accomplishment of CSR activities among the private sector companies. The study finds that though the CG practices are exemplary, there exist differences in the way the companies adopt the CG practices. Recent developments in CG in India after liberalization era have also been covered. CG is important in Indian context because of the scams that have occurred since liberalization in 1991 for eg. the UTI scam, Ketan parekh scam, Harshad Mehta scam and the Satyam fraud case.

INTRODUCTION

The corporate governance issue has recently drawn much attention from all the stakeholders because of the large number of business scandals being reported around the globe. With the globalization and liberalization of the economy, the government had formulated different measures to protect the diverse interests of stakeholders and various other stakeholders in the companies. Good governance is needed to create a corporate culture of consciousness, transparency and openness.

This case describes the CG practices of the three Indian private manufacturing companies namely HUL Ltd., TCS Ltd., and Reliance Industries Ltd. These three companies were chosen as they represent three distinct categories among the Indian private companies. HUL Ltd is fully managed by professionals and does not have any major Promoter group or business family. 67.20% shares being held by its Parent Company Unilever Plc. Reliance Industries is at the other end of the spectrum, with one family and their stake is around 48%. Tata Sons Limited holds 80.64% approx. in TCS. Hence, a study of CG compliance of these companies will throw light on the differences among the blue chip companies with different management control, Promoters holding and shareholding patterns.

Recent Developments of Corporate Governance in India (Post liberalization 1991)

Liberalization of the Indian economy started in 1991. Since then, there have been major changes in both laws and regulations and in the corporate governance landscape.

1. The most important development in the field of corporate governance and investor protection has been the establishment of the SEBI in 1992. It has played a crucial role in establishing the basic foundation of corporate conduct in India. [Chakrabarty R., Megginson W. & Yadav P. (2007)]
2. The next significant step was the CII Code for Desirable Corporate Governance developed by a committee chaired by Rahul Bajaj. The committee was formed in 1996 and it submitted its report recommendations on 8th April 1998. [Chakrabarty, R., Megginson, W. & Yadav, P. (2007)]
3. Later two more committees were constituted by SEBI, one under the chairmanship of Kumar Mangalam Birla and the other by Narayana Murthy. They submitted their reports in early 2000 and 2003 respectively. Clause 49 of the Listing Agreement was the major recommendations of these two committees and had been instrumental in bringing major changes in the corporate governance.[Chakrabarty, R., Megginson, W. & Yadav, P. (2007)]
4. Along with SEBI, the Ministry of Corporate Affairs (MCA) and Government of India, also took some initiatives for improving corporate governance in India. For example, the establishment of a study group under Naresh Chandra Committee on Corporate Governance and Audit to operationalize the Birla Committee

recommendations in 2002, & J.J.Irani Expert Committee on Corporate Law in late 2004. [Goswami, O. (2002)]

5. SEBI put forth the recommendations of the Birla Committee through the introduction of Clause 49 of the Listing agreement. Clause 49, can be referred to as a milestone for Corporate Governance. It is similar to Sarbanes - Oxley Act (SOX) in U.S. [Chakrabarty R., Megginson W. & Yadav P. (2007)]

Clause 49 looks into the following matters

1. Composition of the Board of Directors.
2. Composition & Functioning of the Audit Committee.
3. Governance & disclosures regarding subsidiary companies.
4. Disclosures by the company.
5. CEO/CFO certification of the financial results.
6. Reporting on corporate governance as part of the annual report.
7. Certification of compliance of a company with the provisions of Clause 49.

1. The National Foundation for Corporate Governance (NFCG) is formed by the Ministry of Corporate Affairs (MCA), Govt. of India, in partnership with CII, ICAI and ICSI with the goal of promoting better corporate governance practices in India.
2. Corporate Governance Voluntary Guidelines (2009) were developed by NFCG to help the companies in achieving the highest standard of corporate governance in India.

Approach to Corporate Governance

HUL official believes and propagates 'commitment beyond the market'. It is also one of the early adapters of formalized system of Corporate Governance. HUL defines CG as an organized and pro-active process by which companies are directed and controlled in order to enhance their wealth generating capacity. HUL also believes that the growth process should ensure that these resources are utilized optimally in manner which fulfils the stakeholder's aspirations and societal expectations. What the company calls as the development of the 'triple bottom line' that includes the growth and development of nation's economic, ecological and social capital. HUL also seems to believe that CG must simultaneously empower the executive management of the company while ensuring adequate checks and balances. The cornerstones of HUL CG philosophy are trusteeship, transparency, empowerment, accountability, control and ethical corporate citizenship.

Trusteeship is predicted to ensure rights of all shareholders, large or small are protected. The board of directors has to protect and enhance the shareholders' value as well as protect the interest of other shareholders. Transparency is making appropriate levels and as close to the scene of action as feasible. Control is meant to prevent the misuse of power and is exercised within a framework of checks and balances. HUL believes unethical corporate citizenship' because, unethical behavior ultimately corrupts organizational culture and deteriorates stakeholder value.

Reliance is the one of the seven fortune 500 Indian companies and is known for its new venture and its CG practices. Reliance believes that good governance practices arise from the vision of the Top Management, culture and mindset of the company. Reliance official policy says that the firm is committed to all its stakeholders-employees, customers, suppliers, shareholders, investors, vendors and Government policy planners. At RIL, all employees are encouraged to ensure that stakeholder’s interests are uppermost. Reliance has a well-defined policy guidelines in this regard consisting of ethical values and commitments, code of ethics and conduct, business policies, prohibition of insider trading, program of ethics and management.

TCS Ltd. always seems to believe that the best CG attracts the best investors. Aryan mirth's vision for infuses, envisages a place where people of different genders, nationalities, races and beliefs work together in an environment of competition but with the utmost harmony, integrity, courtesy and dignity.

TCS Ltd. has also complied with the Narayana Murthy committee recommendations on CG. TCS Ltd. is also Sarbanese- Oxley act compliant. TCS Ltd. CG philosophy is based on satisfying the spirit of law and not just its letter, transparency to the highest degree, how the company is internally complying with the laws in all countries in which the company operates and having at all the times of firm belief that the management, and not the owner, is the trustee of the shareholders capital.

Governance Structure and Practices

HUL has governance of three layers which includes strategic supervision by the BOD, strategic decisions by the corporate management committee and executive management by the divisional/ SBU chief executives.

Looking at the board composition, it reveals that HUL has a blend of executive and non-executive directors that include independent professionals. Executive directors along with the chairman do not generally cross one third of the total strength of the board. One third of the directors retires by rotation every year and are eligible for reelection. There does not seem to be any separate position of a managing director in the company.

Meetings and Attendance

The HUL's policy requires the board to meet at least six times a year. The intervening period between two board meetings is less than three months period as per Clause 49 of the listing agreement. Board meetings at HUL are structured by the members, in consultation with the chairman of the company, may raise any matter for board's consideration. Agenda papers are generally made available seven working days prior to the meeting of the board. It includes quarterly performance, half yearly summary of the long term borrowings, bank guarantees issued and investments made, internal and external audit management reports, policy on shareholders' disclosures, write- offs/ disposal (fixed assets, inventories, receivables, advances, etc.) on a half yearly basis, product liability of a notices from revenue authorities including exposure that exceeds 1 % of the company's net worth and the like. The details of the board meetings for the financial year ended March 31, 2011 reveals that out of the eight meetings held, three had a complement of 12 members which is the total strength. The numbers never went below nine. The chairman attended all the eight meetings thus setting a standard.

Table -1 Position of Number of Directors in HUL

Category	No. of directors	Percent of total number of directors
Executive directors	4	33
Non-executive independent directors	6	50
Other non-executive directors	2	17
Total	12	100.00

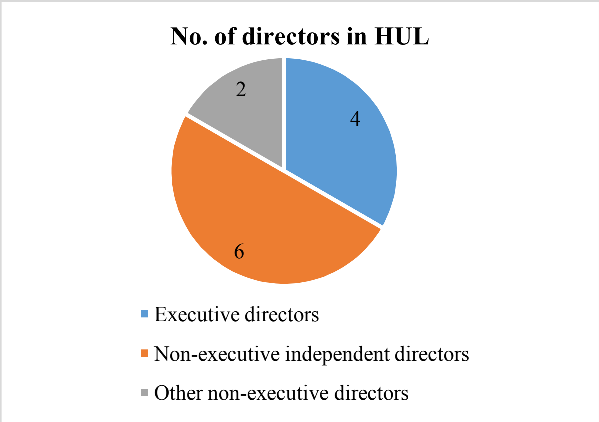

Figure -1

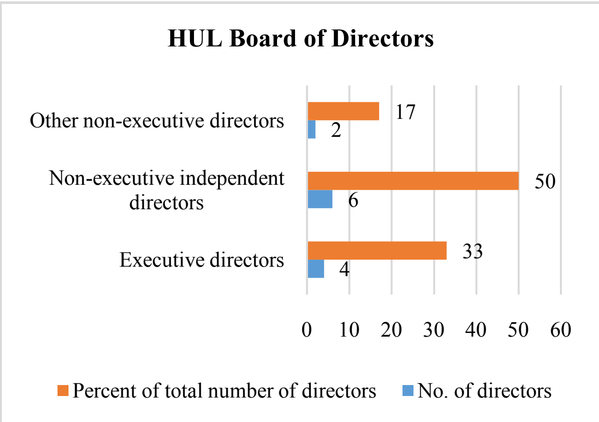

Figure -2

Reliance's CG enforcement system is based on the following principles:

- Constitution of a BOD of appropriate composition, size and commitment to discharge its responsibilities and duties;
- Ensuring timely flow of information to the board and its committees to enable them to discharge their functions effectively;
- Independent verification and safeguarding the integrity of the company's financial reporting;
- A sound system of risk management and internal control;
- Timely and balanced disclosure of all the material information concerning the company to all its stakeholders;
- Transparency and accountability;
- Compliance with all the applicable laws and regulations; and
- Fair and equitable treatment of all its stakeholders including employees, customers, shareholders and investors.

The role of the Independent Directors, as per the CG practices of Reliance, is to oversee the performance of the management, ensure accuracy of accounts, review the remuneration package for executive and non-executive directors, recommend the appointment of new members on the board and on the company's senior positions, etc. Reliance also has the position of a Lead Independent Director who presides over all the meetings of Independent Directors. It is interesting to note that the positions of the chairman and that of CEO are vested in the same person in both HUL and Reliance.

The article of association of company permits up to 14 directors. As on March 31, 2011 Reliance board had 12 directors, of which seven are independent directors. From the following table, it reveals that the composition of the board is as follows:

Table 2 Position of Number of Directors in RIL

Category	No. of directors	Percent of total number of directors
Executive directors	4	33.33
Non-executive independent directors	0	-
Non-executive non- independent directors	1	8.33
Other non-executive directors	7	58.33
Total	12	100.00

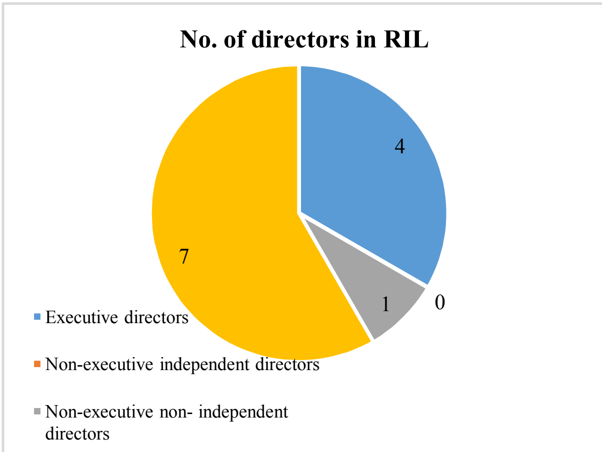

Figure – 3

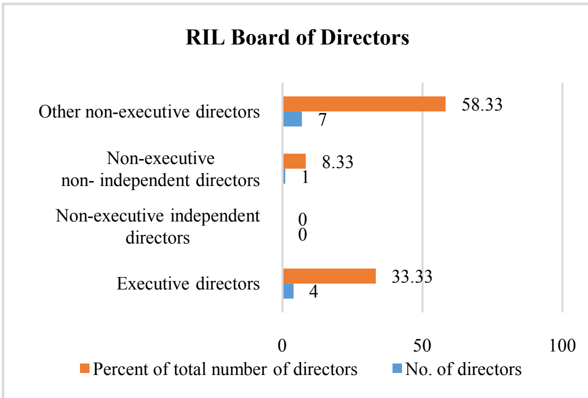

Figure - 4

A comparison of the board composition at Reliance and HUL it reveals that in both the companies the percentage of executive directors to the total number is 33%. Other non-executive directors make up 67% of HUL board, of which 50% are independent ones. This figure is 58% in Reliance, indicating that the 50% requirement as per clause 49.1 (A) of the listing agreement requirement is fully met. The board discourages any kind of transaction, material or otherwise, with the independent directors. Clause 49.1 (A) of the national stock exchange (NSE) listing agreement defines independence' as "absence of any material pecuniary relationship, apart from receipt of directors' remuneration, either with the company or its promoters or its management or its subsidiaries, which in the judgment of the BOD of the company may affect the independence of judgment of the director". Reliance also circulates among the board members the disclosures/ declaration to be given by board members under sections 264, 297, 299, 305, 308 of the Companies Act 1956, as well as under section 13 (2) 10 (d), 10 (e) and 13 (4) regarding 'prohibition' of insider trading' and clause 49 of the listing agreement. There is also the regulation 15 of the reliance code of business conduct and ethics for directors and senior management personnel. The reliance board does not believe that it has to restrict the number of times an individual may serve as a director and also believes that the nomination committee can take care of the requirement of reflecting and accommodating diverse views. As a typical family-owned enterprise, the CMD is not subject too the requirement of retirement. The reliance CG manual also quotes from section 317 of the Companies' Act 1956 wherein a period of five years is fixed for a managing director who can be reappointed for further periods, each period not exceeding a span of five years.

Section 255 and 256 of the companies act provide a method for appointment of directors who shall be liable to retire by rotation. Section 255 provides that two thirds of the BOD is considered to be directors liable to retire by rotation of which one third shall retire at every annual general meeting of the company with an option for reappointment. Both HUL and Reliance seem to be following section 255 in letter and spirit. In Reliance, there is a position of the lead independent director who acts as the spoken person of the independent directors. There is no corresponding position in HUL.

The board at Reliance meets at least six times a year and the agenda for the board meeting is very similar to that of HUL for the year ended on March 31, 2011 there were 11 meetings held and four had the full complement of 12 members. The least number was eight. CMD Mukesh Ambani attended all the 11 meetings.

The CG practices of TCS Ltd. are well admired among the practitioners and researchers. The company has a well defined board charter which defines the scope of the board. As for the board composition, nine out of 16 directors are independent directors. This is something one does not notice in the case of both HUL and Reliance where, arguably, the accent has been on compliance with clause 49.1 (A) of the listing agreement requirements. Truly, TCS Ltd. seems to believe and practice that CG standard should go beyond the law. The annual report of the company also gives additional data like relationship with other directors, directorships held in other companies.

Table 2 Position of Number of Directors in TCS Limited

Category	No. of directors	Percent of total number of directors
Executive directors	2	22.22
Non-executive independent directors	6	66.67
Non-executive non- independent directors	1	11.11
Other non-executive directors	0	0.00
Total	9	100.00

Board Committees

HUL currently has four board committees—the audit committee, the compensation committee, the investor committee and the nominations committee. The terms of reference of the board committees are typically fixed by the board from time to time. Meetings are convened by the chairman and signed minutes are placed before the board. A look at some of these committees are as follows.

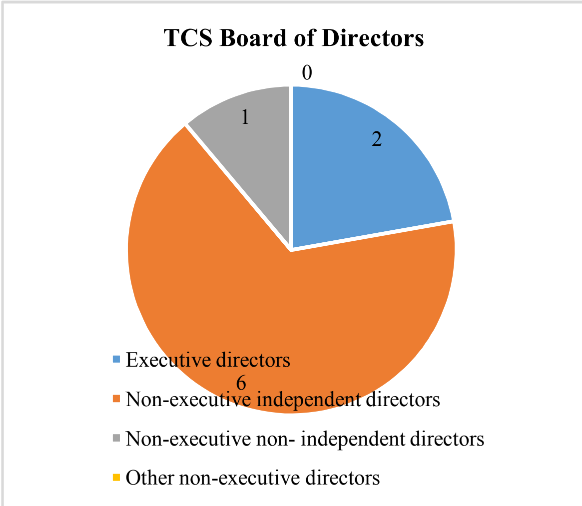

Figure -5

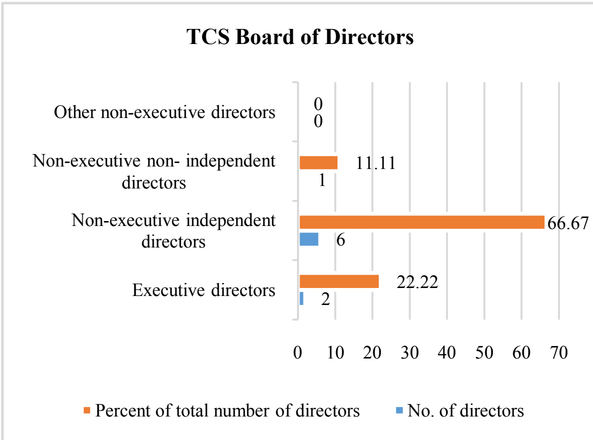

Figure - 6

The audit committee of the board reassures the board that a proper internal control mechanism is in force. The audit committee is empowered to investigate any activity that falls within its terms of reference and seek any information form any employee.

Among other roles, the committee also oversees the company's financial reporting-process reviews changes in accounting policies, major accounting entries, qualifications in the draft audit report, compliance with stock exchange and legal requirements, related party transactions involving top management or their relatives, etc. it also reviews, with the management and the internal and external auditors, the adequacy of the internal control systems. The audit committee comprises of three non-executive directors all of whom are independent directors. Then, there is the remuneration committee called the compensation committee and this committee recommends to the board the compensation terms of executive directors. The compensation committee consists of five non-executive directors of whom three are independent directors and the chairman of the committee is a non-executive independent directors, the remuneration is largely market led. The chairman and executive directors are entitled to performance bonus for each financial year up to 85% and 75% respectively of their consolidated salary.

HUL also has employee stock option scheme and in the year ending on March, 2011 the company granted 8,57,208 options to eligible employees. There is also an investor's grievance committee comprising of three directors of whom two are independent directors, and where the chairman is also an independent director. Then, there is the nominations committee which makes recommendations on appointment to the board, corporate management committee and the senior most level appointment to the board, corporate management committee and the senior most level of executive management one level below the board. The nomination committee comprise of the chairman and all the non-executive directors of the company. The chairman of the company is also the chairman of this strategic management and comprises of all the executive directors and three or four senior member for the management. The HUL code of professional conduct has been replaced by the code HUL of conduct. The code is derived from three inter-connected fundamental principles, viz, good CG, good corporate citizenship and exemplary personal conduct.

The board committee in the case of reliance comprises of the audit committee, shareholders'/ investors' grievance committee, remuneration committee, CG and stakeholders' interface committee, finance committee and the health, safety and environment committee. These committees seem to be playing a role very similar to those of HUL's. Duties and authority of committees in both the companies appear to be very similar and such a repetition is unwarranted. RIL has a finance committee to review the company's financial policies, strategies and capital structures. The corporate management committee of HUL seems to have been rechristened as the CG and stakeholders' interface committee (CGSI) in the case of reliance. The CGSI committee periodically identifies what reliance calls as the 'Competency gaps' and evaluates potential candidates for board appointment. It is interesting to note that the CGSI committee also considers candidates recommended by shareholders. Board members are encouraged to attend training programs/ discussion/ seminars forms to understand topical CG issues and make suggestions for improvement. The CGSI committee assists the board in determining the optimum board size.

TCS Ltd. Board has six committees. These are compensation committee, the nomination committee, the investor grievance committee, the investment committee and the share transfer committee. Unlike HUL or reliance, all the committee, not just the audit committee, consist entirely of independent directors except the investment committee and share transfer committee which have a fair representation of independent directors. An audit committee charter along the lines recommended by the blue ribbon committee is in vogue. This does not seem to be the case with either reliance or HUL

The responsibilities of the audit committee listed vide 2.1 and 2.26 for the annual report is far more exhaustive than those of either reliance or HUL. There are six independent directors in the audit committee. The compensation committee has four members and consists of compensation, audit or nominations committee reports are made available for public scrutiny by TCS Ltd. The investor grievance committee at TCS Ltd. consists of four directors and is headed by an independent director. The investment committee and share transfer the posts of the CEO and the chairman are clearly demarcated in case of compliance with Naresh Chandra Committee, Kumar Mangalam Birla committee, clause 49 listing agreement, Euro, shareholders CG guidelines 2000, OECD principles of CG, etc.

Corporate Social Responsibility Practices

In 2009, HUL released its 'sustainability report' in accordance with internationally accepted global reporting initiative guidelines. HUL takes pride in the fact that it is a water positive company and aims to become a carbon positive company soon. HUL has made significant studies in natural resources management, sustainable livelihoods, community development, and social forestry *e-chaupel* initiative is a unique price recovery knowledge imparting initiative and reaches out to farmers in seven states. RIL is committed to quality and has won prized in this category. For example, Shell Global services have conferred 42 Golden certificates on cumulative basis on RIL's Jamnagar facility for excellence in reliability certification. TQM has been introduced at all sites. State-of art medical care facilities are provided to all the employees through occupational health centers located at various sites. RIL participates in national health programs like pulse polio, revised national tuberculosis control program, etc. The directors' committee on HSE monitors the status of safety performance, practices and systems. There is also a dedicated environment health and safety group reporting directly water to villages near its manufacturing sites. RIL also spends money on education and healthcare.

TCS Ltd. emphasizes the value of each and every employee and is one of the Indian companies to bring human capital on its balance sheet. Integrity, fairness and transparency across operations are the operating philosophy of TCS Ltd. TCS Ltd. believes in spreading education and has specific programs in this regard-TCS Ltd. fellowship program, rural research program, and catch them young program and train the trainer program, the TCS Ltd. also takes part in community service initiatives.

CONCLUSION

It is concluded that all the three companies are doing well both on the CG and the CSR fronts although RIL seems to be doing much better than the other two. That all three companies are also adding 'long-term shareholder value' and almost equating it with 'long-term stakeholder value'.

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