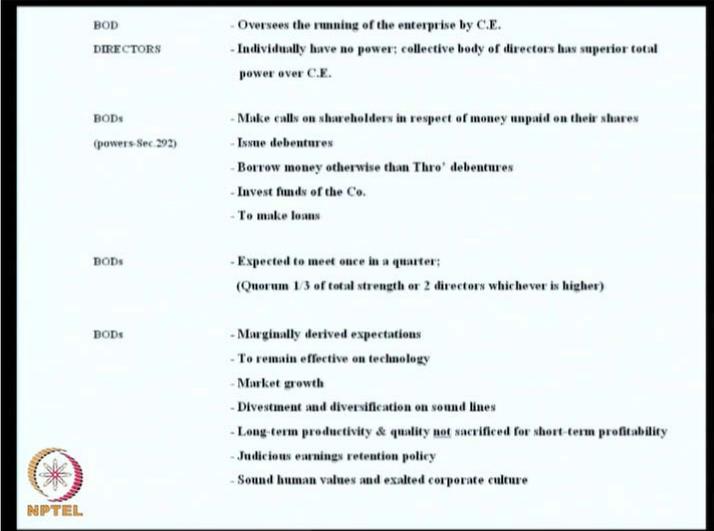


Strategic Management - The competitive Edge
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Module No. # 02
Lecture No. # 07
Board of Directors Role and Functions

Let us come to one more important aspect of running an enterprise. We are looking at the board of directors for an enterprise or in short the BOD. What does the BOD do? BOD oversees the running of the enterprise by the chief executive.

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BOD	- Oversees the running of the enterprise by C.E.
DIRECTORS	- Individually have no power: collective body of directors has superior total power over C.E.
BODs (powers-Sec.292)	- Make calls on shareholders in respect of money unpaid on their shares - Issue debentures - Borrow money otherwise than Thro' debentures - Invest funds of the Co. - To make loans
BODs	- Expected to meet once in a quarter; (Quorum 1/3 of total strength or 2 directors whichever is higher)
BODs	- Marginally derived expectations - To remain effective on technology - Market growth - Divestment and diversification on sound lines - Long-term productivity & quality not sacrificed for short-term profitability - Judicious earnings retention policy - Sound human values and exalted corporate culture

What does that mean? That, oversees the running of the enterprise by the chief executive? The chief executive is responsible for day to day decisions of the enterprise; BOD does not come to that decision making, but it will come periodically to advise the chief executive about the running of the enterprise. **May be** - the BOD may meet once in three months, find out how the form is being run by the chief executive and then advise him suitably.

So, the BOD - one important term of these BODs is board of directors. What does the director mean? What does he do? Individually, the directors have no power, but the collective body of directors has superior power over the chief executive, what does it mean?

It means, suppose a person is a director on a BOD by himself, he may not mean anything extraordinary, but as a body of the BOD, he will then be extraordinary, what do you mean extraordinary? The BOD has got superior power, so the chief executives tell him this is the direction in which we want this organization to go.

So, in other words, the BOD can give directions to the chief executive? So, this is what we want, but the chief executive can also say that if there are any problems in implementing a certain set of directions given by the BOD, he can bring it to the knowledge of the BOD and get it suitably altered.

There is a wonderful book on the Indian companies act, this is by Mr. Ramaiya. So, he has given you, anyone who is interested in this - the companies act can refer to this book, it is also listed as a reference. Go to this chapter number 3 on page number 51, the guide to companies' act that is published by Wadhwan Co. There they have listed this and you can refer to the different sections of this particular book by Ramaiya.

Now, the next question I want to ask - provide for you is there are two important sections in these particular BODs, one is section 292 and what does this 292 do? It makes calls on shareholders in respect of money unpaid on their shares, then issue debentures, then borrow money, otherwise then through debentures, then invest funds of the company and then to make loans.

Now, in the functions of BOD, what is expected of the BOD? **Expected to** be, it once in a quarter, what is the quorum for this BOD? One-third of the total strength or two directors whichever is higher.

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The section 292 of this companies act gives you the powers of the BOD to make calls. What are the powers of the BOD? That is to make calls on shareholders in respect of money unpaid or to issue debentures. There is also one more important section that is section 293, to which we will come a little later.

Now, one important question which you have to address, why it is so important to know about this BOD? I will read from the book which I have coated you, an example of a well-known company. Large enterprises usually have an apex policy making body, which is generally referred to as the board of directors. The members of the BOD have collective authority and responsibility for the functioning of the enterprise.

The composition of the BOD, the professional credentials and their commitment will have a performed impact on the fortunes of the enterprise. The members of the BOD have to act as professional managers to help the enterprise, adjust to the changing environment, in other words, kindly note that the BOD has to act like a vehicle for change. Failed to do so, could cause immense damage to the fortunes of the enterprise, the case of Eastman Kodak Company USA is worth noting.

I will just give you what really happened with respect Eastman Kodak Company that is that film company. Eastman Kodak Company one of the most respected companies both in United States and in other parts of the world, known for its quality products and reliability.

Period 83 to 93 saw the company following from the top 10 to the bottom 18 of the most admired companies. Reasons the firm was bloated, slow moving, short sighted and incapable of dealing effectively with the following market share. This is how the industry analyst put forward the problem of this particular company.

Now, what really happened? One of the other reasons, which another important reason was this company fail to come out with new product. The photography field, the electronics field or the information technology field is always characterized by the development of something new. That something new always happens very fast and very rapidly in all these sectors in fact.

So, this is one of the things which people noted about Eastman Kodak. That had failed to come out with new products; it was obsessed with protecting current products. So, this is what I also gave you in the earlier classes. In marketing, one has to come out of this sentimental attachment to products, especially a competitive arena. When competition is increasing for some reason, you still take down to the old product, the company finds itself difficult to compete against the new emerging trends, especially in the field of electronics, where things are changing so rapidly, the attributes of products are also changing very fast.

Now, with respect Eastman Kodak company what really happened? So, the Kodak's BOD was extremely concerned with the ability of the CEO, his name was Kavikmore to steer the company around. Even though he was in the company since 1957, as a very bold step in August 93 Kodak's BOD lead by few outside directors, replaced Whitmore with George Fisher, who was the then chairman of Motorola Inc, which have been regarded as a company known for its resilience and quality. The BOD expected Fisher to effect cost reduction in the products of Kodak.

Four months later, Fisher reported that cost static cutting alone would not be the answer. The company should look for growth opportunities in imaging, as well as start divesting non core businesses.

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What does this illustrate? This illustrates the effect of top management and BOD on enterprise performance. Kodak's top management - top managers traditionally had been promoted from within and were dedicated to the companies' chemical imaging. Kodak represents a classic case of how the company had failed to adjust to the changing environment by its lack of strategic response. Finally, an outsider as the CEO had to make the company strategically responsive.

So, this is also one of the reasons why an outsider could be a better change agent, because many times it is felt. If a person is from within the organization that is he has moved off from the ranks. It is very possible that he might have grown with the system and sometimes got so much adjusted to this system that he is perhaps getting rusted that is this lack of new ideas. This lack of new visions might be acting as a hindering factor for him to make the organization to effect these changes. So, this is what really happened with respect to such a well-known company as Eastman Kodak. There should be no reason as to why it cannot happen to other companies also.

If you just look at today's news, this is again collaborated in the Indian context. The news item, as the new head of state bank of India will not be an insider, but an outsider.

That is what the ministry sources have come out with today, what does it mean? Why have they come out with this precisely with this statement? It is because of the same reasons, which I listed with respect to Eastman Kodak.

The ministry perhaps thinks that an outsider could be a better change agent or let act as a better catalyst in the present financial scenario of the banking industry. Where we are seeing so many problems with respect to the state bank group, many of the subsidiaries not really going along with their finance ministries dictate of merging with state bank of India, lot of protest going on all those types of things.

So, the ministries thinking in a different direction, saying why we should not look at this BOD experiment. So, this BOD experiment, which was done several years back with respect to many of the well-known companies in the US, it may be played out even in the Indian scenario.

So, what does the expectations of the BOD? We have what is called the marginally derived expectations, what does it mean? So, the BOD many times may marginally helped to improve performance that is what is called, we refer to this whole thing in decision making as logical incrementalization.

We said this is where the BOD can help; it can act as an instrument for change by increments, not very suddenly. It can be viewed as a logical incrementalization decision mode that is in this rapidly changing environment you may like to question that also, because you may say if it is only delta changes, will the organization really benefit.

So, sometimes the answer may be yes, sometimes the answer may be no. So, depending on the way the organization has positioned itself - how, it has? Whether it is a leader or whether it is a follower, all those types of things will start coming into the picture before we make a judgment on this.

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Then, the second thing which is expected is to remain effective on technology. See, the BOD should consist of professionals, we should tell the chief executive, look this technologies outdated; common, change this technology and come to this technology, which is more effective. Then, the third thing, which is expected, is keep close watches on the market growth that will tell you which markets are growing, which markets are not growing, whether the companies in the right type of markets.

Now, why is it required? This will help you to do divestment or diversification on sound lines, but one important aspect of the BOD should be to have this long term productivity and quality as the goal that should not be sacrificed for short term profitability. Another important role of the BOD is to have a judicious earnings retention policy. These are some things which almost all the BOD should help, so they should help the company to have or to improve the position of the reserves of the company.

They should be able to improve the reserves of the company. A very good example of this sound BOD principle can be that of Infosys only. A very healthy financial reserve position, so even when they are making some new investments, they are not going in for borrowings, they are able to invest on their own, a very sound policy. Then, the BOD also should be able to percolate throughout the organization sound human values and exhorted corporate culture.

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Strategic Management - Role of BODs

- To initiate and determine
- To evaluate and influence
- To Monitor

BODs

- 2 or 3 in small private companies to 20 in large public companies
- Structure : Ratio of WTDs to TDs is high in multinational companies like Hindustan Lever, ITC, IEL
- When PTDs Proportion of WTDs to TDs; in case of L&T & TISCO ratio is 1:1
- One MD, few WTDs, besides PTDs – MD managed company
- WTDs & PTDs have complementary roles to play
- Two tier BDs (Policy BD and Executive BD) – not favoured by Sachar Committee (1978)
- Japanese Cos: Most directors are whole time employees
- Part-time outside Chairman Plus WT MD; whole time-inside Chairman, plus whole time inside MD; WT inside C-cum-MD

Remuneration:

- <=5% of net profits if only on WTD
- 10% of net profits for all (more than 1)

NPTEL

(A small inset image shows a man in a dark shirt sitting at a desk with a laptop, looking towards the camera.)

So, these are something which is expected of the BOD. Then, the question that one might like to ask is, with respect to strategic management what should the BOD do or what should be the role of the BOD? The role of the BOD is visualized under three heads; one is to initiate and determine, the second is to evaluate and influence, the third is to monitor.

So, the BOD should really act as an initiator of strategic decisions, it should also evaluate those decisions, monitor those decisions; so how exactly the company is going. The next question one might ask is what should be a number of these BO directors in a BOD? With respect to the BOD numbers, it can be 2 or 3 in small private enterprises, to 20 in large public companies.

So, if you really see many of the PS use - they have, there are nearly 20 directors on their board. So, the structure of this BODs, how it can be is given, here the ratio of the whole time directors to directors of the company- this is given on this, in the case of L and T and Tisco two examples are taken. It is 1 is to 1, whereas sometimes just a small correction, when the ratio WTDs to TDs is high in multinational companies like Hindustan Lever then ITC IEL.

If you really see this people have directors from outside surveying on the board of the companies in good number, when PTDs proportion to WTDs to TDs, if really sees what is this PTD, PTD is a part time director, WTD is the whole time director. So, the in the

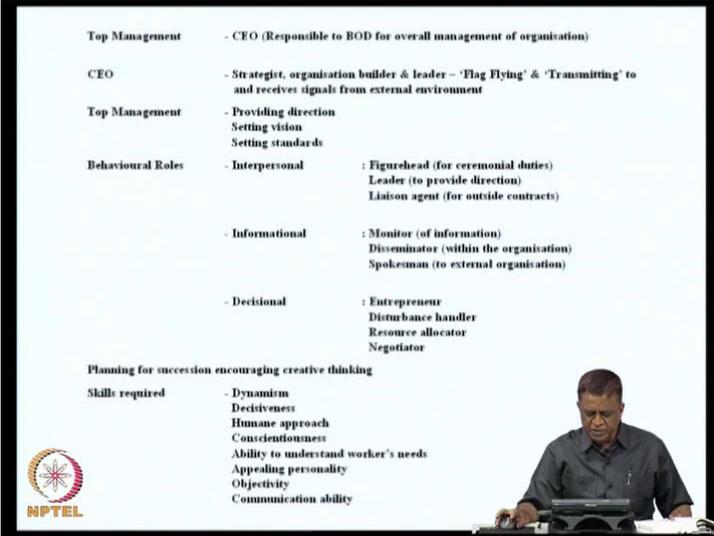
case of L and T, and Tisco the ratio is 1 is to 1, so part time directors to this WTD is to TD, they become 1 is to 1.

Suppose, you have one MD, few WTDs besides PTDs, this is known as an MD managed company. Suppose it is WTDs and PTDs, suppose it is an MD, who is also having the role of both the chairman and MD, then he is called as CMD, for that we will come to that a little later. Then, both these WTDs and PTDs have complementary roles to play. There was one more, which was initiated in the Indian company scenario back in 1970s.

That is, whether to have a two tier board, that is, one would be the policy board, another would be the executive board, which was the norm in some of the Japanese companies then, but this was not favored by the Sachar committee in 1978. If you really see what does the Japanese companies do, in the Japanese companies most directors or whole time directors, whole time employees of the company, where as a part time outsider, outside chairman plus a whole time MD, whole time inside chairman plus whole time inside MD, whole time inside chairman cum MD, so these are the different ways you can have a CMD. You can have a part time outside chairman plus whole time MD, so what does it mean? You will have two people managing the positions. Or you can have a whole time inside chairman plus a whole time inside MD, both of them are within the organization. Or it can be a whole time inside chairman cum MD; this is what I just mentioned.

So, the combinations of the top position can be like this. What could be the remuneration for this board of directors? If the board of directors typically - what the Indian companies says is, the remuneration should be less than or equal to 5 percent of the net profits, if only have WTDs or it can be 10 percent of net profits for all, if it is more than 1.

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Top Management	- CEO (Responsible to BOD for overall management of organisation)
CEO	- Strategist, organisation builder & leader – ‘Flag Flying’ & ‘Transmitting’ to and receives signals from external environment
Top Management	- Providing direction Setting vision Setting standards
Behavioural Roles	- Interpersonal : Figurehead (for ceremonial duties) Leader (to provide direction) Liaison agent (for outside contracts)
	- Informational : Monitor (of information) Disseminator (within the organisation) Spokesman (to external organisation)
	- Decisional : Entrepreneur Disturbance handler Resource allocator Negotiator
Planning for succession encouraging creative thinking	
Skills required	- Dynamism Decisiveness Humane approach Conscientiousness Ability to understand worker's needs Appealing personality Objectivity Communication ability

This is the way the Indian companies has structured itself. Now, the next question that you have to address is what top management in an organization? Generally top management peoples tend to equate with this CEO of the organization. It is not just the CEO who is the top management, any positions from general manager and above in an organization they constitute the top management in an organization.

Now, what is this CEO? The CEO is responsible to BOD for overall management of the organization, he is expected to be a strategist and he is expected to be an organization builder, leader, keep the flags flying of the organization. He, should be able to transmit and receive signals from the external environment, in other words he should keep his eyes and ears opened to the changing environment scenario, what does this mean? This is more applicable in the present day context to Indian companies, than any time earlier. Why is it so? This is because of the LPG era, this LPG era is has contributed in such an extraordinary way that if an organization is found wanting to adopt, it may see the demise of the organization itself, so that is not a good thing to happen.

So, this is where the role of the CEO becomes extremely crucial for an organization. Then, what does a top management do? The top management has to provide direction, it should help in setting vision and it should help in setting standards. Then, what are the types of interpersonal roles, these are called behavioral roles, which the top management or the CEO should exhibit. For example, for the CEO, he should act like a figurehead for

ceremonial duties in addition to being a leader to provide direction and a liaison agent for outside contracts; he also has certain informational roles that are monitoring information, disseminator of information within the organization.

This is what I just refer to in the earlier process. In the present information age you have so much of information. Now, you should take a decision of how much of this information should percolate to what levels that essentially is the job of the CEO. In other words, the job of the CEO, a very important job is to be concerned with management of this knowledge in inverted commas. The knowledge is gained through this information set up, then the spokesman to external organization. Of course, the CEO has got these decisional roles that are to be an entrepreneur, a disturbance handler, a resource allocator and a negotiator.

There is something which Indian organizations somehow failed to do, what is that? Failed to do for number of years, but this scenario is now changing also. That is, they did not do this succession planning, what is the succession planning?

Suppose this top management were to be not there, who is the person to come into the shoes of the top management that is, identify the second line of leadership. Why should you identify the second line of leadership? This second line of leadership is required, because the transition has to be smooth.

In other words, there should not be a void in leadership. The external environment should not feel there is a void in the leadership of the organization. This unfortunately many of the public sectors face this type of situation in the country; there is a void which is felt for what are the reasons. So, this has to be overcome especially in the present day scenario.

Of course, a leader has to be dynamic, decisive, but should not lose sight of the human approach that is sometimes he may have to have a humane approach to solving problems, not be very rude or stricter to rules. Sometimes, he may have to go out and solve problems.

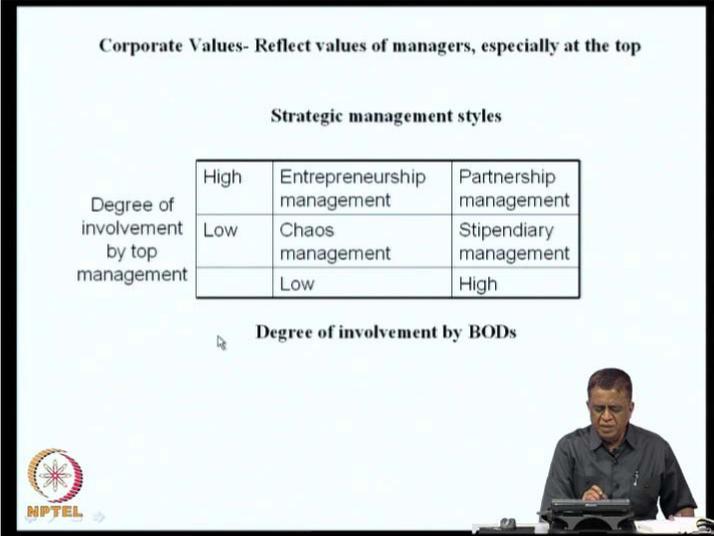
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Corporate Values- Reflect values of managers, especially at the top

Strategic management styles

Degree of involvement by top management	High	Entrepreneurship management	Partnership management
	Low	Chaos management	Stipendiary management
		Low	High

Degree of involvement by BODs



So, conscientiousness, ability to understand workers needs, have a good personality and objectivity, all these contribute a lot in addition to saying that these have good communication ability as well. The corporate values reflect the values of the managers, especially at the top, this is very important for an organization. So, the corporate values which are exhibited by a company reflect the values of the managers especially at the top. That brings you to one more important aspect what could be the management styles, which can be practiced in organizations.

This figure represents to you the degree of involvement by the BODs, then the degree of involvement by the top management. Suppose the degree of involvement is very high by the top management, but very low by the BODs, then it leads to what is called an entrepreneurship management.

What does it really mean? Just start reflecting over this. It really means that the CEO runs the enterprise according to his (()) that is he is not bothered about what the BODs doing or what the BODs trying to say. In other words, he will do what is called builders in BODs. Suppose the BODs involvement is also low, the top management's involvement is also low, what does it lead to? It leads to a situation of chaos, what does it mean? There is no sense of direction in the organization.

So, this is what I said, an organization should never face a void in its top leadership, if there is a long void in its top leadership, this type of situation can arise where there can

be chaos in the organization. Suppose the degree of involvement by the top management is high, by the BOD is also high that is the BOD is a very active player, a collectively taken together every active player, then what does it mean? It does not allow the CEO to run away with his thinking, it keeps on influencing him to take decisions which the BOD as a collective body thinks as the right one. The CEO also in turn, because he is more and more involved in the objective running of the organization, comes out with new idea thinks that could lead to a very healthy management; this is called the partnership management.

The last slot that we are looking at, suppose the degree of involvement by the BOD is high, the CEO is low or we can put it in a different way, the CEO is not allowed to function by certain BODs let us say, then what is the type of scenario you are getting with respect to an organization? What is the type of strategic management's style we are getting with respect to an organization? This is referring to as stipendiary management. What does this stipendiary management do? That means to say the board is using this CEO as the rubber stamp, so the BOD is using the CEO of the company as a rubber stamp to come out with its own decisions.

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Enhancing BODs effectiveness:

- Corporate shareholding should be dispersed
- Part-time non-exec. Chairman should not be ornamental
- Role of Director should be internalised – different from heading profit centre
- BODs should be for two days
- Outside director fees should be not less than Rs.2500
- No. of directorships by a person should be not too many
- should refrain from actual operations and policy implementation

Beer's 5 step system model for organisation's viability

System 1 : Various operational units or division of firm

System 2 : Various common service departments to co-ordinate and create orderliness in operational units' functioning – accounting, purchase, ...

System 3 : Various specialist directors for synergy of operational units – marketing, production, finance, cutting across operational divisions (inside & now of firm's operations)

System 4 : 'Outside & then' for the firm – corporate, planning, R&D, management development (development directorate)

System 5 : Monitor integrate System 3 and System 4

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Now, the next question that we have to address with respect to BODs is how you enhance the effectiveness of BODs. One of things which one can do, or possibly think of doing, is corporate shareholding should be dispersed? What does this mean? This means

more number of shareholders not hold large percentage of shares with one person or a few persons, things like that if it is distributed widely, then it is very possible that the BOD is controlled by one person or a coterie of persons.

So, its effectiveness can improve one of the plastics. Then, the second one is part time non-executive chairman should not be ornamental, so many organizations have a part time executive chairman, he comes for the board meetings, does not make any great significant contributions, so such things need to be avoided. Then, the role of the director should be internalized that is many people come within the organization, raise to the level of the director, but they tend to think in terms of their own compartment from which they came, this has to be given up or this has to be modified, when you are sitting as a director on the BOD of the company. This is different from adding a profit center, because you have to look at the company as a whole.

So, there is one more suggestion that is normally given, but quite difficult to implement, whether the BODs can be for two days. Why is this suggestion coming? Many times it is found that all these gentleman on the BODs of important companies, they are pressed for their time, if they are not able to go through the agenda items very carefully before coming to the board meetings, suppose the BODs for two days, first day could be made use of by the directors to have a decision threadbare on the different agenda items, then the second day could be really used to deliberate on the decisions to be taken.

Then, the other aspect that you are seeing with respect to Indian companies is the fees which are given to a nominee director or an outside director. Many companies give them a fees, which is very less, so the suggestion that is being made is suppose a director comes and attends a board meeting, the (()) or the fees that should be paid to him, should not be less than 2500.

So, there is also one more rider which exports company law or company affairs, keep on giving that is the number of directorships by a person should not be many, say why not you limit it four. Though there is a thinking that it can go up to 10, but many think that suppose a person is a director on ten companies, then he may not be able to do justice for all these companies.

So, should refring from actual operations and policy implementation, this is what I have said earlier. That is a BOD is not going to interfere or should not interfere in the day to

day functioning of the company that is the job of the chief executive. There is a model which is suggested by this gentleman Stafford Beer's that is, he says, he gives what is called a five step system model for organizations viability. He says, for an organization to be viable, it could be recognized under five system heads.

System 1 could be the various operational units or divisions of the form. System 2, could be the various common service departments, to coordinate and create orderliness in operational units, functioning, it could be accounting, purchase, whatever. Then, system 3 could be the various specialist directors for synergy of operational units, whether marketing production or finance. Cutting across operational divisions, this is referred by Stafford Beer as inside and now of the forms operations. Then, system 4 is outside and then for the form, what does this contain? This contains the divisions, corporate planning, R and D management development, which Stafford Beer refers to as development directorate.

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FOUR RESPONSIBILITIES OF BUSINESS

- ⊙Economic - Must do
- ⊙Legal - Have to do
- ⊙Ethical - Should do
- ⊙Discretionary - Might do

Social Responsibility – includes Ethical & Discretionary

Ethical Responsibility:

- ⊙Utility: does it optimise the satisfaction of the stake holders? (Should behave in such a way that it produces the greatest benefit to the society and least harm the lowest cost)
- ⊙Rights: does it respect the rights of the individuals involved?
- ⊙Justice: is it consistent with the cannons of justice (decision makers should be equitable, fair and impartial in the distribution of costs and benefits to individuals and society)

 NPTB

Then, the system 5 is monitor, integrates systems 3 and 4. So, in other words, this system 3 and 4 are very important for an organization. If you are able integrate this systems 3 and 4 effectively; that is inside and now of the form, outside and then for the form, then you are likely to have a good organizational viability model. So, this is a type of thing which Stafford Beer advocates for an effective functioning of the BOD.

Now, I come to some other aspects of business. There are four responsibilities which a business has to really execute. What are these four responsibilities? One is what is called the economic responsibility, what you mean by the economic responsibility? You have formed a company or a company has been formed, why has the company been formed? It has been formed with a certain objective and that objective is sort to be met by coming out with certain products, addressing certain market segments, this is the economic objective of the form.

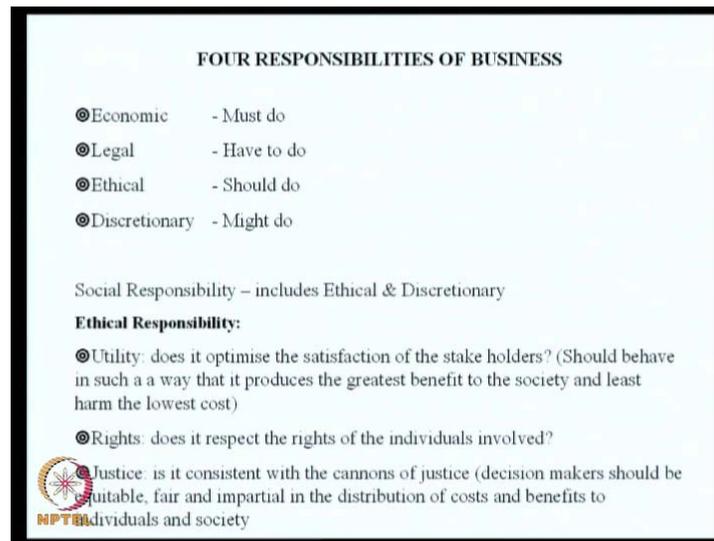
The economic objective of the form is to find the viability of the firm in the market place. In a market place, the firm should find itself viable, so it cannot be incurring losses, so this economic responsibility is a must for the firm, the firm should it.

Now, in order to do this economic responsibility, the firm also has to follow what is called the legal boundaries. That means the firm has to operate under certain legal boundaries or the law of the land. So, this law of the land or the legal boundaries, the firm has to adhere, the firm has to say yes, this is where the company operates, this is what can be done.

There are two other things which the company can do. That is one is ethical that you should do, what is ethical? We will just come to that a little later, then the fourth responsibility is discretionary that is might to do. That is the company might consider doing this, so this ethical and discretionary heads of responsibilities are assuming more and more importance in the present day context.

Why are they assuming more and more importance in the present context, especially in the Indian scenario because, you found that the IT revolution in the country resulted in many IT companies becoming dominant place, not only dominant place within the country but also globally. Now, the question is, in order to sustain this global competitiveness for this IT firms, the government gave them several incentives or sops to sustain their competitive edge, the question that is being asked is what these IT firms done in return?

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So, this is many times the question, which people tend to ask. In other words, in addition to what their economic roles has been of making more and more profits, every year becoming profitable, how else have they contributed to society for all the governmental support they have received? These are coming under two roles or responsibilities; that is the ethical and discretionary; that is referred by a new terminology called the social responsibility. The social responsibility, which includes the ethical and the discretionary roles, is also now referring to in the present scenario as corporate social responsibility.

Now, I give you a small definition of some of the terms which are involved in ethical responsibility. Ethical responsibility has three items to go with it, one is utility and what does it mean? Does it optimize the satisfaction of the stakeholders?

That is the action of the company; does it optimize the satisfaction of the stakeholders? That is should behave in such a way that it produces the greatest benefit to society and least harm at the lowest cost. Then, rights, does it respect the rights of the individuals involved? Justice, is it consistent with a cannons of justice? That is decision makers should be equitable, fair and impartial in the distribution of costs and benefits to individuals and society?

So, the question that comes is every action that is viewed, that is taken in a company is viewed under the bioscope or under this microscope of three heads. One is, what is the utility of this action, second is the rights and then third is the justice. If it is able to really

take these three things along, then the company is supposed to have ethical responsibility or supposed to have taken decision in an ethically responsible manner.

Now, what is all these ethical responsibility? Whether, some studies were done in the Indian context before liberalization itself or is it just something which came only after liberalization? These aspects we will take it up in the next class, so thank you.