

Strategic Management - The Competitive Edge

Prof. R. Srinivasan

Department of Management Studies

Indian Institute of Science, Bangalore

Module No. # 02

Lecture No. # 09

Board Functioning – Indian Context & Environmental Scanning

Last class, we discussed the different committees which were set up by the government and the industry bodies to at look at corporate governance in the country.

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Specifically, we looked at the reports of 4 committees: One is the Cadbury committee report; second the CII committee report; third is the Kumara Mangalam Birla committee report; and the fourth one - Narayana Murthy committee report.

All of them have made important recommendations on different aspects of corporate governance.

Now, before we close this corporate governance, I want to draw your attention to the book which I have written on strategic management.

Go to chapter number 4 and section 4.2. If you go to section 4.2, you have a section devoted for social audit and you have a section devoted to responsibilities of CSR organizations.

I will just read from the book, these particular sections, a few points which may be of interest to you. One - corporate social responsibility - that is, CSR is concerned with the ways in which an organization exceeds the minimum obligations to stakeholders specified through regulations and corporate governance.

This includes such aspects as to how the conflicting demands of different stakeholders can be reconciled.

A company's stakeholders are all those who are influenced by or can influence a company's decisions and actions. Those can include, but are not limited to, employees, customers, suppliers, community organizations, subsidiaries and affiliates, joint venture partners, local neighborhoods, investors and shareholders or a sole owner.

Since the legal and regulatory framework pay uneven attention to the rights of different stakeholders, it is useful to distinguish between different stakeholders who may consist of contractual stakeholders, that is, customers, suppliers and employees who have a legal relationship with the organization and community stakeholders, that is, local communities, consumers in general and pressure groups, who do not have the protection of the law to the same extent as the first group.

Kindly note this sentence. CSR is particularly important to community stakeholders.

Section 4.3 deals with responsibilities of CSR organizations. I just quote from the book: CSR organizations are responsible for internal and external aspects concerning the organization. What are the internal aspects? One is employee welfare - can be medical or assistance for dependents, working conditions - can be social and sporting clubs, safety standards, job design - meaning designing of jobs for the satisfaction of the workers, intellectual property - meaning respecting and not claiming corporate ownership of the

private knowledge of individuals. What do you mean by that? Somebody has done something; the credit should go to the person concerned.

What are the external aspects? Green issues - this is something which is current now - that is, reducing pollution and conservation of energy; products danger arising from the careless use of products by consumers; markets and marketing issues related to advertising standards; withholding of information; supplier's issues related to fair terms of trade and black listing; employment issues related to positive discrimination in favour of minorities and discrimination in jobs and maintaining jobs; then, community activities such as sponsoring of events and supporting good work.

Why do we have social auditing? Because most of the companies lay down guidelines on some or other issues, but some have no programs at all. So, how does social auditing help. Social auditing is a way of ensuring that these issues of corporate social responsibility get systematically reviewed.

The next paragraph tells you organizations own land, consume water, air and take the services of other utilities. Thus, they affect communities in various ways. Social auditing is carried out to study the company's effect on the stability of local employment levels, local taxes paid by it, contribution to local charities, labour relations, hiring, promotion and trade practices, water, air and noise pollution, power and water conservation, plant appearance, traffic flow, impact on local politics, contribution to research and import substitution, support to local industries.

In other words, a social auditor has to look at the positive social changes brought about by the company. He also has to scrutinize the short falls and the non-achievements. When he does that, he has to take into account the effects of events beyond the boundary of the program, all of which the designers of the program may not have been in a position to envisage and allow for implementers to deal with.

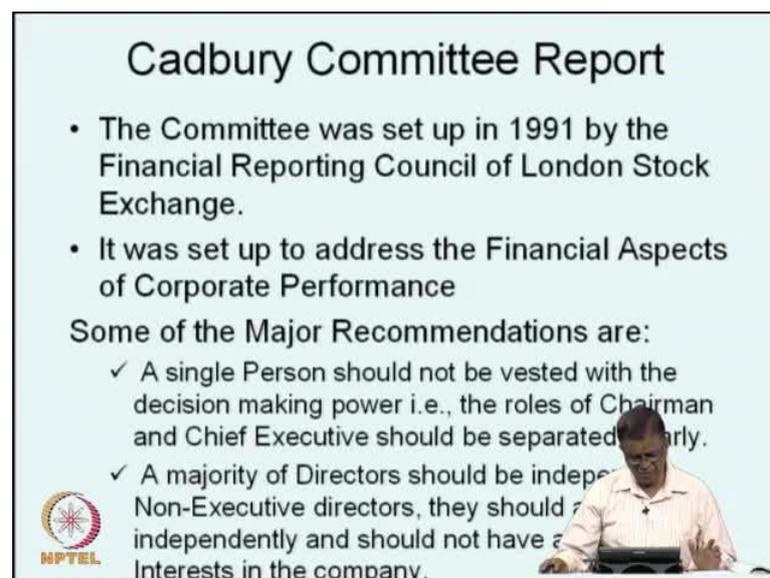
Some of the serious problems which social auditors face or the difficulties they face are the absence of a well-conceived information system as part and parcel of a social welfare program.

These are some of the things which one has to take into account when you are looking at CSR. CSR is also linked very closely to principles of sustainable development in proposing that enterprises should be obliged to make decisions based not only on the financial/ economic factors, but also on the social and environmental consequences of their activities.

If you just look at table 4.1 on page 56, it gives you, under 4 headings, the sub factors of the different groups with reference to employees, customers, government and society. This is what we discussed in a different way with respect to the IPCL Company Chem and that was one of the exercises which was done in the Indian context.

There are some other methods of social auditing also which interested students may like to refer. One is what is called the Leno's model of social audit; second is the social processor program management audit and the third is the macro micro social indicator audit. The fourth is the comprehensive audit covering various aspects such as energy, environment and human resources; the fifth one is the ABC approach to social audit. Of course, we have discussed one method which was done in the Indian context that is, the IPCL social audit check list.

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Cadbury Committee Report

- The Committee was set up in 1991 by the Financial Reporting Council of London Stock Exchange.
- It was set up to address the Financial Aspects of Corporate Performance

Some of the Major Recommendations are:

- ✓ A single Person should not be vested with the decision making power i.e., the roles of Chairman and Chief Executive should be separated clearly.
- ✓ A majority of Directors should be independent Non-Executive directors, they should be independent and should not have any financial interests in the company.

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CII Committee Report

The Confederation of Indian Industry (CII) drafted some codes of Corporate Governance in 1996.

Growing International Competition, Growth in the Economy as well as Scams and Frauds brought forth the Importance Of Corporate Governance and the CII Report.

Some of the Major Recommendations are:

- ✓ Listed Companies with a turnover of at least 100 Crores and a paid up capital of at least Rs 20 Crores must appoint Audit Committees of the board within 2 years.
- ✓ Non-Executive Directors should actively participate in Board Affairs and they should be adequately compensated through Commissions and Stock options
- ✓ No person should hold Directorships in more than 10 Companies



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Ramkrishna Mishra Report

The Committee on Corporate Governance was set up in 1999, by the Securities and Exchange Board of India (SEBI).

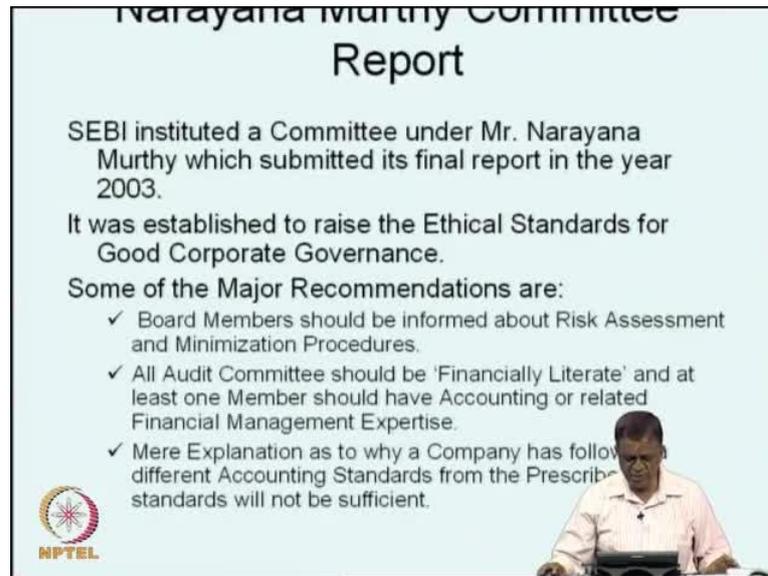
It was set up to address the Safeguards which are to be instituted within the Company to deal with Insider Information and Insider Trading.

Some of the Major Recommendations are:

- ✓ The Board should have an optimum combination of Executive and Non-Executive Directors and at least 50% should be Non-Executive Directors.
- ✓ Board should set up a Remuneration Committee to determine the Remuneration Packages for the Executives.
- ✓ Management should assist the Board in its decision-making process in respect of Company's Strategy, Policies and Conduct and Performance Targets.



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Narayana Murthy Committee Report

SEBI instituted a Committee under Mr. Narayana Murthy which submitted its final report in the year 2003.

It was established to raise the Ethical Standards for Good Corporate Governance.

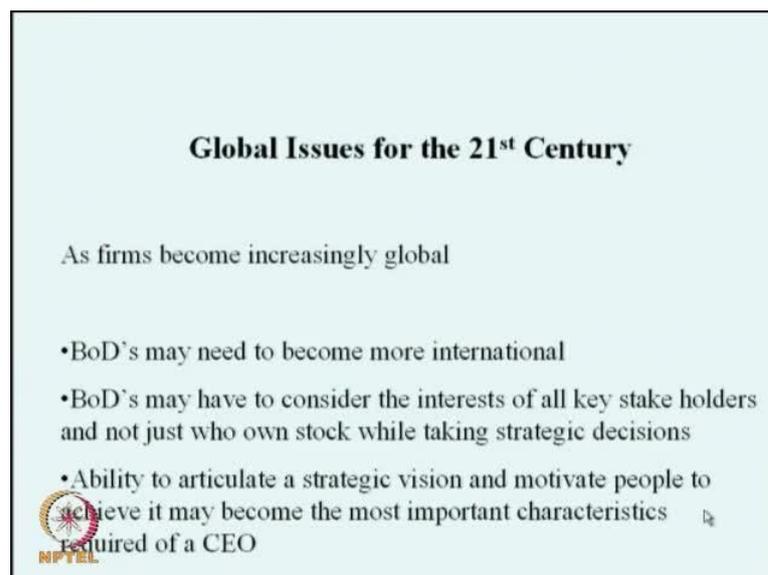
Some of the Major Recommendations are:

- ✓ Board Members should be informed about Risk Assessment and Minimization Procedures.
- ✓ All Audit Committee should be 'Financially Literate' and at least one Member should have Accounting or related Financial Management Expertise.
- ✓ Mere Explanation as to why a Company has followed different Accounting Standards from the Prescribed standards will not be sufficient.

This is what we are looking at. These are the reports which we looked at. When we went further, we looked at the recommendations made by each of these committees - that is, the Cadbury committee, the CII committee, then the Kumara Mangalam Birla report, then the Narayana Murthy committee report. The Narayana Murthy committee report is one of the latest reports in 2003.

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Global Issues for the 21st Century

As firms become increasingly global

- BoD's may need to become more international
- BoD's may have to consider the interests of all key stake holders and not just who own stock while taking strategic decisions
- Ability to articulate a strategic vision and motivate people to achieve it may become the most important characteristics required of a CEO

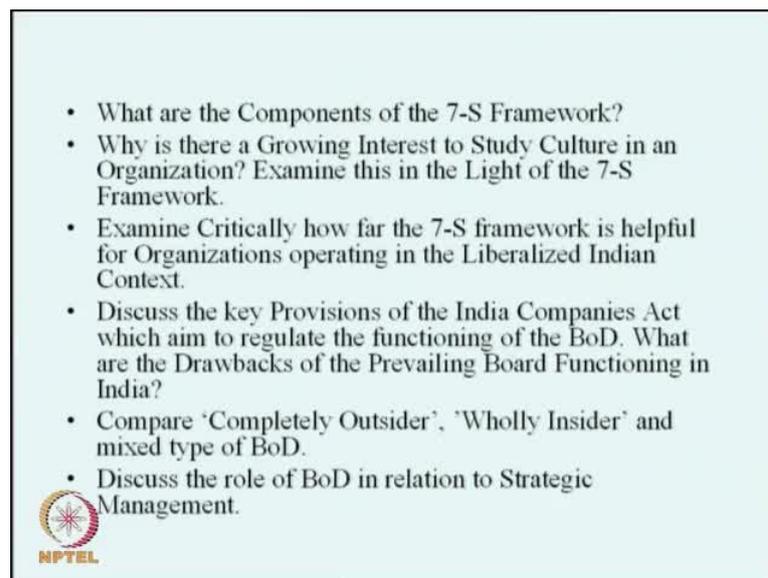
Then we came out with the global issues for the 21st century, where we said as firms become increasingly global, BoD's may need to become more international.

'BoD's may have to consider the interests of all key stakeholders and not just who own stock while taking strategic decisions. This is what we discussed now also. So, many of the stakeholders can be community, and all those types of things.

Then, ability to articulate a strategic vision and to motivate people to achieve may become one of the most important characteristics required of a CEO. This is what we discussed.

Now with the background of all this information with respect to the CSR, the social audit, the 7-S matrix and all that, let us look at a few assignment questions which you can perhaps take up. One of the next assignment questions which you can perhaps handle is what I am going to give you now. These are the questions on the 7-S framework.

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- What are the Components of the 7-S Framework?
- Why is there a Growing Interest to Study Culture in an Organization? Examine this in the Light of the 7-S Framework.
- Examine Critically how far the 7-S framework is helpful for Organizations operating in the Liberalized Indian Context.
- Discuss the key Provisions of the India Companies Act which aim to regulate the functioning of the BoD. What are the Drawbacks of the Prevailing Board Functioning in India?
- Compare 'Completely Outsider', 'Wholly Insider' and mixed type of BoD.
- Discuss the role of BoD in relation to Strategic Management.

The first question is what are the components of the 7-S framework? What am I asking you here? I am asking you here to write down all the 7-Ss; Give me all the 7-Ss starting from structure, strategy, all that 7-Ss. Give me the 7-Ss.

The second one is: I am asking you a question, why is there a growing interest to study culture in an organization? Examine this in the light of the 7-S framework. This is what we discussed in great detail when we were looking at the 7-S framework.

The impact of culture - if you really look at this you can also bring to bear some of the points that have happened after the LPG in the country. This LPG is referred to as liberalization, prioritization and globalization; what has happened?

There is a very strong feeling that in the last 10 years particularly, our value systems that is the Indian culture and the Indian values have suffered a great knock at the hands of this LPG in the sense that there is a feeling among parents that children are not listening to them and there is a feeling that children are going astray by what the media transmits and all those types of things.

There is also a feeling among the parents that as soon as their children get to work that there is a lot of gap between their work culture and the culture in the family. There is a very strong feeling that the children are trying to go away from the established norms. All these things you can bring out on what is happening to culture in the light of this LPG era.

Try to look at it from the 7-S framework, one of the very important 'S'es in that, which we discussed. Then the third question which I want you to answer is examine critically: how far the 7-S framework is helpful for organizations operating in the liberalized Indian context?

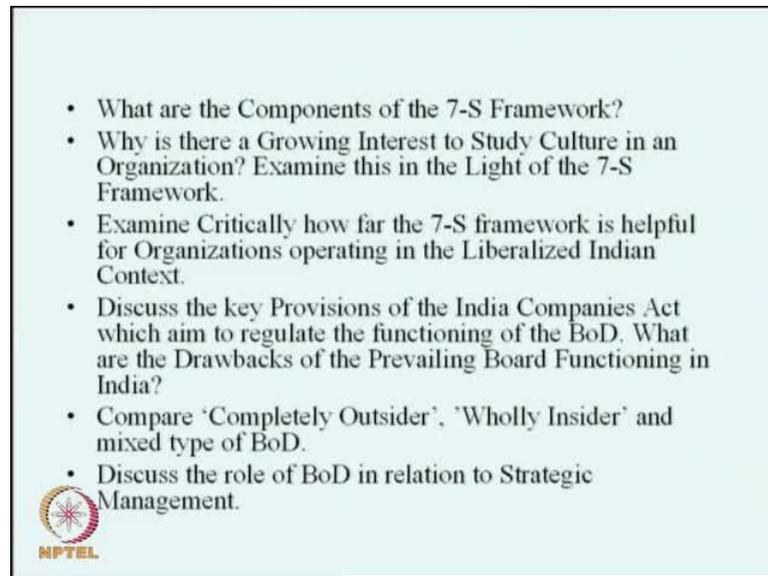
So I have tried to provide answers in my own way if you listen to all the lectures. One of the important things that we have seen is that while liberalization on the one hand has brought about opportunities on the other hand, it has also sounded the death knell for companies which are not able to adapt.

In this category, there are both private sector and public sector organizations. Both of them have suffered and many small scale industries and also medium scale industries have really borne the brunt of this LPG attack, in the sense that if you really see some of the small scale industry sheds, they are more or less empty. You can take the example of Bangalore only and you find that most of them are out of business.

So, normally the small scale industries have their own working capital problems. Here is a new environment which has got created where the technology changes that are taking place are very rapid and the Indian small scale industry has got its own limitations to

adjust to this and they found that this adjustment was a real problem. All these aspects you can bring about while answering the questions.

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The other aspect that you can possibly say is these things have happened but what is the type of suggestion which you can give to organizations which are operating in the present liberalized environment?

How should they really cope with this? You can go to the different modes of decision making, try to see which one can be best and try to bring out the salient points.

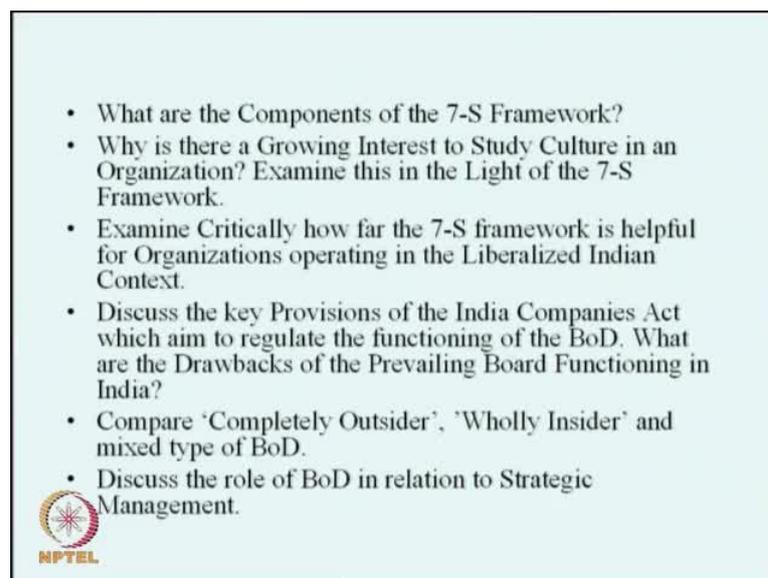
(Refer Slide Time: 18:59) The other question which I wanted you to answer is to discuss the key provisions of the Indian companies act which aim to regulate the functioning of the BoD - that is, the Board of directors.

What are the drawbacks of prevailing board functioning in India? I have just tried to answer this question while I was discussing this topic. What is really happening? Sections 291 to 293 of the Indian Companies Act are very important while discussing the BoD. One gives the power; the other gives the restrictions which are placed on the BoD. When you are able to list these 2 sections which are the 291 and 293 comprehensively, you are able to give the powers and the restrictions of the BoD.

And you can supplement it with section 292 where other key provisions are also mentioned.

I have also brought out what are the types of drawbacks of the prevailing board functions. Some of these drawbacks - how it can be obviated, you can discuss that also; whether it will be better to have a board of director from within or have an expertise from outside, who can be viewing the company more objectively compared to an insider and all those types of things. What is the type of remuneration the director on the BoD should be getting and what is really happening in the Indian context? Are they getting the type of remuneration? If they are not getting that, make recommendations or suggestions for them to get this type of remuneration as well.

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Then the next question which I want you to answer is: Compare completely outsider, wholly insider and mixed type of BoD. Suppose it is completely outsider BoD, so you have a totally objective view.

But you may also have problems like some of the factual problems or factual situations that are prevalent on the ground. That is a company may tend to get glassed over because the person who is controlling is a completely outsider, not fully aware of the gross realities.

Then the wholly insider board, what is the type of problem that you may have? They have all been within, they have all groomed up within the company for a long time. The result is they may not take a very objective view of the competitive environment. This is one of the questions. It may not always happen.

But now what does a company really want? It wants the inside experience and it also wants the objective views. Both of them help the company in coming forward or in going forward. That is the one which is the mixed type of BoD.

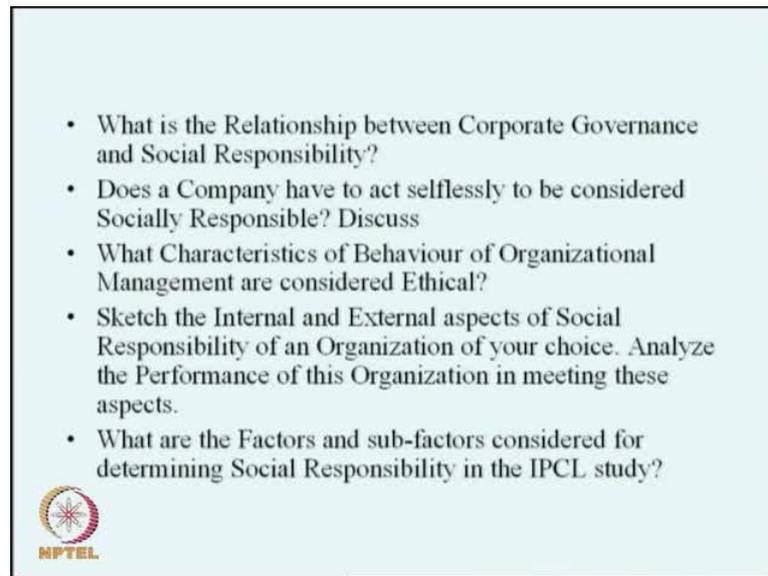
Then the last question which I want you to answer is: What is the role of the BoD in relation to strategic management? I have tried to answer this question also, when we discussed the role of the BoD. Suppose it is a very passive BoD, then what is going to happen?

You find that the CEO really exercises the maximum power. He can bulldoze the BoD and take own strategic decisions. The board just acts as an approval or gives its stamp of approval for the decisions taken by the CEO.

So, the best method of board functioning or the best relationship between the directors and the top management could be the participative style where both of them participate to bring about the desired changes in the organizations.

This is the second assignment, which I want you to attempt. Also, I want you to attempt one more assignment that is, a third assignment. You can just look at these assignment questions also.

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- What is the Relationship between Corporate Governance and Social Responsibility?
- Does a Company have to act selflessly to be considered Socially Responsible? Discuss
- What Characteristics of Behaviour of Organizational Management are considered Ethical?
- Sketch the Internal and External aspects of Social Responsibility of an Organization of your choice. Analyze the Performance of this Organization in meeting these aspects.
- What are the Factors and sub-factors considered for determining Social Responsibility in the IPCL study?



These questions are with respect to the CSR which we have discussed. What are the types of questions which I am asking you? I am asking you the following questions.

One is what is the relationship between corporate governance and social responsibility? We have discussed this in great detail. Then, does a company have to act selflessly to be considered socially responsible? How do you answer these questions?

Discuss the 4 roles or the 4 aspects of business which I have listed for you. Then you will discuss the 4 aspects of business or the responsibilities of business. **One is the ethical, the second is the legal, the third is the One is** First is the economic - where one must do, then legal - have to do, ethical - should do and the fourth one is discretionary - might do. Discuss these 4 responsibilities of business; you will get an answer to this question.

Then the third question which I want you to answer is: what characteristics of behaviour of organizational management are considered ethical?

I have given you what this ethical behavior is. I have brought out for you this utility approach, then the individual rights approach, then the justice approach. So, you can look at that and answer this question.

Then the fourth question which I want you to answer is: Sketch the internal and external aspects of social responsibility of an organization of your choice. What I want you to do

is take any organization which you know of or about which you have got information; look at the internal and external aspects of social responsibility. You can pick up Infosys itself. What is the role with respect to social responsibility? It is doing all those types of things - whether it is provision of toilets or maintenance of roads or assistance to hospitals or provision of what you call directions for traffic in big cities, all these types of things.

Then analyze the performance of this organization in meeting these aspects. You can really look at the way the organization has discharged this responsibility or discharged this role.

Then I want you to look at the IPCL study. That is the factors and sub factors considered for determining social responsibility in the IPCL study.

We can also look at the different committees which I have listed for you that is the 4 committees and highlight the important salient recommendations also. With this we come to the end of an important aspect of this strategic management course.

We will now take up another important aspect of this course. That is how to go about an external environment analysis.

So, this external environment analysis or the environmental landscape analysis - how do we go about this environmental landscape analysis?

Let me just take you down to this landscape analysis, just brining to you the important aspects of this.

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What is the environmental analysis? The environmental analysis, as I mentioned to you in passing, when we were discussing, is looking at the opportunities and threats the external environment holds for an organization.

What are the types of opportunities and what are the types of threats? How do you define this environmental threat? Normally, you look at threat as a challenge, that is, it is a challenge posed by an unfavourable trend; something unfavourable has happened. What is the challenge that it has brought about for the organization? If you would look at liberalization, that was a challenge for the Indian industries - especially the public sector.

They were forced to really look at competition and they were forced to take competition head on - one. Second thing which happened is, this competition was not restricted only to Indian companies, but in came the foreign companies, the multinational companies. The Indian companies not only had to face competition from within, but also from global companies.

This is one of the greatest challenges that came in. If you really see the types of competition which you are seeing in consumer industry, it is something unimaginable, even a detergent industry.

You have an established player like Hindustan Lever. You have other multinational companies coming out with their own products. Even though, being an established player

a company like Hindustan Lever finds the going very tough in order to hold on to the market share, which it has already acquired and which the company has acquired putting in lot of efforts, though it is considered one of the best marketing companies in India.

This is the type of challenge even a company like Hindustan Lever is facing. What is this environmental opportunity? On one hand, you have this; on the other hand, you also have opportunities for companies to expand their horizons of business, that is, you can look at environmental opportunity as an attractive arena for company's action where it would enjoy a competitive advantage

Suppose, you have core competence, that is, the company has the core competence then why should it not encash on the core competence? Why should it just look at the core competence only in the domestic market? Is it possible to expand the horizons? This is what most of these IT companies that are operating in India or who started their operations from India have capitalized on. They said here is some educated man power available to execute the jobs and execute the jobs in a cost effective manner. So, many of these IT companies have become global players.

One you have the threat, you have the opportunity. These 2 aspects that are the threat and opportunities are the ones which are looked at with respect to the external environment.

When you are drawing that taxonomy of the environment for a firm, let us say, you want you want to draw the taxonomy of the environment for a firm, you look at the mega environment, you look at the microenvironment and you also look at the relevant environment.

What can be the mega environment? The mega environment is something more global; then micro environment is something which is more of relevance to the organization that is more local, where the organization is housed or is headquartered. Then, what is the relevant environment? Between this mega and micro, the organization picks up those aspects where it would like to operate; these are the relevant environments. I will explain this to you as we go along by a diagram.

Now, I bring a few aspects of mega environment to your consideration: one could be the technological advances. Suppose the transportation capability of the country has shown tremendous improvement, what does it mean?

The mega environment is such that you can reach between different places very fast. This is what you are seeing in different countries of the world where you have very fast trains, super-fast trains. You have these TGBs in Europe where you can cover some 300 kilometers in about an hour or hour and half time. These are the things which are giving the country an increased transportation capability. So, what is going to happen?

Your logistics capability that is the ability to make your products accessible and the ability to have your man power moved from your headquarters to different places; all these things get a tremendous boost. When they get a tremendous boost, automatically this contributes to the setting up of their industry in that particular place or the particular country.

Similarly, increased mastery over energy - we are everyday facing problems in our country with respect to energy. Some parts of the country are not having power all the 24 hours. When they have power, they do not have the required voltage - it is sometimes low; sometimes the voltage is high. You have this varied frequencies coming in. All these are likely to affect industrial production; all these are likely to affect the organizational environment.

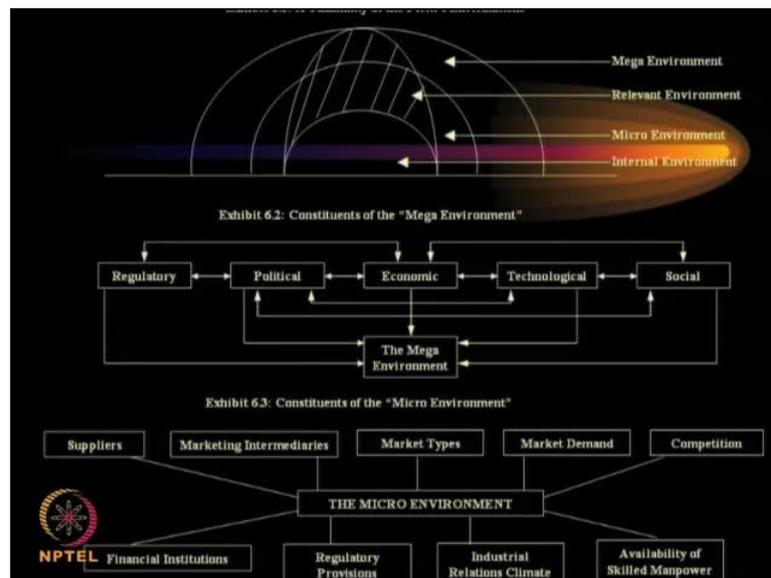
Suppose, as a country, we are able to have a mastery over energy, with none of these problems, which I just mentioned; it can be tremendous boost; it can be a tremendous technological advance.

Similarly, increased ability to extend and control life and serviceability. These are some of the new things which R and D is coming out with. All your advances with respect to many of these nano-materials, then your genes - all these things are the types of research that is going on to increase what you call the serviceability of the human lives itself, not to speak of the products all these things are really contributing to the particular country, getting lot of attention.

Similarly, the increased ability to alter characteristic of material - you have the super conductivity materials. All these types of materials which can give what you call the types of trains which are operating in Japan nearly a supersonic type of train. All these are due to the terrific advancements that have taken place, then the extension of man's sensory capability. All these visual medias which you are seeing, how it is happening?

Similarly, the growing mechanization of physical activities which you are seeing so many things where you have to exert yourself. Starting from your consumer durable products like the washing machine or the oven - all these types of things are contributing to this. Then the growing mechanization of intellectual processes - this is what the IT revolution in the country has brought about. In our own country, many of the jobs on which you have to really exert yourself very heavily are taken over by the IT and you are able to really come out with the answers to the systems quite fast.

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This is what the mega environment is. What do the indicators of this mega environment really mean? I just bring to you some aspects of this. If you look at this figure 6, this first figure here, it gives you the mega environment - that is the outer most circle, the next inner circle gives you the micro environment, then the inner most circle gives the internal environment that is the environment within the firm and then there is a hashed portion which is shown here. This hashed portion which is shown here gives you the relevant environment.

If you look at this relevant environment, it encompasses some aspects of the micro as well as the mega environment and of course, it encompasses the internal environment of the organization.

So, when you are looking at the taxonomy of the firm's environment, you have the internal environment, then you have the micro environment, you have the mega environment and then there is this hatched portion which gives the relevant environment.

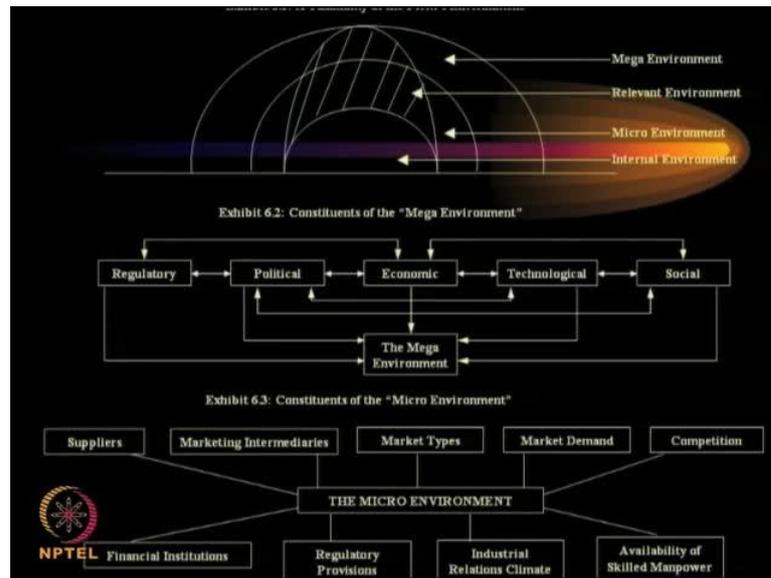
So, the relevant environment comprises of some aspects of the micro and some aspects of the mega and of course, it builds on the internal environment in the organization.

What are these constituents of the mega environment? It is listed to you in the second figure. The mega environment consists of the economic factors, then the technological factors, the political factors, then the social factors and the regulatory factors. All these 5 put together forming what we call the mega environment and I gave you some examples of this mega environment, just now. What could be the indicators of this mega environment like this increased mastery over energy, increase in transportation capability and all those types of things?

Then, what is this micro environment? When we are looking at micro environment, we are going a little further down. What is it that we are looking at? We are looking at suppliers; we are looking at marketing intermediaries; we are looking at market types; we are looking at market demand and we are looking at competition.

So, if you really see the top ones - that is the suppliers, the marketing intermediaries, the market types, the market demand and competition - all these are have an interface with the market.

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Then now, come to the bottom ones - that is financial institutions, the regulatory provisions, the industrial relations climate and then the availability of skilled man power. What are these? What is the financial institution?

The financial institution is an institution which the company may be banking upon to draw some financial resources. It might have helped the company to come into being and it might be continuing to help the company in its working.

The regulatory provisions are something connected with the legal framework within which the company has to operate. So, you have to really conform to this.

The industrial relations climate - what you mean by this? How difficult it is or how easy it is to operate your company.

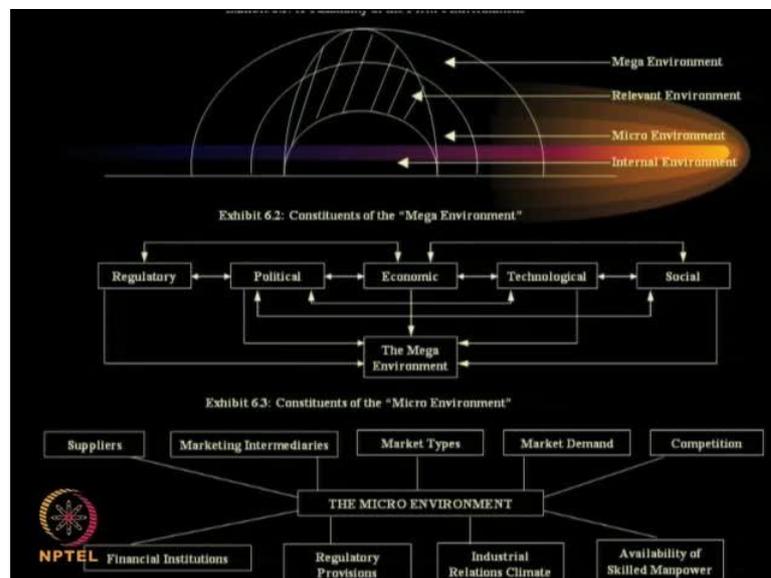
Suppose your company is an IT company, the place from where you are operating must have skilled man power. Almost all these **ITES** companies - if you really see, they are housed in places where the availability of technical man power is very high – so, a place like Bangalore, if you really looked at it, you have large IT companies, because the man power that you are able to get not only from within, perhaps draw from other parts of the

country into a city like Bangalore can be huge, which has fostered the growth of these types of companies.

When you look at this, you can more or less say, these are the different actors in the different environments. (Refer Slide Time: 46:16) That is, with respect to mega environment you have the actors - regulatory, political, economic, technological and social, with respect to the micro environment you have market actors like suppliers, you have marketing intermediaries, you have market types, you have market demand and then you have competition.

Then, you also have some of the institutions with which the company might be dealing. It can be financial institution or it can be institution where you are looking at the institution dealing with the regulatory provisions or it can be one where you look at the industrial relations climate; and then the fourth aspect which I just mentioned is the availability of skilled man power.

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So, these are the different actors which you might be looking at with respect to the different environments.

Then we have this relevant environment, which can have some aspects of micro and some aspects of mega built into it. Of course, you are building this relevant environment on the internal environment that is existing in the organization. So, you are looking at the taxonomy of the firm's environment from the internal environments angle, look at the micro, the mega and relevant environment. I have given what are the constituents of the mega environment; then I have also given you what are the constituents of the micro environment.

I have also given you some examples of indicators of this mega environment. We will stop here. We will continue further on all these indicators in the next session.

Thank you.