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ETHICAL DECISIONS IN MANAGEMENT

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ETHICAL DECISIONS IN MANAGEMENT

Introduction

The management of an organization is responsible for making effective decisions. Managers are responsible for all business operations and they also make all the important decisions. To make decisions ethically correct, various models are considered for the purpose of good decision- making. There are various frameworks of decision-making based on factors such as duty, consequences and virtue. Managerial decision-making involves defining problems and then structuring them for positive results. There are certain steps to be followed during decision- making.

Ethical Decision Making

Managers affect the behaviour and decision-making capability of individuals. The individuals in an organization are responsible for conducting business operations. Management is defined as a decision-making process. Ethical decision-making is a method of evaluating and choosing the alternatives decided by ethics management. The following should be kept in mind while making ethical decisions:

- Identify and eliminate unethical options in the alternatives.
- Identify complex, ambiguous and incomplete facts and try to avoid them.
- Determine the ethical dilemma and resolve it.
- Select the best ethical alternative.

Organisations need to perform a set of activities and take various decisions to achieve organisational goals. These are known as the business strategies of the organization. Business strategies are an important part of businesses, firms and industries. To make a business strategy, all businesses, firms and industries need to develop a strategic plan once a year. Managers of the firms are given the responsibility to achieve the goals stated in the strategic plan. Business strategies are used for the following purposes:

- They help determine the products and services that an organization needs to provide.
- They help determine the various industries in which the organization competes.
- They help identify the competitors, suppliers and customers of the organization.
- They help analyse the long-term goals of the firm.

Simon Decision-making Model

Herbert A. Simon planned a model for decision-making that was known as the Simon's model of decision-making. According to Herbert A. Simon, the decision-making model is based on the following sequence of steps. These steps are:

(i) Identifying the problem

(ii) Generating alternative solution

(iii) Selecting a solution

(iv) Implementing and evaluating the solution This model has the following three phases:

- The Intelligence phase
- The Design phase
- The Choice phase

The Intelligence Phase

A decision-maker gets to learn about the environment where a problem occurs. The scanning of environment may be continuous or irregular. For example, a review of daily scrap report by a production manager to check the problems related to quality constitutes continuous scanning, while frequent visits of a sales executive to the key customers to identify customer needs constitute irregular scanning. The intelligence phase of the decision-making process involves problem searching and problem formulation.

- Problem searching: In this phase, the difference between the expected and real result is obtained after making a decision that helps recognise the problem. The formula for problem searching is as follows:

  Deviation = Expected – Actual

  For example, a sales manager sets a sales target of five lakh in a particular month as his expected target. This target could not be achieved and only four lakhs worth of sales were made. Therefore, the difference between the expected and real value of the target helpsrecognise the problem in setting the target.
- Problem formulation: In this phase, the problem is identified properly to avoid the risk of solving the wrong problem. Here, the problem is clearly stated and well understood. If, sometimes, the problem is difficult to understand, it is broken down into smaller and manageable sub-problems. Also, sometimes, relationships are established with previously solved problems that help in solving the current problem.

The Design Phase

In this phase, various alternatives are developed in order to get the best possible alternative to solve a particular problem. The decision-maker makes a detailed analysis of each and every alternative before taking the final decision.

The Choice Phase

In this phase, an alternative, which was developed in the design phase, is selected. This selection helps the decision-maker in taking appropriate decisions. After making a decision, the decision isimplemented. However, at any phase, the decision-maker may return to the previous phase. For example, the decision- maker in the choice phase may reject all alternatives and return to the design phase for developing new alternatives.

Types of Decisions

Organisational decisions can differ in different ways, which initiates development of different typesof decisions from which organisations can choose the appropriate decisions. Organisationaldecisions are primarily classified on the basis of the purpose of decision-making. Knowledge of outcomes is another approach for classifying organisational decisions. An outcome defines whatis going to happen if a particular decision is taken or a particular course of action is taken.

Organisational decisions involve selecting the best alternative from amongst the available alternatives. Organisational decisions are classified into the following categories:

- **Strategic planning decisions:** These are the decisions in which a decision-maker develops objectives and allocates resources for achieving these objectives. Decisions under this category are used for a long period of time and involve a large investment. For example, introducing new products and the acquisition of another organization are strategic planning decisions.
- **Management control decisions**: These are the decisions taken by the management control- level managers, who are at the middle level of the management hierarchy in an organization.These managers deal with the use of resources in the organization. The management control decisions include the analysis of variance, product mix and planning decisions.
- **Operational control decisions:** These are the decisions that deal with the day-to-

day problems that affect the operation of an organization. For example, decisions such as production scheduling and inventory control fall under this category. Decisions under this category are taken by the operational-level managers, who are at the bottom-level of the management hierarchy in an organization.

- **Structured decisions:** These are the decisions that are well defined and require application and implementation of some specified procedure or decision rule in order to reach a decision. Such decisions require less time for developing alternatives in the design phase. Structured decisions are made by operating procedures or by using other accepted tools. More modern techniques for making such decisions involve operations research (OR), mathematical analysis, modelling and simulation.
- **Unstructured decisions**: These are the decisions which are not well defined and have no pre-specified procedure or decision rule. These decisions may range from one-time decisions relating to a crisis to decisions relating to recurring problems. The unstructured decisions usually consume much time in the design phase of the decision-making process. These decisions could be solved using judgement and intuition. Modern approaches to such decisions include special data analysis on computers and heuristic techniques. Such decisions are usually handled by strategic planning level managers because of their unstructured nature.
- **Semi-structured decisions:** These are the decisions that are neither structured nor unstructured. These decisions fall somewhere between the structured and unstructured decisions. For example, the introduction of a new product is a semi-structured decision.

Knowledge of Outcomes

The knowledge of outcome plays an important role when you have more than one alternative. On the basis of the level of knowledge of outcomes, decision-making can be classified into the following three categories:

- **Under certainty**: Decision-making under certainty takes place when the outcome of each alternative is fully known and there is only one outcome for each alternative. In such a situation, the decision-maker is required to compute the optimal alternative or outcome.

- **Under risk:** Decision-making under risk occurs when there is a possibility of multiple outcomes of each alternative, and a probability of occurrence can be attached to each outcome. Such decision-making is also similar to decision-making under certainty where instead of optimising outcomes, a general rule is applied to optimise the expected outcome. A decision-maker is assumed to be reasonable for choosing a particular decision. For example, a decision-makerhas to choose from two options, one offering a 2 per cent probability of a profit of Rs 1,00,000 and the other an 80 per cent probability of a profit of Rs 10,000. The decision-maker chooses the second alternative because it gives a higher expected value. This is explained by using the following formula:

  Outcome x Probability =

  Expected Value 1,00,000 x

  0.02 = 2,000

  10,000 x 0.80 = 8,000

- **Under uncertainty:** Decision-making under uncertainty takes place when there are many outcomes for each alternative and the probabilities of occurrence of the alternatives are not known. Decision-making under fall under this category. Decisions under uncertainty arises when different people in an organization take decisions by applying different decision rules. For example, some may assign equal probabilities to all the outcomes for each alternative so as to treat the decision-making as 'decision-making under risk', whereas others may adopt different criteria, such as maximal and maximin criteria to minimise regret.

Characteristics of Good Decision-making

different characteristics of a good decision-making are:

- Decision problems should be grabbed by the management both in space and time. This means, the decision problem should be analysed thoroughly by the management.
- The decision made by the decision-maker should keep him in a state of calm.
- Decisions made by the management should contribute to harmony in the organization.
- Self-interest and self-orientation should not come in the way of decision making.

Problems in the Decision-making Process

There are various problems faced by a management in the decision-making process. Theseproblems are:

- Insufficient information: It refers to the lack of information which affects the performance andquality of the management in an organization.
- Insufficient knowledge: It refers to the difference between available knowledge and the requiredinformation for the management to take a decision.
- Lack of time: It refers to the pressure on the management to make decisions. If time is limited,then the management needs to take hasty decisions.
- Poor communications: It leads to the problem that arises due to improper communication ofinformation.

Other limitations of any management in the decision-making process are with respect to the inability of the human mind to handle available knowledge as also human behaviour.

Ethical Decision-making Frameworks

There are three frameworks for ethical decision-making. These frameworks are:

- Consequence-based decision-making
- Duty-based decision-making
- Virtue-based decision-making
- Consequence-based decision-making

Consequence-based decision-making is a useful approach for decision-making managers. This approach is beneficial for all the persons who are affected by this approach. This requires an appraisal of the effects of decision-making and the forecasting of outcomes. The effects of decision-making can be measured in various ways. These are:

- Financial costs and benefits
- Human happiness
- Organisational growth

The limitations of the consequence-based decision-making framework are:

- It is hard for the managers to guess the effects of the actions.
- This approach can reduce the ethics of economics.
- There exist conflicts in the thinking of different individuals in the organization.
- This approach does not care for human life. Duty-based Decision-making

Duty-based decision-making approach is based on the categorical imperative statement of Kant.

This approach states that one should do to others only that which one would want done to oneself. This approach focuses on the people. It also considers ethics of duty. Various limitationsof the duty-based decision- making approach are given as:

- It is difficult to know the intentions of individuals.
- Feelings and emotions of individuals can also cause problems.
- Like the consequence-based decision-making approach, it also does not consider human life.
- It is very difficult to collect the intentions of individuals into a rule and test it for universality.

Virtue-based decision-making

Virtue-based thinking is where a person thinks about the appropriate virtue or good in a particular decision, such as honesty, generosity and justice. It has the following limitations:

- Applicable virtue of a person is dependent on his thinking and his surrounding environment.
- All the ethics related to virtue-based thinking are based on judgement rather than specificrules and regulations.
- Virtue is based on integrity of character. Ethical decision-making models

Research on the actual irrational process of decision-making situations is limited. Ferrell and Gresham developed a multi-stage model with three principles of ethical decision-making, which are as follows:

- Individual factors
- Organisational settings
- Opportunity to act

Individual factors relate to the individual and his value system. Organisational settings refer to the environment that advances or prevents ethical actions. Opportunity to act refers to the chances, if at all, of an unethical act on the part of the individual.

In a decision-making process, it is essential to relate decisions regarding possible processes to ethical content. Ferrell and Gresham also designed a model consisting of four factors that affect ethical decision-making on perceived ethical problems, alternatives, philosophical evaluations and judgements. These factors are:

- Personal experience
- Organisational norms
- Industry norms
- Cultural norms

To some extent, these models look complementary as they try to examine the multiple influences on ethically hypothetical situations rather than on actual decision-making procedures.

Normative Framework

The application of normative theory explains ethical decision-making clarifying two important points. First, normative theory is idealistic and not designed for the purpose of explaining or predicting behaviour. As it is idealistic, it may not involve actual and practical situations. Second, using a normative approach lacks validity, because few decision-makers make normative theories from daily processes. The normative ethical framework may also neglect the situation where an individual possesses conventional ethical norms because of situational variables.

Within normative ethics, differences exist between the deontologists and the teleologists. They differ on the basis of the evaluation and concept of morality. In the case of deontologists, some actions are right from their origin or may be correct according to some formal principle. However, in the case of the teleologists, moral judgements are justified on the basis of references to the goodness of a purpose or the results of an action.

To arrive at a list of representative normative frameworks is a challenging task in itself. The framework must not be narrowly focussed as this may direct all the actions to short-term benefits. The following are the principles that are most commonly applied in ethical discussions:

- **Personal benefit:** This framework acknowledges the range to which any action provides benefits to an individual in question. It also acknowledges the right to life and the freedom ofan individual over his/her actions or information.
- **Social benefits**: It acknowledges the need for actions that are beneficial to society.
- **Principle of neutralisation:** It is utilised to diminish the possible impact of norm-violatingbehaviour.
- **Categorical imperatives:** This framework is based on the idea that an action is morallycorrect or wrong regardless of its consequences.
- **Duty**: An action is originally right because of the duty arising out of a stated or unstatedvalue system
- Principle of justice: It acknowledges the rights of the individuals, fair compensation and fairdistribution of benefits.
- Principle of lawfulness: It does not let anybody violate law.

The above principles depict the range of traditional normative framework and is derived from specific results and non-specific results. The first three principles are consequentialistic as they relate to consequences of an action which affects the individual as well as the society. The remaining are non-consequentialistic as they are derived from duty-based or right-based theories.

Managerial Decision-making

Decision-making and problem solving is a core functions of a management because it is an integral part of all other managerial functions such as planning, organising, directing and controlling. It is also an integral part of life because life cannot be managed without makingdecisions. We are always faced with situations where we have to make choices almost every day of our lives and making a choice out of many options constitutes a decision. This decision may be a simple one, such as choosing clothes to wear, selecting food from a menu or deciding the general activities for the day or it may be a major decision such as changing a job or purchasing ahouse.

Rational decision-making and problem solving may be used interchangeably since a problem has to exist and a decision has to be made to solve such a problem. While most decisions indeed involve a problem, some decisions are part of routine and may not involve a problem. For example, decisions as to what to wear or which movie to see or whether to stay or go for swimming are routine decisions and simple choices among available alternatives, requiring common sense and simple qualitative judgement. Problem solving, on the other hand, is a much more vigorous process which requires rational inquiry based upon unemotional reasoning, identifying the problem, generating feasible solutions for it, choosing the best solution from the point of view of utility and then applying this solution to see if it works efficiently and effectively. In general, while decision-making results in a choice from many alternative courses of action, problem solving results in resolving the disparities between the desired performance and the performance actually obtained.

Decision-making is a complex mental exercise in reality. Some of the decisions we make are highly significant with highly important consequences. The more significant decisions very often need the exercise of considerable analytical judgement and the quality of such judgement is the backbone of successful decisions. These judgements must eliminate the root causes of problems that have necessitated such decisions. Ineffective decisions attack only the symptoms and are only cosmetic in nature. They may solve the problem on the surface or on a short-run basis, but in order to find a lasting solution, the problem must be attacked at its roots. Individuals must make major decisions regarding their careers, their marriage and family and other decisions, which have far-reaching personal implications. Organisational decisions involve problems relating to investments, products, marketing, location of production or service facilities, dealing with personnel problems, contributions towards community welfare, and so on. Societies, in general, have many problems that affect their very survival, such as crime, energy shortages, depletion of finite resources, health services, employment and political conflicts among nations.

All these problems have to be faced and solved. No person can avoid problems and ignoring a problem is never a solution. As Thomas J. Watson Jr put it:

> I never varied from the managerial rule that the worst possible thing we could do would beto lie dead in the water with any problem. Solve it, solve it quickly, and solve it right or wrong. If you solved it wrong, it would come back and slap you on the face and then you could solve it right. Doing nothing is a comfortable alternative because it is without immediate risk, but it is an absolutely fatal way to manage a business.

From organisational point of view, the decision-making process is such an integral and important part of management that some thinkers propose that management is simply a decision-making process. They call it the 'decision theory school of management'. The basic emphasis of this school is not on people or environmental variables influencing the management behaviour, but on the process of decision-making and the theory that all management thought could be built aroundit.

According to Simon:

A theory of administration should be concerned with the process of decision as well as with the process of action. Even if the decision- making is not the only skill required for effective management, it cannot be denied that in fact it is an essential and highly important skill. This skillis actively utilised in all other functions of management such as planning, organising, directing and controlling. Hence, decision-making is widely acknowledged as the centre of executive activity inbusiness and industry and is considered as the major criterion for the evaluation of an executive's administrative performance.

Defining a Problem

Since a problem must exist in order to make a decision for solving it, we must know what the problem is so that we can identify it when it shows up. Being aware of the problem is the first prerequisite for finding a solution. The Webster's Dictionary defines a problem as 'a question raised for inquiry, consideration or solution'. While this definition is not complete or self- explanatory in itself, a problem seems to exist when the symptoms of the outcome of an activity do not seem to conform to the expected outcome of the same activity as planned. For example, you are going to your office in the car and on the way, you get a flat tyre, then you have a problemsince you did not expect this to happen. Similarly, if someone becomes ill, then this is a deviation from the norm of healthy living and this would constitute a problem and the sick person would seek a solution to the problem by going to the doctor.

As we all face the future, its unpredictability brings to us certain situations that are unexpected and hence problematic in nature. As we grow older and share added responsibilities, we develop certain characteristics and some intuitional senses that help us solve some of these problems. Moreover, we also learn some techniques and methodologies through the acquisition of knowledge and skills, which assist us in solving certain types of problems. These problems require decisions that exist at personal, organisational and social levels.

Structure of problems

According to Harvey G. Brightman, problems may be of the following types:

1. Ill-structured versus well-structured problems: The ill-structured problems are unique, unpredicted and unprecedented situations. These problems are ambiguous and poorly understood and defy any cut-and-dry solution. These are generally 'one-shot' occurrences for which standard responses are not available and hence, require a creative process of problem solving which is specifically tailored to meet the requirements of the situation at hand. Such problems may involve the closing of a plant, buying or merging into a new company, starting a new business, and so on. Because the ill-structured problems do not have well-structured solutions, such solutions generally rely upon skill, intuition, creativity, experience and considered judgement and carry with them the consequences of diverse ramifications. The top-level management generally faces these problems because their environment is complex and isinvolved with high-level policy decisions.

Well-structured problems, on the other hand, are clearly defined, routine, and repetitive and respond to standardised responses. They are familiar, complete and easily defined and analysed. These problems are generally faced by lower-level and middle-level managers who have, at their disposal, a set of rules, policies and procedures misses can be used to solve these problems, so that such problems do not have to be referred to superiors for solutions. For example, if a professor cuts too many classes, the chairperson of the department can use the prescribed rules to discipline him and the issue does not have to be referred to the president of the college. Similarly, if you buy some merchandise and it turns out to be defective, you can take it back for a refund. The management of the company has a well-structured set of rules and procedures to deal with the problem of making refunds for defective merchandise.

2. Operating level versus strategic level problems: Operating-level problems are generally well- structured problems encountered by the organization on a daily basis. For example, a newspaper shop owner has the problem of reordering the newspapers and magazines every day and he knows when to order and how much to order. Similarly, daily or weekly production levels, inventory levels or sales levels are set and known and standard solutions exist to solve any problems in these areas when they arise. These situations are not new or unique and do not involve any changes in organisational policies or procedures.

On the other hand, strategic-level problems are unique and demand high- level managerial attention. These problems may involve changes in policies and are important in terms of actions taken or resources committed. While operating-level problems do not affect the survival of an organization, strategic-level problems do. Sometimes, if the operating level problems are left unattended, they may become strategic-level problems. For example, if no action is taken against a professor who habitually miss classes, this may affect other professors thus making it a morale problem for the college, which then would be considered a strategic-level problem.

3. Crisis versus opportunity problems: Crisis problems develop suddenly and are totally unexpected at a given time. These may develop within the general framework of expectations that the management has prepared to some extent to handle these crisis situations. For example, a forest fire will create a crisis problem but the government and the community is generally prepared to fight the forest fire. Similarly, a major strike at the plant may not have been expected, but the management has generally made provisions to handle the situation. Solving crisis problems is reactive in nature and requires reacting quickly and aggressively to solve the problem.It may be achieved through task forces, which may try to mould crisis situations into familiar problems for which the solutions are known to exist.

The opportunity problems are more challenging. These must be exploited for the betterment of the organization, For example, if an opportunity of a highly beneficial merger arises, and the organization fails to recognise the potential, it would be considered a lost opportunity. Similarly, a slightly increased rate of employee absenteeism may mean some deeper organisational problem and if the management does not recognise this opportunity to deal with the problem, this missedopportunity may blow up into a crisis. The central management handles both the crisis problems as well as the opportunity problems.

The problem pointers

First, how do we determine that there is a problem? Even if we know that there is a problem, howdo we determine the extent and seriousness of the problem? According to Miller and Starr, there are certain characteristics that are attributes of problems. One main characteristic of a problem isthe existence of a deviation between what was expected under a given set of conditions and whatactually happened.

Before solutions can be found, the problems must be thoroughly and correctly diagnosed and thedecisions concerning solutions to the problems must be dealt with, keeping in view the underlyingfactors other than the surface symptoms. For example, a doctor prescribing a medicine for a headache as a symptom without looking into the root cause of it will only provide temporary reliefand not really 'solve' the problem. Accordingly, in properly defining a problem, we must ask some critical questions relating to it. Some of these critical questions may be:

- What type of problem is it?
- How large is the deviation from the norm?
- How quickly has this deviation been observed?
- What are the critical factors relating to the problem?
- Why do we want to solve this problem?
- Would the cost of solving the problem be justified?
- Who should solve the problem and what particular method is chosen to solve the problem?

These initial questions would indicate the extent of the problem so that we can become fully aware of it and grasp its significance.

It is very important that the problem be diagnosed as early and correctly as possible. For example, cancer, when detected in earlier stages, may be cured, but in advanced stages it can be fatal. The early awareness of the problem is the first prerequisite for dealing with it. However, sometimes we may not even know that there is a problem when in fact it exists until it is too late. Colon cancer, for example, does not have obvious symptoms for early detection so that the patient may not even know that he has it until it reaches an advanced stage. At other times, we may be aware of a problem but may not consider it serious enough to find a solution until it becomes a crisis. Some problems may hit us when their severity can no longer be ignored. For example, too many lives lost in car collisions may require legislation about seat belts in cars in order to solve the problem of death and injury in car accidents. Similarly, the destruction brought about by typhoons and hurricanes may indicate the problem of inadequate early warningsystems.

Another problem pointer is a built-in signal in the process of operations so that whenever there is a deviation from the expected outcome, it gives out a signal. For example, the Internal Revenue Service computer will create and send a signal to alert an administrator if some tax deductions are excessive in a given tax form so that some action can be taken. Similarly, our organisational accounting system can be set up in such a manner that any change in the cash flow or demand, increases the cost per unit produced; excessive and delayed state of accounts receivables, excessive inventories at hand, and so on will attract the manager's attention quickly for an appropriate action.

Third parties, such as a user of a product or a consumer representative group points out some problems. The problem of toxic wastes almost became a crisis when various consumer groups started pointing out the problem of community health to the government agencies. The polaroid instant camera came into existence because of a 'consumer complaint', when the consumer happened to be the daughter of the instant camera inventor, who wanted to look at the picturestaken right away. Thus, if a product is faulty, it can be brought to the attention of the manufacturer. The Federal Safety Commission and Food and Drug Administration in America test products to see if they conform to the prescribed standards. If they do not, then there is a problem for whichthe solution must be found.

There are some problems that come to the surface due to sheer idle curiosity. The problem may not be a real one but may be considered a problem if solving it leads to better outcomes. Such a problem is not really the deviation between what is happening and what is expected, but a deviation between what is happening and what is actually achievable.

For example, when Fredrick Taylor applied scientific methods to production, the productivity improved tremendously so that there was really no problem in production except that the situation was made into a problem by asking, ‘can we do it better?’ Based upon this premise, some organisations are continuously involved in finding problems with existing methods in order to improve upon them.

In general, a problem exists whenever there is a difference between an actual situation and the desired situation. For example, if the total number of incoming students into a college suddenly goes down than what was expected, then this would pose a problem requiring administrative attention and solution.

Factors affecting Decision-making

Some of the factors and personal characteristics that have an impact on decision-makers are described below. Some factors are more important at higher levels of management and others aremore important at the lower levels.

- **Programmed versus non-programmed decisions:** As discussed earlier, in the types of problems that managers face, programmed decisions are made in predictable circumstances and managers have clear parameters and criteria. Problems are well structured and alternatives are well defined. The problems are solved and decisions are implemented through established policy directives, rules and procedures.

  Non-programmed decisions are made in unique circumstances and the results of such decisions are often unpredictable. Managers face ill- structured problems. These problems require a custom-made response and are usually handled by the top management. To start a new business, to merge with another business or to close a plant are all examples of non- programmed decisions. For example, when Steven Jobs and Stephen Wozniak introduced the first Apple microcomputer in 1978, they were not certain about the market for it. Today, Apple Macintosh computer is a major competitor to IBM computers.

- **Information inputs**: It is very important to have adequate and accurate information about the situation for decision-making; otherwise, the merit of the decision will suffer. It must be recognised, however that an individual has certain mental constraints, which limit the amount of information that he can adequately handle. Less information is as dangerous as too much information. Some highly authoritative individuals do make decisions on the basis of comparatively less information when compared to more conservative decision-makers.
- **Prejudice**: Prejudice and bias are introduced in our decisions by our perceptual processes and may cause us to make ineffective decisions. First, perception is highly selective, which means that we only accept what we want to accept and hence, only such type of information filters down to our senses. Second, perception is highly subjective, meaning that information gets distorted in order to be consistent with our pre- established beliefs, attitudes and values. For example, a preconceived idea that a given person or an organization is honest or deceptive, good or poor source of information, late or prompt delivery, and so on, can have a considerable effect on the objective ability of the decision-maker and the quality of the decision.
- **Cognitive constraints:** A human brain, which is the source of thinking, creativity and decision-making, is limited in capacity in a number of ways. For example, except for some unique circumstances, our memory is short term, having the capacity of only a few ideas, words and symbols. Second, we cannot perform more than a limited number of calculations in our heads and it is tough to compare all the possible alternatives and make a choice. Finally, psychologically, we are always uncomfortable with making decisions. We are never really sure if our choice of the alternative was correct and optimal until the impact of the implication of the decision has been felt. This makes us feel insecure.
- **Attitudes about risk and uncertainty**: These attitudes are developed in a person, partly due to certain personal characteristics and partly due to organisational characteristics. If the organisational policy is such that it penalises

losses more than it rewards gains, then the decision-maker would tend to avoid the alternatives that have some chances of failure. Thus, a manager may avoid a potentially good opportunity if there is a slight chance of a loss. The personal characteristics of a decision-maker regarding his attitudes towards risk taking affect the success of the decision. The risk taking attitude is influenced by the following variables:

A. **Intelligence of the decision-maker**: Higher intelligence generally results in highly conservative attitudes and highly conservative decision-makers take low risks. There are others who are more willing to take calculated risks if the potential rewards are larger andthere is some chance of success.

B. **Expectation of the decision-maker**: People with high expectations are generally highly optimistic in nature and are willing to make decisions even with less information. The decision-makers with low expectations of success will require more and more informationto decide upon a course of action.

C. **Time constraints:** As the complexity of the personal habits of the decision-maker and the complexity of the decision variables increase, so does the time required to make a rational decision. Even though there are certain individuals who work best under time pressures and may outperform others under severe time constraints, most people, by and large, require time to gather all the available information for evaluation purposes. However, most people under time pressure rely on 'heuristic approach', which relies on satisfactory rather than optimal decisions. This limit the search for additional information, considering few alternatives and few characteristics of alternatives and focusing on reasons to reject some alternatives. This approach may also be in use when the cost of gathering information and evaluating all such information is too high.

- **Personal habits**: Personal habits of the decision-maker, formed through social environmental influences and personal perceptual processes must be studied in order to predict his decision-making style. Some people stick to their decisions even when these decisions are not optimal. For example, Hitler found himself bound by his own decisions. Once he decided to attack Russia, there was no going back even when he realised that the decision was not the right one. Some people cannot admit that they were wrong and they continue with their decisions even ignoring such evidence, which indicates that a change is necessary. Some decision-makers shift the blame for failure on outside factors rather than their own mistakes. These personal habits have a great impact on organisational operations and effectiveness.

- **Social and cultural influences**: A major impact on the style of the decision-maker is made by the social and group norms. According to Ebert and Mitchell, social norm is 'an evaluating scale designating an acceptable latitude and an objectionable latitude for behaviour activity, events, beliefs or any object of concern to members of a social unit. In other words social norm is the standard and accepted way of making judgements.' In the same way, cultural background and other social environment have fundamental impact on the decision-making style of a manager. As for instance, in the organisational system followed in Japan, a decision-maker makes a decision after taking into consideration the view of others involved in it. This method is influenced by culture and makes the implementation of the decision very easy, as everyone takes part in the decision-making process. On the other hand, in America, the decision-making style is usually individual based. This is done with the help of decision models and qualitative techniques.

Steps in Decision-making

All decisions involve a series of sequential steps that lead to a particular result. These steps are generally followed to make systematic, objective, analytical and unemotional decisions and somemanagement scholars have called this process a 'rational decision-making process.' Figure 3.1 shows the steps in decision- making.

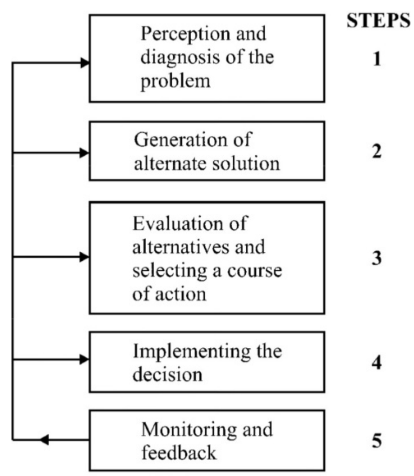

Figure 3.1: *The Decision-making Steps*

These steps are explained in more detail as follows:

1. Perception and diagnosis of the problem: Problems are defined in terms of discrepancy or deviation between the desired and actual state of affairs. The greater this deviation the more serious is the problem. This discrepancy must be perceived correctly, since any solution to a wrong problem would be a wrong solution. This deviation could develop either because the performance slips when the goals remain constant or because the goals change and the performance remains constant.

A problem once isolated, must be defined and formulated. A written problem statement must bedeveloped, describing as specifically as possible the nature and extent of the symptoms andwhen and where they occurred and what the underlying causes are thought to be. A written problem statement is easier to work on and more people can work on the problem at the same time. Furthermore, a written form provides an excellent form of communication to all parties concerned.

2. Generation of alternate solutions: The next step in decision-making process is to generate possible solutions and their consequences to the organization. All possible solutions should be considered because the most obvious solution may not be the optimal solution. However, creativity should be encouraged so that the focus can be shifted to unique solutions. The degree and depth of creativity would generally influence the quality of decisions and consequently the results of actions that are based on such decisions.

Creativity must not be-locked by personal values or perceptions about the problem. It must be objective and removed from emotions and cultural taboos that might affect the outcome of a decision.

While developing alternate courses of action, the decision-maker should take into consideration possible changes in the organisational environment as a result of the decision made and that might pose either a threat or an opportunity in a given period of time. In searching for alternatives,some of the resources that can be drawn upon are: the past experience of the decision-maker to look for similarities with the problems and solutions in the past, drawing on the experience of other experts both within and outside the organization and the responses of the people who would be affected by the decision.

3. Evaluation of alternatives and selecting a course of action: The evaluation of alternatives and selecting the best alternative with the most advantages is the most critical part of the decision-making process. A wrong choice would negate the effects of all efforts put in the preparation of the process. Finding the optimal choice requires the consideration of the possible impact of all alternatives in such a manner that the chosen course of action will not only meet therequirements of the objectives, but also eliminate the root cause of the problem. Some of the criteria against which the alternatives are to be measured are quantitative in nature such as returnon investment, market share or net profits. Some other criteria are qualitative in nature such as consumer attitude, employee morale and ethics of the organisational mission. The bottom line inany decision criterion is the benefit derived from it in financial terms. This may be in the form ofcost effectiveness, which means that for a given cost, the alternative with a greater degree of achievement of objective will be selected. Similarly, for a set level of achievement, the alternative with a lower cost will be accepted.

No matter how tangible the methodology of the decision-making method may be, the effect of thepersonal judgement of the decision-maker in choosing the best alternative is always dominant. This judgement will be a reflection of current management values, ethics, social commitment and organisational politics. This judgement cannot be quantified and hence, must be based upon strong intuition and past experience.

4. Implementation of the decision: Implementation means putting the selected alternative into action and seeing it through to its completion. The process of implementation starts with assigning responsibilities to persons who will be involved in carrying out the decision. The possibility of any resistance to change should be examined, especially if it affects or conflicts withpersonal values and personalities and group norms or, as the case may be, group objectives. The implementation, of course, becomes easier if the persons implementing it and persons affected by it were also involved in the decision-making process and if they have some stake, financial or otherwise, in the success of the solution. It is vital to communicate the details of the decision andprocedures for implementation to all the employees clearly, in detail, and in a manner that would invite commitment and dedication. This commitment can further be improved if the implementation plan has provisions for any necessary modification that may be required and the members of the organization should be empowered to modify the solution during implementation based upon their experience with it.

5. Monitoring feedback: Feedback provides the means of determining the effectiveness of the implemented decision. If possible, a mechanism should be built into the process, which would give periodic reports on the success of the implementation. In addition, the mechanism should also serve as an instrument of 'preventive maintenance' so that the problems can be prevented before they occur.

In many situations, computers are very successfully used in monitoring, since the information retrieval process is very fast and accurate and in some instances, the self-correcting is instantaneous.

Monitoring the decision is necessary and useful irrespective of whether the feedback is positive or negative. Positive feedback reaffirms the correctness of the decision and the process. Negative feedback indicates either that the implementation requires more time, resources, efforts or planning than originally thought or that the decision was a poor one and needs to be re-examined.

ETHICAL DILEMMAS IN ORGANIZATION

There exist many different ethical issues in an organization or at the workplace. Some of them areas follows:

- Identifying the conflict issues in the organization and trying to avoid them
- Deciding different methods to motivate employees
- Managing fairness in employee performance appraisals
- Protecting secret information of the organization
- Identifying the areas of interest of customers, employees, suppliers, owners and the staff
- Taking action against the reports of complaints in the organization
- Handling different problems of employees
- Taking corrective action against employees

Ethics management programmes are used by the organisations to manage ethics at their workplace. According to Brain Schrag, 'Ethics programmes convey corporate values using codes and policies to guide decisions and behaviour, and can include extensive training and evaluating,depending on the organization.' Ethics management programmes are made up of values, policiesand activities that can affect the behaviour of the organization.

Managing ethics as a programme is advantageous to organisations in many ways.

These are:

- These programmes can assign an independent role to each individual in the organization tomanage ethics.
- Ethics management can provide the necessary operating values and behaviour to theorganisations.
- These programmes are used to align the operating values and behaviour.
- Ethics management programmes are used to schedule different ethics
- requirements.
- These programmes are used to make the organisations aware of ethics issues.
- These programmes provide structural mechanisms to handle ethical problems.
- They also provide some guidelines to decision-making.

SOCIAL RESPONSIBILITY OF BUSINESS

Social responsibility of business involves the consideration of general public interest by businessmen while taking business decisions and actions.

According to Bowen, social responsibility refers to the 'obligations of businessmen to pursue those policies, to make those decisions or to follow those lines of action which are desirable in terms of the objectives and values of our society'.

This entails that businessmen should perform their operations with due consideration to the aspirations of society. They should fulfil the demands of those who have a claim on the operations of business. They must measure the consequences of their decisions and courses of action onthe society and ascertain that no undue harm is done to the interests of the society.

The concept of social responsibility has emerged due to several economic, social, political and legal influences. These forces, which have obliged, persuaded and helped businessmen tobecome aware of their responsibility to society, are as follows:

- **Public opinion**: Public interference with the help of the government has instilled a fear in the heart of businessmen. The threat of public regulation and public ownership has compelled them to acknowledge the fact that responsible behaviour is essential on their part for survivalin the private sector.
- **Trade union movement**: The recent development of socialism that boosted the strength of labour unions has forced businessmen to give a fair share to workers.

Human relations and labour legislation have facilitated trade unions to increase their influence.

- **Consumerism**: Consumer organisations have encouraged awareness about consumer rights. Consequently, businesses have become more responsive to consumer needs and stress the dictum of 'consumer is the king'. Businessmen can no longer adopt the approach of 'let the buyer beware'.
- **Education**: Extensive education has made businessmen conscious about the quality of life, moral values and social standards. Liberal business leaders have been pressing the business community to acknowledge its social obligations.
- **Public relations**: Modern businessmen are aware that a good public image contributes to their growth. There is a greater alertness in their hearts that business is a construction of society and hence, it should consider and react positively to the expectations of society.
- **Managerial revolution**: Separation of ownership from control in large corporations has resulted in professionalism in management. A professional manager is fairly aware of the society's expectations and attempts to meet the demands of all social components, like customers, employees, shareholders and the government, in a well- adjusted manner.

The case of social responsibility has been subject of controversy since long. There have been arguments both in favour and against it. The main points that support the assumption of social responsibility by business enterprise are as follows:

- **Long-term self-interest of business**: As stated earlier, a good public image is bound to give better returns to a business enterprise. Businessmen can benefit in the long run by providing for the welfare of the society through education and better living conditions. This will result in better employees in business and enlightened customers in society who will benefit through their increased purchasing power.
- **Ascertainment of law and order**: Social responsibility on the part of business can avoid unrest in society. If the society feels that it is not getting its appropriate share in business, itis bound to create disorder by adopting anti-social and illegal activities and rebellions. Pursuing the doctrine of social responsibility can help business organisations prevent social chaos.

- **Maintenance of free enterprise**: Government or public regulation can hinder the development of business by decreasing the flexibility of decision-making and the freedom of choice and action. Therefore, the voluntary assumption of social responsibilities is essential for the growth of a business organization.
- **Creation of society**: Business is a part of society and survives on the demands of the society. Therefore, it should be responsive to social expectations and welfare. The right of the business to grow goes hand in hand with its awareness of social responsibility and welfare. It is the duty of the business enterprise to contribute in some way to the well-being of its society.
- **Moral justification**: Enlightened businessmen have now become more aware about their moral duty to serve the society. Business has the resources and power to solve social problems. Therefore, its power should be balanced with social responsibility.
- **Profitable environment**: To ensure a profitable environment in the society in which it operates, business needs to meet the challenges of social evils. Active interference on the part of businessmen in solving these challenges can convert them to opportunities, which in turn will ascertain not just the existence, but also the benefits of the organization.
- **System interdependence**: Business system and social dependence are interrelated and thus affect each other.

The arguments against social responsibility on the part of business enterprise are as follows:

- **Dilution of profit maximisation:** Economic value is the main criterion by which the success of a business should be estimated. According to Milton Friedman, 'Few trends could so thoroughly undermine the very foundation of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for shareholders as possible. This is a fundamentally subversive doctrine. Management's spending for society is hypocrisy. Only people can have responsibilities not corporations.'
- **Loss of incentive**: The motivation to utilise resources effectively is decreased when social responsibility is considered important. It is the profit motive principally that encourages optimum use of resources and manpower to run the

business with enthusiasm.

- **Lack of standard**: Besides the effort motive, profit serves as a standard to measure the performance of business. A business organization goes off course as it loses the guiding measure that depicts the efficiency of its performance and thus hinders decision-making.
- **Business is an objective venture**: The emotional insights and experience essential to tackle social problems are lacking in the temperament of businessmen. They cannotdetermine what is in public interest. The solutions to social problems should be expected from specialised social agencies and not from businessmen.
- **Undue use of power**: If business organisations are involved in social institutions they are likely to dominate the decisions of these institutions for their own interests. They can use their financial power to take decisions concerning the functioning of these institutions. This may further lead to increased social detriment.
- **Market mechanism gets distorted**: The principle of social responsibility is based on the assumption that market mechanism is not the appropriate way to allocate scarce resources to alternative uses and so it should be replaced by political mechanism. If the market priceof a product contains the cost of social actions, it does not actually represent the relative cost of producing it and thus the market mechanism gets distorted.

CORPORATE GOVERNANCE

Corporate governance is defined as an act of controlling, directing and evaluating the activities ofan organization. The structure of corporate governance specifies that the others taking part in theorganization, such as the board managers, board of directors, shareholders and other stakeholders must be provided with some rights and responsibilities. Providing powers to the participants of the organization results in the monitoring of performance of the employees in an organization. Corporate governance helps the organization achieve the goals and objectives of anorganization in a desired manner.

Corporate governance has achieved a great deal of success in attracting public interest because corporate governance gives importance to the economic health of the corporation and the societyas a whole. However, corporate governance covers a wide variety of the distinct economic phenomenon. Therefore, many people have given different definitions of corporate governance. A few definitions of corporate governance are as follows:

According to Shleifer and Vishny, 'Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.'
An article from Financial Times has defined corporate governance as 'the relationship of a company to its shareholders or, more broadly, as its relationship to society'.

According to the J. Wolfensohn, 'Corporate governance is about promoting corporate fairness, transparency and accountability.'

The Need for Corporate Governance

There are various reasons for the need for corporate governance in an organization. These are:

- A corporation, which is a union of many stakeholders, such as employees, customers, investors, vendors, and so on, must be fair and transparent to its stakeholders in all its dealings. It is very important in today's globalised business world, where corporations require to have access to global pools of capital attract and retain the best human resource from all parts of the globe. If a corporation does not take up and show ethical conduct, it isnot considered to be successful.
- Corporate governance covers ethical conduct in business, the code of values and principles that helps an individual to choose between right and wrong or make the right selection fromthe options or alternatives provided. Managers decide on certain actions on the basis of an principles that are governed by the culture, context and values of an organization. An organization that follows ethical values

feel that it is better for the business, as it helps in thelong run and the stakeholders observe that the management is running the organization in the desired way.

- It is beyond the sphere of law, i.e., it stems from the background and outlook of the management and cannot be regulated by legislation alone. It deals with running the affairs ofa company in such a way that it is fair to all the stakeholders and that its dealings benefit the greatest number of stakeholders. It is about honesty, integrity and responsibility. Laws should set up a common framework to maintain standards. Since substance is very much linked with the mindset and ethical standards of management, it shall in the end lay down the creditability and integrity of the process.

- Corporations should realise that it is necessary for all the stakeholders to cooperate in orderto facilitate development. Such cooperation and support can only be possible by adheringto the best practices of corporate governance. In this context, management has to take the responsibility of the shareholders at large and stop any unbalanced benefits of the varied sections of the shareholders.
- The economic competence of a company can be improved through corporate governance. Corporate governance also ensures that corporations consider the interests of a wide range of constituencies and also of the communities within which they function. Corporate governance also makes sure that the boards of directors are responsible to the shareholders. This even helps to ensure that corporations work for the benefit of the societyat large, including the society's concerns about labour and environment.
- If the execution of good governance fails, heavy losses can result in terms of cost other than regulatory problems. Many organisations that do not give due importance to corporate governance end up paying a large risk premium while contending for scarce capital in the public markets. Of late, stock market analysts have started realizing, accepting and appreciating the relationship between returns and corporate governance.
- The confidence of both foreign and domestic investors is maintained and upheld due to the trustworthiness that comes from good measures of corporate governance. The cost of capital should be brought down so that more long-term investment is attracted.
- Often, importance and attention is given to corporate governance in times of financial crisis. In the US, when scandals disturbed the otherwise calm and contented corporate environment, new initiatives thrown up by them led to fresh debates in Asia and the European Union. With many instances of corporate misdemeanour coming into limelight, the emphasis now is on compliance with substance, rather than on form. It has also brought to the fore the need of intellectual honesty and integrity. The financial and other disclosures made by

firms are only as good as the people who make it.

- In 1998, the Confederation of Indian Industry (CII) made public a desirable and voluntary code. This marked the beginning of corporate governance initiatives in India. Then, on the basis of the Kumaramangalam Birla Committee Report in February 2000, Securities and Exchange Board of India (SEBI) made the first formal regulatory framework for listed companies.
- Corporate governance has been defined in different ways. Many definitions do not give its scope and the motives of many of the definitions vary. However, the crux is that corporate governance is a concept and not an individual instrument. It encompasses necessarymanagement and control structures of a company, the rules about the power relationship between owners, the board of directors, stakeholders and others. The easiest definition of corporate governance has been given by the Cadbury Report. It has been paraphrased as, 'the system by which business are directed and controlled'. The other all-inclusive definitionhas been given by the OECD (Organization for Economic Cooperation Code). According toit, corporate governance includes complex relationships among the management, its shareholders, board and others. It also establishes the framework through which the aims of the company are established and the methods of attaining those objectives and observing the working are decided.

- Corporate governance is aimed at increasing the long-term value of an organization for not only its shareholders, but also partners. It represents an amalgamation of all those involved in a process that is socio- economic. It is imperative for all organisations to govern and manage. Corporate governance includes the entire stakeholder and at the same time the process is economic as well as social.
- Studies related to corporate governance practices conducted worldwide by various institutions clearly indicate that no single model is available for good corporate governance.The OECD also recognises this. It also accepts the fact that a wide range of approaches to corporate governance have developed due to the differences that exist in institutional frameworks, legal systems as well as traditions in various countries. All good corporate governance regimes place high preference on the interests of shareholders, as the latter place their trusts

on corporations to use their investment funds in an effective and wise manner.

Principles of Corporate Governance

Corporate governance includes principles such as honesty, trust, integrity, responsibility, accountability and commitment to the organization. Apart from these, the other principles of corporate governance are as follows:

- Rights and equitable treatment of shareholders: The organisations must acknowledge the rights of the shareholders and they must help the shareholders in exercising their rights effectively. Shareholders must also be encouraged to participate in the general meetings of anorganization.
- Interests of other stakeholders: It is the duty of an organization to recognize the legal and other obligations of certain stakeholders.
- Role and responsibilities of the board: In order to deal with various issues of a business, an organization needs a wide range of skills among the members of the board. The members of the organization must work with great responsibility.
- Integrity and ethical behaviour: In order to promote ethical and responsible decision-making,organisations must develop a code of conduct for the directors of an organization.
- Disclosure and transparency: The roles and duties of directors must be clearly defined by an organization. Organisations must implement certain procedures in order to verify and safeguard the integrity of the organization. An organization must disclose the financial information to investors and shareholders.

Role of the Board of Directors in Corporate Governance

Board of directors is made up of individuals elected by a corporation's shareholders to oversee the management of the corporation. An organization allows different individuals or parties to addto the capital, expertise and their knowledge so that the organization can function efficiently without facing any difficulties. There are various participants in the organization such as investors and shareholders. They do not participate in the operations of the organization. Their main interest is to have a proportion of the share in the income of the organization. The shareholders and investors have the right to elect the board of directors of an organization in order to represent andprotect their interests. The board of directors has the power and duty to form the corporate policies of an organization. Therefore, the board of directors has the powers to take certain decisions, which can in turn affect the long-run performance of the corporation. It means that the board of directors has a very significant function in the working of the business as it also oversees the top management of the organization.

The duties and rules that the board of directors has to follow are plainly laid down by the organization. It includes monitoring the performance of the company and its management and approving important business policies. The board of directors is fully briefed in advance of boardmeetings and the matter that will be discussed in the meeting. The board of directors receives regular reports on the financial position of the organization, key areas of the organisations' operations and other issues.

The board of directors provides multi skills and knowledge to the organization and it also participates fully in making decisions on key issues that the organization faces. The organization follows its own performance review process to access how well the board and its committees areperforming and how they might be further improved.

Responsibilities of the board of directors

The board of directors has to handle a wide variety of roles and responsibilities. There are certain laws and standards that define the responsibilities of the board of directors. These laws and standards differ from country to country. For example, the US does not have any laws and standards that the board of directors must comply with. The various responsibilities of the boardof directors are as follows:

- Providing continuity to the organization by setting up the organization as per the legalrequirements and effectively advertising its products and services to the customers.
- Selecting and appointing a chief executive whose basic duty is to review and evaluate the performance of the organization and offering administrative guidance to the organization
- Governing the organization by setting up broad policies and objectives and monitoringwhether the organization follows the policies.

- Acquiring the resources and finance for effectively running the day-to-day operations of theorganization.
- The board of directors must be accountable to the public for the products and services of the organization, which include approving the budget and formulating the policies related tothe contracts for producing a product.

In legal terms, the main duty of the board is to direct the affairs of the organization but not to manage them. If the board of directors does not perform its responsibilities in the right manner and if it harms the organization in any manner, then the directors can be held responsible for the harm that is caused by them. Section 291 of the Companies Act had specified some of thegeneral powers of the board and they are as follows:

- According to the provisions of the Companies Act, the board of directors is allowed to exercisethe following powers within the organization:
  - The board will do only those things which are directed by the management of the
    organization. The board must also assist in doing the things that are not mentioned in theclause of the Companies Act.
  - The organization will abide by the provisions that are in the Companies Act and will also
    follow the provisions that are formed in the general board meeting of the organization.
- The company cannot make any regulations in the general meeting of an organization toinvalidate any act of the board.

New trends of the board of directors in corporate governance

The board of directors plays a very important part in an organization. If a company possesses very good corporate governance and board of directors, then it will induce the investors to invest more in the organization. Investors are willing to invest more in an organization because good governance and the board of directors in an organization lead to better performance of the organization. Further, good governance reduces the chances of the organization falling into trouble. The various trends of the board of directors in corporate governance are as follows:

- There is more participation of the board not only in evaluating the performance of the company, but also in formulating the plans and policies of the organization.
- Institutional investors such as pension funds, mutual funds and insurance companies actively participate in the functioning of the board and they put pressure on the board to improve the performance of an organization.
- Non-management directors, which is not recognised in the eyes of law, are now actively participating in the board of an organization.
- The number of the board members is reducing nowadays. This is because organisations prefer directors who have good knowledge and expertise rather those with general experience.
- As more and more organisations operate their services globally, they look for boardmembers who possess international experience.

Role of top management in corporate governance

The board of directors occupies the top management whose prime concern is startegic management of the organization. The top management is supervised by the president in coordination with the vice-president of the organization and the vice-presidents of divisions and functional groups.

Responsibilities of Top Management

The responsibility of the top management is to get the objectives of an organization accomplished within the organization and in the industry. Thus, the role and responsibility of the top management is multifaceted and is directed towards the welfare of the organization. The duties ofthe top management are distinct as they may vary from organization to organization. The development of the tasks of the top management are developed by the analysis of objectives, strategies and fundamental activities of the organization. These tasks are divided among differentlevels of the top management staff which leads to diversity in skills. The analysis of this diversityin the top management team can be significantly related to improvements in the market share and profits of the organization. The top management should primarily support two critical responsibilities, crucial for strategic management to be effective. The two responsibilities are asfollows:

- Provision of executive leadership and strategic vision: Executive leadership means directing the activities of the organization to accomplish its objectives. Strategic vision refers to the description of the capabilities of the organization, which is generally described in the mission statement. The top management defines the strategic vision of the organization to the employees. The enthusiasm and passion for the organization comes from the top management. Top management must have clear strategic vision, enthusiasm and dynamism. They possess three important characteristics that enable them to command respect and alter the process of strategy formulation and its implementation:
  - Articulation of strategic vision with strategy: The top management visualises the organization as what it is expected to become and not to what it already is. He adds a new aspect to the strategic activities that enables the employees to refresh their working habits to attain new heights.
  - Makes guidelines for others to identify and follow: The behaviour of the top management towards the values concerning the objectives of the organization should be clear and must be communicated constantly through his work and activities. If the top management behaves responsibly then the employees trust in him and get inspired to work with the same enthusiasm.
  - Communicate high performance level and confidence to the followers: Leadership of the managers of an organization involves setting up of goals for the employees accompanied with challenges and training his people for the same. He should provide his workforce with power and resources before setting targets.
- Manage strategic planning process: In an organization, the characteristics of strategic planning are same as that in learning organisations where ideas can come from any division of the organization. Top management should encourage the planning process so that strategic management can work effectively in the organization. In multidivisional organisations, the top management should ask its

units to prepare a strategy for themselves, which should be considered before planning and formulating the final strategic plan. Such practices make the work atmosphere dynamic and encourage the workforce to work according to their potential. The other method is to provide the workforce units with the mission statement and objectives and allow them to formulate strategies accordingly. Regardless of the approach taken to formulate a strategy, the board of directors expects the top management to prepare such a strategic plan that works well with the organisational objectives. Therefore, the top management's responsibilities include evaluating each unit's proposed objective, planning strategies to seek how effectively it satiates the organisational goals with respect to available resources and providing feedback.

Role of the CEO in Corporate Governance

Any action that is taken by any individual in the organization can affect the firm's operations to a great extent. For example, if any individual is appointed as a team leader, then he has the responsibility to take certain decisions that would help in the progress of his entire team. If an individual is provided with any sort of power, then it is up to him to use it for the benefit of the organization or he can use the powers to fulfil his own requirements. It is the same for CEOs in an organization. Organisations achieve great success in business because of their chief executive officer (CEO). The CEO oversees the company's finances and strategic planning.

The powers of a CEO can greatly influence the working of an organization. Therefore, it is very important to know about the powers of the CEO and how his powers can ultimately influence the results of an organization. The CEO of an organization has a very important role to play in certainareas of the organization, which are:

- Personal action
- Handling of organisational politics
- Role as a negotiator
- Role as a communicator
- Role as a role model

Personnel action

The CEO of a firm has the power to take personnel actions in a manner that is beneficial for an organization in the following ways:

- **Ordering the employees**: A CEO of an organization uses his authority to order the employees. The employees of an organization are directed by a CEO to perform certain tasks at a defined period of time. If any of the employees are disobedient or their actions are not very good, then the CEO has an authority to throw him out of the organization. The ordering ofemployees is done to achieve the goals and objectives of an organization.

The ordering method, which is employed by the CEO, provides certain benefits to the organization. When there is a need of any structural changes to be made in the organization, thenthe ordering method is very helpful. For example, if an organization decides to implement a newand improved structure for managing the performance of the employees in the organization, thenthe CEO has to just give instructions and train employees in operating the new system.

- **Making cultural changes**: It is very difficult for a CEO to change the culture of an organization. Cultural changes are those changes that are deeply rooted among the employees such as collective thinking, and mindsets, which have become a part of the organisational's working environment. For bringing about cultural change in the organization, just ordering the employees will not help the CEO. A CEO has to use the right approach for bringing about a change in the cultural mindset of the employees. For bringing about a change, a CEO must look after certain agendas and the communication network of an organization. If he finds any defects in the agendas or the communication network, then he must rectify those defects in order to make cultural changes among the employees and achieve the goals and objectives of the organization.
- **Persuading the employees:** A CEO of an organization persuades the employees to perform certain tasks in an efficient manner. If the employees find it difficult to perform certain tasks, then the CEO looks after the problems that the employees face in performing those tasks. After looking at all the difficulties, a CEO must persuade the employees to work better and direct their efforts towards the achievement of the goals. A CEO also negotiates with the employees if there is a

situation of dispute between the employees and the management.

- **Inducing the employees**: A CEO also induces the employees to work towards the attainment of the goals and objectives of an organization. There may be certain employees in an organization that may not be performing well in accordance with the expectations of the organization.

A CEO can induce the employees by asking them to change their ways of working and thinking,so that organisational goals can be achieved in a desired manner.

Handling of organisational politics

The CEO must accept the fact that politics is certain in every organization. Pfeffer has defined politics as ‘those activities taken within organisations to acquire, develop and use power and other resources to obtain one's preferred outcomes in a situation in which there is uncertainty ordissension about choices’.

Pfeffer further notes, ‘If power is a force, a store of potential influence through which events can be affected, politics involves those activities or behaviour through which power is developed andused in organisational settings.’ While power is a property of the system at rest, politics is the study of power in action. An individual, subunit or department may have power within an organisational context at some period of time; politics involves the exercise of power to get something accomplished, as well as those activities, which are undertaken to expand the power already possessed, or the scope over which it can be exercised.

Therefore, it is clear that political behaviour is designed and started to surmount opposition or resistance. If there is no opposition, there is no need for politics. Opposition and resistance are bound to occur in all organizations because of severe competition for scarce resources. Five major reasons that have strong influence on the political orientation of organizations are:

- **Scarcity of resources**: Any person or subunit having control over the allocation of scarce resources; their power and political influence play an important part in how these resources will be distributed to various departments, rather than fulfilling their own needs.

- **Non-programmed decisions**: Non-programmed decisions involve unique problems that cannot be solved by structured methods and procedures. These unique problems involve many factors and variables that are ambiguous in nature leaving room for political planning by those who have the knowledge and techniques to successfully confront and solve such complex problems. Such non-programmed decisions are likely to be made in the areas of strategic planning, mergers and acquisitions and policy changes.
- **Ambiguous goals**: When the goals of an organization are clearly defined and each member ofthe organization is aware of these goals and is also aware of his role in contributing towards the achievement of such goals, then there are limited grounds for political influences. However, when the goals of a department or the entire organization are ambiguous then there is more room available for playing politics.
- **Technology and environment:** An organization must have the ability to appropriately respond to an external environment that is highly dynamic and generally unpredictable. The organization must adequately adapt to complex technological developments that are changing day by day. Therefore, the political behaviour in organizations is increased when the internal technology is complex and when the external environment is highly unstable.
- **Organisational change**: Whenever there are changes in the organisational structure or the rearrangement of organisational policies, individuals in powerful positions have the opportunity to play political games. These changes may include restructuring of a division or creation of a new division, personnel changes and introduction of a new product line. All these changes are invitations to political processes when various individuals and groups try to control the given situation.

All the above reasons apply to most organizations because the resources are continuously becoming scarce and competitive and the ever-changing technology makes the environment more complex to handle, which requires organizations to continuously evaluate their goals and strategies. This would make most organizations political in nature so that managers in responsible positions must become sensitive to political processes in order to play their role in acquiring and maintaining political power.

There can be politics among the different departments in an organization. For example, the research and development department of an organization requires Rs 5,00,000 for testing the new instrument and, on the other hand, the maintenance manager also requires Rs 5,00,000 for replacing an old pipeline. This puts CEOs in great difficulty in deciding to whom to allot the money. If the CEO gives 50 per cent of the money to both the departments, then both the departments will not be satisfied and will blame the CEO if anything goes wrong in the organization. Therefore, in order to minimise these problems, a CEO has to perform the followingsteps, which are:

- A CEO must sit with the two managers and with an open mind listen to their problems. The managers and the CEO must appreciate each other's viewpoints. By appreciating the views of both the managers, a CEO arrives at a particular figure that he will be able to meet the requirements of the managers.
- If the CEO finds that the demands of both the managers are urgent, then he will try to meet thedemand by further borrowing the money from the finance department of the organization.
- If is not possible for the CEO to implement both the above options, then he must inform the managers that they have to use alternative methods and as soon as the finances are available they would be given to them.

Role as a negotiator

The CEO performs the role of a negotiator in which he has the full support of an organization. A CEO negotiates the problems that the employees face in performing the tasks in a specified period of time. If the CEO is busy in performing some other tasks, then the role of negotiator canbe delegated between the general manager and any other departmental head. A CEO must keep some factors in mind before performing the negotiations:

- If the demands of the two persons cannot be met, then the person who is shouting should not get what he wants. If the demand of a person who was shouting more is fulfilled then it will lead to the belief that the demands of the person who shouts will be fulfilled. Therefore,to mitigate these problems, a CEO must patiently hear the problems or demands of the employees and must arrive at a situation that is acceptable by all wholeheartedly.

- A CEO must negotiate the problems in such a manner that the employees of an organizationagree to increase the productivity and reduce the absenteeism.

Role as a communicator

A CEO plays the role of a communicator in an organization. It is an important duty of a CEO to communicate the organisational mission, vision, goals and objectives to the employees. The CEO, while playing the role of communicator, must listen to the employee's complaints and problems. A CEO must understand the problem first and then respond in a positive manner to the satisfactionof the employees who are facing the problem. Right communication given correctly at the desiredtime can motivate the employees and can charge them to perform the most difficult tasks with great ease.

Role as a role model

The CEO of an organization sometimes becomes a role model for the employees of the organization. The employees try to emulate the working style of the CEO. For example, if a CEO of an organization comes late, then the employees will follow him and they will also start cominglate. On the other hand, if a CEO is punctual, then the employees will also be punctual. Therefore,the CEO has a great deal of influence on the employees and he must remain perfect in his actions.

Managerial Roles in Corporate Governance

The managers of an organization also play a very important role in the success of an organizationand corporate governance. An organization must examine the roles that the managers are expected to perform. Henry Mintzberg developed these roles in the late 1960s after a careful study of executives at work. All these roles in one form or another deal with people and their interpersonal relationships. These managerial roles are divided into three categories. The first category of interpersonal roles arises directly from the manager's position and the formal authoritybestowed upon him. The second category of informational roles is played as a direct result of interpersonal roles and these two categories lead to the third category, that of decisional roles. Figure 3.2 shows the various managerial roles.

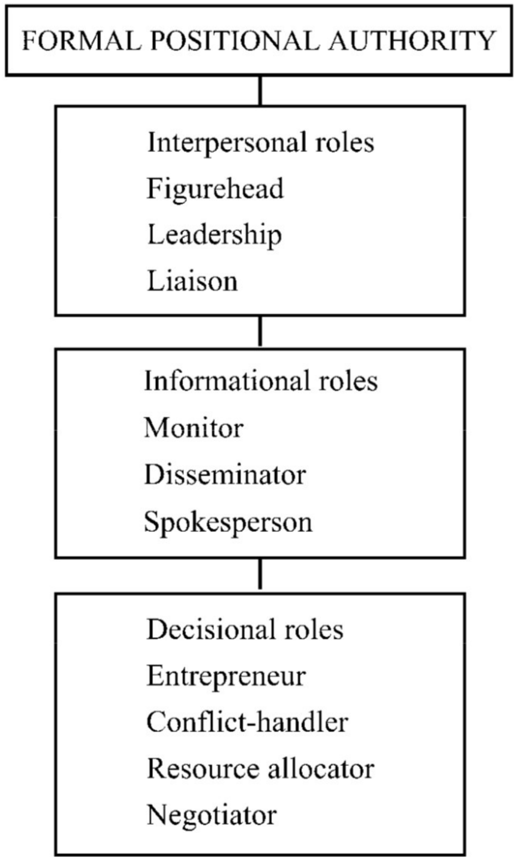

Figure 3.2: *Various Managerial Roles*

Interpersonal roles

Managers spend a considerable amount of time in interacting with other people, both within their own organizations as well as outside. These people include peers, subordinates, superiors, suppliers, customers, government officials and community leaders. All these interactions require an understanding of interpersonal relations. Studies show that interacting with people takes up nearly 80 per cent of a manager's time. These interactions involve the following three major interpersonal roles, which are:

- **Figurehead**: Managers act as a symbolic figurehead performing social or legal obligations. These duties include greeting visitors, signing legal documents, taking important customers to lunch, attending a subordinate's wedding and speaking at functions in schools and churches. All these, primarily, are duties of a ceremonial nature but are important for the smooth functioning of an organization.

- **Leader**: The influence of a manager is most clearly seen in his role as a leader of the unit or organization. A manager is responsible for the activities of his subordinates, he must lead and coordinate their activities in meeting task-related goals and he must motivate them to perform better. He must be an exemplary leader so that his subordinates follow his directions and guidelines with respect and dedication.
- **Liaison**: In addition to their constant contact with their own subordinates, peers and superiors, the managers must maintain a network of outside contacts in order to assess the external environment of competition, social changes or changes in governmental rules, regulations and laws. In this role, the managers build up their own external information system. In addition, they develop networks of mutual obligations with other managers in the organization. They also form alliances to win support for their proposals or decisions. The liaison with external sources of information can be developed by attending meetings and professional conferences, by personal phone calls, trade journals and by informal personal contacts within outside agencies.

Informational roles

By virtue of his interpersonal contacts, a manager emerges as a source of information on a variety of issues concerning the organization. In this capacity of information processing, a manager executes the following three roles:

- Monitor: Managers are constantly monitor and scan their environment, both internal and external, collect and study information regarding their organization and the outside environment affecting their organization. This can be done by reading reports and periodicals, by asking their liaison contacts and through gossip and speculation.
- Disseminator of information: Managers must transmit the information regarding changes in policies or other matters to their subordinates, their peers and to other members of the organization. This can be done through memorandums, phone calls, individual meetings andgroup meetings.
- Spokesperson: A manager has to be a spokesman for his unit and he represents his unit in either sending relevant information to people outside his unit or making some demands on behalf of his unit. This may be in the form of the

president of the company making a speech to a lobby on behalf of an organisational cause or an engineer suggesting a product modification to a supplier.

Decisional roles

On the basis of the environmental information received, a manager must make decisions and solve organisational problems. In that respect, a manager plays four important roles, which are:

- **Entrepreneur**: As entrepreneurs, managers are continuously involved in improving their units and facing dynamic technological challenges. They are constantly on the lookout for new ideas for product improvement or products addition. They initiate feasibility studies, arrange for capital for new products if necessary and ask for suggestions from the employees for ways to improve the organization. This can be achieved through suggestion boxes, holding strategy meetings with project managers and research and development personnel.
- **Conflict handler**: Managers are constantly involved as arbitrators in solving differences among the subordinates or the employee's conflicts with the central management. These conflicts may arise due to demands for higher pay or other benefits or these conflicts may involve outside forces such as vendors increasing their prices, a major customer going bankrupt or unwanted visits by governmental inspectors. Managers must anticipate such problems and take preventive action if possible or take corrective action once the problems have arisen. These problems may also involve labour disputes, customer complaints, employee grievances, machine breakdowns, cash flow shortages and interpersonal conflicts.
- **Resource allocator**: The third decisional role of a manager is that of a resource allocator. Managers must establish priorities among various projects or programmes and make budgetary allocations to the different activities of the organization based upon these priorities. They assign personnel to jobs, allocate their own time to different activities and allocate funds for new equipment, advertising and pay raises.

All these roles are important in a manager's job and are interrelated even through some roles may be more influential than others, depending upon the managerial position. For example, sales managers may give more importance to interpersonal roles, while the production managers may give more importance to decisional roles. The traits of effective managers are their ability to recognise the suitable roles to play in each situation and the flexibility to change roles when required. However, managerial effectiveness is determined by how well the decisional roles are performed by the manager in the organization.

Managerial Skills in Corporate Governance

A manager must possess certain skills in order to translate knowledge into performance. It is the level of competency that allows for performance to be superior in the field in which the employeeshave the required skill. All managers need to possess technical, interpersonal, conceptual, diagnostic, communicational and political skills. The technical and diagnostic skills refer to the knowledge and ability of understanding the processes involved and scientifically analysing problems and opportunities. These human skills are the most important assets of any successful manager.

It is the manager's job to achieve the organisational objectives through proper utilisation of its human and material resources. However, since the material resources such as equipment, capital,facilities and information can only be used by humans, the human resources are the most valuable assets of any organization. Accordingly, a manager must be highly skilled in the art of optimally utilising the human resources. The various skills that the managers must possess are:

- Technical skills
- Human skills
- Conceptual skills
- Diagnostic skills
- Communication skills
- Political skills

Technical skills

Technical skills basically involve the use of knowledge, methods and techniques in performing a job effectively. Technical skills are specialised knowledge and expertise, which is utilised in dealing with day-to-day problems and activities. For example, engineers, accountants, computer programmers and systems analysts, all have technical skills in their areas and these skills are acquired through education and training. These skills are highly necessary at the lower level of management and as one moves to higher levels of management, the relative importance of technical skills usually diminishes. This is so because unlike the first-level supervisors, managers at higher levels have less direct contact with technical operating problems and activities at the lower levels of an organization.

Human skills

Human skill is the ability to work with other people in a cooperative manner. It involves understanding, patience, trust and genuine involvement in interpersonal relationships. These are interpersonal skills and are necessary at all levels of management. People with good interactory human skills build trust and cooperation as they motivate and lead and thus become successful managers. This skill is gaining more importance as the workplace is becoming more and more ethnically diversified and the manager has to be aware and become adaptive to cultural differences. Furthermore, since businesses are becoming more and more multinational and global, managers are required to learn new ways of dealing with people in different countries withdifferent cultures and value systems.

Conceptual skills

Conceptual skill is the ability to view the organization as a whole and as a total entity as well as a system comprising of various parts and subsystems integrated into a single unit. This skill is especially crucial for top-level executives who must keep the whole system under focus. They must understand the complexities of the overall organization, including how each unit of the organization contributes towards the overall success of the entire organization. This skill generally depends upon an organised thinking process which deals with the understanding of various functions of an organization, their interdependence and the relationship of the organization withthe outside environment in terms of threats and opportunities.

Diagnostic skills

Diagnostic skill refers to a manager's analytical ability where a manager can logically and objectively investigate and analyse a problem or an opportunity and use scientific approaches to arrive at a feasible and optimal solution. It is important however, that a manager gets to the root cause of the problem so that the solution is real and a permanent one rather than simply a short-term or a cosmetic one. This skill overlaps with other skills because a manager may need to use technical, human, conceptual or political skills to solve the problem that has been diagnosed.

Communicational skills

Communicational skills are an important component of interpersonal skills and are basic to all other skills and these are important and necessary at all levels of management. A manager's best ideas will have little impact if they cannot be communicated effectively. Good communication is the foundation of sound management. Proper communication eliminates delays, misunderstanding, confusion, distortions and conflicts and improves coordination and control. All the four communicational skills, namely writing, reading, listening and non-verbal gestures are important ingredients of successful leadership.

Political skills

Political skill can be described as the ability to get your own way without seeming to be selfish orself-oriented. It is the ability to get your share of power and authority and use it without the fear of losing it. It is the most complex of skills in the sense that it is required to establish the right connections and impressing the right people and then skillfully using these connections to your own advantage. Political skill is most important at the middle management level because middle managers always aspire to reach the top levels of management and right connections help in such aspirations.

Leadership Strategies in Corporate Governance

Leadership strategies have a very important role to play in corporate governance. A manager of an organization must be a good leader and must possess very good leadership strategies to effectively lead the group of employees in order to achieve the goals and objectives. Leadership is very crucial for the success of an organization. Leadership is an integral part of organizations andplays a vital role in organisational operations. It provides direction, guidance and confidence to the employees and helps in the attainment of goals in a much easier way. In industrial organizations, managers play the role of a leader and activate the employees in order to make them work.

Need for leadership strategies

The various reasons why the organization needs leadership strategies are:

- Leadership is needed for influencing the behaviour of employees of an organization.
- It is needed to coordinate the activities of the employees of an organization.
- It is needed to attain the tasks that are assigned to the employees be giving them instructions.
- It is needed to provide the employees a vision for the future.
- Leadership is needed for encouraging the employees.
- A leader is a friend to the employees. Only a leader can recognise the talents of individuals,and help them realise their dreams.
- It is only possible for a leader to unite the employees as a team.
- Only a good leader can build up a high morale within a team.
- A leader is required to help the team focus on a common goal or mission.

According to Koontz and O'Donnell, 'The leadership is an art of influencing people so that they will strive willingly and enthusiastically towards the achievement of group goals'. It emphasises the fact that the leaders help people to understand the objectives of an organization. Thus, leadership is an endless process of influencing people to willingly and enthusiastically strive towards the achievement of the organisational goals. The leader of an organization must possess the following qualities:

- **Smartness**: A leader should be smart enough to solve the problems of employees.
- **Knowledge of business**: A leader should have a good grasp of business, and theorganisational goals should be clear in his mind.
- **Decisiveness**: A leader should be a good listener, that is, he should take a decision aftertaking the opinion of employees.
- **Willingness to admit mistakes**: A leader should accept all the mistakes and learn from themin order to maintain his dignity.
- **Innovative**: A leader should be innovative in order to meet various environmental changes.

Emerging perspectives on leadership in organizations

There are two new perspectives that have attracted attention in organizations. These are the concepts of substitutes for leadership and transformational leadership.

Substitutes for leadership

The behaviour of a leader must be appropriate for different situations. This does not include situations where leadership is not required. This concept recognises situations where the characteristics of the subordinates, the task and the organization replace the leaders' behaviour. For example, when a patient is admitted to an emergency room in a hospital, nurses, doctors andattendants act immediately without waiting for directive or supportive behaviour of leaders in anemergency ward.

Numerous traits of the subordinates may alter or replace the leader's behaviour. For instance, employees who are able and also have relevant experiences do not require to be instructed on what to do. The features of the job that may substitute leadership are intrinsic satisfaction and the availability of feedback. For instance, the subordinate may not need direction when the task is uncomplicated and routine. However, he may require or want support when the task is challenging.

Organisational traits that may substitute leadership are group cohesion, formalisation, a rigid reward structure and inflexibility. Thus, for example, leadership may not be required when policiesare official and inflexible.

Transformational leadership

There are various new concepts of leadership that are used by the organization, such as charismatic leadership, inspirational leadership, symbolic leadership and transformational leadership. These new concepts of the leadership transmit a sense of mission, increase learning experiences and inspire new ways of thinking among the leader.

Charisma is a form of interpersonal attraction. Charismatic people attract followers and this type of leader has great power over his or her followers. Charismatic leaders are self-confident and can influence others. The followers of a charismatic leader identify with the leader's beliefs, accept, trust and obey the leader without questioning him and thereby contribute toward the success of the organisational goals.

Developments in Corporate Governance

The purpose for which an organization is being established has to be defined. An organization must not just state what they can offer to the customers. but they must also state what will be required by customers in the future and the manner in which these demands can be fulfilled.

The CEO must possess an ability to clearly identify the stakeholders. The managers, workers, suppliers and the government all form the stakeholders of an organization. A CEO must clearly define the importance of all these stakeholders. The organization must maintain a very good relationship with the stakeholders. The relationship between the organization and the stakeholders is very critical for the success of an organization. Later, the organization must also maintain an effective relationship with the suppliers. Suppliers are the persons who supply raw materials in anorganization. A good relationship with the suppliers will ensure the timely supply of the raw materials in an organization. An organization must also make timely payments to the suppliers inorder to maintain a regular supply of raw materials in an organization.

In order to maintain an effective business strategy, an organization must have a full understanding of the vision, mission, values and responsibilities towards the shareholders. During the event of any crisis, an organisation's relationship with the stakeholders and the suppliers will go a long wayin protecting the organization during the time of crisis.

In the future, an organization must have a clear understanding with its stakeholders. An organization must involve the stakeholders in their decision process. The managers must be accountable for the decisions that they take in an organization. If the manager takes any decision that is not beneficial for the organization in the long run, then the manager must be held liable for any losses that the organization suffers. An organization must make a very purposeful accountability plan which must be linked with the performance of the managers. The role and responsibility of the employees must be clearly defined by the organization. The various changes that will take place in the 21st century are:

Balance accountability and enterprise

The CEO of an organization must show results in a very short period of time. A CEO must perform the tasks in a very well-planned manner. If any act of the CEO results in losses for an organization, then the CEO is held accountable for his actions and this may ultimately result in his ouster from the organization. There is a certain element of risk associated with taking decisions, which could either bring a lot of profits or losses. A good CEO is one that has a very good knowledge of the risk factor and planning in an organization. A CEO can take more accurate decisions if he has a complete knowledge of his competitive strengths and weaknesses.

Search for competitive knowledge

The CEO of an organization must continuously try to gain and maintain the competitive advantage of an organization. A CEO tries to gain competitive advantage with the help of the 4Ps, which are product, price, placement and promotion. A CEO must always be quick in taking the decisions regarding the need of the market. However, competitive advantage could result in losses for an organization. If an organization gains competitive advantage in the market by lowering the prices of products, then it may lead to a belief among the customers that the price reduction is due to poor quality of the product. This may lead to a decrease in the sales of the products of an organization, which, in turn, affects its profit.

Accountable entrepreneurs and directors

One of the main tasks of an entrepreneur is to provide quality goods to the customers at the right price with the help of proper distribution channel. A right decision taken by the entrepreneurs goes a long way in providing an impetus to the employees for performing to the best of their abilities. The entire division of organization must work in accordance with each other to achieve the goals and objectives of the organization. The directors and entrepreneurs of an organization must be well-accountable for their actions as the decisions taken by them could either make or destroy the organization.

Corporate governance and stakeholders

Corporations are always concerned about the interest of the stakeholders of the corporation. Stakeholders also take care about social causes and the commercial value of society in relation to different interest areas of the stakeholders. The success of different corporations is dependant on the operations of the organizations, which are performed to provide profit to the stakeholders of the corporation. Stakeholders of a corporation are of four types:

- Primary social stakeholder: These are those stakeholders who have direct relations with the corporation. The presence of these stakeholders in the corporation can affect the progress of the corporation.
- Primary non-social stakeholder: These are also directly related to the corporation, but they are never present in the corporation as primary social stakeholders.
- Secondary social stakeholder: These are those stakeholders who are not directly related to the corporation but changes in these stakeholders can affect the corporation.
- Secondary non-social stakeholder: These are those stakeholders who are not related to the corporation and can rarely affect the corporation.

Primary social stakeholder	Primary non-social stakeholder
Customers	Natural environment
Suppliers	Future generation
Investors	
Managers and employees	
Local communities	
Business Partners	
Global citizen	
Secondary social stakeholder	**Secondary non-social stakeholder**
Government	Environmental pressure group
Society	Animal welfare pressure group
Unions	
Media and communicators	
Trade bodies	
Competitors	

Figure 3.3: *Stakeholders of a Corporation*

1.5.10 Corporate Governance Models

Corporate governance models are required to make an outline of the corporate governance structure of a corporation. Corporate governance structure is determined by various factors of thecorporation. These factors are the rights and responsibilities of different members of the corporation, internal factors such as the working environment and the policies of corporation andexternal factors such as the capital market of the country.

There are several members involved in a corporation, who have different rights and responsibility. A fluent communication between these members is required for a healthy environment in the corporation. Different models for corporate governance are required to provide fluent communication between all members of the corporation. Models for corporate governancearrange all the important members of the corporation in a well-structured manner that follows various government policies related to the capital market of the country. There are two differentmodels used to govern a corporation. These are as follows:

- Outsider model
- Insider model

Each model for corporate governance has different participants, corporate actions, regulatory framework and disclosure requirement. Participants are those members of corporation who play an important role in the corporation. Stakeholders, shareholders, CEOs, related industrial groupsand management of the corporation are examples of different participants of the corporate models. Corporate actions are used to describe essential actions, which are taken by different members of the corporation. Electing directors for the board of corporation and the appointment of auditors of the corporation are examples of corporate actions. Disclosure requirements determine necessity, such as interaction between different participants of the corporation that is used to perform various corporate actions of the model. Figure 3.4 shows the different models forcorporate governance.

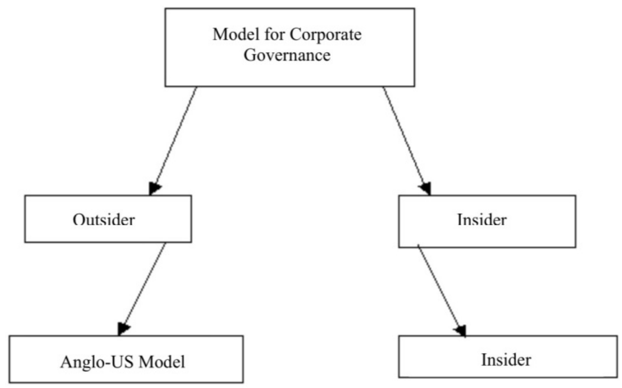

Figure 3.4: *Models for Corporate Governance*

Outsider model

European countries, such as England, as well as America, generally follow the outsider model. The outsider model is also known as shareholder model because in this model, ownership of the corporation is divided among a number of shareholders of the corporation. Thus, the financial section of the corporation is divided among different shareholders of the corporation. The corporate bodies that use the outsider model of corporate governance mostly have a good financial position in the stock market. Different banks help the clients of a corporation that uses the outsider model of corporate governance to obtain short-term finance. The outsider model has the following features:

- A priority to market regulation.
- There is a transitory interest in the firm on part of the owners.
- The absence of close relationships between shareholders and management.
- The primacy of shareholder rights over those of other industrial groups. Insider model

Most countries except European countries follow the insider model. This model is also known as the stakeholder model because those people who have long-term relationship with the corporation hold the entire control and ownership of the corporate body. Stakeholders of the corporation are examples of such people. Stakeholders of a corporation can be categorized as follows:

- Employees of the corporation
- Customers of the corporation
- Management
- Creditors
- Suppliers
- Local communities

The financial section of the corporation that uses the insider model is not distributed among different outsiders such as the shareholders of the corporation. In this model, the bank is an important part of the corporation that monitors clients of the corporation. The insider model hasthe following advantages and disadvantages:

- Priority is given to stakeholders' control.
- The firm owners show a long lasting interest in the company.
- They, many a times, hold positions in senior managerial positions or on the board of directors.
- The relationships between management and shareholders are close and stable.
- The formal rights of employees exist so that the key managerial decisions can beinfluenced. There is hardly any market for corporate control.

Insider model in eurasian countries

In most countries, such as the Eurasian countries, which constitute all European countries exceptEngland and America, and most Asian countries, the insider model is used for corporate governance. The following are the various aspects related to the insider model for corporate governance in Eurasian countries:

- The mass privatisation with favourable conditions for employees in Eurasian countries has created prerequisites for the insider model of corporate governance.

- The Russian tendency that the employees' shares pass to other holders is also present inEurasian countries but not so sharp.
- For some countries, there is high concentration of the shares' capital at the management.
- Nevertheless, employees continue to play an important role as shareholders in Armenia,Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Ukraine and Uzbekistan.

International private initiatives in corporate governance

The role of employees in corporate governance has an important place in widespread corporate governance guidelines and codes of conduct as, for example, in Corporate Governance Forum Principles (1998), Bosh Report, General Motors Board Guidelines, Dey Report and others (Holly J. Gregory, international comparison of board 'Best practices' in developed markets, 1999).

Corporate Governance Structure

The corporate governance structure of a corporation is affected by several factors such as the country to which a corporation is related, responsibilities and roles of different participants of thecorporation and the position of the corporation in the capital market. In other words, the corporate governance structure of any corporation varies according to a specific factor, which is the countryto which the corporation is related. There are two different models used to govern different corporations according to their corresponding countries. These are as follows:

- The Anglo-US model
- The Japanese model

The Anglo-US model

The Anglo-US model is an outsider model used for corporate governance. This model is influenced by share ownership of an individual or an outsider. The Anglo-US model is a well- maintained framework, which is used to represent different roles and responsibilities of different participants of a corporation, such as management, shareholders and directors. This model provides an easy way of communication between different participants, because this model maintains good relations between different participants of the corporation. This model is used bythose countries, which have the largest capital market in the world. USA and UK are good examples of these countries. Most of the corporations of these countries use equity financing for increasing their capital values.

The Anglo-US model also maintains a causal relationship between different factors of a corporation such as equity financing, capital market size of corporation and corporate governance structure. In this model, shareholders play the most important role in maintaining capital market and corporate governance of the corporation among all other participants of corporation. Figure 3.5 shows the different participants of the Anglo-US model used for corporategovernance.

Figure 3.5: Different Participants of Anglo-US Model

According to the Anglo-US model, ownership and control of the corporation is distributed among different shareholders of the corporation. Distribution of ownership and control among different outsiders helps the corporation in maintaining a strong capital market, because outsiders contribute their efforts and capital to make a strong position of the corporation in the market. Astrong position of a corporation in the capital market increases the profit of the shareholder. Thecost of distributing ownership and control among different outsiders is known as agency cost.

In the early days of the use of the Anglo-US model, corporations in the US and UK had only two types of participants—individual shareholder and institutional shareholders. After some time, the board of directors of the corporations was also involved in the list of participants of the Anglo-US model. The board of directors consisted of many insiders and outsiders. Insiders refer to those people who have a strong relationship with the corporation, such as employee, manager and stakeholder. Outsiders refer to those people, who are not directly connected with the corporation. Shareholders and investors are examples of outsiders of corporation.
Outsiders such as individual and institutional investors observe many running factors of corporations to know about the trends of corporation and to represent their interest in corporations.

Observation is necessary to obtain more information about the corporation so that they never facethe problem of lack of information which is one of the most common problem that outsiders of a corporation face. Lack of information is also a limitation for outsiders because of which they never provide their effective oversight to the corporation.

Corporations using the Anglo-US model for corporate governance attract many outsiders due to the following reasons:

- Attracting pattern of stock ownership
- Increasing importance of institutional investors among all participants of
- corporation
- Importance of outsiders in the Anglo-US model's voting behaviour
- Better proposal of private corporations such as Committee on the Financial Aspects ofCorporate Governance and Shareholder Corporation

Necessity of the Anglo-US Model

When the board of directors were involved in the list of participants of the Anglo- US model, the entire power of ownership and control of corporation was moved to the hands of Chief Executive Officer (CEO). The person controlling the power can cause the occurrence of negative factors. These factors are as follows:

- All decisions related to corporation is dependent on one person.
- Sometimes, a group of insiders can control the corporation.
- In many cases, insiders or CEOs are always concerned about their own profit.

A lot of outsiders started becoming involved as participants of corporations because of the abovereasons. Many factors contribute to increasing the interest of corporate governance with the involvement of outsiders. These factors are as follows:

- Provision of new government regulations
- More involvement of institutional investors
- Introduction of takeover activity
- More competitiveness with Asian countries's corporation

Regular Framework in the Anglo-US Model

Anglo-US model provides a well-maintained relationship between all the participants of the corporation. In America, a centralised agency, Securities and Exchange Commission (SEC) is used to regulate communication between all participants of corporation involved in the Anglo-USmodel.

The size of the capital market and communication system, of corporation affects the framework of Anglo-US model. Many laws related to funds and finance of a country also regulate the corporate governance. In England, framework of corporate governance is established according to its parliamentary rules, which is established by private or self-regulatory firms such as security and investment board. The security and investment board maintains the securities market of the corporation.

Disclosure requirement

In the Anglo-US model, corporations require the distribution of information among all participants of the model. Information can be released by an annual report, which contains the following information:

- Entire financial data of the corporation
- Breakdown of capital structure of corporation
- Name, occupation, corporate relationship of every member involved in the board of directorsas a member of the Anglo-US model
- The compensation paid to the upper management and the CEOs of the corporation
- List of all shareholders, who have more than 5 per cent of corporation shares
- Name of the auditors of the corporation
- All the factors that are used to restructure any part of the corporation

Shareholders are also permitted to submit their proposals in the report represented in the Anglo- US model. These proposals are known as shareholder proposals. Shareholder proposals include information about those activities which are related to the corporation's progress.

Note: All the corporations in UK and other countries use the semi-annual report. Corporate actions

Corporate actions in the Anglo-US model require the approval of shareholders. The shareholders, who have more than 10 per cent of the total share of the corporation, have permission to assemble an extraordinary general meeting (EGM) for approving different corporate actions. These actions are of two types—routine actions and non-routine actions. Routine actions include election of directors and appointment of auditors of the corporation. Non-routine actions involve the establishment of stock option plans mergers and takeovers and the restructuring of any part of corporation, if required.

The Japanese model

In the Japanese model, stakeholders of the corporation hold ownership and control of the corporation. The main bank system provides most of the finance for the company requirements. In other words, it is the largest creditor of the corporation. It provides cross shareholding arrangement to the corporation that make the bank one of the important shareholders of the corporation. The main bank system is responsible for monitoring investment decisions and various clients of the corporation. It is also concerned with the running progress of the corporation. It provides financial help to the corporation. The main bank system is responsible for handling the client of the corporation. It provides the following services to the clients for handling clients of the corporation:

- Enabling long-term investment of clients
- Securing lender of the corporation
- Providing stability to the shareholders of the corporation
- Providing solution to the problem of irregularity of information
- Managing the financial position by gathering rents from excessive deposits

Japanese corporations mainly use the Japanese model, where equity financing is one of the most important financing factor of the corporation. The stakeholders of the corporation help in maintaining good relationships between the main bank system and the corporation. This model requires a legal and well-maintained framework to promote industrial groups. Industrial groups are related with the corporation using cross share holding of equity and trading relationship. Industrial groups are known as keiretsu in Japan.

The Japanese model is mainly used by Japanese corporations, where equity financing is one of the most important financing factor of the corporation. Stakeholders of corporation are also one of the most important factors of Japanese corporations. They play an important role in the corporation and its entire system. In Japanese corporations, outsiders do not play as important a role as in Anglo-US model, because outsiders never take more interest in the corporation's profitsand loss.

Participants of Japanese model

The Japanese model of corporate governance has many participants, which are as follows:

- The main bank system
- Keiretsu
- Management
- The government of the country
- Shareholders
- Independent directors Main bank system

The main bank system is one of the most important participants of the corporation. It is concerned with the financial position of the corporation. It also provides financial help to the corporation if required to maintain a good position in capital market of the country. The main banksystem is responsible for handling the various clients of the corporation and also helps corporations in providing their customers with services related to loans, equity issues, bond issues, settlement account and consultancy services. It is one of the major shareholders of the corporation.

Keiretsu

Keiretsu refers to those industrial groups that are related to the corporation in terms of handling different financial transactions of the corporation. It also plays an important role in the Japanesemodel of corporate governance. Keiretsu is responsible for handling debt and equity transactionsof the corporation, trading of products of the corporation and informal business contacts.

Management

The management of the corporation is responsible for managing communication between the insiders and the stakeholders of the corporation. Managing communication between different insiders is an important task in any model. Thus, the management of the corporation is also an important participant of the corporation, and it uses the Japanese or insider model of corporate governance.

The government of the country in which the corporation is established also affects the model of corporate governance by introducing different policies related to the corporation. For example, inthe 1930s, the Government of Japan introduced a policy, according to which every corporation has to show official and unofficial representation on its corporate board when the corporation faces financial problems.

Shareholders

Outside shareholders are not very important participants in the Japanese model. There is a very small number of shareholders in corporations, which is the reason behind the less significance of these participants in the Japanese model.

Independent directors

Independent directors refer to the chief executive officer (CEO) of the corporation. In Anglo-US model of corporate governance, CEOs of the corporation play an important role, but in the Japanese model, CEOs do not play such important role as in the Anglo-US model. These CEOs represent the outside stakeholder of the corporation who is only responsible for getting profits.

The main bank system, keiretsu, the management and the government are important participants in the Japanese model of corporate governance. Shareholders and independent stakeholders are two other participants that do not have not so much importance as the other four participants. Figure 3.6 shows different participants of the Japanese model.

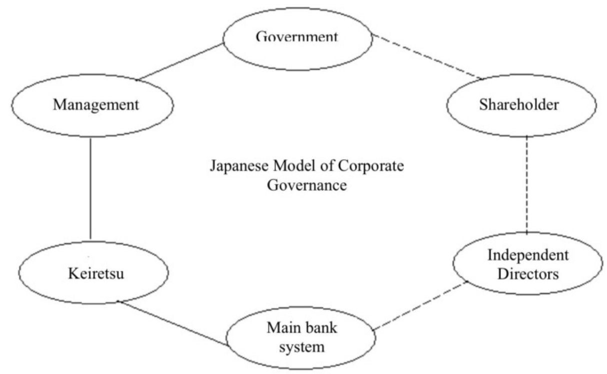

Figure 3.6: *Participants in the Japanese Model*

In the above figure, the dashed lines show the less significant participants of the Japanese model. Shareholders and independent directors are less significant participants of Japanese model of corporate governance, because these participants are in very few numbers and are only interested in their share of the corporate profit.

Solid lines show the important participants of the Japanese model of corporate governance. Government policies, management processes such as communication management, industrial groups, which help corporations in the distribution of products and other services that are knownas keiretsu, and the main bank system are the most important participants of the Japanese model.

Composition of the board of directors

The board of directors in the Japanese model contains fifty members that include executive manager of corporation, heads of different departments of the corporation and administration ofthe corporation. The executive manager, heads of departments and administration of thecorporation are directly connected to the corporation. In the other words, all the members of board of directors are insiders of the corporation.

The main bank system and keiretsu of the corporation can also add new members in the board of directors. For example, if a corporation takes more time to get the required profit than expected, then other participants such as keiretsu and the main bank system of the Japanese modelappoint their own member in the board of directors. Some corporation also include government bureaucrats in the board of directors, because they help corporations in managing the financial section of the corporation.

Regulatory framework

Japanese government ministries frequently develop industrial policies according to the role of Japanese corporations in the international market. The Ministry of Finance and the Ministry of International Trade and Industry are also responsible for formatting different industrial policies. Industrial policies are changed due to the following reasons:

- Japanese corporations are becoming more and more globalised day by day, which makes Japanese corporations more dependent on the domestic market of other countries.
- Most of the Japanese corporations have become partially liberalised in the international capital market and opening to global standards.

Regulatory framework of Japanese model has developed after World War II. Government agencies of Japan provide little effective, independent regulation of the Japanese securities industry.

Disclosure requirements

Disclosure requirements of the Japanese model are somewhat similar to the Anglo-US model of corporate governance. In the Anglo-US model, an annual report, which contains information about different factors such as financial performance of the corporation and members of the board of directors of the corporation, is required. The main difference between the Japanese andthe Anglo-US models is that in the Anglo-US model, the annual report is represented to the boardof directors while in the Japanese model, semi-annual information is provided in the reports represented to the board of directors. This report includes information about financial data of corporation, name and information about top ten shareholders of the corporation.

Corporate Action

In the Japanese model, corporate actions are divided into routine corporate actions and non- routine corporate actions. Routine corporate actions include the following actions:

- Paying dividends and allocation of reserves
- Election of directors
- Appointment of auditors
- Authorisation of the capital of the corporation to the bank
- Management of the required changes of the corporation
- Payment of the retirement bonuses to the directors and auditors
- Providing compensation to the directors and auditors

Note: Non-routine corporate action is similar to the Anglo-US model of corporate governance.Interaction among different participants

In the Japanese model of corporate governance, interaction among different participants produces a strong relationship between each other. Interaction is one of the basic characteristics of the Japanese model. In the Japanese model, good interaction is required because the main participants of the Japanese model are the insiders of the corporation, This requires fluent communication for the distribution of knowledge about each factor of the corporation. Various reports and annual general meetings (AGM) are used to provide good interaction between different participants in the Japanese model.

Overview of Various Codes of Corporate Governance

There are various codes of corporate governance that the organizations have to implement. The Cadbury code originated in the United Kingdom and it led to the development of the various other codes. The Kumaramangalam code originated in India as a result of the committee that was headed by the Shri Kumaramangalam at the Securities and Exchange Board of India (SEBI). However, the codes are only guidelines, which the organizations must follow to achieve the goalsand objectives of the organization. For the corporate governance code to have real meaning, it must first focus on the listed organizations. The organizations that are listed are largely financed by the public money such as equity and debt securities. There are three aspects of codes of the corporate governance. These are the following:

- There is a set structure of corporate governance available worldwide. Therefore, a code of corporate governance cannot be designed for an individual's own purpose.
- Better corporate practices can no longer afford be ignored by Indian companies andfinancial institutions.
- Corporate governance is far beyond the company law. It is difficult to legislate in detail thequantity, quality and the length to which the board of directors exercise their responsibilitiestowards the shareholders.

The Cadbury Code 1

In the post Enron era, much regulatory attention has been given to non-executive directors (NEDs) and their role in contemporary corporate governance. The Higgs Review (2003) in the UK suggested the potentially important role or non-executive directors in improving corporate governance. As part of the firms' board, non-executive directors participate in monitoring and controlling the executive layer of the firm. The UK regulatory scene has sought to encourage good corporate behaviour through a 'comply or explain' approach with fines and imprisonment as a last resort. In contrast, the US with its Sarbanes Oxley legislation has not actively promoted the role of non-executive directors. Instead the US has used the threat of fines and imprisonment to deter undesirable corporate behaviour. For example, the US approach can be seen in the 25-year prison sentence given in July 2005 to Bernard Ebbers, former CEO at WorldCom, and the 24-year sentence given in October 2006 to Jeffrey Skilling, former CEO at Enron.

According to the UK approach, to serve as an effective counterweight to the executive layer in the board, non-executive directors are expected to be independent from the firm they take part in directing. Therefore, the role of non-executive directors follows a risk-regulatory rationale. By serving as a counterweight to the top executive part of firms, non-executive directors are indented to limit the risk of excessive power concentrating in the hands of the chief executive officer and senior executive board members. Therefore, in spite of the crucial importance attributed to non- executive directors' independence, as it evolved in the last decade, is lacking, misguided and introduces a considerable source of risk to the governance of large corporation and, through a systemic effect, to the entire economy.

There are inherent problems regarding the regulatory requirements from boards of directors. In theUK, in reaction to various corporate scandals in the last two decades, a chain of regulatory documents were published, starting at the Cadbury Report, followed by the Greenbury Committee, the Hampel Committee and culminating in the first version of The Combined Code in 1998, each stressing more forcefully the importance of appointing independent non-executive directors for transparent and efficient corporate governance.

The evolution of the regulatory definitions regarding the independence of NEDs shows a gradual crystallisation of two related concepts such as the negative probabilistic concept and the negative bilateral concept. Practices following the negative bilateral concept assign an independent status to a director according to his/her lack of connections with a specific firm. In contract, the negative probabilistic concept regards a director as independent according to their lack of connection with certain categories or groups in the general population.

These two concepts, which together dominate the British regulatory discourse about non- executive directors, contain several problematic characteristics that may bring about systemic risks. First, the concepts do not define positively what counts as directors' independence, but only provide a 'by-default' deducible definition. Hence, the regulators cannot assess to what extent firms are interdependent and to what degree their interlocking connections may affect their decision-making. Second, the existing regulatory concepts create a situation in which the recruitment of non-executive directors becomes a utility maximisation exercise (in effect, a zero- sum game). Therefore, in so doing, the regulation effectively channels firms to circumvent the regulatory recommendations.

The Negative Bilateral Concept2

The Cadbury Report, published in 1992, was the first attempt to focus on non-executive directors as an important mechanism for improving governance in UK quoted companies. The preface to the report of the Cadbury Committee referred to 'the continuing concern about standards of financial reporting and accountability, heightened by Bank of Credit and Commerce International (BCCI), Maxwell and the controversy over directors' pay which has kept corporate governance in the public eye' (Cadbury Report, 1992: 9). The Cadbury Report recommended that quoted company boards should each have a minimum of three non-executive directors. It was recommended that a majority of the non- executive directors should be independent, that is theyshould be independent of the management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment.

The Cadbury Report signifies the beginning of the bilateral negative definition for non-executive directors' independence: the less connections there are between the director and the firm, the more independent the director is deemed to be. Three years after the Cadbury report, the Greenbury Committee was formed following widespread public concern over what were seen as excessive amounts of remuneration paid to directors of quoted companies and newly privatised companies. The Greenbury Committee recommended that the remuneration committee should consist exclusively of non-executive directors. These non- executive directors should have no personal financial interest, other then as shareholders, in the committee's decisions. Also, there should be no cross-directorships with the Executive Directors, which could be thought to offer scope for mutual agreements to bid up each others remuneration'

Also in 1995, the Hampel Committee published a report in which it reviewed the implementation of the findings of the Cadbury and Greenbury Committees. The Hampel Committee recommended that 'boards should disclose in the annual report which of the directors are considered to be independent and be prepared to justify their view if challenge'. Principles of Good Governance and Code of Best Practice were published by the London Stock Exchange in 1998. The recommendation to disclose the independence status of the directors and the backing of that recommendation by the London Stock Exchange signified a further strengthening of the bilateral concept: the corporate discourse that interprets the board's independence was no longer hidden, but was placed in the public domain.

The Negative Probabilistic Concept

In 1998, following a string of financial scandals including those of Enron and WorldCom, Derek Higgs had been commissioned by the UK government to review the role and effectiveness of non-executive directors. Public confidence in non-executive directors had been eroded, for example, by reports that a third of non-executive directors are recruited through personal contacts (the old network) and that Lord Wajeham, a former UK government cabinet minister, sat on the boards of sixteen companies. For example, the report stated that the nomination committee should 'consider candidates from a wide range of backgrounds and look beyond the 'usual suspects'. The Higgs Review also led to the Department of Trade and Industry commissioning a report on the recruitment and development of non-executive directors. This report (The Tyson Report, 2003) explicitly recommends increased diversity in board membership, particularly with regard to femaleparticipation.

In addition, Higgs recommended that the nomination committee should consist of majority of independent non-executive directors and should be chaired by an independent non-executive director. The nomination committee should lead the process for board appointments and make recommendations to the board. These recommendations (with some minor changes) were incorporated in a revised (2003) version of the Combined Code. Following a review by the Financial Reporting Council in 2005, a few minor changes were made to the latest version of the Combined Code, published in 2006.

In addition, one must stress on the importance of directors' independence to proper corporate governance The Combined Code also states that on the boards of all FTSE 350 companies, 'at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent'. (A.3.2). In their decisions, the Higgs Committee and the Combined Code entrenched the independence according to the negative probabilistic approach more deeply by focusing on nomination of directors. Decisions made by a nomination committee would be independent of the board as long as and to the extent that its members are themselves independent. Hence, by recommending that nomination committees will be composed of non- executive directors, the committee introduced a structural-recursive element that, in effect, distanced the board from a position of responsibility and accountability. By calling for a more diverse background from which directors are appointed, the Combined Code has tried to offer a potential remedy to the 'negative' definition approach and its problems. The implicit assumption here is that if NEDs come from outside the social networks of the existing directors, it is more likely that they would be independent. The organisational tools that are expected to ensure a wide diversity of appointees are set procedures that firms must follow prior to appointments.

The presentation of the probabilistic approach may seem like a solution but in fact it simply moves the 'negativity' problem to a different location. By demanding firms to appoint non- executive directors from 'diverse backgrounds' the Combined Code actually asks the firms to appoint non-executive directors from backgrounds that are different from those from which NEDs usually came. Hence, the Combined Code still does not provide a positive definition about directors' independence, but only a deducible, 'by-default' definition. Assuming that there is a correlation between expertise and vicinity to the firm, simply asking firms to diversify their appointments is not likely to diminish the causes for the knowledge versus connection optimization process that firms currently perform.

The developments reviewed above reveal that although non-executive directors' independence is regarded as an important regulatory resource and as a vital non-executive directors had been eroded, for example, by reports that a third of non-executive directors are recruited through personal contacts (the old network) and that Lord Wajeham, a former UK government cabinet minister, sat on the boards of sixteen companies. For example, the report stated that the nomination committee should 'consider candidates from a wide range of backgrounds and look beyond the 'usual suspects'. The Higgs Review also led to the Department of Trade and Industry commissioning a report on the recruitment and development of non-executive directors. This report (The Tyson Report, 2003) explicitly recommends increased diversity in board membership,particularly with regard to female participation.

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The developments reviewed above reveal that although non-executive directors' independence is regarded as an important regulatory resource and as a vital attribute of corporate governance, the two negative definitions of independence, the bilateral and the probabilistic, leave the question of defining positively the independent directors unanswered. This fact creates a regulatory loophole that allows British companies to appoint a wide variety of people as directors without providing any positive benchmarks against which the appointments' independence could be assessed. Furthermore, the definitions create an implicit, but potentially risky, trade-off between independence and expertise. The negative definitions state that a non-executive director would be deemed independent if he or she is not connected to the firm. These definitions are likely to bring about a mode of operation in which the firms would link at the appointment of non- executive directors as an optimization exercise between independence of the appointed director and his/her relevant knowledge and expertise. Thus, under these regulatory definitions, it is likely that companies would try to appoint non-executive directors that are as expert as possible and satisfy the minimal independence criteria.

To address the inherent problems of the non-executive directors' independence concept, an individual needs to think about an alternative concept to that of independence. Instead of defining people and boards of directors according to a bilateral binary scheme (where they could either be independent or non-independent and in relation to only a single organization or person) An individual should consider a decision that would assess the degree of connectedness of each of the non-executive directors in relation to the entire network of connections. This alternative conceptualisation brings with it a host of regulatory challenges. The fundamental conceptual difference between directors' independence and directors' connectedness lies in the scope of analysis. To determine the degree of independence of a director vis-à-vis a board, it is necessaryto examine and assess the strength and efficacy of the connections between the individual director and a specific company.

In contrast, to measure the director's connectedness, one would need to trace the network of connections of which the board member is part and then to establish how important is the role of the specific board member in maintaining the structure of connections among other members, and through them, among companies. What are the advantages that this concept can bring to corporate regulation. The interconnected view of corporate boards will allow us to placeindependence in wider perspective. That is, directors may not be associated with a company in a direct business respects (not sure how this should be phrased of whose board they are members). However, this does not show us the complete picture. An interlocking position of board members makes them crucial in relaying information among the economic organizations. Therefore, studying the inter-board network as a predominantly informational arena allows us to provide a more comprehensive interpretation to the nature of directors' independence in it.

Kumaramangalam Birla Committee Report

The report of the Kumaramangalam Birla Committee on corporate governance states that it is almost a truism that the adequacy and the quality of corporate governance shape the growth and the future of any capital market and economy. The concept of corporate governance has been attracting public attention for quite some time in India. The topic is no longer confined to the halls of academia and is increasingly finding acceptance for its relevance and underlying importance in industry and the capital market. Progressive firms in India have voluntarily put in place systems of good corporate governance. Internationally also, while this topic has been accepted for a long time, the financial crisis in emerging markets has led to renewed discussion and inevitably focused them on the lack of corporate as well as governmental oversight.

The same applies to recent high-profile financial reporting failures even among firms in the developed economies. Focus on corporate governance and related issues is an inevitable outcome of a process, which leads firms to increasingly shift to financial markets as the pre-eminent source for capital. In theprocess, more and more people are recognising that corporate governance is indispensable to defective market discipline. This growing consensus is both an enlightened and a realistic view. Inan age where capital flows worldwide, just as quickly as information, a company that does not promote a culture that is strong and independent, risks its very stability and future health. As a result, the link between a company's management, directors and its financial reporting system has never been more crucial. As the boards provide stewardship of companies, they play a significantrole in their efficient functioning.

- Studies of firms in India and abroad have shown that markets and investors take notice of well-managed companies, respond positively to them, and reward such companies with higher valuations. A common feature of such companies is that they have systems in place, which allow sufficient freedom to the boards and management to take decisions towards the progress of the companies and to innovate, while remaining within the framework of effective accountability. In other words, they have a system of good corporate governance.
- Strong corporate governance is thus indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high-quality accounting practices. It is the muscle thatmoves a viable and accessible financial reporting structure. Without financial reporting premised on sound, whole numbers, capital markets will collapse upon themselves.
- Another important aspect of corporate governance relates to issues of insider trading. It is important that insiders do not use their position of knowledge and access to insideinformation about the company, and take unfair advantage of the resulting information asymmetry. To prevent this from happening, corporations are expected to disseminate the price- sensitive information in a timely and proper manner and also ensure that till such information is made public, insiders abstain from transacting in the securities of the company. The principle should be 'disclose or desist'. This, therefore, calls for companies to

devise an internal procedure for adequate and timely disclosures, reporting requirements, confidentiality norms, code of conduct and specific rules for the conduct of its directors and employees and other insiders. For example, in many countries, there are rules for reporting or transactions by directors and other senior executives of companies, as well as for a report on their holdings, activity in their own shares and net year-to-year changes to these in the annual report. The rules also cover the dealing in the securities of their companies by their companies by the insiders, especially directors and other senior executives, during sensitive reporting seasons. However, the need for such procedures, reporting requirements and rulesalso goes beyond corporate to other entities in the financial markets such as stock exchanges, intermediaries, financial institutions, mutual funds and concerned professionals who may have access to inside information. This is being dealt with in a comprehensive manner, by a separate group appointed by SEBI, under the Chairmanship of Shri Kumaramangalam Birla.

- The issue of corporate governance involves, besides shareholders, all other stakeholders.

  The Committee's recommendations have looked at corporate governance from the point of view of the stakeholders and in particular that of the shareholders and investors, because they are the raison deter for corporate governance and also the prime constituency of SEBI. The control and reporting functions of boards, the roles of the various committees of the board, the role of management, all assume special significance when viewed from this perspective. The other way of looking at corporate governance is from the contribution that good corporate governance makes to the efficiency of a business enterprise, to the creation of wealth and to the country's economy. In a sense both these points of view are related and during the discussions at the meetings of the Committee, there was a clear convergence of both points of view.

- At the heart of the Committee's report is the set of recommendations which distinguishes the responsibilities and obligations of the boards and the management in instituting the systems for good corporate governance and emphasises the rights of systems for good corporate governance and the rights of shareholders in demanding corporate governance. Many of the recommendations are mandatory. For reasons stated in the report, these recommendations are expected to be enforced on the listed companies for initial and continuing disclosures in a phased manner within specified dates, through the listingagreement. The companies will also be required to disclose separately in their annual reports, a report on corporate governance delineating the steps they have taken to comply with the recommendations of the Committee. This will enable shareholders to know where the companies, in which they have invested, stand with respect to specific initiatives taken to ensure robust corporate governance. The implementation will be phased. Certain categories of companies will be required to comply with the mandatory recommendations of the report during the financial year 2000–2001, but not later than 31 March 2001, and others during the financial years 2001–2002 and 2002–2003. For the non-mandatory recommendations, the Committee hopes that companies would voluntarily implement these. It has been recommended that SEBI may write to the appropriate regulatory bodies and governmental authorities to incorporate where necessary, the recommendations in their respective regulatory or control framework.

- The Committee recognized that India had in place a basic system of corporate governance and that SEBI has already taken a number of initiatives towards raising the existing
  standards. The Committee also recognised that the Confederation of Indian Industries had published a code entitled 'Desirable Code of Corporate Governance' and was encouraged to note that some of the forward looking companies have already reviewed or are in the process of reviewing their board structures and have also reported in their 1998–99 annual reports the extent to which they have complied with the Code. The Committee however feltthat under Indian conditions a statutory rather than a voluntary code would be far more purposive and meaningful, at least in respect of essential features of corporate governance.

- The Committee, however, recognized that a system of control should not impede the ability of the companies to compete in the marketplace. The Committee believes that therecommendations made in this report mark an important step forward and if accepted and followed by the industry, they would raise the standards in corporate governance, strengthen the unitary board system, significantly increase its effectiveness and ultimately serve the objective of maximising shareholder value.

The Recommendations of the Committee

This Report is the first formal and comprehensive attempt to evolve a code of corporategovernance in the context of prevailing conditions of governance in Indian companies, as well as the state of capital markets. While making the recommendations, the Committee has been mindful that any code of corporate governance must be dynamic, evolving and should change with changing contexts and times. It would, therefore, be necessary that this code also be reviewed from time to time, keeping pace with the changing expectations of the investors, shareholders, and other stakeholders and with increasing sophistication achieved in capital markets.

Objectives of Corporate Governance4

There are various objectives of corporate governance. These are:

- Corporate governance has several claimants such as shareholders and other stakeholders which include suppliers, customers, creditors, the bankers, the employees of the company,the government and the society at large. This Report on Corporate Governance has been prepared by the Committee for SEBI, keeping in view primarily the interests of a particular class of stakeholders, namely the shareholders, who together with the investors form the principal constituency of SEBI while not ignoring the needs of other stakeholders.
- The Committee, therefore, agreed that the fundamental objective of corporate governance is the 'enhancement of shareholder value, keeping in view the interests of other stakeholders'. This definition harmonises the need for a company to strike a balance at all times between the need to enhance shareholders' wealth, while not in any way being detrimental to the interests of the other stakeholders in the company.

- In the opinion of the Committee, the imperative for corporate governance lies not merely indrafting a code of corporate governance, but in practising it. Even now, some companies are following exemplary practices, without the existences of formal guidelines on this subject. Structures and rules are important alone but these cannot raise the standards of corporate governance. What counts is the way in which these are put to use. The Committee is thus of the firm view, that the best results would be achieved when the companies begin to treat the code not as a mere structure, but as a way of life.
- It follows that the real onus of achieving the desired level of corporate governance lies in theproactive initiatives taken by the companies themselves and not in the external measures such as breadth and depth of a code of stringency of enforcement of norms. The extent of discipline, transparency and fairness, and the willingness shown by the companies themselves in implementing the code, will be the crucial factor in achieving the desired confidence of shareholders and other stakeholders and fulfilling the goals of the company.

Narayana Murthy Committee Code

The Narayana Murthy Panel Report on Corporate Governance

The whistle blower policy recommended in the recent report of SEBI's committee on corporate governance and Clause 49 of the Listing Agreement, which was headed by Mr N.R. Narayana Murthy, Chairman and chief mentor of Infosys is Technologies, seems to have evoked the sharpest response from veteran company secretaries, who have studied the key suggestions in detail.

In fact, judging by what they have to say, it is apparent that this particular recommendation, which is intended to curb unethical and improper practices in corporate, is being singled out by company law experts as simply impractical.

What is the 'whistle blower' policy? It is an internal policy on the access to audit committees. What is the committee's recommendation? Personnel who come to know about unethical or improper practices, which may not necessarily be a violation of law, should be able to approach the company's audit committee 'without necessarily informing their supervisors'.

The committee wants corporations to take steps to see that this right of access is communicated to all employees through internal circulars. Further, a company's employment and personnel policy should provide a mechanism to protect whistle blowers from 'unfair termination and otherunfair, prejudicial employment practices'.

Senior company secretaries that spoke to Business Line said that this recommendation, if implemented, would be instrumental in breeding indiscipline as the audit committee would mostlikely be flooded with frivolous complaints and minor issues. Many complaints might go by their personal likes and dislikes and thus the possibility of the right of access to the audit committee being misused would always be there.

They noted that the committee had not said anything on providing evidence in support of a complaint, disclosure of the identity of the complainant and the maximum number of complaintsthat an employee could make in a year.

The elimination of unethical or improper practices is the responsibility of respective corporate promoters and management, for which they have to put in place systems for efficient administration and transparent transactions. Much also depends on the environment in which corporations operate and the policies that govern their operations. A whistle blower policy cannotbe a foolproof safeguard against unethical and improper practices, they contend.

The recommendation regarding composition of an audit committee has given rise to confusion. While this panel has suggested that audit committee members should be non-executive directors, the Naresh Chandra committee that preceded it suggested that only independent directors shouldbe on audit committee. The reality is that while all independent directors are non-executive directors, it is not so vice versa.

Regarding contingent liabilities, it has been suggested that management's views thereon and auditor's comments on management's views should be given in the annual report. According to senior company secretaries, there are instances where contingent liability cannot be ascertained,such as labour disputes and court cases. As the description suggests, it is all contingent upon future developments and, therefore, it cannot be proper for a management to pass a judgement about the risk involved. Ideally, a management should only give the background of a contingent liability.

The Narayana Murthy panel is for restricting the tenure of non-executive directors to three termsof three years each, running continuously. The Naresh Chandra panel said that after a nine-year term the director would not be considered independent, but surely the concerned person would be able to continue as a non-executive director.

Company secretaries make two points: If the intention is to follow the Naresh Chandra committee's suggestion, the Narayana Murthy panel's recommendation should be redrafted. Representatives of a promoter remain on the board of a company as non-independent directors. The recommendation now made rules out continuation of promoter-directors on the board beyond nine years at a stretch.

It needs to be clarified whether a partner of an audit firm or a solicitor's firm can be treated as an independent director of a company if his firm is the auditor or legal advisor of another company inthe same group.

On Analysis and Media Role

The Narayana Murthy committee on corporate governance also discussed reports brought out from time to time by security analysts and the media, especially the financial press. As for reports of security analysts, the committee has desired SEBI to make rules, which are:

- Disclosure of whether the company that is being written about is a client of the analyst's employer or an associate of the analyst's employer, and the nature of services rendered to such company, if any

- Disclosure of whether the analyst or the analyst's employer or an associate of the analyst's employer hold or held (in the twelve months immediately preceding the date of the report) or intend to hold any debt or equity instrument in the issuer company that is the subject matterof the report of the analyst

Regarding scrutiny of the media, particularly the financial press, it has observed the committee considered views expressed by members.

The Press Council of India has prescribed a code of conduct for the financial media. However, verifying adherence to the code is difficult. A detailed review by SEBI on the subject is desirable, keeping in mind issues such as transparency and disclosures, conflicts of interest, etc., before making any rule. SEBI should consider having a discussion with the representatives of the media, especially the financial press.

Naresh Chandra Committee Code

Section 2.3.8 of this Report states that the Committee would also recommend that the following mandatory recommendations in the report of the Naresh Chandra Committee, relating to corporate governance, be implemented by SEBI.

This section sets out such recommendations of the Naresh Chandra Committee that wereconsidered by this Committee.

Disclosure of Contingent Liabilities (Section 2.5 of the Naresh Chandra Committee Report) The Committee makes the mandatory recommendation that the management should provide a clear description in plain English of each material contingent liability and its risks, which should beaccompanied by the auditor's clearly worded comments on the management's view. This sectionshould be highlighted in the significant accounting policies and notes on accounts as well as inthe auditor's report, where necessary.

This is important because investors and shareholders should obtain a clear view of a company's contingent liabilities as these may be significant risk factors that could adversely affect the company's future financial condition and results of operations.

CEO/CFO Certification (Section 2.10 of the Naresh Chandra Committee Report)

The committee makes the following mandatory recommendation

For all listed companies, there should be a certification by the CEO (either the executive chairman or the Managing Director) and the CFO (whole-time finance director or other person discharging this function), which should state that, to the best of their knowledge and belief. The committee makes the following mandatory recommendations:

- They have reviewed the balance sheet and profit and loss account and all its schedules and notes on accounts, as well as the cash flow statements and the director' report.
- These statements do not contain any untrue statement or omit any material fact nor do they contain statements that might be misleading.
- These statements together present a true and fair view of the company, and are in compliance with the existing accounting standards and/or applicable laws/regulations.
- They are responsible for establishing and maintaining internal controls and have evaluated the effectiveness of internal control systems of the company; and they have also disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of internal controls,if any, and what they have done or propose to do to rectify these.
- They have also disclosed to the auditors as well as the Audit Committee, instances of significant fraud, if any, that involves management or employees having a significant role in the company's internal control systems.
- They have indicated to the auditors, the audit committee and in the notes on accounts, whether or not there were significant changes in internal control and/or of accounting policiesduring the year.9

3.5.14 Risk Management in a Corporation

The management of a corporation is responsible for managing all functions, activities and processes of a corporation. It must also be able to solve different problems, which arise out of improper management of the risks. Risk refers to the uncertainties existing in any process related to the corporation and the losses occurred during an uncertainty. The management of a corporation has to manage a reliable risk management system in the corporation for proper management of risk.

Risk management is defined as the steps taken to detect a risk, calculate the probability of occurrence of the risk and take corrective actions. Due to the uncertainties that normally occur inthe product development process, the process of risk management is useful during the scheduling processes of the corporation. Risk management involves various features, such as risk assessment, risk identification, risk analysis and risk estimation for the analysis and managementof risk.

Risks indicate possible future happenings and are not concerned with the effects that have been observed in the past due to these risks. Risks are identified using the following attributes:

- Probability that an event will occur: Events can occur at any time during the projectdevelopment process. An event, for example, can occur when a project developed on one computer system is transferred to another computer system. Here, both the computer systems can create incompatibility in the hardware or project. This incompatibility causes anevent to occur and is identified as risk.
- Loss associated with the event: The adverse impact of an event could be loss of time, loss of money and lack of expected quality. For example, there can be change in user requirements after the coding phase is complete. The change in user requirements results in the loss of control when team members develop the project according to earlier user requirements.

Note that there is no fixed time for the occurrence of risks. Hence, to keep track of risks, risk management needs to be carried out throughout the project development process. Risk management is a systematic process, which focuses on identification, control and elimination of risks. The objective of risk management is to determine the loss before risks occur and then determine the ways to prevent or avoid the adverse impact of risk on the project. Risk management depends on the number and complexity of risks. Based on this, the impact of risks can be low, medium, high or very high.

Uncertainty and constraint

Risks are a combination of uncertainty and constraints. To minimise the risks, either constraint oruncertainty or both can be minimised. Generally, it is observed that it is difficult to minimise constraint, so uncertainty is reduced. Note that it is difficult to develop a project in which all the risks are eliminated. Therefore, it is essential to minimise the effect of risks, as they cannot be eliminated completely. For this purpose, effective risk management is required. Figure 3.7 showsthe curved line that indicates the acceptable level of risk, depending on the project.

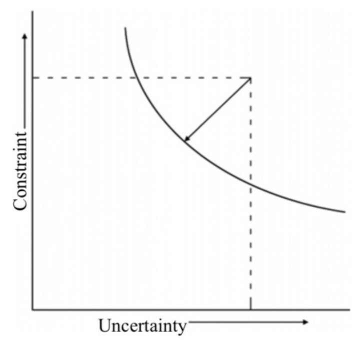

Figure 3.7: *Minimizing Risks in a Project*

Risk is associated with the uncertainties existing in a project and the losses occurred during an uncertainty. Risk management is defined as the steps taken to detect a risk, calculate the probability of occurrence of the risk and take corrective actions. Due to the uncertainties that normally occur in project development, the process of risk management is useful during project scheduling. Various steps involved in risk management are:

1. Identify the probable risks that can occur during the project duration.
2. Calculate the probability of occurrence of a risk and the possible damage caused by the risk.
3. Provide ranking to the risks identified, in order of the probability of occurrence of the risks andthe severity of damage caused by the risks.
4. Develop a plan to handle risks that have a high ranking.

The plan to handle risks involves making the Risk Mitigation, Monitoring and Management (RMMM) plan and developing the risk information sheet. The risk strategies implemented by the management team are:

- Proactive risk strategy
- Reactive risk strategy

The proactive risk strategy involves the identification of risks in advance and taking corrective actions to avoid the risks. The proactive risk strategy is based on the preventive action of a risk. The reactive risk strategy includes allocating resources and taking corrective actions when a risk occurs. This strategy allocates the resources necessary to deal with the risk.

Risk analysis

Risk analysis discovers the possible risks by using various techniques. These techniques include decision analysis, cost-risk analysis, schedule analysis and reliability analysis. After a risk is identified, it is evaluated in order to assess its impact on the project. Once the evaluation is done,risk is ranked according to its probability of occurrence. After analysing the areas of uncertainty, a description is made, which assists in how these areas affect the performance of project.

Principles of risk management

Every corporation is subjected to risks. It is essential to manage the risks to prevent losses in a corporation. If the risks are not managed, it results in project failure. Failure to manage risks is usually the result of the inability to do the following:

- Determine the measures used for managing risks.
- Determine when risk management is required.
- Identify whether risk management measures are taken or not.

Risk management is necessary because without the elimination of risks, projects cannot be developed properly. There are several principles that help in effective risk management. These arelisted below:

- Maintain a global perspective: Risks should be viewed in relation to the project, consideringall the aspects of constraints and uncertainties in it. In addition, the impact of risks on business should be considered.

- Have a forward-looking view: Risks that may occur in future should be assumed.
- Encourage communication: Communication should be encouraged among the team members of the project to increase understandability of the concept, thereby reducing the number of risks associated with the project.
- Develop a shared project vision: Both the project management team and the senior management should be able to view the project and its risks in terms of the common objective, say, that of developing quality project and preventing loss. By following this approach, better risk identification and assessment is achieved.
- Encourage teamwork: The skills and knowledge of every person involved in risk management should be combined when risk management activities are performed.
- Risk management comprises of two activities, namely risk assessment and risk control. These activities identify the risks and determine ways to eliminate them or reduce their impact.

Risk assessment

Risk assessment concentrates on the occurrence of risks depending on their nature, scope and timing. The nature of risks specifies the problems that arise when a risk occurs. The scope of risksspecifies the capability of risks to affect the project. Timing of risks considers when and for how long the affect of risk is observed. With the help of proper risk assessment, risks could be prevented. It is important to provide information according to the level of risks. With complete information of risk assessment, the probability of occurrence of risks and its severity is determined.

Generally, risk assessment can be carried out any time during the project. However, it is better tobegin risk assessment as soon as possible in the development process. To effectively perform risk assessment, the management should consider the occurrence of risks instead of assuming that no risks will occur during project development. In addition, a record of risk assessment should bemaintained during the process. For understanding the severity of risks, which is termed as low, high or very high, earlier documents should be used as a reference and compared with the risks being assessed in the present project. Figure 3.8 shows the risk assessment process.

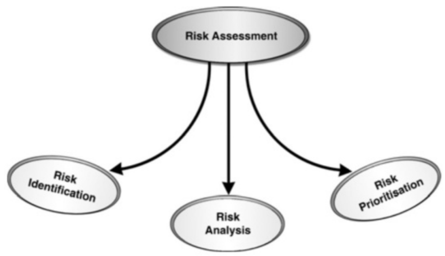

Figure 3.8: *The Risk Assessment Process*

Risk assessment comprises three functions, namely risk identification, risk analysis and risk prioritisation. Risk identification is used to identify the different risks that impact the project. Riskanalysis uses different techniques related to decision analysis, cost risk analysis, schedule analysis and reliability analysis to analyse the different types of risks involved in the project. Risk prioritisation is responsible to manage various risks according to their effects on the projects.

Classification of risks

The risks occurring in a project are classified according to the degree of uncertainty and the extent of loss associated with the risk. The various types of risks in project management are:

- **Project risk:** These risks are the risks that cause delays in the project schedule and increase the cost of the project. These risks include uncertainties associated with the project schedule, client requirements, resources, human resource allocation and the budget of the project.
- **Technical risk**: These risks are risks that affect the effectiveness of the project that is being developed. Technical risks include uncertainties associated with the implementation of the project, interfacing, designing and other maintenance problems. These risks can also arise due to technical uncertainties, such as problems in the integration of two project modules.

- **Business risk**: These risks are the risks that affect the usability of the project. Business risksinclude the following risks:
  - o Losing the demand of a good project in the market. This is also called market risk.
  - o Developing a project that does not go in accordance with the business strategy of a company. This kind of risk is called strategic risk.
  - o Developing a project that the marketing team of the company is unable to sell.
  - o Developing a project by changing the schedule for work allocation to the personnel. Forexample, when the management decides to handle the project with the junior staff ignoring the effort of the senior personnel. This kind of risk is called management risk.
  - o Developing a project due to the lack of personnel support or economic support in the form of the budget of the project. These risks are called budget risks.
- **Known risk**: These risks are the risks that are identified and rectified after making a thorough investigation of the prepared project plan and the technical and market situations. These risksinclude problems, such as poor programming of the project and lack of proper planning for the dates of project completion.
- **Predictable risk**: The predictable risks are those that are identified from the past experiences of the project. The predictable risks include risks, such as the risks involved in the sudden change of personnel allocation and the lack of good communication with the client.
- **Unpredictable risk**: These risks are not predictable in nature and are not easily identifiable.

For each of the risks specified above there is another classification—product- specific risk and generic risk. The product-specific risks are traced by personnel with the knowledge of the projectenvironment and technology. Generic risks are those that are easily traceable.

Risk identification

Risk identification is the process of detecting risks or threats occurring in the process of project development. The threat can be on the basis of the aspects of the project such as resource allocation and planned schedule of the project. The process of risk identification starts with identifying the known and predictable risks. The project manager identifies the product-specific risks by studying the planned project schedule and the statement of scope of the project to be developed.

Risk identification helps identify the events that have an adverse impact on the project. These events could be the changes in user requirements and the development of new technologies. In order to identify the risks, inputs from project management team members, users and management are considered. The project plan including the sub plans should be carefully analysed in order to identify the areas of uncertainty, before starting the project. There are various kinds of risk that occur during the project development process.

The risk identification process is performed by preparing a list of risks and checking for their occurrence throughout the process of project development. This list of risks is called the risk itemchecklist. The checklist involves a set of predictable risks, which are generic in nature. The variousrisks mentioned in the checklist are as follows:

- Risks associated with the size of the project developed
- Risks associated with conditions prevalent in the market and other
- management constraints on the project
- Risks associated with the sophistication of the client to specify the requirements and risks caused due to the communication gap between the project manager and the client
- Risks associated with the planned schedule for the project development
- Risks associated with the tools used in project development
- Risks associated with the complexity of the project to be developed and the complexity ofthe technology used for development
- Risks associated with the experience of the personnel involved in project development

A project manager assesses the probability of the occurrence of risks in a project by answering questions such as:

- Are the senior personnel of the development team assigned the critical activities of projectdevelopment?
- Is the project being developed, useful to the end users?
- Are the project requirements clear to both the project development team
- and clients?
- Is the scope of the project considered stable?
- Are the clients clear in defining their requirements or have they missed some requirements?
- Are the requirements of end-users of the project realistic?
- Does the personnel involved in developing the project make a skilled
- team?
- Have all the requirements of the process of project development been met?
- Does the personnel have knowledge about the technology involved in project development?
- Does the number of personnel employed for the project fulfil the requirements of theproject?
- Is the client fully satisfied with the development of the project?

When the answer to any of these questions is no, then it means that the project manager has to start with the RMMM plans. The impact of the risk is computed using the effect, which a risk driver produces on the risk components. The types of impact of a risk based on the decreasing order of severity are:

- **Catastrophic**: It causes the cancellation of the project.
- **Critical**: It has a great impact on the project.
- **Marginal**: It has an impact on the project, which can be controlled.
- **Negligible**: It has a minor impact on the project.

Risk estimation and exposure

Risk estimation is the process of rating the risk according to the probability of its occurrence andthe consequence associated with its occurrence. Risk estimation is also called risk projection. The primary objective of risk estimation is to rank the risks according to their capability and their impact on the project. This order is decided by the project planners who along with technical and other managerial staff perform the following four steps:

- Setting up a scale that reflects the likeliness of occurrence of a risk
- Determining the affects of the risk
- Calculating the impact of the risk on both the project and the final product
- Maintaining a record of the overall accuracy of the risk projection in order to avoid any type ofmisunderstanding

All the above-mentioned steps help prioritise the risks. The project manager of a project performs risk estimation by preparing a risk table. The risk table contains the various risks, a categorization of the risks, the probability of occurrence of the risk, the impact of the risk on the risk components and the RMMM plan to counteract the risk. The project manager lists down the risks by consulting the risk item checklist. The risks are classified according to business risk and market risk. Each member of the project development team calculates the probability of occurrence of these risks. The probabilities calculated by each team member are then compared with each other until the values of the probability turn out to be the same.

The risks in the risk table are then placed in the decreasing order of priority. The risk with the highest probability and highest impact is listed first and the list is followed by the risks of lower impact and lower probability. This process of arrangement of the table is called first-order risk prioritisation. The project manager then defines a cutoff line such that only the risks above the cutoff line are under consideration. The risks placed below the cutoff line are evaluated again and a second-order prioritisation is established. The risks above the cutoff line are provided with their RMMM plans and risk information sheets.

The nature, scope and timing of occurrence of the risk affect the impact of the risks. ‘Nature’ refers to the types of problems which arise when the risk occurs. ‘Scope’ refers to the extent of harm that is produced when the risk occurs. ‘Timing’ of the risk is concerned with the duration ofthe impact of the risk.

Thus, all the possible types of risks are listed initially in the risk table. After this, each risk is categorised followed by the probability of their occurrence. Finally, each risk is scaled on the basis of their impact.

Once the risk is scaled, the risk exposure is computed for each risk mentioned in the risk table. The determination of risk exposure is done with the help of statistically-based decision mechanisms. These mechanisms specify how to manage the risk. The risk that has a greater impact on project needs to be eliminated. On the other hand, the risks that are minor and have noor little impact on the project can be overlooked.

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