Case Studies in Business Ethics!

Case Study # 1. Report Card on Corruption:

Corruption is one of the most damaging consequences of poor governance combined with the absence of transparency and accountability. The Corruption Perception Index of Transparency International has depicted India as growing in its corruption rate in recent years. Corruption is of two types – one wherein the powerful pocket crores of rupees under the guise of public welfare.

This is exemplified by the number of scams and scandals like the ones India has witnessed in recent years. The other is the under-the-table kind where people pay money for their entitled services like bribes to excise duty inspectors, doctors, bureaucrats etc.

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While the former is difficult to detect, the latter is easier to survey and quantity. Hence, most of the corruption surveys and reports including the Transparency International (TI) reports are accounts of these "petty corrupt acts".

TI is an international body checking on the levels of corruption engulfing the world. They have been responsible for various surveys conducted across nations for their growth in corruption. Recent studies done in South Asia have revealed the pathetic state of work related affairs in India and her neighbours.

The survey by TI done between November 2001 and May 2002 entitled Corruption in South Asia-Insights & Benchmarks from Citizen

Feedback Surveys in Five Countries, identified high levels of corruption encountered by citizens attempting to access seven basic public services.

In India, Pakistan and Sri Lanka, 100 per cent of respondents that interacted with the police reported encountering corruption. In Bangladesh, this figure was 84 percent and in Nepal, 48 per cent.

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In their experiences with the judiciary, nearly all India (100 per cent), Sri Lankan (100 per cent), and Pakistani (96 per cent) households polled reported paying bribes. Judicial corruption was also significant in Bangladesh (75 per cent of users) and Nepal (42 per cent of users).

After the police and judiciary, land administration was identified as the next most corrupt sector across the region, according to the experiences of South Asian households. In Pakistan, 100 per cent of respondents who had experience with the land administration authorities reported corruption and in Sri Lanka this figure was 98 per cent. Land administration was somewhat cleaner in Bangladesh (73 per cent of users reported corruption), India (47 per cent of users) and Nepal (17 per cent of users).

The survey, conducted in Bangladesh, India, Nepal, Pakistan and Sri Lanka was carried out on households, both urban and rural, in each country. When asked about the source of corruption, most respondents answered that public servants forced bribes. Middle and lower level civil

servants were identified as the key facilitators of corruption in all sectors probed.

The survey results show that even when public services are meant to be freely available, bribes and delays keep many from receiving them, and it is most often the poorest in society that suffer most. The attitude of general Indian public against corruption is not good and feel that they cannot free themselves from the corruption. TI's survey of international perception of business ranks India worse than China.

Case Study # 2. Legal Web:

The recent arrest of the CEO of Internet auction portal Baazee exposes the lacunae in Indian law on affixing liability for online sale of explicit video footage. The arrest focuses attention on Section 67 of the Information Technology Act, 2000, (IT Act) which makes publication or transmission of obscene material in an electronic form an offence punishable with imprisonment up to five years and fine up to Rs. 1,00,000 on first conviction, and imprisonment up to 10 years and fine up to Rs.2,00,000 on second or subsequent conviction.

The case also draws attention to the Indecent Representation of Women (Prohibition) Act, 1986 (IRWP Act). Section 3 of the IRWP Act prohibits all persons from getting involved, directly or indirectly, in the publication or exhibit of any advertisement containing indecent representation of women in any form. Section 7 of the IRWP Act fixes liability for indecent representation on the company and every person who was in charge of the conduct of the company's business.

There are two principal. Types of Internet auctions conducted by auction websites: business to – consumer (B2C) auctions and consumer-to-consumer (C2C) auctions. In the case of B2C auctions, the owner and operator of the auction website have a certain degree of control over the goods auctioned on their site.

However, in C2C auctions, the auction site has no control over the goods auctioned; it merely acts as a lender of virtual market place for buyers and sellers to strike their deals. In the case of B2C auctions, auction websites have knowledge of the goods sold, as they are in each case an actual party to such transactions. However, in C2C auctions, auction sites have no such knowledge of the goods sold as they are not a party to such transactions.

An analysis of the offending sale reveals that it was probably a C2C auction for the following reasons:

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The actual video clip was not shown on Baazee's website byt instead the seller offered to e- mail the video clip to the buyers directly: Baazee was neither the owner nor in possession of the video clip; Baazee was not the buyer or seller of the video clip; Baazee was merely acting as an auction house space provider to the seller; and the sale violated Baazee's policy prohibiting the sale of pornographic content thought its website. The element of "knowledge" which is essential to establish the commission of a criminal offence seems to be lacking in the instant case.

To Baazee's defence, Section 79 of the IT Act may also be deployed. Section 79 expressly states that a network service provider (an intermediary) shall not be liable for any offence for any third party information or data made available by it if it proves that the offence was committed without its knowledge or that it has exercised due diligence to prevent the same.

Moreover, the provision to Section 7 of the IRWP Act, exempts a company and its principal officer from liability if they are able to establish that they lacked knowledge of the offence. While these two points exempt auction sites and their officers from liability if they lack knowledge, they still leave the burden of proving such lack of knowledge on the accused, contrary to the principles of criminal law.

Auction sites are not liable under US law for the actions of their users due to the immunity granted under two legislations: The Communications Decency Act (CDA) and The Digital Millennium Copyright Act (DMCA). Under the CDA, **"no provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider"**.
Similarly the DMCA does not hold a service provider liable for contents on its network if it does not have actual knowledge that the content on the network or system is infringing; in the absence of such actual knowledge, is not aware of facts from which makes the infringing activity apparent; or upon obtaining such knowledge acts expeditiously to remove or disable access to the content.

Defining the scope or import of the required "due diligence" (showing care and steady efforts) to be exercised by auction website is another ticklish issue. The concept of due diligence might best be categorized into three levels.

The primary level of possible diligence might be the formulation of disclaimer of liabilities, membership agreement and endures agreement prohibiting the uploading, display or sale of any illegal merchandise including pirated software and music, adult content and other illegal-illicit products on the auction site. The acceptance of this agreement could be made mandatory prior to any user accessing the contents of the website.

The secondary level of diligence could involve retaining a certain level of control over the activities of sellers by introducing and exercising the right to remove infringing or illegal content from the auction site. The tertiary level of diligence could consist of the establishment of control mechanisms like automated software that screen the content to disable anything not complying with the policy of the website.

However, the use of automated means to weed out undesirable content remains a far cry in the Internet wilderness.

Case Study # 3. An Indian Morality Play:

The Ambani saga is an Indian morality play that refuses to have a happy ending.

Act one is a classic rags-to-riches story. A poor schoolteacher's son from Chorwad village in Junagadh district goes to Aden to make his fortune.

He returns with Rs 15,000 to Bombay and becomes a trader in synthetic yarn in Pydhonie. It is the height of the License Raj in the 1950s, which means that supplies are scarce and smuggled. He buys from the informal “replenishment licenses” market (Called REPs).

But since he takes bigger risks, he soon control the supply line, and quickly becomes the “king of REPs” His critics allege much wrongdoing. But unlike other Gujarati traders, he understands men’s minds.

He believes synthetics will become his poor country’s fabric one day, even though the government taxes them as a luxury. Sense will prevail, he thinks, and invests his trading profits in a technologically advanced synthetics textile mill, and begins to build a legendary brand called Vimal.

Act Two:
The village boy becomes master gamesman of the License Raj, who manipulates the decaying and corrupt controls regime to his advantage. Against all odds, he integrates backwards to create an outstanding, petrochemical company, which grows at a scorching pace to become India’s largest company. Opponents scream “bloody murder” and detractors point to illegal acts.

After the Reforms, they predict his fall, but he proves them wrong again. He sets up to the world’s largest multi-feed refinery, explores for gas, and makes impressive finds. From the “prince of polyester”, he becomes the powerful king of industrial India.

When Act Three opens, the king is dead. The elder prince is anointed the new king. He is in a hurry and he gathers his army and goes to conquer new telecom territories. But the younger prince refuses to accept the new king. With his horsemen he launches an attack on his brother.

In the fight, many governance failures come out in the open-about the nature of the family's shareholding and the ownership of Reliance Infocom. The kingdom is headed for a split. The country watches the awesome tragedy unfold each day.

The play raises deep moral questions. Reliance became a hero to the lost generation of 1965- 1990, an inspiration to hundreds of entrepreneurs, and the stock market's darling. When the world's largest refinery started in record time in 1999, many Indians felt that dreams could become real.

It became common place to hear, "if only there were ten Dhirubhais". Critics, however, charge the Ambanis with deceit and manipulation of laws and officials on their way to success. The apologists retort that the laws of the License Raj were so bad you could only succeed by manipulating them; even the government realised this and began to dismantle them after 1991. But the opponents are unmoved. It is never justified to break a law, they say. Ends cannot justify the means.

This is an old debate among philosophers. Consequentially claims that an act is moral if it has good consequences. Reliance has produced enormous good for the nation – 3% of GDP, 10% of government

revenues, excellent returns for its 3.5 million shareholders – thus, its errors ought to pale into insignificance.

However deontologists like Immanuel Kant maintain that morality is based on absolute values and on intentions. Breaking promises or telling lies is wrong even if the consequences are good. Whichever side you are on, the truth is that Reliance will never be the same again. Nor will corporate governance in India.

Case Study # 4. Setting Standards:

Special steel company limited (SSCL) is a reputed company and specializes in alloy steel manufacturing in Nagpur. The company turnover is 650 crores in last fiscal and has quality reputation in the market. Since it entered market in mid-70's. It exported in last year value 69 crore. Growth rate of the company is 11% and SSCL is looking forward for brown field expansion of its capacities.

SSCL markets its products at competitive prices in all industrial towns in India. The exports are handled from its head office in Nagpur and export division in Mumbai. The domestic marketing is divided in 4 Zones North with its office in Delhi, South Zonal Office in Chennai. Similarly Eastern Zonal Office, Kolkata. Mumbai is Western Zonal Office and also in addition handled experts and imports activities.

The company by practice has established good ethical standards. The standards were by the chairman of the SSCL Aravind Jain. The company executives were known for their integrity and hard work and

thus taking the company to growth path. Chairman of SSCL was assisted by Board of Directors and Company Secretary.

The functional and full time directors were in the area of Finance, Production, Marketing, HRD and Project. Director marketing and Director Project used to go on tours frequently to Delhi, Kolkata, Chennai, and Mumbai and to overseas on their work. The tour frequencies were almost weekly. Regular coordination and follow up of activities were done in department and Zonal meetings.

Last Saturday Aravind Jain was following news item on Star News. He was shocked to see news flash that the Marketing Director K. Ram of SSCL was alleged for molestation of a lady employee serving in his office in Mumbai. The Mumbai police were looking for Ram for arresting and further action. Ram was in Delhi on Saturday. Jain telephoned immediately Zonal Manager in SSCL Mumbai and Delhi, so that he can get first-hand information. He was angry that he should get his company information through TV news.

The Zonal Manager Delhi informed that he was not aware of any Mumbai incident. The Zonal Manager Mumbai was not available in his house in Mulund (a suburb of Mumbai). Even after 2 days there was no news or whereabouts of the Mumbai Zonal Manager.

TV news on 3rd Day gave that Mumbai police were searching the absconding K. Ram, Marketing Director of SSCL. Newspapers and weekly business magazines published and news articles on the subject.

A business weekly gave a story with photographs of K. Ram and the lady employee giving their side of the story.
Ram aged 54, is a marketing wiz-kid and considered good in exports and international negotiations. Son of Ram was in UK as a software engineer. Ram's story gave that the lady employee, a secretary in Mumbai office, did come to his five star hotel room and went away.

The TV story was made up by Competitor Company to tarnish SSCL image. The lady employee contended that she was called by Ram along with Zonal Manager for official work to the hotel. In the hotel room Ram molested her telling that she will be promoted as officer shortly. The lady ran and lodged FIR in police station. The lady was middle aged and has a son going to high school.

The next week TV news said **"Ram, Director of SSCL surrenders to Mumbai police. Police took him to custody and produced in Magistrate Court. The court granted bail to Ram".**

Questions:

(1) Discuss the ethical issues of the company involved in this case.

(2) What are reactions on the issue from different stake holders of SSCL? (3)(a)What actions you suggest that Jain should take immediately and (b) Policy decisions to stop such recurrences

Case Study # 5. The Ethics of Advertisement:

New Pharma Ltd., (NPL) established by Mr.R. Rao, who came from a business family. The family was into the medium scale jewellars business and had made quite a name for itself in that segment. Its

jewellery shop stretched from the main markets of Kerala to Madras and from Goa to Bombay and were famous. The Chairman of NPAL Pharma was Gopal Rao the father of R. Rao, an octogenarian who was an institution by himself. R. Rao (RR) was post graduate and a doctorate in pharmacy.

With the family funds R.R set up a pharmaceutical unit at Nagpur. His aim was to produce drugs which would sell in the various tourist spots all over India and which would not attract the penalties under the Law on Drugs and Narcotics at the same time. A team of research scientists set to work under the direct supervision of R.R. The aim was to produce pills which could be marketed among the young upwardly mobile urban professionals all over India.

Men and women between the ages of 18 and 38 were the target customers. The company was floated and a seven member Board of Directors was appointed to run the business. Gopal Rao was the Chairman of the New Company but it was R.R. and his Marketing Chief who wielded all the power.

NPL used hotel-tourist resort network to set up small chemist shops in the lobby of the hotels owned by them. The chemist shops were named New Chemists and the logo at the bottom of his sign board showed a very beautiful mermaid within a cryptic pentagon and the words we aim to please. Son some chemist shops were also opened along the beaches all over India and the neon signs showing the mermaid become extremely well known.

After a year NPL came up with a highly effective relaxant which was packed in a silver foil and named Lal pari or red angel. The pill would be as potent as a 10 mg Valium but which would also have a slight hallucinatory effect on the brain besides. They marketed it as an anti-depressant and the advertisement showed a tent on a beach with a skimpy bikini hanging on the side of it, a pile of clothes scattered around it and two pairs of feet sticking out form under the canvas.

The caption in bold print on the top of the picture read: tired of life? Relax with a Lal pari. A packed of six pills cost Rs. 50. The product was an instant success and every chemist shop especially in the tourist spots was registering spiraling sales.

The chairman was not too pleased with what was happening but when he saw that the Chemical Analysis showed the drug to be relatively harmless and when he saw the profit figures his opposition was muted.

After 2 years NPL introduced yet another pill. This item it was rejuvenator and named Neel Pari or blue angel. The advertisement showed and old man jogging alongside of several youths and the procession of runners being hungrily eyed by a bevy of beauties. The pill came in an attractive plastic bag and was to be taken with a glass of milk every morning and evening. A packet of 10 pills cost Rs.80.

The caption in the advertisement, in bold print at the bottom of the picture, read: is the strain of work wearing your energy off? Do you feel old before your time? If so, do not worry and take a Neel Pari. Sales in

all metropolitan cities soared and revenues began to plough back at a rate faster than expected.

In the meanwhile, a self-styled body called Guardians of Society filed a writ petition in the Bombay High Court against the advertisements and claimed that the pills should be banned. The writ was based on a public interest petition and the society claimed further that the company was corrupting the youth.

The Guardians of Society comprised of some social workers and selected clergy from the seven major religions of India who took it upon themselves to reform society in the name of God and wanted to purify the human soul and rescue it from the gates of hell.

The lawyers for the Guardians of society wanted the pills banned and the pharmaceutical firm closed down. They argued that in a society where such diseased like AIDS were spreading fast, any advertisement that had anything to do with sex ought to be banned for the greater good of mankind.

The company lawyer claimed that laboratory reports did not show any dangerous substance in the two drugs nor did the pharmaceutical specification on the packets say anything that was untrue. Besides, the manufacture date and the expiry date were clearly printed on each packet. Hence there was no deception at all nor was there any intent to cheat the customer.

Moreover, there were numerous other drugs already in the market that met the same specifications. And above all, the lawyer argued, what

legal position did the Guardians of Society have to take issue with the Company products without adequate medical opinion to back them?

The question of advertisement then arose. The plaintiff claimed that the advertisements were offensive to public sensitivity. The company lawyer pleaded that the advertisement were far from vulgar and contained nothing which the average Indian youth did not see elsewhere, such as in Hindi movies, anyway.

As to the question of removing the advertisements from the bill boards and hoardings along the motor ways, the companies saw no point. Of course they would be removed if the court so directed but the company would challenge the ruling in a higher court of appeal first.

After all, with liberalization of markets, privatization of industry and globalisation of competition, Indian consumers had the right to know the facts of life. And these facts were stated in the literature that accompanied the packets containing the pills. Furthermore, the bulk of the advertisements were being carried in magazines such as 'Debonair' and 'Chastity' which certainly did not come cheap. And anyone who would buy those magazines was no child who could be corrupted.

The court ruled that there was nothing wrong in manufacturing pills or marketing them but directed that the advertisements be removed from hoardings along the motor ways. The company did not appeal against the ruling and complied with the Court's directive.

However, it did two things at once. It carried public apologies on the hoardings stating that no offence was intended and what the

advertisement meant and what the intention of NPL was. It thereby reinforced its massage to the public. Secondly it intensified its advertisement campaign in night clubs, pubs and beer parlours all over the country. This added to the advertisement budget but also increased sales revenue considerably

After five years NPL came up with a new pill called Tope ki goli (or cannon shell) and launched a hard sell campaign. It claimed, in the literature which accompanied the packet, that it could intensify the sex drive in the human male and the sex appeal in the human drive in the human male and the sex appeal in the human female.

All the person had to do is to take one Lal pari or one Neel pari depending on the mood, then go out for a nice meal accompanied by an attractive partner and top the evening with three piles of the new drug Tope ki goli. The results would take the consumer right to the gates of heaven, his advertisement read. As always the sign of the beautiful mermaid within a cryptic pentagon appeared with the words we aim to please. But this time the Company was careful about its advertisement.

The Company distributed fliers advertising not the Lal pari and Neel pari drugs but the Chemist Shops that sold them, at all main line and major suburban railway stations all over India through its network of Chemist Shops. It came across as a promotional advertisement by the local chemist shop and nothing more.

On the sales counter in the Chemist Shops, were ostensibly kept some fliers for anyone to pick up, and in which Tope Ki Goli was advertised.

The flier had a beautiful border within which the literature appeared, and the border carried erotic scenes from the sculptures in Khajurao. The contents of the drug were given in fine print as well as the claim that it could improve a person's health and well-being.

The Guardians of Society went on a nationwide agitation against NPL. As the campaign against the company become more virulent, the sales of the three drugs skyrocketed. NPL directors were smiling all the way to the bank. The Guardians of Society then used the media of the Press and had sponsored pages decaying the drugs.

NPL filed a defamation suit jointly and severally against the office bearers of the Guardians of Society. The Press Reporters had a field day with the sensational news and as the news spread the positions of the two parties became even more acrimonious.

The Guardians of Society once again went to Court and his time the chief competitors of NPL agreed to fund the legal cost. A team of five hot shot advocates from India were handpicked and retained to fight the Company. This was even bigger news and ensured even bigger sales of the three drugs. The hotels and tourist trade in the Group owned outlet also benefited as a result of this. But the Chairman was upset at the media coverage and did not like his family name dragged around like this.

The Board of Directors of New Deal Pharmaceuticals met when a furious Chairman asked for an explanation and wanted to know what would happen if the Courts ruled against the Company. Was money

everything in life he asked? Sure he said, profits are the basis of all business but they cannot become the end goal of business. There seemed to be no long run vision or was there a mission statement of NPL even after years of being in business, he said.

Head of marketing spoke up. He gave everyone a copy of three laboratory test report received from Germany, Britain and United states on the samples of Tope ki goli sent to them by him anonymously.

Their verdict was unanimous; it was nothing but a high potency multi I vitamin capsule which could not have any known side effects. What the company, he said was doing was marketing hype and nothing else. It was making money on the gullibility of customers.

Case Study # 6. Antitrust Case of Microsoft:

Microsoft (MS) is a global computer software leader and well known all over the world as most valuable company. In fact, MS has revolutionised in Operating Systems (OS) for Personal Computers (PCs). The products of MS include OS software, Personal Computers, software applications, interactive media programmes, internet platforms, applications for client environments and special tools in the operating software.

In last two decades MS has made a name for itself and the market capitalisation exceeds 500 billion dollars. MS came into prominence in 1995 for its “MS Office” software and monopolized by capturing more than 90% share of the market. It also had large share of markets in internet browser and server OS.

Department of Justice (DOJ), USA started investigating in the monopoly practices alleged to have been followed by MS that is, compelling PC makers to incorporate to its internet browser which are provided free with “Windows 95”. Assistant Attorney General for antitrust remarked that “this kind of product-forcing is an abuse of monopoly power and we seek to put an end to it.” The legal battle between MS and DOJ started in 1997.

DOJ alleged that MS is arm twisting to include internet explorer web browser with its Windows 95 OS. During the investigation DOJ collected relevant documents from MS in one of the exchange of e-mails an employee had written “strategic objective was to kill cross-platform Java.”

One more engineer had noted “Screw Sun .... steel the Java language.” It was found that MS had created its own version of Java which fitted on Windows platform. DOJ collected evidences, witnesses and built its case how MS used its financial strength and monopoly position.

The Judgement of the US District Court came in June 2000. The judgement was that MS violated US antitrust laws and abused its monopoly power in computer OS the judge based is judgement on MS share in OS which was very high, high entry barriers created by MS and hence the customer had no alternatives but to follow what MS gave. The judge ordered that MS be split into two smaller companies one for Windows OS and the other for Internet business. The judge also insisted that MS should not violate antitrust laws.

Antitrust Laws of USA:
USA encourages free and fair business which has healthy competition and vigorous rivalry in the market place so that the consumer gets best value for its money. No company should have monopolistic powers.

Antitrust policies have two approaches:
(i) The price and other market dealings which restrain the competitive forces in the market should be prohibited.

(ii) The monopoly market structure be avoided.

US legislations like Sherman Act (1890), the Clayton Act (1914) and the Federal Trade Commission Act (1914) constitute the backbone of antitrust laws. Supreme Court in its judgement in September 2000, did not agree with propose of the government to break up the MS to stop monopoly practices.

MS is likely to prolong the legal battle and introduced new products in the market to keep its monopoly. DOJ advised MS in September 2001 to restrict MS on their monopolistic tactics. The legal battle between MS and US Govt. is like to have more legal battles with more parties.

Case Study # 7. Fudging Accounts:
Less than a year AGO, Semb Corp Logistics (SCL), a Singapore-based firm, got a rude shock. It mismanages at its Indian subsidiary, Semb Corp Logistics (India) (SCLI), had systematically cooked the books. Revenues have been inflated and expenses misclassified.

The dressing up of balance sheet was first detected when a qualified accountant from Singapore was sent to India as Deputy Managing Director in April 2003. and when accountants and lawyers from Deloitte & Touche and Drew & Napier, respectively, started their investigations, the true extent of deception at SCLI was discovered.

Between 2000 and 2002, profits had been bumped up by Rs. 38.80 crore, and expenses of Rs. 7.5 crore had been incorrectly classified as fixed assets prior to 2002. In a press release put out on July 28 last year, the Singapore-based parent revealed what had happened: **"It was found that certain individuals in the finance department of SCLI had artificially inflated revenue and expense figures through the creation of fictitious documents, invoices and journal entries."**

While SCL may be the first foreign firm to have publicly announced mismanagement at its India subsidiary, it is hardly the only such victim. Two years ago, Xerox found that its Indian accounts had been misreported. The CEO and the CFO of the company had to pay huge fines and were also banned from practicing accountancy.

More recently, in March 2004, there were rumours of financial irregularities at Adidas India. The company's Managing Director, Chief Operating Officer, and the Chief Financial Officer all left. A spokesman of Adidas India, However, denied that anything had been amiss and that the departure of the top team had anything to do with the rumours.

Out of Sight:

Fudging of accounts is by no means a new phenomenon, and subsidiaries of multinationals are no exception. In fact, most auditors will tell you that this has been going on for years. So why all the hoopla now? For one thing, post Enron, WorldCom, et at, and the passing of the Sarbanes Oxley Act in the US that makes Global CEOS and CFOS owners of subsidiary accounts, the penalties of oversight, intentional or otherwise, can be telling.

Says Sunil Chandiramani, National Director, Risk & Business Solutions Practice, Ernst & Young India: “Indian subsidiaries of Global Companies can be either very large or very small. Until recently, the smaller o nee sometimes flew under the radar because from a significance perspective, they did not have top management focus. But now, everyone’s started looking at financial matters from a risk management perspective so even if the subsidiary is very small, but it is putting the company to risk, it must be taken care of.”

But what makes the MNC subsidiaries in particular easy game? Blame it on a host of factors. One obviously is the Physical distance: more often than not, the head-quarters is based several thousand miles away, making day-to-day monitoring impossible.

Another is adequate systems of checks and balances. But he’s the interesting bit: Not all managers who end up dressing up their performance do so to enrich themselves. More often than not, it’s simply the pressure to performance do so to enrich themselves. More often than not, it’s simply the pressure to perform that leads them astray.

What seems to have added to the pressure is the linking of pay to performance, with performance being defined largely in financial terms. Says R. Sankar, country Manager, mercer HR Consulting: “This system is good, but it has its downsides.

A large percentage (between 40 percent and 60 percent) of top management compensation is linked to performance. Therefore there is an incentive to abuse the system and produce figures that help their bonuses.” Adds Amit Mukherjee, Partner, Ambit Corporate Finance: It is a natural instinct. It happens all over the world, not just in India.

It’s probably a convenient excuse, but the fact remains that trade management in India is not always black and white. Take transfer pricing. The Challenge is to determine what the fair transfer price is, be it imports or exports. But any auditor will tell you that the transfer price is often determined by what suits the management, and not what it ought to be.

Then, there are considered par for the course in industry. Like booking sales when they haven’s been sold, but are at the dealer’s Says an auditor at one of the Big Three: “For most FMCGS, the April quarter is a washout. Fudging accounts happens mostly in the fourth quarter and, in fact, 80 to 90 percent of sales happen in the last seven days of every quarter.”

Checks and Balances:

Is there anything that the absentee parent can do to prevent managerial shenanigans? Lots Create a system that, if not inviolable, sets off early

alarm bells when rules are not being followed. For instance, if there is consistent growth quarter after quarter, or stocks seem to concentrate at a handful of dealers, or sundry debtors are increasing, then it may be worth instigating. But to create a fairly foolproof system, a number of things must fall into pale.

It stars with people. Do through reference checks of top managers you hire. Ask not just how he or she succeeded in work place, but also how that person handled failure. Ask if that person is prone to taking shortcuts to achieve targets. Does he bring out the bad news early enough, or does he wait for it to reach a head before informing his senior's

Most companies have audit committees, a large number of which increasingly include members from overseas, thereby making sure the subsidiary operation are not totally isolated. Internal audits need to be regularized, on a case by case basis and the audit heads must report to the board.

Then, CFOs of subsidiaries could report directly to regional CFOs rather than the local CEO. Mercer HR, for instance, ahs a system where the India CFO does not report to Sankar, but to the CFO is Singapore. Mercer's internal auditor from New York visits India and interacts with the CO, clients and external auditor. Strong IT systems, such as ERP systems, can also be deployed for greater transparency in accounts and reports.

The external auditors must be made to realize that they are ultimately responsible for the accounts they pass. In SCL case, the service of its auditors (Price water house Coopers and KPMG consulting) were dispensed with after the irregularities were detected.

Says Mukherjee of ambit: “As far as overstating or understanding accounts is concerned, the responsibility lies squarely with accounting firs. Andersen went down because of that. It is their job to see that compliances are followed. If auditors feel that it is difficult to detect irregularities then who will detect it?”

Ultimately, it all depends 011 the people and the level of trust permeating through the company. A coherent policy of ethics has to be drilled in slowly. Introducing effective controls is the need of the hour, but imposing too many checks can cripple decision making besides imposing very high cost on companies, because every other aspect of the business taken a backseat as everyone focuses on compliance.

Notes Sankar: “Let’s also admit that risk is intrinsic to business. If you introduce too many controls, business will become a bureaucracy.” In other words, if you don’t want your managers to cheat, don’t want your managers to cheat, don’t give them he means or the reasons to.

Case Study # 8. Gas Leak at UCIL, Bhopal:

In the early morning hours of December 3, 1984, a poisonous grey cloud (forty tons of toxic gases) from Union Carbide India Limited (UCIL’s), a subsidiary of the US based Union Carbide Corporation (UCC), pesticide plant at Bhopal spread throughout the city. Water carrying

catalytic material had entered Methyl Isocyanate (MIC) storage tank No.610. What followed was a nightmare.

The killer gas spread through the city, sending residents running through the dark streets. No alarm ever sounded a warning and no evacuation plan was prepared. When victims arrived at hospitals breathless and blind, doctors did not know how to treat them, as UCIL had not provided emergency information. It was only when the sun rose the next morning that the magnitude of the devastation was clear.

Dead bodies of humans and animals blocked the streets, leaves turned black, and the smell of burning chilli peppers lingered in the air. Estimates suggested that as many as 10,000 may have died immediately and 30,000 to 50,000 were too ill to ever return to their jobs.

The catastrophe raised some serious ethical issues. The pesticide factory was built in the midst of densely populated settlements. UCIL chose to store and produce MIC, one of the most deadly chemicals (permitted exposure levels in the USA and Britain are 0.02 parts per million), in an area where nearly 120,000 people lived.

The MIC plant was not designed to handle a runaway reaction. When the uncontrolled reaction started, MIC was flowing through the scrubber (meant to neutralize MIC emissions) at more than 200 times its designed capacity.

MIC in the tank was filled to 87 percent of its capacity while the maximum permissible was 50 percent. MIC was not stored at zero degree centigrade as prescribed due to UCC's global economy drive.

Vital gauges and indicators in the MIC tank were defective. Other safety measures were not made available.

As part of UCC's drive to cut costs, the work force in the Bhopal factory was brought down by half from 1980 to 1984. This had serious consequences on safety and maintenance.

The size of the work crew for the MIC plant was cut in half from twelve to six workers. The maintenance supervisor position had been eliminated and there was no maintenance supervisor. The period of safety-training to workers in the MIC plant was brought down from 6 months to 15 days.

In addition to causing the Bhopal disaster, UCC was also guilty of prolonging the misery and suffering of the survivors. By withholding medical information on the chemicals, it deprived victims of proper medical care. By denying interim relief, as directed by two Indian courts, it caused a lot hardship to the survivors.

In February 1989, the Supreme Court of India ruled that UCC should pay US $ 470 million as compensation in full and final settlement. UCC said it would accept the ruling provided Government of India (GOI) did not pursue any further legal proceedings against the company and its officials. GOI accepted the offer without consulting with the victims.

Case Study # 9. Tender Negotiations:

Sen Alkalis (SA) was a large company manufacturing caustic soda. SA was well known in business circle and was producing 55,000 tons of caustic soda per year in its plant which was based on a river bank. There

was a requirement of 2 Nos. of special transformers for use in their sub-station. The transformers had critical operations of converting AC to DC electricity (Rectifier type of transformers).

The budget for the 2 transformers was Rs. 75 lakhs. SA management emphasised that the transformer should be of high quality, reliability and good after sale service for smooth running of the plant.

SA also plant for a tender for the 2 transformers which was based on a complete turnkey concept of supply, erection, commissioning, testing of the equipment, training of personnel, two year normal operation spares and handing over the plant.

The quotations were floated by the Chief Materials Manager (CMM) of SA in two part bid system. The part-I consisted of the technical parameters of the plant and part-II consisted of the commercial and price aspect.

The limited tender action was approved by the top management of SA considering the special nature of the equipment and that few names are famous in the field. The enquiries were floated to Siemens – Germany, ABB – Sweden, Alsthom – France, GE – USA and BHEL – India. The first four parties had good experience in manufacture of such large equipment, whereas the fourth party had no previous experience of building such large transformers.

The technical bids were opened by the CMM of SA per the procedures of the company on the appointed date. The offers of the first four bidders namely, Siemens, ABB, Alsthom and GE were technically found

suitable. BHEL informed that they are finalising a technical collaboration with Alsthom of France for manufacture of this type of transformers. Based on the reputation of BHEL and broad parameters of collaboration, BHEL was also found technical acceptable.

The price bid from all the five bidders were opened as per normal practice of the company and in the presence of the representatives of the bidders. The price bid opening showed the bare prices as opened were: Siemens – Rs.38 lakhs each, ABB – Rs.37 lakhs each, BHEL – Rs.59 lakhs each and Alsthom – Rs.61 lakhs. GE did not quote. After loading taxes, duties, handling cost, expert costs, technical loading and Net present value there on the inter say tender position was Siemens – Rs.39 lakhs , ABB – Rs.41 lakhs, BHEL – Rs.60 lakhs and Alsthom – Rs.63 lakhs.

The CMM of SA ordered re-bidding from all the four tenders. The scope was slightly altered, extended warranty for 6 months was added and the few additional spares for the transformers were included. The re-bidding prices that came were Siemens – Rs.48 lakhs each, ABB – Rs. 48.8 lakhs each, BHEL + Alsthom who made a combine bid – Rs.49.3 lakhs each.

The bidding and tender opening procedures were in line with the normal practices followed. The purchase manual of SA had no guidelines for re-bidding and negotiations.

BHEL and Alsthom had the strong backing of the French collaborators of the SA. SA management was planning for negotiations with BHEL

and Alsthom for finalising the contract. Siemens and ABB started complaining that the unethical methods are being adopted by the CMM of SA to help Alsthom group.

Case Study # 10. What You Should Do When Cos Slip On Ethics?

Don't press the panic button. Here are a few things you can do before taking a call.

On August 31, the Central Bureau of Investigation (CBI) arrested P Kishore, managing director of Everonn Education, on charges of bribing an income tax official. According to media reports, Kishore has admitted to paying the bribe and trying to conceal an income of 110 Crore.

JJ Irani, one of the independent directors on board of the company, also resigned soon. Investors hit the panic button and the stock crashed to . 247 from . 439 — a fall of 48% in four trading sessions. Similarly, issues of poor corporate governance have cropped up earlier in companies like LIC Housing, Mahindra Satyam (erstwhile Satyam Computer Services), Uni-tech and DB Realty. In all the cases, the stocks fell sharply once the investors lost faith in the leadership of the company.

Bigger investors like domestic institutions and foreign funds are the first ones to desert a stock once there are issues related to corporate governance, says Alok Churiwala, managing director, Churiwala Securities.

Predictably, small investors were badly hit and they had to really struggle to get out of the stock even at a loss. This is because in such cases the stock would be frozen at the lower circuit with only sell orders from investors, with no one willing to buy. So, it may be difficult to even exit the stock once the news hits the market.

The situation could be extremely fluid and in a matter of days, the stock could be down by as much as 30-50%, depending on the extent of the damage. The question is, what should investors do in similar situations? "The situation in one company could be very different from the other. Investors will have to evaluate each company on a case-by case basis, before arriving at a decision," says Alok Ranjan, portfolio manager, Way2Wealth.

Check Promoters' Pedigree:

The promoters of a company play a very important role in giving direction to the business of the company. So, if the company under question belongs to a larger corporate group like that of the Tatas or is a public sector entity, then the promoters will be quick to step in.

"If it is a company run by a big group, the management will act fast and a damage-control mechanism will quickly fall in place and the board will take care of lapses," says Varun Goel, head, portfolio management services, Karvy Stock Broking.

A case in point is LIC Housing Finance, where the managing director was involved in a case of taking bribes for giving loans. Since the parent was LIC, a strong PSU entity, it acted fast. Immediately, a new

managing director was put in place, who reassured investors that systems were in order and the business model robust. Though the stock price fell from. 258 on November 23 to. 186 on November 26, it subsequently recovered and on Friday it was quoting at. 220.

However, for smaller promoter-driven companies, that may not be the case. There may be very little management depth besides the key promoter and his family. The core business of the company could be at risk, causing most investors to lose confidence. Hence, investors need to be very cautious in such cases. “If the other members of the board don’t inspire confidence, the best case here for investors would be to sell the stock even though it might mean booking a loss,” says Varun Goel.

Do the Fundamentals of the Business Change?

Another thing which investors need to look at carefully is how the future business of a company would be impacted. For this, we need to look at what industry or business the company is into. Companies like DB Realty and Unitech are primarily in the real estate business, which is going through a rough patch.

Shahid Balwa of DB Realty and Sanjay Chandra of Unitech are under arrest in connection with the 2G scam. Stocks of DB Realty and Unitech have been on a downtrend ever since their promoters were arrested. While DB realty’s shares fell from. 144 to 59. trading at a loss of 59%, Unitech’s fell from. 45 to. 29, trading at a loss of 36%.

An issue of corporate governance like the arrest of the managing director would unnerve both lenders and buyers. “No prospective buyer

would like to book a flat in a project floated by a developer whose MD is behind bars," says a fund manager who did not want to be named.

Similarly, bankers would be unwilling to lend to such projects or if they did, then they would do so at very high rates. Ultimately, this will affect the profitability and model of the business, which raises the business risk for an investor. In industries like IT or education, many a time the managing director or the promoter is the key business driver. His relationships, built over the years, would have helped the company win key deals.

"Lots of clients come on board due to the confidence in the promoter," says Sadanand Shetty, fund manager, Taurus Mutual Fund. Now, if there is an issue of corporate governance with the promoter, this situation could change. It is quite likely that new alliances or contracts may not come through at all. "The company could get tainted or blacklisted and in such a case it may make sense for retail investors to exit," says Ranjan of Way2Wealth.

Taking A Final Call:

Once you have assessed the fundamentals of the business, the next thing which you need to look at is how much damage has been done to the share price already. "If there is some value in the company and the stock price has already fallen by 30% or more, then it may not make sense to exit immediately," says Alok Churiwala. See how the company management reacts before deciding.

However, experts caution retail investors from getting into averaging or buying more of the stock, when it falls. "Once an issue of corporate governance crops up, it could open a Pandora's Box and it becomes very difficult for a retail investor to keep track of such situations," says Ranjan.

He points out that though the erstwhile Satyam Computer has been taken over by the Mahindra Group, its share price is still. 75, which is less than half the price the erstwhile Satyam Computer used to command before the fraud came into light.

Share markets give thumbs down to malpractices and bad corporate governance cases:

1) EVERONN EDUCATION- MD of the company has been arrested for paying bribe to an IT official for concealing an income to the tune of 122 crores – the stocks are going down from Rs.439 to Rs 250

2) LIC HOUSING- CEO was arrested on charges of accepting bribes for sanctioning loans – stocks fell from Rs. 255 to Rs. 188, post a new MD coming in it has recovered its losses

3) SATYEM COMPUTERS- Executive Chairman confessed to overstating profits—the company now has been taken over by Mahindras. The stocks are at Rs.73 which is half of what it was before the scam broke out.

4) DB REALITY- CBI arrested Shahid Balwa in connection with 2G spectrum allocation scam—stocks falling from Rs. 144 in Feb. 2011 to Rs. 50

5) UNITECH- MD Sanjay Chandra was arrested in connection with 2G Scam— stocks falling from Rs. 45 in Feb. 2011 to Rs. 29.