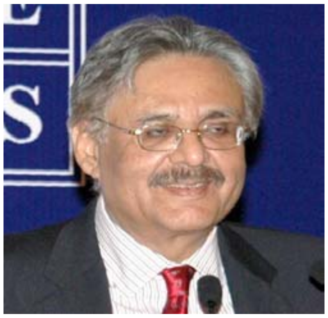

A Chairman's view of the Boardroom

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Good governance has only one aim and that aim is to create value under competitively challenging circumstances. There is a need for rewarding shareholders because it helps to access one very important resource i.e. financial capital, which helps to grow your company. Therefore, to win the confidence of shareholders, existing and potential, and money markets, it is extremely important that value is created for them.

We live in a society and we are its integral part, business is only an economic organ of the society specifically charged with economic function, but it impacts other stakeholders. It impacts social structures, income distribution, environment and ecological balance. Depending upon the type of industry, how much green house gases you'll emit, how much of natural capital you utilize - it has a long-term impact on society. It is not only the shareholders return that companies can merely account for. They also have to be accountable for the value impact they create on society at large. In an emerging economy such as India, more and more resources are now being managed in private hands and we're growing at a very fast pace at around 9% of the recent past and our next five-year plan is envisioning that we could by the end of the plan reach a double digit rate of growth. In India, the population is 17% of the global population but the land resources are merely 2.4%, the water resources are 4% and the forest resources are just 1%. We can visualize that if everybody in India as a result of high rate of economic growth has a sense of well being not only financially but also quality of life, then only we can visualize how much of natural resource would get utilized and sustained. Unless all of us begin to look at our long term accountability to society with not only uni-dimensional view of business, which is returns to shareholder capital, but also return on societal capital, which is a triple bottom line approach.

It is very easy to envision that it is important to get shareholder returns because if shareholders are unhappy there may be no business. So, for the company to survive, there has to be value creation for the shareholder. But if a company can in addition to creating shareholder wealth also be able to create societal wealth, then it will in the long run get powered by reputation asset called branding. We also agree that over a period of time, consumers would begin to view the companies' products emotionally.

What is corporate governance? What is good governance? Good governance is using shareholders' resources as trustees in a manner that can provide long-term shareholder wealth, create long-term reputational asset, ensure societal resources are used carefully and additional values are created for stakeholder, whether inside the organization or outside. When balance sheets are analysed, we find they do not give a clue as to what is the long term sustainability of the enterprise, because all the vital interests, the brand equity, reputational asset, values, quality of leadership, vitality of human resource, collaborative culture, its alignment to the end goals, innovative capacity, entrepreneurial energies, all these being even more important than the financial assets are not available in the balance sheets.

We know that India is getting next to Japan, the second highest private equity, because of the reputation created by the Indian entrepreneurs. If we have this vitality inside our corporation then that becomes a means to create perpetuity, a means to enable the organization to revitalize, reinvent, re-energize itself and remain contemporary with the current and emerging needs of consumers and for the rest of the stakeholders around. So this vitality is extremely important and that really cannot be measured by some code.

There are principles of good corporate governance around the world but practice has to be adapted accordingly to one's own circumstance. A decade ago, British companies had no outsiders on their board. Since we're an emerging economy, a lot of entrepreneurial energies along with global best practices in terms of the principles and concepts of good corporate governance are required to be able to grow. But its application has to be according to the special circumstances. The conventional wisdom was - stick to your knit as the global economies are opening up with high level of competition and don't do anything other than what you have done always. But today, the top Indian business houses that are really performing are diversified companies because of the emerging economy with large opportunities. However, there are constraints related to financial and management resources and also the institutional strength of organizational skills is not that widely available. People with the management capacity and financial resources, can actually in the emerging economy, play and leverage the institutional strengths and create unique sources of competitive advantage.

There are three things that create value for an organisation and these are its values, vision and vitality. These all interact with each other. Suppose, you have a large capacity you will revise your vision to be more broader and futuristic, more encompassing, but values really guide what you will do and not do in reaching your vision in mobilizing the vitality.

The subject of my topic was the Chairman's view from of the Boardroom, but I add to it a little bit more and say - of and from the boardroom. The term 'Board' is an amalgam of the above-mentioned three things i.e. values, vision and vitality - what are its values' quotient - how deeply it is committed to them. It is not what you write on a piece of paper and circulate in your organization, it is your body language, your day-to-day conduct. It is what you practice, not only when the times are good but also when there are downs. It is extremely important that the composition of the board has diversity in it. People with different backgrounds and adaptive skills are better to bring multiplicities of skills.

The point I want to make is that I am not so much enamoured by concentration of power and therefore create mechanism so that there is nobody who is powerful. My formula particularly for emerging economy would be to empower, because to exploit the growth circumstance, you need empowered people. Empowered doesn't mean only one man, the organization has to be empowered at each level. It has to be distributed leadership. One person cannot manage a large organization such as ITC.

The task of the board is to ensure that the systems, processes, practices and enough empowerment are there with the right quality of people, with right skills. For taking decisions dynamically, exploiting the opportunity, assessing the risk and creating value, there has to empowerment. However, with high degree of empowerment there should be simultaneous high degree of accountability also. So instead of elimination of power there would be empowerment and systems of accountability. Suppose, you give your chief executive a job and everyday you tell him to do this or that, then that is not good. Empowerment should be free from management, but within a framework of accountability, which has good systems of transparency, processes, information flow and no distortion. This is the key message that I wanted to give you and one reason why ITC has succeeded despite not following the conventional wisdom. Another thing is that dynamics of the board also depends upon the ownership. The governance systems in U.S. and U.K. companies have emerged, because majority of them have institutional shareholders, who were in the driving seat, therefore their management and ownership was divorced, so you get an agency to manage which is the board. Therefore, it is important to get a link through governance practices between the shareholders and the management through the board.

Now in our company we have created three tiers – this is a unique system. In 1996, we had to struggle because the management said that India is a great opportunity and we want to diversify and use skills that we have in creating larger value. Overseas shareholders can grow, because they can grow through even a shrinking market, they can grow through acquisition, so our overseas shareholder will benefit, whereas our shareholders, who are also 68% would not grow. They would not have the opportunity, so we had this little bit of disagreement, we had some challenging times, but we had other shareholders, who were institutional shareholders - about 34%. It so happened that board managed to get an idea of creating value – not only shareholder value by high rates of growth but also creating this two others legs of the triple bottom line.

As per this three tiers system, at the top is the board, whose role is to do strategic supervision, in the middle we have a corporate management committee - whose role is strategic management, and at the bottom we have business heads and divisional committees – whose role is executive management. So what we have within ITC are focused businesses because it is always easier to handle one thing than handle many things. That is why we created companies within a company, and each of these business is a strategic business unit headed by our chief executive and a divisional management committee and their role is nothing else but to succeed in that business in their own competitive environment. I can also tell you that the way we yearn about it is create focus business where at the same time an umbrella can be created within which institutional strength for ITC could be made available to people and have lot of mechanisms for alignment including ESOPs, incentives and collaborations, so that everybody is pointing in the same direction. We want everybody to be aligned with the stakeholders, when it pinches to the stakeholders, it should pinch everybody, but I agree that there has to be a balance. It should be such that it should not corrupt, it should not bring short term orientation with the independent or non executive director.

The message is that it depends upon which country you are operating, what is the kind of economy, the environment, the size of your company, what is the nature of your business, single or multi-business and innovation, lies in creating governance mechanism and strategy of organization as the key inputs into governance, so that you are able to synergise and create dynamism within your organization and be able to succeed and create wealth along the triple bottom line.