

# Then and Now: The Evolution of Regulatory Requirements and Governance Framework

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The legal and regulatory landscape has been constantly evolving over the last 20 years.

Ethical practices are not just 'good to have' but, 'must have' as people have realized that 'lack of ethics and integrity' not only lead to regulatory risks, it can also pose existential risks too. Around the turn of the century, new laws were framed, existing laws strengthened, and the enforcement authorities were given more teeth. New regulations and standards were introduced with the objective of making corporates more responsible and accountable to all 'stakeholders' because business is more than just delivering numbers at any cost.

Laws were framed to cover 'Workplace Harassment', 'Conflict of Interest', 'Insider Trading', Bribery and Corruption which were hitherto, 'moral' issues and not legal offences (except in some countries). Even though strict laws did exist in some countries, the enforcement actions have increased significantly only in the last decade.

While instances of unethical cases are not new, yet the scale and magnitude of such issues are much higher now than before due to the complex nature and globalized scale of businesses, caused by easing of trade barriers and free flow of goods and services across countries.

The electronic and internet era have obviated the necessity of physical movement, connect and exchange to do commerce internationally. Thus, frauds today may have huge consequences and international ramifications.

## Phases of Governance

Even with emerging laws and regulations, some companies still resort to shortcuts and unethical practices to achieve ambitious growth numbers and targets. Let's examine how the regulatory governance phases have evolved over the last few decades from being merely compliant to being completely committed. While I'm writing about the phases from a largely Indian ecosystem, the same would've been true for many countries at some point.

### A. Prescriptive Phase of Governance

In this first phase of governance, requirements are prescriptive, such as required approvals (to set up factories, for example), time frames and fees organizations need to pay. In this procedure

driven compliance phase, "permissions" from the government are important. A typical governmental body isn't interested or even knowledgeable about business norms and practices.

Compliance is largely binary in nature: You either comply or you don't. This procedure-heavy bureaucratic phase can spawn corruption and a "speed money" culture (greased payments to hasten processes and services).

While this aspect of governance is important, it just fosters rule-based adherence and doesn't necessarily promote ethical compliance or even regulatory controls.

### B. Regulatory Phase of Governance

In the second phase of governance, regulatory arms of government become stronger and become involved in the "how" of business by mandating processes that organizations need to follow in the interests of consumers. This phase had pros and cons. Some view such governmental actions as meddlesome and invasive. However, most believe that, for example, the central bank in India (RBI) has become a good regulator and has protected Indian currency from much financial turmoil in Asia and even globally.

Developing countries are often found to be in this second phase, but this varies from country to country. This phase of governance brings a focus on customer interests, compliance to standards and a fair degree of probity, but it doesn't mandate organizations to be absolutely ethically upright.

### C. Ethics and Values Phase of Governance

In probably the most evolved of the three phases, governments expect businesses to go beyond mere compliance and demonstrate the highest levels of ethical conduct as their core principles whilst pursuing their goals and mission-driven priorities. Stakeholder interests are vital to businesses and are key to their survival. This isn't to say that businesses will become less competitive and innovative. The cost of unethical practices is so high that businesses can't afford to disregard the risks anymore. So, the best way forward is to be innovative with their products and processes to stay relevant and competitive.

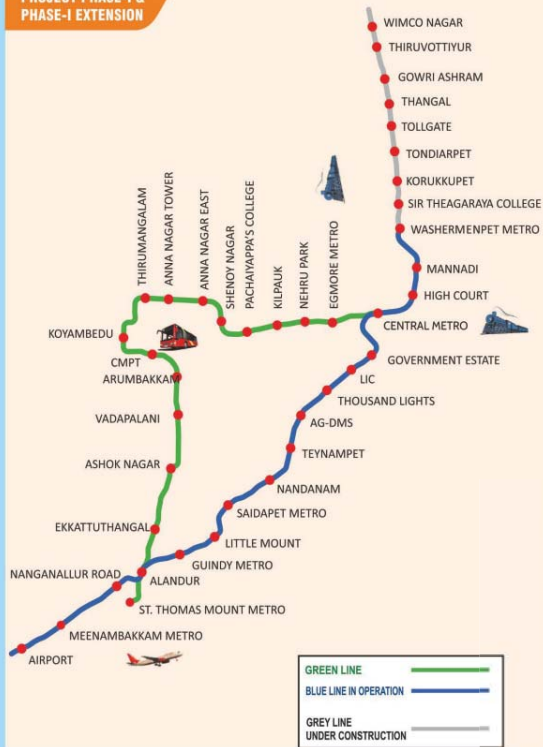


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	First Train	04.23 Hrs	04.22 Hrs
Last Train	23.00 Hrs	23.01 Hrs	

This phase underscores the significance of staying ethical and morally upright as an organization. Businesses realize the existential challenges posed by unethical practices and the power wielded by enforcement authorities.

We've seen numerous instances in which businesses have paid huge prices for unethical deeds. Mismatches among differing governance standards across countries and cultures often cause these ethical violations. Most companies operating in diverse markets face this challenge.

Standards across the globe are fast converging to the 'Ethics and value' phase of governance.

### Governance at Corporations

In the ethics and values phase of governance (the optimum phase in ethical processes), corporations take a proactive approach in devising processes to monitor business, gauge ethical parameters, identify instances of fraud or corruption, and implement corrective and preventive actions, among other measures.

We know that an organization must institute a comprehensive program across all levels, so it'll become ingrained into the fabric of that organization. Governance processes should embed values and principles into business decision-making. It's not about an overtly "rule-based culture" where people just follow regulations without considering why; it's about upholding values and principles in all interactions, especially those that involve ethical dilemmas.

Corporate leadership need to fully own a good governance model. Management should apply its principles and processes across the organization with the goal of enthusiastic employee participation. The model should have strong oversight, written policies and standards, training and development, open lines of communication, and monitoring and corrections.

#### 1. Strong Oversight

A governance model with strong oversight doesn't require a hierarchical structure. An organization isn't about one person; company leaders must be responsible for oversight of governance processes. A chief compliance officer or a governance, risk management and compliance head can manage the program. But the ultimate responsibility must be with the CEO and board of directors, who have the authority to review the governance framework and suggest any needed changes or corrections.

#### 2. Written Policies and Standards

Organizations need written policies and standards on ethical subjects such as bribery and corruption, conflicts of interest, gifts and hospitality, codes of conduct and similar topics. Clearly written procedures that set boundaries on what's acceptable and what's not are a must. These policies and procedures should define situations involving ethical dilemmas and explain the decision making processes. An organization's policies and procedures should be based more on values than on rules and should promote societal good.

#### 3. Training and Development

Organizations should have distinct training and awareness campaigns for all ethics and values aspects. Regardless of employees' functions, organizations should educate them about subjects such as bribery and corruption, sexual harassment and conflicts of interest. Such training should focus on ethical decision-making, in particular.

#### 4. Open Lines of Communication

An organization should foster a culture of openness in which individuals can share their concerns with management if they observe any actual or perceived breaches of ethics without retaliation. At many large organizations, employees, vendors and other associates have access to hotlines through which they can register their concerns and even suggestions. The most effective reporting systems maintain the anonymity of those reporting.

It's management's responsibility to evaluate and resolve genuine concerns that employees submit through the reporting process. Ultimately, it's the board's responsibility to ensure that each concern is handled in a just and fair manner and that management's response is unbiased and thoughtful.

It's important to identify concerns before they become complaints. A complaint could refer to an incident that has happened, while a concern can be merely an indication that something is amiss and needs further investigation.

#### 5. Monitoring and Corrections

A good monitoring process (including internal audits, reviews, management walkthroughs) measures the process outcomes and offers evidence-based suggestions for improvements and corrections. The monitoring process should highlight successes besides identifying non-compliance, failures and gaps. Organizations then should identify corrective measures and preventive steps and carry out the necessary remediation.

#### 6. Response Mechanism

Organizations need to be nimble and more than just rules-driven; they should follow their core values when they respond to any kind of ethical issue. This is particularly true if such issues can affect their reputations and ethical stances. They then must follow corrective and preventive measures in spirit and letter and consider response strategies based on sound judgment and deeply rooted in their values.

#### A New Approach becomes the Norm

We are living in the day of high regulatory enforcements and standards. Organizations must act ethically and not just legally. On the plus side, we've seen countless cases of companies doing the right thing by going well beyond the law and making ethically sound decisions based on their core values and principles. For example, some companies have taken strong action in response to cases of harassment when the incidents weren't, technically, criminal in the eyes of the law. However, we've seen too many cases of corporations still following a culture of "do it until you are caught" philosophy. This dubious approach might have worked in the past, but not any longer. Good leaders are laboring to make sure of that. ■

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