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Shashank Shah

Sri Sathya Sai Institute of Higher Learning

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A Series on Values-Based Business and Stakeholder Management: *Case Studies and Interviews*

Dr. Shashank Shah, Sri Sathya Sai Institute of Higher Learning, India and International Advisory JVBL Board Member

Ethical Governance in the Indian Construction Industry: *A Case Study of Larsen & Toubro Ltd.*

Abstract

Governance has moved beyond mere fulfilment of legal requirements. The corporate debacles of the last decade and more have indicated how very respectable corporate organisations across the globe succumbed to greed and compromised on ethics and organisational value systems. Corporate Governance is mainly concerned with the intrinsic nature, purpose, integrity, and identity of an organisation. It encompasses the entire gamut of organisational stakeholders. While a lot of literature is available in the field of Corporate Governance, an analysis of corporate organisations in terms of their stakeholder-related initiatives has hitherto not been attempted. In this paper, the author has used the case study of an Indian multinational corporation — Larsen & Toubro's Engineering, Construction and Contracts Division (ECC) — and has attempted to study its practices with respect to two major stakeholders: the Shareholder and the Government. ECC is a market leader in the Indian construction industry and has been associated with some of the most prestigious governmental, commercial, and religious construction projects in the country over the last six decades. Triangulation of data has been gathered for this case study primarily through personal interviews with top executives of the Company and responses to an Executive Perception Survey on the Shareholders and the Government. This has been supplemented through other information available in the public domain.

Company Introduction¹

Larsen & Toubro (L&T) is a US \$11.7 billion technology, engineering, construction, and manufacturing company and is one of the largest and highly respected companies in India's private sector. Headquartered in Mumbai, the Company operates primarily in India but its operations extend across the globe. It markets plant and equipment in over 30 countries,

¹ The Company introduction is based on a case study written by the author on Larsen & Toubro for another journal.

has manufacturing facilities in India, China, and the Gulf and a supply chain that extends to 5 continents. Within India, L&T is said to have its presence in almost every district through a nationwide network of distributors of its products. L&T operates through multiple divisions including Engineering & Construction Projects, Construction, Heavy Engineering, Electrical & Electronics, IT & Technology Services, Machinery & Industrial Products, and Financial Services. Across the Divisions, 12 distinct Operating Companies have been carved out under the L&T umbrella, each housing a separate strategic business unit. The 2015 strategic vision of the Company is: “To make L&T an INR 75,000-crore² Company.”

L&T has a distinguished record of achievements including the manufacture of the world’s largest coal gasifier in India and exported to China, India’s first indigenous hydrocracker reactor, and the world’s largest Continuous Catalyst Regeneration reactor. Among the recent success stories of L&T is its association with India’s first nuclear submarine, *Arihant*, inaugurated by Prime Minister of India, Dr. Manmohan Singh, at Vishakhapatnam in July 2009.

In spite of having a diversified expertise, the revenues of the Company are highly concentrated at present. For the financial year ending 2008, the Engineering & Construction Division accounted for approximately 69.3% of the Company’s total revenues and 75.2% of the total income. Of these, the Construction Division (ECC) has been the largest contributor to the top line growth of the Company. This Division—ECC is the focus of this case study.

Construction Division

ECC — the Engineering Construction & Contracts Division of L&T— is India’s largest construction organisation. It figures among the top 225 contractors in the world and ranks 47th among global contractors (revenues outside home country) and 72nd among international contractors (revenues from home as well as outside country).³ Many of the country’s prized landmarks have been built by ECC. ECC capabilities cover all disciplines of construction – civil, mechanical, electrical, and instrumentation. It is also equipped with the requisite expertise and wide ranging experience to undertake Engineering Procurement & Construction Jobs with single-source capability.

L&T – Vision⁴

“L&T shall be a professionally managed Indian multinational, committed to total customer satisfaction and enhancing shareholder value.

L&T-ites shall be an innovative, entrepreneurial, and empowered team constantly creating value and attaining global benchmarks.

L&T shall foster a culture of caring, trust and continuous learning while meeting expectations of employees, stakeholders and society.”

L&T ECC – Services

ECC’s range of services include:⁵

- Pre-engineering, feasibility studies, and detailed project reports;
- Engineering, design, and consultancy services;

² 1 crore = 10 million

³ Survey conducted by *Engineering News Record Magazine*, August 2007.

⁴ As stated on the ECC website, accessed in April 2012.

⁵ Landmarks (2007-2008), published by Corporate Communications Dept., L&T–ECC, Chennai.

- Complete civil and structural construction services for all types of buildings as well as industrial and infrastructural projects;
- Complete mechanical system engineering including fabrication and erection of structural steel works, manufacture, supply erection, testing, and commissioning of plant and equipment, heavy lift erection, high-pressure piping, fire-fighting, and HVAC and LP/utility piping networks;
- Electrical system design, project electrification, and automation and control systems, including instrumentation for all types of industrial and telecom projects; and
- Design, manufacture, supply, and installation of EHV switchyards and transmission lines.

Effective April 1, 2008, the ECC Division was divided into four independent operating companies with related businesses. The operating companies and the constituent divisions are:⁶ ***Building & Factories Operating Company*** (Institutional & Commercial Buildings, Residential Buildings, Factory Structures, and Formwork); ***Infrastructure Operating Company*** (Roads & Runways, Bridges, Metros & Ports, Nuclear & Defence, and Power Generation); ***Minerals, Material Handling & Water Operating Company*** (Minerals & Metals, Water Effluent Treatment, and Bulk Material Handling); and ***Electrical & Gulf Projects*** (Electrical Instrumentation & Communication, Transmission Lines & Railway Electrification, and Gulf Projects). ECC's Engineering Design and Research Centre provides a broad spectrum of engineering, design, research, and consultancy services, ranging from concept to commissioning of all types of projects in the above divisions.

L&T ECC – Subsidiary and Associate Companies⁷

These include L&T International FZE, Larsen & Toubro (Oman) LL, L&T and Eastern Contracting LLC (Eastern) Joint Venture, Larsen & Toubro Readymix Concrete Industries LLC, Larsen & Toubro Saudi Arabia LLC, Larsen & Toubro Qatar LLC, Larsen & Toubro Kuwait Construction WLL, L&T-ECC Construction, SND, BHD, L&T-Ramboll Consulting Engineers Ltd., Voith Paper Technology (India) Ltd., NAC Infrastructure Equipment Ltd., L&T-HCC JV Jharkhand Road Project, L&T-KBL JV, HCC-L&T Purulla JV, L&T-AM JV, Patel-L&T Consortium, International Seaports Dredging Ltd., and Metro Tunneling Group.

Objective of the Case Study

While Corporate Governance mainly deals with the mandatory and suggested guidelines by a number of regulatory bodies, the main objective of this case study is to examine and assess the Shareholder and Government-related practices of Larsen & Toubro Ltd.

Methodology of the Case Study

The case study data follows the Descriptive Research Design with an Inductive Approach. The now popular and evolving “anecdotal style of narrative” has been used in this case. The case has been compiled based on triangulation of data from primary and secondary sources of information. While the primary sources of information consist of responses to an Executive Perception Survey on Government and Shareholders as well as interactions with

⁶ Based on the information provided to the author by the President's Office at the Chennai headquarters of ECC in November 2009.

⁷ Based on the information provided in Landmarks (2007-2008), published by Corporate Communications Dept., L&T-ECC, Chennai.

senior executives of the Company, the secondary sources of information consist of information published in the public domain. Details of each of these are provided.

Personal Interactions with Senior Executives of the Company

The case study data has been collected based on personal interaction by the author with top executives of the Company and based on the following five parameters:

Needs. The needs and the expectations that the Shareholders and the Government have of the Company.

Constraints. The constraints and challenges faced by the Company in order to fulfill the needs and the expectations of the Shareholders and the Government.

Alterables.⁸ The alterables and best practices undertaken by the Company in order to satisfy the needs of the Shareholders and the Government or to overcome the challenges and the constraints that are associated with them.

Strengths. The strengths possessed by the Company with respect to the Shareholders and the Government.

Areas of Improvement. The areas where the Company needs to improve with respect to the needs and expectations of the Shareholders and the Government.

The parameters of Needs, Constraints, and Alterables as stated above are based on the landmark work in the area of Social Systems Engineering Tools as proposed by Warfield (1976) and Sage (1977). The top executives interviewed by these authors include:

Table 1: Details of the Interviewees

Subject No.	Designation	Type of Interview
1.	Member of the L&T Board & President (Construction)	Personal
2.	Former Deputy Managing Director – L&T ⁹	Personal
3.	Vice President – Finance, Accounts & Administration ¹⁰	Personal
4.	Vice President & Head – Materials Management & Vendor Development ¹¹	Personal
5.	Vice President & Head – People & Organisation Development ¹²	Personal
6.	Head – Corporate Communications ¹³	Personal

Responses Gained through Executive Perception Survey

Responses were also garnered by the author to an Executive Perception Survey on Shareholders and the Government. This consisted of 15 parameters relating to various

⁸ As per Social Systems Engineering Tools, “Alterables” mean “*Those elements pertaining to the Needs that can be changed, modified, and/or managed.*”

⁹ Throughout the case study and for the sake of convenience and ease of reading, the former Deputy Managing Director is referred to as former Dy. MD.

¹⁰ Throughout the case study and for the sake of convenience and ease of reading, the Vice President of Finance, Accounts & Administration is referred to as VP (FAA).

¹¹ Throughout the case study and for the sake of convenience and ease of reading, the Vice President & Head of Materials Management & Vendor Development is referred to as Head (MM).

¹² Throughout the case study and for the sake of convenience and ease of reading, the Vice President & Head of People & Organisation Development is referred to as Head (POD).

¹³ Throughout the case study and for the sake of convenience and ease of reading, the Head of Corporate Communications would be referred to as Head (CC).

aspects and initiatives related to the Shareholders and 6 parameters relating to various aspects and initiatives related to the Government by the organisation. Nineteen respondents across different levels of the management hierarchy within the Company responded to the survey and indicated the level of implementation of each of the stated customer-related initiatives within the organisation. Important observations relevant to the case study have been appropriately included.

Respondents to the Executive Perception Survey (19 Respondents)

Presented below is the classification of the Respondents to the Corporate Stakeholders Management — Executive Perception Survey based on positions in management hierarchy and functional areas.

Figure 1: Respondent Classification Based on Management Hierarchy

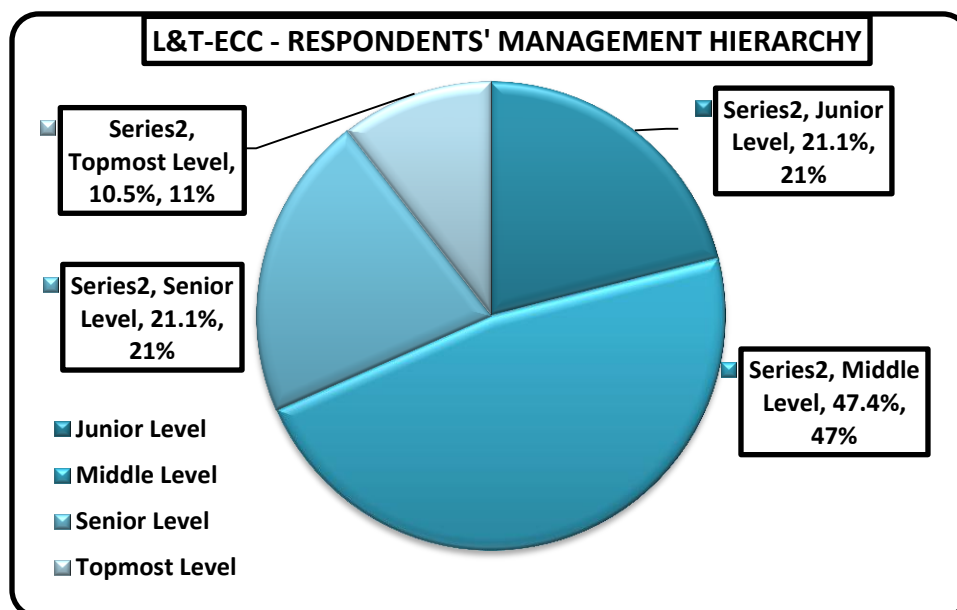
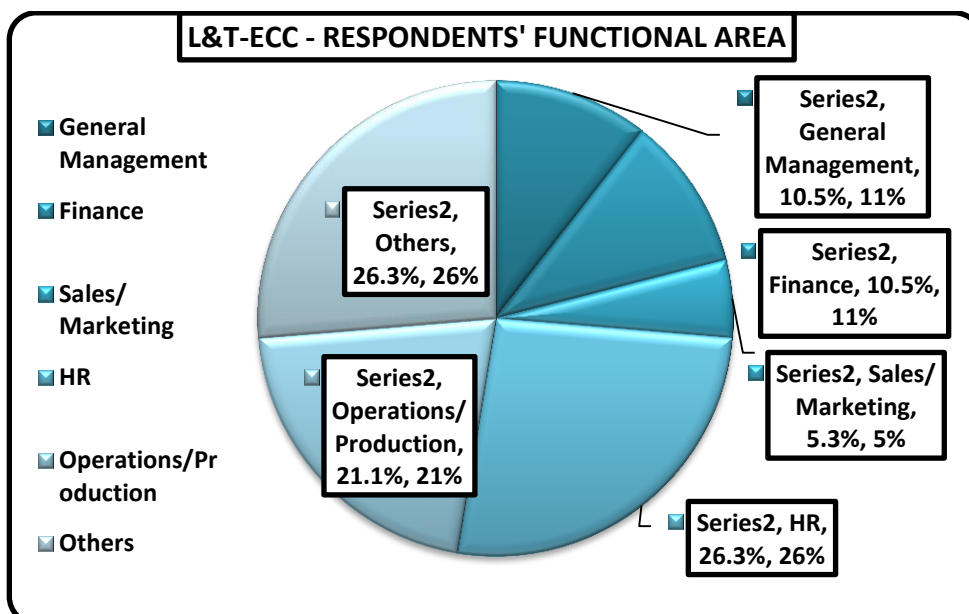


Figure 2: Respondent Classification Based on Functional Area



Secondary Sources of Information

The interview and survey responses have been supplemented by information available in the public domain through documents such as the Company Annual Reports, newspapers, magazines, and journal articles, as well as information available on the Company website.

Shareholder Management: An Introduction

Undoubtedly, Shareholders are one of the most important constituencies any organisation would need to analyse. One important reason for this is that they provide valuable funds for the Company's functioning, expansion, and growth; the other reason is that they play a role and have a say in the key decision-making processes of the Company, especially during the annual general meetings of the Company. Since the policy is "one share, one vote," the more shares held by the shareholder, ostensibly the more influence that entity has in the Company's decision-making processes and in the appointment of important personnel within the top strategic team of the business.

In this context, it is important to note the unique shareholding pattern of L&T. Unlike most Indian companies, it is not a family or professionally-run organisation characterized by the dominance of a single family in terms of ownership. In the true sense of the term, it is a "publicly-owned and professionally-run" company. As stated in the Annual Report of the parent company L&T, the shareholding pattern for the year ending March 31, 2011, was: Financial Institutions – 32.99%, Foreign Institutional Investors – 15.18%, Shares underlying GDRs – 3.55%, Mutual Funds – 4.31%, Corporate Bodies – 6.59%, Directors & Relatives – 0.84%, L&T Employees Welfare Foundation – 12.22%, and the General Public – 24.32%.

The Company has four tiers of Corporate Governance structure: **Strategic Supervision** (by the Board of Directors composed of the Executive and Non-Executive Directors); **Executive Management** (by the Corporate Management comprising the Executive Directors); **Strategy & Operational Management** (by the Operating Company Board of verticals in each Operating Division); and **Operational Management** (by the Strategic Business Unit (SBU) Heads). In addition to ensuring greater management accountability and credibility, the four-tiered governance structure facilitates increased autonomy of businesses, performance discipline, and development of business leaders, leading to increased public confidence.

The Board currently has three committees: the Audit Committee, the Nomination and Compensation Committee, and the Shareholders' and Investors' Grievance Committee. The Board is responsible for constituting, assigning, and co-opting the members of the Committees.¹⁴ The Board of Directors of L&T Ltd., for the year ending March 31, 2011, was comprised of the Chairman & Managing Director, six Executive Directors and nine Non-Executive Directors. The composition of the Board was in conformity with Clause 49 of the Listing Agreement.¹⁵

Mr. A.M. Naik has been the Chairman and Managing Director of the Company since 2003. He joined the company as Junior Engineer in 1965 and has been serving as Managing Director and Chief Executive Officer since 1999. Mr. K.V. Rangaswami took over as the Head of the ECC Division from Dr. A. Ramakrishna in 2004 and became the President (Construction) and Member of the L&T Board. Mr. S. N. Subrahmanyam is currently the full-

¹⁴ Based on the information provided in the Corporate Governance Report of the Company for the year ending March 31, 2011.

¹⁵ Based on the information provided in the Corporate Governance Report of the Company for the year ending March 31, 2011.

time Director and Senior Executive Vice President (Construction) and heads the ECC Division since 2011.

Based on discussions with the President, former Deputy Managing Director, Vice President of Finance, Accounts, and Administration, as well as the Vice President and Head of the People and Organisational Development, a detailed list of the each of these Needs, Constraints, Alterables, Strengths, and Areas of Improvement with respect to the Shareholder as Stakeholder has been collated.

Needs of the Shareholders

Top Management Said...

“Our major stakeholder is our shareholder. They have invested money, we have to give them a return.”

— President, ECC Division, Larsen & Toubro Ltd.

The important needs identified for the Company's shareholders are Transparency, Accountability, Reporting, and Grievance Redressal. The Annual General Meetings of the Company provide the annual forum to undertake the necessary approvals from the entire body of the Company's shareholders. The shareholders expect that these are held on a regular basis.

Since shareholders have invested their money in the Company, they naturally would expect a favourable Return on Investment (ROI). The former Dy. MD explained the concept of Return on Capital Employed (ROCE) as follows: *“One of the stakeholders of the Company is the shareholders and you must give them a return on the capital employed more than the weighted average cost of capital (WACC). If you invest Rs.100 and if your capital is costing you 13% then you should earn more than 13%. We have today the ROCE of 28%. Today's turnover is roughly Rs.30,000 crores and 7-8% is the profit i.e. Rs. 2,400 crores profit. But that's not the real profit. The real profit is what we have invested and put as buildings, equipment, people, machinery; all that should produce profit and should be related to the capital employed. The return on funds employed should be more than the WACC. That way you will satisfy the shareholders.”*¹⁶

Constraints/Challenges faced by the Company

Two major challenges have been identified by the Company:

Manipulation

If there is a bad return and if the expectation of the shareholder is a good return, they would expect the Company to probably give a rosy picture, or they would want the Company to mention this in a way that it does not reveal the full factual scenario but, at the same time, does not obfuscate the losses or poor returns. Senior executives of the Company often face such conflicting situations.

¹⁶ Personal Interview on October 25, 2009.

Transparency

While the Company's priority is to maintain high standards of openness and probity, maintaining this level of transparency is a challenge for the organisation. Explaining how maintaining transparency is a challenge in the construction industry in India, the VP (FAA) stated that: *"If a company is doing 100 projects, in 94 projects it may be doing exceedingly well and in 5-6 projects it may be doing very badly. Somehow one would try to hide these and say that overall performance is good. Things like these could be a challenge. Because of this today, there are lots of disclosures that have been made mandatory. So we (as an organisation) comply with all those disclosures. There are sometimes conflicts. For example, related party transactions (i.e., if the Director's relatives are working, or if any Director is interested in an organisation other than the organisation where he is full time), we have to disclose the dealings with that organisation. Sometimes a Company's resources may get siphoned off to some other company where the Director has got interest, putting the parent Company into trouble. There are cases of this kind, both in India and outside India, which we would like to avoid in our organisation."*¹⁷

Alterables/Noteworthy Practices for Shareholders

Presented below are some of the practices at ECC with respect to shareholders:

Finance, Accounts, and Administration (FAA) Department

This department administers the finance and accounts-related policies of the Company at all its establishments — headquarters, regional offices, and project sites. The department manages the working capital for the ECC division through effective funds management, monitoring of receivables, and vendor financing. It also ensures compliance of statutory requirements and internal controls at regional offices and project sites. The department also consolidates and presents the audited accounts of the Division as applicable under the relevant Acts. Budgeting process and preparation of periodic MIS reports for corporate management, issue of policy guidelines related to finance and accounts, and specialist functions like insurance and taxation management for the division are other key activities of the department.¹⁸

Preparation of the Annual Report

Through the Annual Report, the shareholders come to discover the real happenings in the organisation. The Company's Annual Reports typically demonstrate compliance with various standards and statutory requirements, assuring the shareholders that the Company has not violated any laws or tax obligations nor engaged in any conflicts of interest relating to shareholder interests.. With respect to any failings of the organisation, the Reports serve to communicate this information directly to the shareholders who should always be the first stakeholders to be apprised of the true situation. Highlighting the role of the Annual Report, the VP (FAA) explained: *"Preparing the annual report in the right fashion is very important. You may have heard of the terminology called 'window dressing' and also what Enron did. How things were given in the charge of a single person without any processes being in place. So we would like to ensure that such things do not happen in our organisation."*¹⁹

¹⁷ Personal Interview on May 30, 2008.

¹⁸ Based on information provided in Landmarks (2007-2008), published by Corporate Communications Dept., L&T-ECC, Chennai.

¹⁹ Personal Interview on May 30, 2008.

Quarterly Compliance Reports to the Management

ECC gives quarterly confirmation to management that the Company is complying with all the statutory requirements while any minor deviations are being rectified immediately. The VP (FAA) opined that: *"It is possible that we may not be 100% compliant because we are spread across 300 odd sites and things can go wrong somewhere. If anything goes wrong, we have a senior level person at the ECC head office in Chennai taking care of the compliance requirements. He goes to the site, examines the issue, and takes the corrective steps necessary. We are giving a compliance certificate to the management saying that we have gone through the Acts and whatever compliance is required, we are taking care of that. Wherever there are deviations, we write it in the covering note and state that we are taking corrective steps for the deviations. Like this we provide reports and correct information to the management."*

Clean Reporting

In the opinion of the VP (FAA), ECC is better than many others in the industry in the area of reporting. This is because the construction industry is vulnerable to so many "opportunities" to circumvent any of the statutory rules and regulations. In spite of this, the Company is said to be meeting all the compliance requirements. ECC also has a system of awarding the best presented accounts where all accounting standards are followed, where comprehensive compliance has been achieved.

Grievance Redressal

The President shared that if a shareholder writes a small grievance letter to the Company, it is given importance and attention. The Company has formed a Shareholders Grievance Redressal Committee. At the Mumbai Head Office,²⁰ there is also a Grievance Department.

Unique Approach to Tax Payment

In ECC, there is a general guideline : "In case of doubt, err on the government's side." In the event there is a conflicting opinion on paying taxes in a particular case, the senior management is instructed to pay the amount deemed to be owed despite another's reservation. This is the conservative approach ECC has constantly maintained.

Preparation to Follow any Recommendatory Statutes

There was a proposal to account for the forex derivative transactions as a part of the final accounts of the Company. On August 30, 2008, the Institute of Chartered Accountants of India (ICAI) stated that the relevant part of the forex transaction should be incorporated in that year. An accounting standard was introduced and ICAI stated that it was mandatory to implement the same from the year 2011. Instead of waiting for two years, ECC implemented it from the year 2008-09 with assistance. While advertising the accounts in the newspapers, the Company emphasized this practice first and foremost (though such transactions generated a negative impact and depleted Company's bottom-line).

Institutionalised Risk Management Process

The CMD of the Company, Mr. Naik, explained the risk management process of the Company: *"We have a highly institutionalised risk-management process – same for projects in India and outside. Our risk-management process goes through four levels of committees. Each of our 12 operating companies has a chief executive and their own board. For a small project of, say, INR 150-200 crore, the chief executive and his board can decide. When it*

²⁰ The Head Office of Larsen & Toubro is located at Mumbai, while the head office of the ECC Division is located in Chennai.

gets to INR 500 crore, a central financial officer and the chief risk officer sit for risk review. When it goes up to INR 1,000 crore, the president of the division and the group CFO are in the committee. And the moment it crosses INR 1,000 crore, I sit in the committee. Over half the projects that we bid for are INR 1,000+ crore. We had hiccups in the past, before risk management was institutionalised. Seven or eight years ago, our margins were about 4%. In the past 5 years we have raised that to 12%.”²¹

Organisational Strengths with Respect to Shareholders

The top management leaders of the Company are all professionals and not promoters. This is one of the greatest strengths of the Company. Unlike many other Indian organisations, the Directors hold less than 3% of the Company’s shares. The VP (FAA) stated: “*We are totally professional. The vision of L&T states: foster the culture of trust and continuous learning while meeting the expectations of the employees, stakeholders, and society. That’s the importance they are being given. The top management is committed to these organisational values.*”²²

The Head (POD) shared the example of the principles of the founders Mr. Holck Larsen and Mr. Soren Toubro by stating: “*Both Mr. Larsen and Mr. Toubro never wanted to and never did own any shares of L&T since they were owners of the company. When they passed away, they only had some double digit number of shares in their name which is just incidental. For all practical purposes, they never owned any shares. That is something I always quote in my sessions and call it ‘Standing Tall’ which is incidentally the name of a book written on L&T.*”²³

Responses to the Executive Perception Survey on the Shareholders

The responses to the Executive Perception Survey from the Company indicate the following to be its Strengths with respect to Shareholders (in order of importance as identified by the respondents):

Business Excellence. The organisation aims at achieving professional excellence in all its undertakings.

Shareholder Wealth/Value Maximisation. The primary aim of the organisation is “shareholder wealth/value maximization.”

Corporate Citizenship. The organisation endeavours to be acknowledged as a responsible Corporate Citizen in the business world.

Organisational Areas of Improvement with Respect to Shareholders

The major areas of improvement include:

Greater Allocation for CSR Initiatives

According to the VP (FAA): “*There are many organisations which adopt a village or undertake specific projects for women where in a village or town. They can be educated, and are given some employment. Even tree plantations, health awareness programmes, blood donation camps, eye camps, etc could be stated in greater detail. While there is a mention of this in the Annual Report, there could be a greater focus on such initiatives. There could also be*

²¹ Restructuring has been a way of life. *Business World*, August 10, 2009.

²² Personal Interview on May 30, 2008.

²³ Personal Interview on May 30, 2008.

*greater allocation of profits for such initiatives. However, we are already participating in such activities whenever the need arises. When there is an earthquake or a major accident, we go there and help the people.”*²⁴ Since it is mandatory, the CSR-related initiatives are stated in the Annual Report. However, in the opinion of the VP (FAA), there is scope for improvement in this area as well.

Dividends Payout

Another area of observation could be the Dividend Payout. During the period March 2005 to March 2009, the Dividend Payout decreased from 1375% to 525%. However in actual terms, the dividend increased from Rs. 357.21 crores to Rs. 614.97 crores.²⁵

Rising Interest Rates

Engineering and construction companies are facing pressure on their earnings due to the high interest rates on working capital. L&T's interest costs increased more than three-fold in the first 6 months of FY2009, which had an impact on its profit before tax (PBT).²⁶

Responses to the Executive Perception Survey on the Shareholders

The responses to the Executive Perception Survey from the Company indicate the following to be its Areas of Improvement with respect to Shareholders (in order of importance as identified by the respondents):

- **Triple Bottom-line Reporting.** The organisation can be seriously engaged in high quality “Triple Bottom Line” (dealing with the 3 dimensions – economic, social, and environmental) initiatives and reporting.
- **Information Dissemination.** There is a greater scope for sharing detailed, periodic, and pertinent information with its shareholders.

Government Management: An Introduction

The Company's Philosophy on Corporate Governance

The Company's essential character revolves around values based on transparency, integrity, professionalism and accountability. At the highest level, the Company continuously endeavours to improve upon these aspects on an ongoing basis and adopts innovative approaches for leveraging resources, converting opportunities into achievements through proper empowerment and motivation, fostering a healthy growth and development of human resources to take the Company forward.

– Larsen & Toubro's Annual Report

For any corporation, the Government is an important stakeholder. This is especially true in the highly regulated and complex construction industry in India. For L&T, the Government is an important stakeholder for two reasons. Firstly, it is an important regulatory authority and lawmaker on vital labour, reporting, and environmental issues which are crucial in its regular projects. Secondly, the Government of India and the different State Governments are very important customers for L&T as almost three-fourths of its projects are undertaken by the

²⁴ Personal Interview on May 30, 2008.

²⁵ Based on the information provided in the Capitaline Company Reports.

²⁶ Based on the information provided in the Datamonitor Company Report dated December 11, 2008.

Company for the Government and Government-owned institutions. Hence, catering to the needs of this stakeholder is important for the Company.

Based on discussions with the President, former Deputy Managing Director, and the Vice President of Finance, Accounts & Administration, a list of the each of these factors (i.e., Needs, Constraints, Alterables, Strengths, and Areas of Improvement (with respect to the Government Stakeholder) has been separately identified.

Needs of the Government

Top Management Said...

“Government is very important because you are running under the overall administration of the government. The government has its policies and for various reasons is getting elected. And they run their administration through well-selected officials. So one must be in tune with what they want. But at the same time, it is good to keep a little balance relationship with them. One cannot become a conduit for making extra money especially for political leaders and masters. Without doing such things you can be a support for the political leadership.”

— Former Deputy Managing Director, Larsen & Toubro Ltd.

The Government expects corporate payments in the forms of direct and indirect taxes. This is a very important need of the Government. There is yet another need with respect to the government, especially in India. With respect to the Indian construction industry, companies have to follow and fulfill 65-70 Acts. Describing how each of these are interrelated and complex, the VP (FAA) explained: *“Suppose we are doing the quarrying of a mine. We have to have proper licenses and have to take appropriate care to store the blasting material. Even for the movement of the vehicles, we have to take care of the RTO (Road Transport Office) formalities. Insurance has to be taken so that in case any mishap happens on site, the welfare of the concerned workmen is taken care of and the organisation doesn’t suffer any loss on account of that. Labour laws at site have to be followed. Industrial relationships have to be maintained without disturbing the general public. These are mostly related to the prescribed procedures of the government which we have to comply with. On the site we have to provide for the crèche for the babies of the workmen. There are so many such rules and regulations which we have to follow.”*²⁷

Constraints/Challenges of the Company

Time consuming governmental procedures are a constraint. Stating ECC’s philosophy with regard to this constraint the VP (FAA) said, *“We ensure that in spite of the time consuming nature of the procedures, we still abide by them. This is one reason why people say that L&T is a costly company. We have to take care of all these expenses. There are many*

²⁷ Personal Interview on May 30, 2008.

organisations who may say that I will do the job at 90% of what L&T does. But then they might follow short-cut methods. We don't follow such methods and would not like to.”²⁸

Alterables / Noteworthy Practices for the Government

Top Management Said...

“We must ensure that whatever rules prescribed by the government must be meticulously followed. Every statutory stipulation has some logic and background. We feel that we should be law-abiding and not flout any law. At L&T we don't want to bend anything in this respect.”

— President, ECC Division, Larsen & Toubro Ltd.

The following describe practices at ECC which are in accordance with the President's message.

Compliance with Governmental Policies

Sometimes there are situations where compliance with a particular act would lead to a certain amount of outflow and that would hit a company's bottom line. This would lead to poor returns to the shareholders. In such a case, some companies would try to avoid compliance and try to find some mechanism to have that outflow minimised. There are some agencies which help in this regard by incurring some expense. There are many who succumb to this shortcut and reduce the outflow. But the VP (FAA) asserted that L&T does not indulge in such unethical practices. It does not resort to short-cuts. It complies with governmental policies. Though, on occasion, there could be certain delays in compliance due to unavoidable circumstances.

Provident Fund Compliance

For anyone who has worked for more than 30 days, the Company may have to make a Provident Fund (PF) cut from his/her salary. The employees may not want this deduction as it reduces their net paychecks. However, the employee may not realise that the Company is also contributing an equivalent 10% and depositing the amount in a fund so that when (s)he retires, the PF amount would be received by that employee. However, the employee may not be willing to wait for that long as a 10% deduction on a salary of Rs. 100 would reduce a substantial amount from his/her salary. ECC has close to 3-4 lakh²⁹ labourers working for its division. The Company monitors the entire PF for all those people. Each worker has been given a passbook where his or her earnings can be recorded as well as that employee's and the Company's respective contributions towards the same. This latter sum represents the amount contributed by the employee's immediate employer (the sub-contractor). ECC is gradually developing a system where the worker directly receives the amount of the PF which can then be claimed from the PF office through the passbook system. In spite of this sizeable task, the Company is trying to incorporate this procedure into its usual operations. The VP (FAA) described: *“I can say that more or less in this regard we have taken care of all*

²⁸ Personal Interview on May 30, 2008.

²⁹ 1 lakh – 100,000.

the workers. In spite of their unwillingness and in spite of it being a cost for us, we are taking care of all this.”³⁰

Indirect Taxes Formula

For many decades, the construction industry was totally exempted from any sales tax levies. However, in 1984, the government introduced the rule that the construction business would also be subject to the assessment of sales tax. The VP (FAA) stated that it was ECC that provided the formula for calculation of tax in the construction industry: *“For example, if you raise a building, how do you value how much is the material, how much are the services, how much has been incurred on labour and how much on converting the material to make it usable for the construction purpose? So we have worked out a formula which is working and has been accepted for the construction industry even today.”*

Legal Department

The Legal Department at ECC extends advice and legal services to all the operational heads, business units, regions, overseas establishments, and also to the various joint venture companies on:

- Procurement and drafting transactions;
- Drafting, vetting, and preparation of various contract documents including project finance deals and risk management;
- Formulation claims and dispute avoidance;
- Dispute resolution, adjudication, arbitration, and conciliation;
- Legal and commercial issues of contract management and industrial relations; and
- Changes in legislation, statutory rules and regulations, and judicial precedents set by courts.³¹

Organisational Strengths with Respect to Government/Regulatory Authorities

Top Management Said...

“We have a basic discipline that we will not indulge in any corruption.”

— President, ECC Division, Larsen & Toubro

In the opinion of the VP (FAA), the Company has a proven track record of compliance and transparency. It has in place appropriate systems and procedures to facilitate this. This is a major strength of the organisation with respect to the government stakeholder which expects that such mechanisms ought to be in place. Even the credit ratings of L&T with respect to Fixed Deposits, Debt Programmes, Non-convertible Debentures, Short-term Debts, and like instruments are very high. Many of the instruments are rated at the “AAA”

³⁰ Personal Interview on May 30, 2008.

³¹ Based on the information provided in *Landmarks* (2007-2008), published by Corporate Communications Dept., L&T-ECC, Chennai.

level (AAA instruments are judged to offer the highest safety of timely payment of interest and principal).³²

The Government is one of ECC's major customers. The Company's management asserts that ECC makes things which make India proud. The earlier logo of the Company which highlighted this sentiment was "Builders to the Nation." Nearly 70-75% of ECC's work is commissioned by the Government. With respect to international projects, ECC produces most of its work for the Government of UAE. In India, most of its work is for Public Sector Undertakings³³ like the Oil and Natural Gas Commission (ONGC), Indian Oil Corporation (IOC), Bharat Heavy Electricals Ltd. (BHEL), state electricity boards, National Highway Authority of India (NHAI), Airports Authority of India (AAI), and similar agencies. Contributing to nation-building and participating and facilitating the completion of projects of national significance and importance are considered by the Company as its main strength.

Many times important Government projects have to be completed in very short time periods. Highlighting one such project undertaken by ECC for the Government of Andhra Pradesh, the former Dy. MD commented: *"The political leadership wants some immediate project to be taken up. For example, the Government of Andhra Pradesh wanted a project to be taken up for the Tirumala Hills³⁴. The then Chief Minister of Andhra Pradesh, Mr. Chandra Babu Naidu, telephoned me one morning and said that the temple atop the hill does not have more than two months water and as a result all pilgrims will get affected and that you must immediately help. Normally it takes a year to do such a project. However, we went to his help and found a solution. We said that 60 days is impossible but would probably try to complete in 90 days. We combined the efforts of the other contractors and also invited other politicians including the opposition because it is the state requirement that the public be taken care of. The Opposition Parties also provided support and we finished the project in a record time of 77 days. And the then Prime Minister of India, Mr. Atal Bihari Vajpayee, came to Tirumala and appreciated how well this project was done. And we attribute that if this could be achieved, it is God's grace and not just our efforts. So it is such an impossible task but it happened. Similarly is the case with the Sri Sathya Sai Super Specialty Hospitals³⁵ at Puttaparthi³⁶ and Bangalore³⁷ and the Sri Sathya Sai Drinking Water Supply Projects³⁸ in the Districts of Anantapur, Medak, Mahbubnagar, East and West Godavari, and also to the city*

³² Based on the *Capitaline Database Company Report* – Information dated May 25, 2009.

³³ Public Sector Undertakings or PSUs are organisations unique in the Indian context. These have been set up by the Government of India in crucial industry categories where private investment may not be easily forthcoming primary because of the heavy investment involved and also because of the long gestation periods. The PSUs also have social objectives such as providing secured employment opportunities. Because of the protection they enjoy from the government and lack of competition, some of the PSUs have not been performing at optimal levels and some have also incurred heavy losses. On the other hand, there are many PSUs which have adopted modern management practices and have initiated benchmark practices with respect to multiple stakeholders.

³⁴ A highly revered Hindu Shrine in South India.

³⁵ These are world class institutes of higher medical sciences providing tertiary level medical care absolutely free of cost to the patients

³⁶ Inaugurated by Prime Minister of India, Mr. P.V. Narasimha Rao, on November 22, 1991; details can be accessed at <http://psg.ssihms.org.in/>

³⁷ Inaugurated by Prime Minister of India, Mr. Atal Bihari Vajpayee, on January 19, 2001; details can be accessed at <http://wfd.ssihms.org.in/>.

³⁸ The largest drinking water supply projects undertaken by a non-governmental organisation in the world; details can be accessed at http://www.srisathyasai.org.in/pages/service_projects/anantapur.htm.

*of Chennai. Many times it appears that things are happening on their own, but God's grace is always needed for accomplishment of any task."*³⁹

Responses to the Executive Perception Survey on the Government

The responses to the Executive Perception Survey from the Company indicate the following to be its Strengths with respect to Government (in order of importance as identified by the respondents):

- **Spirit of Law.** The respondents opine that the organisation sincerely abides by all the laws and regulations of the government both in letter and spirit.
- **Tax Payment.** The respondents assert that the organisation gives high priority to contributing its share to the national exchequer in the form of taxes and other social or governmental dues.
- **Policy-Making.** The policy initiatives of the Company are based on cordial relations with the Government, chambers of commerce, and policy-influencing bodies like CII, FICCI, and ASSOCHAM.

Organisational Areas of Improvement with Respect to the Government

The areas of improvement with respect to the Government are similar to those identified with respect to the shareholders. These include the need for detailed CSR Reporting beyond the requirements of the annual report and also a need for providing for greater allocation for CSR projects.

Responses to the Executive Perception Survey on the Government

The responses to the Executive Perception Survey from the Company indicate the following to be its Areas of Improvement with respect to Government (in order of importance as identified by the respondents):

- **National Priorities.** The respondents opine that the objectives of the organisation can be formulated so as to be in consonance with broad national priorities.⁴⁰
- **Joint Activities.** The organisation can share its facilities and skills (R&D facilities, management expertise, etc.) for government-sponsored social initiatives (such as literacy drives, medical camps, village adoption, etc).
- **Participation.** The organisation can have a greater representation on critical advisory bodies, commissions, and think tanks.

Reflections

By undertaking the above-mentioned analysis (based on the Needs, Constraints, Alterables, Strengths, and Areas of Improvement), greater visibility of the Shareholder and Government-related issues of the organisation can be highlighted for appropriate organisation-wide and industry-specific interventions.

³⁹ Personal Interview on October 25, 2009.

⁴⁰ This is an important point to note that though most of the projects undertaken by ECC are of national importance, the Company executives who have responded to the Survey consider this as an area of improvement.

Governance in corporate organisations should have a balance of the letter of law and its spirit. Such an approach would be beneficial to corporate organisations in their own long-term interest. This case highlights some of the initiatives undertaken by Larsen & Toubro and its ECC Division with special focus on the Shareholders and Government.

The Company has in place a number of well-monitored processes and has also been attempting to be above industry standards in terms of its reporting and accounting practices and their presentation. ECC's concern for its employees and the local community and society at large is visible through its initiatives. The top priority accorded by the Company to certain projects of national and social importance irrespective of the returns from the same, reveals the Company's holistic approach to business and its commitment to nation-building. The opinions expressed by the senior management of the organisation also clarify the management's philosophy and approach on important issues relating to these stakeholders. From the issues discussed through this case study, it can be said that the Company is an example of Good Governance and Business Ethics.

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Biographical Note

Dr. Shashank Shah completed his Ph.D. in the area of Corporate Stakeholders Management from the School of Business Management, Sri Sathya Sai Institute of Higher Learning (deemed to be University), Prashanti Nilayam, Andhra Pradesh, India in 2010 and was awarded the *Association of Indian Management Scholars International Outstanding Doctoral Management Student Award 2010* at the Indian Institute of Management Ahmedabad in 2011. He was also awarded the *HR College Golden Alumnus Award* by the Honourable Sheriff of Mumbai for his outstanding research achievements in 2011. He has been awarded the *Governor's Gold Medal* for standing first at the Master of Philosophy in

Business Management Programme in 2006 and the *President of India Gold Medal* for standing first at the MBA Programme at the University in 2004.

He has published over 60 research-based papers in reputable national and international journals and conferences in the areas of Corporate Governance, Corporate Social Responsibility, Corporate Stakeholders Management, and Values-Based Education. He has also co-authored 4 books in the areas of Corporate Social Responsibility, Corporate Stakeholders Management, and Integral Education. He has compiled and edited 12 books and 2 monographs in the areas of Indian Culture, Spirituality, Values-Based Management, and Education.

Currently, Dr. Shah is a Post-Doctoral Fellow at the Department of Management Studies, Sri Sathya Sai Institute of Higher Learning, and is also the Coordinator and Editor for the University Publications Division. He has recently been appointed as a Member of the Review Board, Journal of Human Values (Sage Publications), Management Centre for Human Values, Indian Institute of Management, Kolkata, India.

He can be contacted at:

Sri Sathya Sai Institute of Higher Learning
Department of Management Studies
Vidyagiri, Prashanti Nilayam – 515134
Anantapur District, Andhra Pradesh, India
Email: shashankjshah@gmail.com; shashankshahjs@sssihl.edu.in
Telephone Number: +919441034682

Dedication

The author humbly dedicates this endeavour to Sri Sathya Sai Baba, Revered Founder Chancellor, Sri Sathya Sai Institute of Higher Learning. He is also grateful to his parents – Mrs. Shefali Shah and Mr. Jagesh Shah for their loving support in his academic endeavours.

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