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CORPORATE GOVERNANCE – NEW CHALLENGES

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Abstract: *Corporate Governance in different countries is the biggest challenge faced by the business world. It is a Universal Phenomena so corporate governance lies at the heart of the most important issues of the society. Different models for corporate governance were developed. So statutory duties of director and nature of independent directors and adoption of corporate social responsibility are different dimensions of corporate governance.*

Key words: *Corporate Governance, Corporate social Responsibility, Duties of Director, Independent Director, Faith, Fairness, Accountability, Integrity, Transparency and Honesty.*

Introduction

Corporate governance is a universal phenomenon. Yet there is no concrete, precise and universally accepted definition of corporate governance. Mr. Gourvevitch and Shinn lucidly outlines the concept of corporate governance in his book 'Political Power and Corporate Control: The New Global Politics of Corporate Governance' as:

"Corporate governance – the authority structure of a firm – lies at the heart of the most important issues of society"… such as "who has a claim to the cash flow of the firm, who has a say in its strategy and its allocation of resources." The corporate governance framework shapes corporate efficiency, employment stability, retirement security, and the endowments of orphanages, hospitals, and universities. "It creates the temptations for cheating and the rewards for honesty, inside the firm and more generally in the body politic". It "influences social mobility, stability and fluidity… It is no wonder then, that corporate governance provokes conflict. Anything so important will be fought over… like other decisions about authority, corporate governance structures are fundamentally the result of political decisions".

Due to the divergent practices followed by management of companies in different countries, attempts have been made time and again, however, to define the term corporate governance across the globe. The first initiative in this respect was taken up by Sir Adrian Cadbury who defines Corporate Governance as[1], "the system by which companies are directed and controlled". He further enunciates it as a system of structuring, operating and controlling a company with the specific aims of: Fulfilling long-term strategic goals of owners; Taking care of the interests of employees; a consideration for the environment and local community; Maintaining excellent relations with

[1] Cadbury, A. (1992). Report of the Committee on the Financial Aspects of Corporate Governance: The Code of Best Practice. Gee & Co. Ltd.

customers and suppliers; Proper compliance with all the applicable legal and regulatory requirements. In similar lines, in the year 1999, The Organization for Economic Co-Operation and Development (OECD) defined Corporate Governance as, "Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance".

According to World Bank, Corporate Governance is blend of law, regulation and appropriate voluntary private sector practices, which enables the corporation to attract financial and human capital to perform efficiently, and prepare itself by generating long term economic value for its shareholders, while respecting the interests of stakeholders and society as a whole. According to Milton Friedman, a Nobel Laureate, 'Corporate governance is to conduct the business in accordance with owners or shareholders desires, which generally will be to make as much as money as possible, while conforming to the basic rules of the society embodied in law and local customs'. This definition is based on the economic concept of the market, value maximization that underpins shareholder capitalism. In the present day context, unlike the definition of Cadbury and OECD, Friedman's definition is narrower in scope. Over a period of time, the definition of 'corporate governance' has been widened so as to include not only the shareholders but many stakeholders.

Shareholders Model of Corporate Governance

The Shareholder Theory was originally propounded by Milton Friedman. According to him, the businesses do not have any moral obligations or social responsibilities at all, other than to maximize their own profit. Friedman opines that shareholders are those individuals who own a business, or a part of a business. As owners, the shareholders of business have employed certain managers to run their company for them; and, there is but one goal that they have set for these managers to achieve: Profit. If a business does not profit, it inevitably fails. Therefore, since the sole purpose of a business is to profit, and since the sole desire of those who own businesses is also to make a profit, Friedman infers that employees of any business are obligated to do one and only one thing: Maximize that business's profit. This view of him was more popularly called as "Shareholder Theory", which is now known as the shareholder model of business.

Stakeholders Model of Corporate Governance

These propositions have been, however, criticized earnestly. In this theory, the focus is more on short term strategy because concentrating more on the shareholders will lead to the satisfaction of shareholders and will lose importance in the long run. That apart, continuous pressure on the managers of the company to increase shareholder value always will lead to a greater risk. Failure on the part of the company to fulfill such a target will result in the corporate demise. For example, Satyam Scam which involved the continuous effort to increase

the returns to the shareholders led them to manipulate the company's accounts.

This theory was propounded by Edward Freeman in 1984. Stakeholder's theory is the modern extension of the older concepts of business which stipulates that doing business is not just restricted to making money but extends beyond it. This theory, unlike shareholders theory, states that a company owes a responsibility to a wider group of stakeholders, other than just shareholders. In other words, the concept of stakeholder theory is a generalization of the notion of the shareholder. Freeman intends to replace the notion that the managers of the company owe a duty towards the shareholders with the concept that managers bear a fiduciary relationship to the stakeholders. Stakeholders, here, means any person/group which can affect/be affected/respected by the actions of a business. This includes customers, employees, suppliers, creditors and even the wider community and competitors.

Symmetric Approach

Despite the challenges in the Shareholders Model of Corporate Governance or Stakeholders Model of Corporate Governance, both the model seems to be the two sides of the same coin. Though the shareholders model seeks to protect the shareholder value while the stakeholder model intends to safeguard the interest of all the stakeholders but ultimately both are concerned with fulfilling the purpose of the company and strategies to improve its competitive position. As regards the best among the two models, there are few reservations developed over a period of time. But businesses, realizing that there are disadvantages of concentrating solely on the interests of shareholders, now see the shareholders model of corporate governance as the historic way of doing business.[46] Similar is the case with the Stakeholder's model, wherein, prioritizing the interest of stakeholders becomes quite difficult. Harmonizing both the approaches would better suit the present condition. Therefore, efforts are made in certain parts of the globe to adopt the stakeholders approach. The same efforts are reflected under new corporate law, the Companies Act, 2013, which balances both the models. The Companies Act, 2013 seems to espouse the Stakeholders model without giving away the Shareholders model[2].

The Companies Act, 2013 incorporates certain provisions which balance the interest of stakeholders and shareholders and needs special mention:

Statutory Duties of Director to safeguard the interest of stakeholders

Under the Company law, the Director acts as an agent and trustee of the company. The director is also sometimes described as Managing Partner. By virtue of the position he holds in the Company, the Companies Act, 2013 expressly mandates the directors to comply with certain duties in the discharge of their functions. Prior to the Companies Act, 2013, the statutory duties of the director were looked upon and adapted from common law principles. The Companies Act, 2013 now confers various duties on the directors; any default by the concerned is penalized. More importantly, one amongst such duties of the director is enumerated under section 166(2) of Companies Act, 2013. This section

[2] Kumar, P. (2017). Balancing stakeholders and shareholders: A critical analysis of the Companies Act, 2013. Company Lawyer, 38(9), 264-270.

mandates that a director of a company shall act in good faith in order to promote the objects of the company and for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of the environment. This means that, in promoting the objects of the company, shareholders are not the only bodies that deserve the attention of directors; even the employees, the community and the environment are to be equally considered by the directors. Therefore the Companies Act, 2013 adopts the pluralistic approach by placing all the interest (Shareholders or stakeholders) on par without creating any hierarchy.

The provision also further says that any default by the director of the company in complying with the duty shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees. Thus the section intends to protect the interest of not only the shareholders but stakeholders as well.

Independent Directors and Stakeholders protection

Code of Conduct has been imposed on the Independent director under Schedule IV of the Companies Act, 2013, which ones again highlights the legislative intent to protect the interest of stakeholders. Importantly, Paragraph II of the Code of Conduct of stipulates the roles and functions of the Independent director wherein, it mandates that independent director shall in discharging their functions shall 'safeguard the interest of all the stakeholders, particularly the minority shareholders. Further, it also requires that independent director to 'balance the conflicting interest of the stakeholders'. This means that, the minority shareholders seems to have been included in the wider categories of the stakeholders.

Adoption of Corporate Social Responsibility (CSR) Policy

Another provision of the Companies Act, 2013 which incorporates the Stakeholders model of corporate governance is section 135 of Companies Act, 2013 which mandates for the adoption of the concept of Corporate Social Responsibility. According to this section, every company with the targeted profit of net worth of rupees five hundred crores or more, or turnover of rupees one thousand crores or more or a net profit of rupees five crores or more during any financial year has to mandatorily contribute 2% of its profit on those activities which are enumerated under the Schedule VII of the Companies Act, 2013. This is not the exclusive list on which the company is required to invest for safeguarding the interest of the stakeholder. The company can invest on any of the areas which it feels fit in the interest of society. The only idea is to mandate the companies to bear the social responsibility and serve the community in which they are based. The true realization of the noble cause would ultimately rely on the determined and focused approach of the managers of the company.

Thus, as our Ex-Prime Minister, Mr. Atal Bihari Vajpayee rightly remarked that, corporate governance is a conscious, deliberate and sustained effort on the part of the entity to strike a judicious balance between its own interest and the interests of various constituents on the environment in which it is operating. Therefore, considering the present legal stand in adopting the Stakeholders model of corporate governance seems to be more suitable for the sustainable corporate sector.

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Basic Principles of Corporate Governance: 'FAITH'

Corporate governance is not just about corporate management or strategy to make the company attain the highest goals. It is something much broader to include a fair, efficient and transparent administration to meet certain well-defined objectives. It is a system of structuring, operating and controlling a company with a view to achieve long term strategic goals to satisfy shareholders, creditors, employees, customers and suppliers, and complying with the legal and regulatory requirements, apart from meeting environmental and local community needs. When it is practiced under a well-laid out system, it leads to the building of a legal, commercial and institutional framework and demarcates the boundaries within which these functions are performed.

Fairness

The term fairness literally means just treatment or impartial treatment. The term fairness used in reference to corporate governance means treating all the stakeholders equally without discrimination amongst the shareholders and other stakeholders. This includes the fair approach in ensuring the rights of the shareholders, majority and minority and stakeholders in all the transaction entered amongst the company and other parties. Here, the term Stakeholders involves broader meaning which not just includes the shareholders but all the other internal and external stakeholders.

Accountability

The term accountability generally means the fact of being accountable or responsible. To account is to give a description or depiction of something that happens or happened. Accountability would also literally mean the process of giving an account of an event. In the companies, the management of the company should be accountable to the board, while, the board should be accountable to the shareholders. Corporate accountability refers to the obligation and responsibility to give an explanation or reason for the company's actions and conduct.

The Company acts through the natural persons, so called director and managers of the company. They owe the responsibility to act in the best interest of the company. Any contrary act would make them accountable to the shareholders. There are twin advantages of upholding accountability in the company. One, it reduces the risk of conflict which may likely to arise due to the separation of management and control. Two, it is a key to prosperity. If there is poor accountability by players in the economy, stakeholders may lose the confidence, which they would have otherwise had in the company and hence become reluctant to put in their best.[68] Therefore, there cannot be two opinions that holding the board and the managers' accountable to all shareholders is the essence of corporate governance."

Integrity

Integrity implies the quality of having strong moral and ethical principle. Ethical conduct promotes corporate success. It motivates the employees, managers and every person acting on behalf of the company to adopt the ethical approach. Good corporate governance and ethical conduct is a good policy for achieving success. Practically speaking, it is not generally possible to legislate on all matters and implement that legislation in its true spirit. What actually matters is how a person acts consciously. That is where, Russian Author rightly remarks, 'A Clear Conscience is the softest pillow'. Therefore, every member behind the

effective functioning of the company must act with integrity and the same contributes to the company socially, ethically and economically in the long run.

Transparency

Another component of corporate governance is to provide information about the company's activities, what it plans to do in the future and any risks involved in its business strategies, which thereby amounts to transparency. The term 'Transparency' means openness, a willingness by the company to provide clear information to shareholders and other stakeholders. It can be any disclosure of reports by the company either on CSR or regarding the operational and financial information, or any decisions taken beyond the closed doors of board room, or related party transaction etc., however, the averments so made should be truthful and accurate and, must be made in open and free environment and in socially responsible manner. In brief, the transparency can be ensured by disclosure of all relevant information regarding the financial condition of the company and the internal process of management, oversight and control. In the absence of which, the shareholders may lose confidence in the entire corporate sector. One good example for it would be Satyam Scam, which reserved the discloser of all important matters to it and cooked it up. The day finally the chairman of the company decided to maintain the transparency by way of confession entire company was doomed and reportedly involved the accounting fraud worth Rs 7,000 crore ($1.1 billion) resultantly shook the confidence on the corporate sector.

Honesty

Honesty means the quality of being ethical, noble and righteous. Whenever the company or any person on behalf of the company acts in a combination of all the four mentioned components would automatically be an honest act of an individual. This would ultimately result in the harmonious development of not only the company but of the shareholders, managers, society and all other stakeholders. Therefore, this factor bridges the gap between the company and the scattered shareholders. Develops the bond and gradually acquires the trust and confidence, which is the true asset of the company. The honest approach of the managers of the company can be gradually adopted and developed in carrying out all the affairs of the company.

Therefore, the businesses are expected to adopt these principles in their blood and veins. If incorporated, would not need any external mechanism or body or any other set of codes to ensure the corporate governance, corporate sustainability and excellence would follow automatically.