

Internal Stakeholders' Perception of Current Corporate Governance Regime



Management

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ABSTRACT

The objective of this paper is to evaluate the internal stakeholders' perception of the current corporate governance regime. The respondents feel that there is a need to make the internal and external corporate governance better, enhance the standards of accounting, audit and disclosures, prohibit or check related party transactions, improve relation between board and management and conduct and publicize corporate governance ratings of companies. It is extremely important for corporates to develop, ensure and follow a corporate governance regime for the benefit of all its stakeholders. At the same time, it is important for all stakeholders to participate and help the business organisations in doing so.

INTRODUCTION

If Indian securities market is a model for others, it is natural that it leads in the area of corporate governance. The initiatives for improvement in corporate governance regime are coming mainly from three sources namely, Market, Regulator and Legislature. While the legislative initiative is directed towards bringing about amendments to the basic law – India's Companies Act - to include certain fundamental provisions related to corporate governance, other dynamic aspects of corporate governance such as disclosures, accounting standards, etc., the regulatory initiatives include bringing about amendments to the Listing Agreement. The most important initiative comes from market forces and mechanisms which encourage and insist on the management's commitment to improve the quality of corporate governance. While the corporate governance is expected to enhance the interests and fulfil the aspirations of all stakeholders, it does not necessarily happen always. While the ultimate purpose of all corporations is to create wealth for its shareholders, it is important to recognise that shareholders are indeed the residual stakeholders. The obligations towards the contractual stakeholders such as customers, employees, vendors, creditors and the society get precedence over the interests of the shareholders. It is expected that the strength of stakeholder relationships would add to/impede future wealth creation by the corporation. The Corporate governance framework must be such that wealth created is evenly distributed across all classes of stakeholders, management quality must be such that it is able to adapt the same to match the dynamics of the business environment and lastly, all these impact stability of future wealth creation.

Since 2000, despite many initiatives and resultant changes, it is generally felt that corporate governance is about abiding by the rules and laws i.e it is practically followed merely in letter and not in spirit. In the light of the above, it is important to assess the perception of various stakeholders regarding the present corporate governance regime.

REVIEW OF LITERATURE

In the early twentieth century it was seen that companies were focusing only on shareholder wealth maximization and other stakeholders were ignored (Bhasa 2003). Later it was suggested that all parties who are either directly or indirectly affected by the corporation's operations are to be compensated either in pecuniary or non-pecuniary terms. This line of thought led to the stakeholder theory that corporations must attempt to maximize stakeholders' interests instead of plainly focusing on shareholders' benefits. The concept of Stakeholder theory is ascribed to R. Edward Freeman (1984) whose original concept was that managers have a moral obligation to consider and appropriately balance the interests of all stakeholders. Evan and Freeman (1993) stated, "A stakeholder theory

of the firm must redefine the purpose of the firm...the very purpose of the firm is...to serve as a vehicle for coordinating stakeholder interests" (pp. 102-103). Stakeholder theory expresses the idea that business organizations are dependent upon stakeholders for success, and stakeholders have some stake in the organization. Stakeholder theory is now foundational to business ethics courses in MBA programs (Carroll & Buchholtz, 2006; Jennings, 2002). Schneider (2002) posits that stakeholder theory extends the concept of ownership of the firm beyond that of the traditional legal or economic owners of the firm, who become a stakeholder by contribution of capital or other means that results in equity ownership

The question of who is a stakeholder is controversial. Questions arise such as whether stakeholders represent a broad class of those who are affected by or affect the corporation (Evan & Freeman, 1993, p. 79), or are only "those individuals and constituencies that contribute...to [the firms'] wealth-creating capacity and activities" (stakeholder theory includes only those who affect the corporation and its profits, then it becomes subordinate to shareholder value theory, not an Post, Preston, & Sachs, 2002, p. 19). If alternative to it. A broad framework of stakeholders is offered by Wheeler and Sillanpää (1997). They include four categories of stakeholders: primary social, secondary social, primary non-social and secondary non-social. Primary stakeholders are vital to a corporation's success and secondary stakeholders are less influential. While stakeholder theory began as an alternative to shareholder value theory, it has diverged along two paths: normative and instrumental. The normative stakeholder path continues in the tradition of a view of the firm in relationship to its various stakeholders with no stakeholder having preeminence. The instrumental path, however, attempts to connect stakeholder management to wealth creation. In doing so, instrumental stakeholder theory becomes a subset of shareholder value theory. Goodpaster (1991) builds on the work of Freeman (1984) and divides stakeholder theory into three approaches of strategic, multifiduciary, and a synthesis. The strategic approach to stakeholder theory views stakeholders instrumentally. Stakeholders are means to generating a profit for shareholders. Stakeholders might be considered depending on the extent they can positively or negatively influence profits. The multifiduciary approach views the firm as having a fiduciary responsibility to all stakeholders, not just shareholders. The concerns of the broader community of stakeholders are taken into account and no one stakeholder is assumed dominant. The synthesis approach combines elements of both. The corporation has a moral and ethical duty to stakeholders, but the fiduciary responsibility remains solely to shareholders.

The general type of maximization that companies pursue is stakeholder-owner maximization. Maximization of shareholder

value is a special case of stakeholder-owner maximization (Mygind 2009). Only under quite restrictive assumptions is shareholder maximization larger or equal to stakeholder-owner maximization. Total stakeholder maximization is calculated on the sum of the returns to all stakeholders including shareholders. Because of problems of measurement and practical application, total stakeholder maximization is difficult or impossible to achieve. Firms generally approximate to total stakeholder maximization by implementing stakeholder-owner maximization under constraints defined by other stakeholder interests. With stronger regulation, pressure from different stakeholder groups, and more emphasis on corporate social responsibility, the decision area where the company can simultaneously maximize stakeholder-owners' returns and stakeholder interests will be increased.

The review of literature indicates that even though there is a plethora of research literature on CG, most of the studies have been done on its conceptual framework, the practices of CG, and the Chief Executive Officer characteristics influencing company's performance, the role of the board and shareholders wealth maximisation for the efficient markets of the developed nations of the world like US, UK etc., In India, very limited research work is done on perception of the stakeholders on CG practices. Hence this study is taken up to identify and analyse the stakeholders' perception towards their level of expectation and satisfaction on CG practices in India.

OBJECTIVE

The underlying aim of the minor research project is to explore and evaluate the stakeholders' perceptions of the current corporate governance regime in India. The hypothesis/proposition taken for the study is:

Hypothesis: There is no positive perception of employees towards current corporate governance practices and strategies

RESEARCH METHODOLOGY

In order to analyse the stakeholders perception on current corporate governance regime, various components and issues were identified from the literature review. A structured questionnaire about the perception of employees on various aspects of corporate governance like components and performance implications of corporate governance in India, current status and major issues in corporate governance, Indian corporate governance strategies and practices, key players of corporate governance was prepared based on the literature review and objective laid down for the study. The corporate governance assessment instrument consisting of 54 items on a five point Likert scale. The primary data has been gathered through electronic correspondence i.e LinkedIn and other professional networks. The respondents were the employees between the age group of 26-45. Nearly 220 respondents were collected and only 185 were used for data analysis after data cleaning. The tool used for data analysis was Confirmatory Factor Analysis to gauge the perceptions of employees towards corporate governance framework in India.

RESULTS

Most of the respondents were male (87 per cent) as compared to 13 per cent of females. With respect to qualification, most of the respondents had done post graduation (77.29 percent) and out of the rest only 12 had professional degree while 26 were graduates. Nine factors with minimum factor loading of 0.586 were extracted and ten statements did not fall in any of the factors. Internal consistency and Reliability of the scale is tested using the Cronbach's Alpha. The value of Cronbach Alpha is 0.680. The grouping of items in the extracted factors together with factor loadings, eigen values and the percentage of variance explained is shown in the table.

DISCUSSION

This exploratory study investigated the stakeholders perception on corporate governance regime in India and identified nine factors which are as follows:

- Regulation
- External players
- Way ahead
- Components
- Hindrances
- Internal Players
- Impacts
- Role of stock exchanges
- Social factors

With regard to the regulations of corporate governance, the majority of respondents indicate that Indian corporate governance is comparable to that of Asian countries and other developed countries. Further, the existing regulations are appropriate to improve corporate governance and corporate social responsibility. The existing corporate governance rules are being implemented by most of the listed companies and there is no need for more rigorous CG rules. The external players in CG framework in the order of importance are Judiciary, Reserve Bank of India, Civil activists, the Institute of Chartered Accountants of India, Other professional institutions, outside directors, Securities and Exchange Board of India. These institutions or bodies are the monitoring institutions which need to do their duty and exercise their powers judiciously. The outside directors are placed with other external players thereby reinforcing the fact that the non-executive and independent directors are accountable and responsible for well-functioning of those companies in which they sit on board. The respondents feel that there is a need to make the internal and external corporate governance better, enhance the standards of accounting, audit and disclosures, prohibit or check related party transactions, improve relation between board and management and conduct and publicize corporate governance ratings of companies.

Another important aspect identified was the components of corporate governance which include financial reporting framework, ownership structure, corporate culture and practices, internal management regulations, policies and procedures and lastly the code of best practices. A group of items namely, inadequate protection of minority shareholders rights, insider trading, lack of integrity and ethics among top management, Drain off of funds through associate or subsidiary companies, Conflicts of interest of directors, Lack of transparency in financial reporting are perceived as hindrances in the CG framework. Lack of proper balance between executive and non-executive directors in the board, Independent directors do not exercise true independence in decision making, Lack of transparency about directors' remuneration, Reducing ownership concentration by tightening control on cross shareholding and pyramids ownership structure etc. is another factor named as internal aspects of CG. Of the impact of corporate governance, the respondents agreed on good governance leading to reducing share price volatility, reducing political or regulatory intervention and increasing market value of shares.

The survey found that the respondents strongly feel that role of stock exchanges in another important aspect in strengthening CG framework. Intervention by stock exchanges ensuring transparency would lead to improved access to new capital, improved ability of companies to generate equity capital. Corporate governance regime would improve society by enforcing culture and value system and improving relationship among core stakeholders.

CONCLUSIONS, RECOMMENDATIONS AND LIMITATIONS

It is extremely important for corporates to develop, ensure and follow a corporate governance regime for the benefit of all its stakeholders. At the same times it is important for all stakeholders to participate and help the business organisations in doing so. The present study attempts to understand the perception of employees with respect to the present corporate governance regime in order to provide a direction to develop, ensure and follow a corporate governance regime for the benefit of all its stakeholders.

The findings of the study will contribute to the future development of corporate governance regime in India. The findings will help the regulators, policy makers, stock exchanges and think tanks to rethink their priorities and develop rules or codes of best practices on corporate governance that would respond to the ever increasing need for good governance. This is a study of employees perception of corporate governance regime in India so the findings do not apply to other countries and the perception of other stakeholder groups should also be considered in the future research.

The genesis of the stakeholder theory is the trust and commitment on the part of management. It broadens the managerial responsibility to various stakeholder groups, besides the shareholders. Based on the findings, the board of director's should work ethically and in the interests of all. Their decisions should be independent and fair. They must understand their accountability and responsibility towards all stakeholder groups. Another aspect is the vigilance and enforcement mechanism of the owners in ensuring independence and commitment of board of directors and strengthening minority shareholders protection mechanism.

Grouping of Factors	Factor loading	Percentage of variance explained	Eigen value
Factor One Regulations		11.904	6.428
The standard of CG in India is comparable to that of Asian countries	.797		
The existing CG regulations are adequate to ensure good CG in India	.792		
CG will improve corporate social responsibility	.761		
The existing CG regulations are effectively implemented by most India firms	.740		
Most listed companies in India could have done more to strengthen CG	.596		
The standard of CG in India is comparable to that of a developed country	.589		
The stock exchanges should have introduced more rigorous CG rules	.500		
Factor Two External Players		8.745	4.722
The Judiciary	.759		
Reserve Bank of India	.747		
Civil activists (such as investors association minority shareholder etc.)	.738		
The Institute of Chartered Accountants of India	.736		
Other professional institutions (NISM, MCA,IICA)	.717		
Outside directors (Non- executive and independent directors)	.715		
Securities and Exchange Board of India	.487		
Factor Three Way ahead		8.272	4.467
Enhancing the standards of accounting, audit and disclosures	.837		
Making the external corporate governance mechanism work better (E.G. Enact specific regulations, monitoring, facilitating hostile acquisitions etc.)	.757		
Prohibiting or tightly controlling some types of related party transactions (E.g. lending to directors, cross guarantees of repayment etc.)	.686		
Improving ineffective connectivity between board and management	.562		
Making the internal corporate governance mechanism work better. (E.G. Effective board function, active shareholder participation etc.)	.523		
Conducting and publicizing corporate governance rating of companies	.516		
Factor Four Components		5.742	3.101
Financial reporting framework of the country	.780		
Ownership structure of the companies	.772		
Corporate culture and practices	.664		
Companies internal management regulations, policies and procedures	.611		
Code of best practices of corporate governance	.527		
Factor Five Hindrances			
Inadequate protection of minority shareholders' rights	.767	4.665	2.519
Insider trading	.760		
Lack of integrity and ethics among top management	.643		
Drain off of funds through associate or subsidiary companies	.603		
Conflicts of interest of directors	.473		
Lack of transparency in financial reporting	.415		
Factor Six Internal Aspects			
Lack of proper balance between executive and non-executive directors in the board	.731	4.336	2.341
Independent directors do not exercise true independence in decision making	.713		
Lack of transparency about directors' remuneration	.658		
Reducing ownership concentration (E.g. tighter control on cross shareholding and pyramids ownership structure etc.)	.437		
Factor Seven Impacts			
Reduce shares price volatility	.717	3.448	1.862
Reduce political or regulatory intervention	.691		
Increase market value of shares	.661		
Factor Eight Role of stock exchanges			
Improve access to new capital	.762	3.158	1.705
Improve ability to generate equity capital	.732		
Stock exchanges- NSE-BSE play an important role in strengthening corporate governance	.468		
Factor Nine Social factors			
Culture and value system of the society	.745	2.734	1.476
Improve financial performance	.715		
Relationship among core stakeholders	.450		

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