Corporate Governance – Looking Back, Looking Forward.

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"The further back you can look, the further forward you can see". Winston Churchill.

INTRODUCTION

Corporate governance has always lagged political governance. Ever since businesses were first incorporated, they have turned to the structure of governance prevailing in the political world for a suitable model to copy from. The first business corporations came into being over four centuries ago. In the years since, politics and its governance has changed substantially. Corporate governance, reluctantly it would appear, has followed suit, often after a lag of many decades if not of centuries. In recent years the structures of governance in the political world are undergoing substantial changes. Many of those changes are resulting in the undoing of developments that occurred after World War II. Corporations that are yet struggling to digest the recent consequential changes in their own governance, could revert to a structure we have all been familiar with. Intertwined into this is Capitalism and its dominating influence on both forms of governance.

It is fashionable, especially in recent years, to draw inspiration, howsoever tortuous and tenuous, from India's Vedic past to justify or illustrate any article. I could pretend to be be inspired by shrenis, Kautilya's Artha Shastra, Vedic nigamas, the gana sanghas during the Buddhist period and other such ancient Indian corporate forms to flaunt my knowledge of Indian history. But that would be false. Indian business corporations came into existence with the passing by the British of the first companies act in 1857. This was modelled on the first, then recently legislated, companies act in England. Ever since, all significant developments in Indian corporate law have been inspired by developments in Judeo-Christian, especially Anglo-Saxon, countries. I am not aware of any known Vedic influence on our company legislation. This article is, therefore, based on the development of political and corporate governance in Judeo-Christian countries.

LOOKING BACKWARD

The first business corporations came into existence in Europe in the beginning of the seventeenth century. This was 200 years before the Industrial Revolution swept across those countries. These early corporations were partnerships of merchants who sought to trade with other countries. As no company law existed till the middle of the nineteenth century, each of these corporations was created by a charter from the sovereign of the country they were formed in. Hence, the first of these, the East India Company, came into existence by a charter issued by Elizabeth I on the memorable date of December 31, 1600.

The charters of these corporations empowered their members to elect a board of governors who would manage the corporation. That board of governors were empowered to elect a President and to appoint various employees and functionaries for carrying out the corporation's business. The governors were required to periodically submit stewardship reports to the members, who then discussed those in general meetings. The governors themselves met in meetings to decide the conduct of the business. The members contributed the capital required to run the business and shared in its profits or losses in proportion to the contributions made. After 425 years, this is still the structure of corporate governance around the world. So much for "dynamism" in the business world and the oft parroted mantra of its doyens that "the only constant is change."

How was this structure inspired by political governance then prevailing? The Magna Carta forced English kings to concede their absolute rights of governance. They could no longer tax their subjects as they wished nor could they exercise total power over the lives and liberty of their subjects. These powers were transferred to Parliaments. It was those bodies that were empowered to determine how the king should govern, at least in the areas in which his absolute powers had been curtailed. Who constituted these Parliaments? The first group, or "estate", were the barons who provided the soldiers to the king when he needed to fight a war and who paid land revenue, the principal form of revenue for the king's treasury. The second estate was the Church, represented by its bishops, who provided the king with legitimacy – the king being believed to be God's representative on earth. And the third were the major towns because they too provided revenue to the king in the form of octroi or customs duties, the other form of revenue for the treasury. These three estates were granted by the king the right to have a say in the country's governance because each of them gave something substantial in return to the king. Later, the Press was recognized as a significant element in any country's governance because it was their role to expose to the people the failings and abuses of the king and his parliament. Hence, their moniker "the fourth estate." If the Press is left aside – and it is significant that it assumed this role around the time of the French Revolution, each of the other three estates had a transactional relationship with the king: because they gave him something, he granted them a say in how he could govern the country.

When business corporations were first formed, an identical transactional model was used – those who contributed the capital were granted a say in a corporation's governance even though it took many different stakeholders to make a business.

But, in the political world the transactional model of governance began to be challenged. In the seventeenth century civil wars in England were fought to further curtail the king's powers. The American Revolution and the French Revolution at the end of the eighteenth century wholly threw out the transactional model of governance. For the first time, the right of anyone affected by a country's governance to have a say in it was recognized. That is, the right was not to be limited to those who gave something to the king in return, it was available to every citizen. Universal adult franchise became the norm. Of course, it took another 100 years before the right to vote became truly universal – women and slaves were denied it till then. But most citizen males for the first time were able to have a say in their nation's governance by being able to elect members to their parliament.

In a corporate context, what is the term for someone who is affected by the activities of a corporation? It is "stakeholder". So, the concept of stakeholders entered political governance over two hundred years ago. But in the business world? It was first recognized, however feebly, in a report by a group of businessmen that was constituted by Kofi Annan, the Secretary General of the United Nations. This report issued in 2005, "Who Cares, Wins", introduced the concept of Environment, Society, Governance (ESG). It recognized the obligation of businesses to stakeholders other than only those who provided it with equity. In other words, it challenged the transactional model for the first time. Governments around the world, and corporations, began to pay it service. But the concept as it has been introduced is far from what happened in the political world. Neither society nor future generations (for whom environment is the transition proxy) have a say in a corporation's governance. They have no voice either in annual meetings or in the board room. Indeed, they have no right even to information that could help them judge if the stewards of a business are serving their interests. Those stewards continue to be chosen by the providers of capital.

But that is a sweeping statement. Legislation introduced an element of independence in the board room – the independent director. Even if the purported purpose of these individuals was to protect the interests of minority shareholders from abuse by the controlling shareholder, it expanded to include within their remit the protection (balancing) of the interests of all stakeholders (see part II of schedule IV of the Companies Act, 2013).

So, as I wrote earlier, business has half-heartedly copied what is happening in political governance. Half-heartedly because unlike in the political world, stakeholders have no right to select representatives who protect their interests in the way a corporation is governed. The protection of those interests is outsourced to people selected through the old transactional method. No wonder that ESG is struggling to make any impact in the corporate world.

The creation of independent directors made it possible to set up independent governance bodies: the audit committee and the nominations and remuneration committee. However imperfect the solution, an element of thinking that was independent of the blinkered purpose of maximizing shareholder value was introduced. Some of the liberal ideology that had changed political governance after 1945 also seeped into its corporate counterpart. These included:

- Accountability to stakeholders and, to enable it, the right to information
- Fairness and equity
- Human rights (Diversity, equity, inclusion – DEI)
- Intense work through committees of the main governance body
- Independent institutions that acted as a check on the executive (independent auditors, independent valuation experts, independent advisors)
- Transparency through detailed financial disclosure requirements.

However slowly, the corporate sector is being compelled to acknowledge its social obligation – the obligation to do good for society. Corporations enjoy the privilege of limited liability and indefinite life because society has granted them these. In return, they have begun to acknowledge an obligation to that society; not to their equity providers alone.

What does the future hold? In the political world many of the liberal ideas that swept across the world in the past 200 years – human rights, liberty of the individual, freedom to express dissent, the consensual leader, accountability of the executive, the right of the citizen to information from government, checks and balances provided by institutions independent of the executive – are being weakened. There is a return to the strong, unchallengeable leader (a monarch) and the concomitant denial of information, weakening of independent oversight, the leader serving the interests of only his electors, any means justifying the end these electors want the leader to achieve.

If corporate governance is to follow suit, as it has always done, what do we foresee? A sweeping away of stakeholder interests, a weakening or abolishing of independent functionaries (independent directors and committees where they are preponderant), dilution of financial disclosures. In short, a return to governance in the 20th century.

In the political sphere, large swathes of society today look back to monarchial ages, when liberal thinking was in its infancy. Will the same be the case with corporate governance?