

CORPORATE GOVERNANCE: NEED, BENEFITS AND ITS THEORIES

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ABSTRACT

The corporate governance concept is a well known in modern times due to the dependency on them of the society. As the profit generation is the core objective of any business, their effect on the other aspects and stakeholders continues to be of greater importance as any negative effect can be consequential for many. This is why, in the current times, with political implications, corporate frauds and so on, there's a greater need of corporate governance. Due to the increasing relevancy of the concept, the topic was studied effectively by many leading to development of what is considered to be inclusive of the concept and what not. This is where the theories originated, which determine as to what aspect, relation or mindset needs to be placed for effective governance. Although different theories focus on different aspects, they're to be understood in a broader and inter-connected manner for execution of effective governance that benefits all.

Keywords: Corporate Social Responsibility, Corporate Governance

INTRODUCTION

Systemic execution of rules, processes and practice incorporated by any organization to manage its affairs in a directed manner is the basic understanding of the concept of Corporate Governance. The practice incorporates the objective of the organization and is mindful of its interests. The focus is on balancing the Company's work and profit-generation with the interests of the Company's stakeholder he social, regulatory and market environment including monitoring the actions, policies, practices, and decisions of corporations, their agents, and affected stakeholders. Corporate governance practices can be understood as way to align to the best interests of all or majority of its stakeholders.

NEED FOR CORPORATE GOVERNANCE

Corporate governance is a practice through which a company or an organization is controlled, directed and so on.

Corporate Governance is needed primarily for the reasons that in the modern times, in a company there are varied shareholders and majority are unorganized and have indifferent opinion at the affairs of the company they're promoting. The concept of **shareholders' democracy** is restricted to theoretical aspect only including Articles of Association (AOA). Therefore, there needs to be increased awareness on the same amongst the people through proper implementation which is by adopting a code of conduct for corporate governance.

The modern aspect of working of a corporate has changed from early times.

Currently, the **ownership** is maximum controlled by the institutional investors. They're the biggest reason for driving the said organization to incorporate the governance mechanisms for effective results. They demand management, adherence to code of conducts and mostly, accountability, in case of any neglect or failure or scandal and so on.

With the recent trends of **corporate scandals**, frauds, whistleblowers and so on, the confidence of people with the working of an organization is not very strong. The same can be addressed by having an effective and open relationship about the working of the company with the general public, increasing the confidence, its consumer base and overall profitability.

With greater capitalism and consumer based society, the people in modern times are mostly **dependent on corporations** for basic needs as well. The corporate sector, due to this has higher responsibility to cater to the needs of the public and make it accessible, without compromising the quality or having any major consequence environmentally or socially and so on. Therefore, to meet such expectations, effective governance within the system is a must for ensuring the quality and reliance of the people on the said organization.

Hostile take-over is a major reason to incorporate corporate governance. It can be observed across the globe that the corporations that are weak internally are more susceptible to hostile takeovers. The same can be prevented with the Corporate Governance. The fact of increasingly **globalized world** that is inter-dependence, Indian country is known to attract foreign investors and also promote Indian businesses to get international. Indian companies are desirous of getting listed on the international stock exchanges. This is not effectively possible without a robust internal governance mechanism.

BENEFITS OF CORPORATE GOVERNANCE

Inarguably the concept of corporate governance is accepted by the corporations to be an effective method to ensure profit generation as it includes interests of all stakeholders, increasing the consumer base of the corporation itself. Therefore, the profit generation cycle gets enhanced. There are not one or two, but numerous benefits of effective Corporate Governance. Some of benefits ensured by Corporate Governance are indirect corporate success and profit generation, maintaining investor confidence, reduction of the capital cost, positive impact on the share price as investor confidence increases, motivation of corporate owners and management to work effectively as the shareholders interests benefits them. Corporate Governance also reduces wastages, corruption and risks in the Company. The effective management also helps the corporation to have a brand image of its own and further development. To conclude the advantages of the same, the concept execution ensures that interests of all the stakeholders are taken care of.

THEORIES OF CORPORATE GOVERNANCE

The concept of Corporate Governance forms a basis of dependence on the corporate by the stakeholders it involves. Although the focus is on profit generation and fulfillment of aims and objectives of the firm, the benefits are enjoyed by the entire stakeholders. This leads to effective pressure on the corporation to incorporate effective management and code of conducts. Since the concept has been around for a while now, it has been readily studied by many scholars. This has led to development of certain theories i.e. how a company should be governed and managed. Although there are several of them and niche on an aspect, there are 4 major theories present in almost every

conclusive research on the same. The explanation of the major four theories are as follows:

1. Agency theory

This theory stipulates that the relation between the shareholders and the company or its directors is of a principal and an agent where the shareholders are the principal and directors being the agent.

The theory means that the principal delegates the management of the business to its agent, who're to make decisions and act as per the interests of the principal. There is a clear-cut separation between ownership and controlling of the business. The principal owns it, but the directors control it for managing the same. Due to the abovementioned feature, there are instances where the interests of the principal and agent can be different i.e. interests of the shareholders and of the directors and the Board members. In such instances, there can be disputes and can lead to frauds, scandals etc causing distrust from the public affecting the business. Both parties are to effectively balance their interests to benefit. There has to be harmonization of the interests for maximizing the company value.

2. Stewardship Theory

As the name suggests the focus is on stewards or as basically known as company owners. The organization value is maintained and developed through effective management and leadership within the organization. The key aspects of the theory are that the executives such as directors and managers focus in the aim and objective of the organization. The entire hierarchy of the executives work together with a single mindset rather than individual goals. This ensures that their acts meet the goals/objectives of the said organization. The employees are supposed

to hasten the above mentioned goal. Therefore the stewards work for the owners/shareholders.

On achievement of the goal the stewards tend to be satisfied and further motivated. The theory stresses on the fact that the employees or executives need to act autonomously so that the business operates effectively and the returns are maximized. The employees tend to take ownership of their work and diligently deliver the same.

Compare to the agency theory, where there can be in conflicting situations executives acting for their own interest rather than that of shareholders. The stewardship theory stipulates that the executives act in company's interest on their own goodwill in any such situations.

3. Stakeholder Theory

As the term suggests the theory focuses on stakeholder of the company. It focuses on the fact that all stakeholders are equally important. The features includes that there are several stakeholders apart from owners only who have interest in the said organization and their goals can be different. The term stakeholder refers to all person, group or organization that impact/influence any companies activity. For example owners, shareholder, customer supplier, NGO, media, government, local government, employees and so on all can be stakeholders of a company. The business should focus on all such parties. It is considered that all of them have equal stakes and none can be above the other.

For instance, an enterprise creates profit for share meet customer demands ensures employee satisfaction and is mindful of its activities concerning the environment. In such instance the shareholders are satisfied, the company makes profit, the customers gain confidence due to their demand been met and little, to no

consequence to environment. Hence, this is how a company inculcates the theory into practice

Therefore, as per the theory the manager act to maximize company value and at the same time avoid ignoring any stakeholder. Such organization is ensured by effective corporate governance system. This theory is considered most efficient for longevity any corporation as the economic success is additionally based on peoples trust in the corporate's activity.

4. **Shareholder Theory**

The shareholder theory is further is narrowed of the stakeholder theory. Economist Milton Friedman emphasized that shareholder have primacy in a corporations operation than any other stakeholder. The fundamental of this theory is maximizing shareholder wealth. Their view as owners and their interest should be a priority. The primary goals if the organisation is profit maximisation and corporate governance can be used to ensure that shareholder interest is taken care of. The directors, board members, managers, etc. are all accountable to the shareholder. They are to justify their actions based on financial returns. The value of the shareholder and its maximization aligns with overall market efficiency of a company i.e. stock prices reflect the image of the company. If shareholders interests are taken care of, company can be stipulated is performing well. The financially metric are usually used to measure company's performance and shareholders demands accountability and transparency.

Although the theory focuses on shareholders it acknowledges other stakeholder as well such as customer, employee, supplier etc.. However, other stakeholders are treated as secondary. As per the current legal framework the theory is mostly supported through provisions such as shareholders right to vote on

certain issues such as merger and acquisition.

In contrast with stakeholder theory which states balance of interest of all stakeholders, critics point out that focus in shareholder only, as per this theory, can lead to unethical practice and disregard for the society at large. In modern time there is pressure from other stakeholders for a more holistic approach. Broadly, this includes the fact that Corporate Governance includes Corporate Social Responsibility upto some extent. There are statutory and regulatory mechanisms in place to ensure CSR such as provisions of Companies Act, 2013 incorporate the same.

CONCLUSION

Corporate Governance is a subjective concept. There are strict rules and regulations in place to determine effective corporate governance in a company. With privatization, the dependency of people on corporations is at maximum. This creates the need for corporate governance to ensure that the corporate go beyond their aim and take accountability of the consequence their actions hold for the society at large. The theories of corporate governance are a conclusion of studies conducted on the topic and methods to ensure the execution of the same. These theories are different and co-dependent in broader terms as they focus on actions and effect on all, from the directors to shareholders and all their stakeholders and impact of corporate actions on the society. Independence of directors, relationship of people within the organization, eternal relationship of the company, ownership of the role one holds in the functioning of the business etc are some of the fields that have an impact on a corporate action and thus need for their governance for benefit of all. Hence, it can be easily concluded that effective corporate governance requires application of a combination of

the above explained theories.

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