REALITY OF THE APPROACH TO CORPORATE GOVERNANCE IN INDIA: THE COMPANIES ACT, 2013

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ABSTRACT

The debacle between the shareholder theory and the stakeholder theory has existed since time immemorial. There are two main popularly recognised approaches towards the accountability of a company - The shareholder theory approach and the stakeholder theory approach. The governance of a corporate entity can be best understood by considering the approach used by it. The shareholder theory approach states that the shareholder and the corporate executive of a company share a principal and agent relationship respectively. This approach states that the shareholder is the owner of the company and is therefore entitled to the profits made by the company in its course of business. This approach is based on the profit maximization and does not recognise the doctrine of social responsibility. The stakeholder theory approach, was brought to light in order to refute the shareholder theory approach. This approach states that the shareholder is not the only person who should be entitled to the profits made by the company in its course of business. Rather, these profits should be bestowed upon the stakeholders of the company i.e., every person who has a stake in the company. India, follows a stakeholder approach only in theory and therefore, the below made suggestions should be inculcated in order to make it a reality.

Keywords: Corporate Governance, Stakeholder Theory, Shareholder Theory, The Companies Act.

1. INTRODUCTION

The study of corporate governance consists of a wide array of disciplines under its umbrella. All these disciplines cannot be accurately inculcated under one definition to bring out the true meaning of this term. There are a number of definitions trying to explain the same. However, the most commonly used and globally accepted definition of corporate governance is the one given by Sir George Adrian Hayhurst Cadbury in the Cadbury Report[1], "Corporate governance is the system by which companies are directed and controlled."[2] Consequently, it can be understood, that the study, in the field of corporate governance both internationally and nationally, for the most part, deals with the interaction between the board of directors of an organization, the officers who are entrusted with the duty of running the organization and its shareholders.[3]

The corporate governance regime in a country can be inferred from the accountability approach it uses. [4]The two well-established accountability approaches are – The Shareholder Theory Approach and The Stakeholder Theory Approach.[5] These approaches play an extensive role in moulding and shaping of the corporate governance regime in the country. "These have influenced in terms of what the constituents say, do and report. It is clearly stated in the annual report, other form of documents, website, internal and external policies or regulations. Both theories have their own strengths and weaknesses."[6]

2. SHAREHOLDER THEORY

To understand the shareholder theory model, we need to understand who a shareholder is. A shareholder is a person who is considered to be the owner of a company by way of shares. "A shareholder also referred to as a stockholder, is a person, company, or institution that owns at least one share of a company's stock, known as equity. Because shareholders are essentially

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[1]Adrian Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance* (Gee Publishing Ltd., 1 December 1992).< https://www.icaew.com/-/media/corporate/files/library/subjects/corporate-governance/financial-aspects-of-corporate-governance.ashx?la=en > accessed on 25 September 2021.
[2]ibid
[3] Afra Afsharipour and Martin Gelter, Research Handbook on Comparative Corporate Governance: Introduction (Edward Elgar Publishing, Forthcoming, November 5, 2020), Fordham Law Legal Studies Research Paper No. 3725679, European Corporate Governance Institute - Law Working Paper 552/2020, <https://ssrn.com/abstract=3725679> accessed on 12 October 2021.
[4] Norazamina Mohamed, Dr. Abdullah & Hamzah Ismail, Vertical Accountability: Possible Resolution towards Drawbacks in Accountability to Shareholders and Stakeholders (2012) <https://www.researchgate.net/publication/282641899_Vertical_Accountability_Possible_Resolution_towards_Drawbacks_in_Accountability_to_Shareholders_and_Stakeholders> accessed on 12 October 2021.
[5] ibid
[6] Mohammed, Abdullah and Ismail (n 4)

owners of the company, they reap the benefits of a business's success. These rewards come in the form of increased stock valuations or as financial profits distributed as dividends."[7] There are two major type of shareholders, namely – common shareholders and preferential shareholders. The common shareholders of the company possess a right to vote in matters related to the company, they not only enjoy control and say in regard to how the company functions but they also have the right to file a suit against the company in cases where they are of the opinion that the company is carrying out wrong doings that may cause harm to the entity's reputation, where they hold the common stock.[8] On the contrary, preferential shareholders are the kind of shareholders that do not have a say in matters relating to the functioning of the organization or company and therefore they do not enjoy voting rights like the common shareholders, however the preferential shareholders receive the dividend before it can be distributed among the common shareholders.[9] The major point of difference between a shareholder and a director is that shareholders are observed to be the owners of the organization or company whereas the directors of the organization or company are hired by the shareholders to perform managerial tasks and look after the well-being of the company, however, it is to be noted that though the shareholder of the company and the director of the company are two different entities and carry out two different functions, the director can also be a shareholder of the said company, similarly employees of the company can also be considered as shareholders if they own the shares of the company.[10]

The companies under the Indian Law are mostly governed by The Companies Act, 2013. "Under the Act[11], any person can become a shareholder and a person could mean an individual, body corporate, an association or a company irrespective of its incorporation."[12]

The shareholder theory approach is also known as The Friedman Doctrine because it was propounded by the renowned Economist Milton Friedman.[13] According to this theory,

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[7]Adam Hayes 'Shareholder' (*Shareholder,* 28 September 2021*)*
<https://www.investopedia.com/terms/s/shareholder.asp> accessed on 27 January 2022.
[8] 'Shareholder' (*Corporate Finance Institute*)
<https://corporatefinanceinstitute.com/resources/knowledge/finance/shareholder/> accessed 7 May 2022.
[9] ibid
[10] Corporate Finance Institute (n 8)
[11] The Companies Act, 2013
[12]India Filings, 'Shareholder' (*Who can become a shareholder?)*
< https://www.indiafilings.com/learn/eligibility-of-a-shareholder/> accessed on 27 January 2022.
[13] Milton Friedman, 'A Friedman doctrine-- The Social Responsibility Of Business Is to Increase Its Profits' *New York Times* (New York, 1 September 1970) 17
<https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html> accessed on 27 January 2022.

Friedman is of the opinion that, "In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom…[T]he key point is that, in his capacity as a corporate executive, the manager is the agent of the individuals who own the corporation or establish the eleemosynary institution, and his primary responsibility is to them."[14] The corporate executive must be directly responsible to the shareholders of the organization or company and not to the society or the general public. The profits that the company makes in the course of its business, should be distributed among its shareholders as they are the rightful owners of the company and the corporate executive should merely work for their welfare.

Friedman goes on to state that, the Doctrine of Social Responsibility, which iterates, "individuals and organizations should advance the interests of society at large"[15], lacks rigour and is notable for its analytical looseness. The corporation being an artificial entity cannot possess responsibilities let alone possess social responsibilities. The shareholders are considered to be the owners of the company as they own shares of the company or organization. The corporate executive is merely an agent, who is entrusted with the duty of managing all the operations of the company.

It is to be noted that this doctrine cannot be applied to a one-person company. As stated by Friedman himself in his article, a proprietor is responsible to himself as he is the corporate executive of the company and its shareholder. The act of him carrying out a social responsibility would be considered as exercising a personal right rather than carrying out a responsibility in favour of someone else. Therefore, the shareholder theory approach set forth by Milton Friedman in his New York Times Article, is in the view point of the profit maximization of the shareholder. It states that the corporate executive is solely responsible to its shareholders. In this theory, there is a principal and agent relationship between the company's shareholders and the company's corporate executive, where the shareholders are the principal and the corporate executive, the agent. Hence, the agent is responsible to the principal.

[14] ibid
[15] Hayes (n 7)

3. STAKEHOLDER THEORY

The term stakeholder, in simple terms, refers to a person who has an interest in the company. "Thus, the principal stakeholders of the corporation are the shareholders, management, and the other board of directors. Other stakeholders include the customers, creditors, suppliers, employees, regulators, and also the community at large." [16]He can either affect or be affected by the business of the company. A shareholder comes within the purview of a stakeholder but a stakeholder does not necessarily have to be a shareholder. "The international standard providing guidance on *s*ocial responsibility, called ISO 26000, defines a stakeholder as an '[I]ndividual or group that has an interest in any decision or activity of an organization.' Stakeholders may include suppliers, internal staff, members, customers (including shareholders, investors, and consumers), regulators, and local and regional communities. Additionally, stakeholders may include purchasers, clients, owners, and non-governmental organizations (NGOs)."[17] Different scholars have a different view on the types of stakeholders that are in existence, however, the most commonly acknowledged types of stakeholders are –Customers, having a stake with respect to the product/service value and quality; Employees, who possess a stake in the company by way of income through employment and safety; Investors, having a stake in the financial returns; Suppliers and Vendors, having a stake in the revenues and safety; Communities having a stake in health, safety and economic development; and Governments having a stake in collection of various taxes as well as the overall Gross Domestic Product (GDP).[18] The companies or organizations often face difficulties in prioritizing their stakeholders with regard to competing interests, one of the most common hierarchy includes – (i) Customers; (ii) Employees; (iii) Investors.[19]

The stakeholder theory approach was propounded by R. Edward Freeman in 1984. This approach was put forth to strengthen the views on the works of Ian Mitroff and Richard Mason, and James Emshoff. Freeman put forth his approach in his book "Strategic Management: A Stakeholder Approach". This book "identifies and models the groups which are stakeholders

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[16] 'All You Need To Know About Stakeholder Governance Structure - Ipleaders' (*iPleaders*, 2021) <https://blog.ipleaders.in/all-need-know-about-stakeholder-governance-structure/> accessed 2 February 2022.
[17] ASQ, 'Stakeholder' (*WHAT ARE STAKEHOLDERS?)* <https://asq.org/quality-resources/stakeholders#Identifying> accessed on 16 October 2021.
[18] 'Stakeholder' (*Corporate Finance Institute*) <https://corporatefinanceinstitute.com/resources/knowledge/finance/stakeholder/> accessed 7 May 2022.
[19] ibid

of a corporation, and both describes and recommends methods by which management can give due regard to the interests of those groups."[20]

The stakeholder theory approach was formulated by Freeman, in order to refute the shareholder theory approach, propounded by Friedman. Freeman, in his approach, is of the opinion that every person who has a stake in the company should be benefitted from the profits made by the company rather than just the shareholders of the company. This approach goes beyond the shareholder's interest and takes into account the stakeholder's interest.

"The stakeholder emphasizes the importance of efforts and risks of various concerned parties who have contributed capital in the form of financial, human, social, or environmental. In addition, the company has a social mission that is to create lasting value for all parties involved, and for society as a whole. The stakeholder theory is easily accepted as it allows win–win situations and furthermore the interests of shareholders coincide with that of the stakeholders."[21] The stakeholders in a company consist of all the parties that have a stake in the company and are affected by the business that the company carries out. The stakeholders of a company include the management, the employees, the clients and the general public at large. In short, any person who affects or is affected by the business of a company can be called a stakeholder.

"The 21st Century is one of 'Managing for Stakeholders.' The task of executives is to create as much value as possible for stakeholders without resorting to trade-offs. Great companies endure because they manage to get stakeholder interests aligned in the same direction."[22] The idea of this approach is to create a larger interest which will benefit a large number of people as compared to the interests of a smaller group of people.

4. THE SHAREHOLDER THEORY VS. THE STAKEHOLDER THEORY

The debacle between the shareholder theory and the stakeholder theory, pertaining to which approach is most suitable for the corporate governance of an organization, has been an issue generating a significant amount of coverage and discussion. As the name suggests, the shareholder theory approach model, favours the shareholder over all the members of the

[20] Stakeholdertheory, 'Stakeholder Theory' (*Stakeholder Theory)* <http://stakeholdertheory.org/about/> accessed on 2 February 2022.
[21] Mohamed, Abdullah and Ismail (n 4)
[22] Edward R. Freeman, 'The Stakeholder Theory Approach', *Strategic Management: A Stakeholder Approach* (Cambridge University Press 2010) <https://www.cambridge.org/core/books/strategic-management/E3CC2E2CE01497062D7603B7A8B9337F > accessed on 2 February 2022.

organization whereas, the stakeholder theory approach model, favours the stakeholders of the organization, which includes within its purview, the shareholders as well.

5. THE CORPORATE GOVERNANCE REGIME IN INDIA – THE APPROACH

The change in times lead to the change in need, this is due to the fact that new problems arise and hence new solutions are required to beat these solutions. Similar is the case with respect to the governance of corporate entities. As times are evolving, there is a need to adapt to this change and adopt a varying stand than the already existing one. Some of the major aspects that act as a source of shaping the governance of a company or organisation are (1) the ethics of an individual along with the corporate culture (2) the internal control/ownership and mechanisms related to incentives (3) the market (4) the external monitoring mechanisms (5) the laws and regulations and the enforcement of the same (6) the firm's institutional environments and its own attributes.[23]

The debacle between the theory relating to the shareholder the stakeholder, pertaining to which approach is most suitable for the corporate governance of an organization, has been an issue generating a significant amount of coverage and discussion. As the name suggests, the shareholder theory approach model, favours the shareholder over all the members of the organization or company whereas, the stakeholder theory approach model, favours the stakeholders of the organization, which includes within its purview, the shareholders as well.

The corporate governance system in India has utilized both – the shareholder theory model and the stakeholder theory model – in governing an organization, over the years.[24] To comprehend the governance of corporations and various organizations in India over the past decades, the historical perspective should be acknowledged. The historical perspective of the corporate governance regime in India can be broadly divided under two heads, for the purpose of this dissertation, namely – The Pre-Companies Act, 2013 era and The Companies Act, 2013, era.

1. THE PRE-COMPANIES ACT, 2013, ERA.

The concept of corporate structure in India emerged with the advent of the Royal Charter of

[23] Dr Namita Rajput and Bharti, 'Shareholder Types, Corporate Governance and FirmPerformance: An Anecdote from Indian CorporateSector' (2015) 7 Asian Journal of Finance & Accounting <http://dx.doi.org/10.5296/ajfa.v7i1.6070> accessed 29 March 2022.

[24] Ritu Birla, *"From the Colonial to the Postcolonial: India and Pakistan in Transition"* (Oxford University Press 2007) <https://onlinelibrary.wiley.com/doi/abs/10.1111/j.1540-6563.2009.00260_33.x> accessed 29 March 2022.

the East India Company in 1600. This Charter was issued by Queen Elizabeth in order to facilitate the trade between India and Africa. The conferring of privileges by the British government to not just the East India Company but other companies too, gave rise to profit but along with it, created an emergence of public service.[25] India achieved its Independence from the British in the year, 1947. In the post-independence era, India was said to have followed a stakeholder theory approach. This can be rightly said so because in companies where insolvency was present, employees of such companies were given preferential payments in order to clear their dues, this provision for the special right for the employees was laid down under Section 529A of The Companies Act, 1956 by way of The Companies Amendment Act, 1985.[26] In furtherance of this, if a company was found to be pursuing activities that were against the public interest, all those affected by these activities were bestowed with the right to exercise remedies under Section 397(2) of The Companies Act, 1956 which talks about "Public Interest" and was added by way of The Companies (Amendment) Act, 1963.[27] Hence, the company law in India imbibed the "public service" aspect into its legislation thus, showcasing that its concern went beyond the private interests of the shareholder and extended to the interests of the stakeholders.[28] The Hon'ble Supreme Court in the case of **National Textile Workers Union v. P.R. Ramakrishnan**[29], upheld the stakeholder theory by stating that, "The workers are so intimately tied up that their interest in the survival and the well-being of the company is much more than the interest of any shareholder."

2. THE COMPANIES ACT, 2013, ERA.

The key legislation that is responsible for the governance of the companies and corporate entities in India, at present, is The Companies Act, 2013. The Preamble of this Act states, "An Act to consolidate and amend the law relating to companies and certain other associations." The Companies Act, 2013, came into existence after a hefty number of amendments were made to the Companies Act, 1956, and also after a series of bills were passed and referred to. The Legislature with the intent of making the Companies Act, 2013, follow a more stakeholder

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[25] Lynn A Stout, 'Corporate Entities: Their Ownership, Control, and Purpose' [2016] Oxford Handbook of Law and Economics, Forthcoming, Cornell Legal Studies Research Paper No. 16-38 <http://dx.doi.org/10.2139/ssrn.2841875> accessed 29 March 2022.

[26] The Companies Act, 1956, s. 529 A

[27] The Companies Act, 1956, s. 397(2)

[28] Anchal Chhallani 'Shareholder vs. Stakeholder' *(Shareholder vs Stakeholder Theory: Historical Perspective in India,* 19 October 2021*)* < https://thecompany.ninja/shareholder-vs-stakeholder-theory-a-historical-perspective-in-india/ > accessed on 5 February 2022.

[29] 1983 AIR 75

theory approach model included three sections into the Act namely – **Section 135, Section 166(2) and Section 181**.[30]

(i) Section 135 of the Companies Act, 2013.

Section 135 of the Act "Corporate Social Responsibility" which deals with the contribution of companies to social causes. Corporate Social Responsibility is a business model by way of which the company is accountable to itself, the stakeholders and the public at large with regard to aspects of society that includes "economic, social and environmental aspects".[31] It is considered as the 'social imperative and social consequence' of a business.[32] The stakeholder theory and Corporate Social Responsibility can be said to be interlinked because the social, economic and environmental concerns which are deemed to be as societal concerns are now considered as corporate responsibilities as they not only work for the welfare of the shareholders of the company but also for the stakeholders.[33] "The Act has not only provided a corporate sustainability variant but also in turn offers a great contribution towards context-specific and culture-sensitive business-society nexus by formulating the attention towards not only business activities but also towards social and environmental goals."[34]

According to this Section 135 of the Act, stipulates that "at least two percent of the average net profits of the company made during the three immediately preceding financial years"[35] have to be kept aside for the purpose of Corporate Social Responsibility. This provision is applicable to companies having, "Net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year."[36] Schedule VII of the Act titled "Activities which may be included by companies in their Corporate Social Responsibility Policies" lays down the activities that can be carried out in pursuance of Corporate Social Responsibility. The companies that fall within the ambit of the companies that mandatorily have to carry out Corporate Social Responsibility activities are

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[30] Rajput and Bharti (n 23)
[31] Jason Fernando, 'What Is Corporate Social Responsibility (CSR)?' (*Investopedia*, 7 March 2022) <https://www.investopedia.com/terms/c/corp-social-responsibility.asp> accessed 30 March 2022.
[32] Matten, Dirk, and Jeremy Moon. "'Implicit' and 'Explicit' CSR: A Conceptual Framework for a Comparative Understanding of Corporate Social Responsibility." *The Academy of Management Review*, vol. 33, no. 2, Academy of Management, 2008, pp. 404–24 <https://doi.org/10.2307/20159405> accessed 29 March 2022.
[33] Bergman, Manfred Max, Zinette Bergman, Yael Teschemacher, Bimal Arora, Divya Jyoti and Rijit Sengupta. "Corporate Responsibility in India: Academic Perspectives on the Companies Act 2013." (2019). <https://pdfs.semanticscholar.org/> accessed on 30 March 2022.
[34] ibid
[35] The Companies Act, 2013, s. 135 (5)
[36] The Companies Act, 2013, s. 135 (1)

required to form a Corporate Social Responsibility Committee; this committee would be responsible for formulating and monitoring the Corporate Social Responsibility policy.[37]

(ii) Section 166 of the Companies Act, 2013

Section166 of the Act deals with the "Duties of Directors", Section 166 (2) of the Act states that, "A director of a company shall act in good faith in order to promote the objects of the company 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 environment." This section again showcases the Director's obligations towards the stakeholders of the company or organization. This provision shows that the duty of the directors is not only towards the profit maximization of the shareholders but also towards the stakeholders and thus they have to carry out their functions by creating a balance between the two.[38] It is to be noted that this provision is not mandatory in nature and mostly depends on the Director's perception towards the same.

(iii) Section 181 of the Companies Act, 2013.

Section 181 of the Act talks about "Company to contribute to bona fide and charitable funds, etc." It states that, "The Board of Directors of a company may contribute to bona fide charitable and other funds: Provided that prior permission of the company in general meeting shall be required for such contribution in case any amount the aggregate of which, in any financial year, exceed five per cent. of its average net profits for the three immediately preceding financial years". This section is again very similar to Section 135 of the Act and is not mandatory in nature and hence depends on the Board of Directors and the Directors' perspective towards the stakeholders.[39]

With the addition of three new sections made to the Act [40], the corporate governance regime in India is now believed to adhere to a stakeholder theory approach model of corporate governance.

6. DOES INDIA FOLLOW A STAKEHOLDER THEORY MODEL IN REALITY?

Legislature of India, "with the intent" of ingraining the Stakeholder Theory approach into its

[37] The Companies Act, 2013, s. 135 (3)
[38] Deva Prasad M, "Companies Act, 2013: Incorporating Stakeholder Theory Approach into the Indian Corporate Law", *Statute Law Review*, Volume 39, Issue 3, (2018) <https://doi.org/10.1093/slr/hmx016> accessed 30 March 2022.
[39] ibid
[40] The Companies Act, 2013

corporate governance regime, introduced three new sections in the Companies Act, 2013, as explained above. The basis of the stakeholder theory approach is that, "a firm should create value for all stakeholders, not just shareholders" i.e., Doctrine of Social Responsibility. It focuses most importantly on the "public interest" pertaining to the stakeholders than just the "private interest" of the shareholders. However, the author is of the opinion that, the Indian Legislature, seems to have taken the concept of "public interest" and interpreted it right to its core, while including the three sections in the Act.

Section 135 of the Act, in short, pertains to directing the companies to contribute to social causes. This section is for the welfare of the public at large, and hence can be partly considered as a move towards the Stakeholder Theory approach. Section 166(2) of the Act, broadens the duties of the directors and make them more inclusive towards interests of stakeholders including as well such as employees and environment. This section is very unambiguous as there is no proper definition as to what "kind of objects should be promoted". Section 181 states that a company "may" contribute to charitable funds, etc. Apart from this section not being a mandate, it is also very similar to Section 135 that deals with Corporate Social Responsibility.

Therefore, the following suggestion are made in order to adapt to the Stakeholder Theory model in a better way. The first being, the Companies Act, 2013, has to include within it, a section that deals with the definition of who comes within the purview of a Stakeholder. If this is followed up, the Legislature can distinctly make laws pertaining to each kind of stakeholder. Secondly, all the three sections included in the Act with a view to achieve the Stakeholder Theory approach, more or less deals with the public at large and does not pertain to any one particular type of stakeholder whereas, on the other hand, the shareholders and their rights, their functions and other aspects are elaborately mentioned across the Act. Thirdly, these amendments should be brought about in the Companies Act, 2013, as it is the key legislation governing the companies in India.

7. CHALLENGES FACED BY INDIA IN THE INCORPORATION OF THE STAKEHOLDER THEORY FORM OF GOVERNANCE

1. IMPLEMENTATION OF THE CORPORATE SOCIAL RESPONSIBILITY MODEL

The Companies Act, 2013, in Section 135 mandates that companies falling within the purview of this provision have to spend two percent of profit on specified activities as the sole Corporate

Social Responsibility obligation.[41] This approach towards the activities of the Corporate Social Responsibility obligation narrows down the broad and holistic approach to a mere charitable one which is philanthropic in nature.[42] The Corporate Social Responsibility obligation though mandatory in nature lacks clarity in cases with regard to non-compliance of the same, thereby assuming that there is no penalty in case of non-compliance.[43] "Considering the objective of mandatory Corporate Social Responsibility is to engage the corporates in developmental activities, it is significant to have clear incentives and penalties being stipulated for compliance and non-compliance, respectively."[44] Furthermore, Corporate Social Responsibility activities are sometimes pursued merely for increasing the goodwill of the company or organization, this is an unethical stance and Corporate Social Responsibility activities should always be carried out keeping in mind the societal concerns and with a view to help the stakeholders.[45]

Section 135 of the Act, in short, pertains to directing the companies to contribute to social causes. This section is for the welfare of the public at large, and hence can be considered as a move towards the Stakeholder Theory approach only if it is carried out in an ethical sense.

2. CONUNDRUM REGARDING THE IMPLEMENTATION OF DIRECTORS' DUTIES TOWARDS STAKEHOLDERS

Another reason for the failure of the stakeholder theory in the Indian corporate governance regime is the lack of accountability, the reason primarily being the non-shareholders who are the stakeholders, are identified as "community" and "environment" in Section 166(2) of the Act, which is very vague in nature and hence no enforceable right of action can be conceptualized.[46] This section of the Act lacks clarity which in turn leads to ambiguity. The term "stakeholder is not defined which further adds to the ambiguity. Thus, this vagueness that

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[41] The Companies Act, 2013, s. 135 (5)

[42] Corporate Social Responsibility Voluntary Guidelines 2009' (Ministry of Corporate Affairs 2009) <https://www.mca.gov.in/Ministry/latestnews/CSR_Voluntary_Guidelines_24dec2009.pdf> accessed on 30 March 2022.

[43] Bergman, Max, Teschemacher, Arora, Jyoti and Sengupta (n 33)

[44] ibid

[45] Wan-Jan, Wan Saiful. "Defining corporate social responsibility." *Journal of Public Affairs: An International Journal* 6, no. 3-4 (2006): 176-184. <https://www.researchgate.net/profile/Wan-Saiful-WanJan/publication/229578267_Defining_corporate_social_responsibility/links/58e5daafa6fdcc6800b14f35/Defining-corporate-social-responsibility.pdf> accessed on 30 March 2022.

[46] Surbhi Soni, 'Experiences with Pluralist Stakeholder Model in India: For Whom Should a Company Be Run?' [2020] NLISReview <https://nlsir.com/experiences-with-pluralist-stakeholder-model-in-india-for-whom-should-a-company-be-run/> accessed 30 March 2022.

centres around the ambit of the stakeholder gives rise to imbalance with regard to the shareholder and stakeholder concerns, that is to be managed by the directors of the company.[47]

Adding to this, Section 181 states that a company through its Board of Directors "may" contribute to charitable funds, etc., apart from this section not being a mandate, it is also very similar to Section 135 of the Act that deals with Corporate Social Responsibility.

3. AMBIGUOUS MEANING OF THE TERM "STAKEHOLDER"

The Companies Act, 2013, which is considered to be the primary law of the land when it comes to the governance of companies and organizations, focuses more on the shareholders and their rights as compared to the stakeholders. However, the term "stakeholder" has not been defined in the Act which leads to ambiguity in interpreting the provisions with regard to the stakeholder.[48] India can be said to follow a stakeholder theory approach only when the concerns of the stakeholder are addressed in a rightful manner and appropriate remedies are provided for these concerns, however, in the current scenario, there lacks a clear picture with respect to the ambit of the stakeholder thus leading towards ambiguity.[49]

The following points are the lacunae as observed in the Companies Act, 2013. The first being, the Companies Act, 2013, has to include within it, a legal provision that deals with the definition of who comes within the purview of a Stakeholder. If this is followed up, the Legislature can distinctly make laws pertaining to each kind stakeholder. Secondly, all the three sections included in the Act with a view to achieve the Stakeholder Theory approach, more or less deals with the public at large and does not pertain to any one particular type of stakeholder whereas, on the other hand, the shareholders and their rights, their functions and other aspects are elaborately mentioned across the Act. Thirdly, these amendments should be brought about in the Companies Act, 2013, as it is the key legislation governing the companies in India.

8. CONCLUSION

The major aspect that contributes to the wellbeing of an entity is its approach to the structure of functioning and governance. The approach to corporate governance has been a rather trending topic since the beginning of time. The key concept in the governance of any corporate entity is accountability, it is a concept that refers to where individuals and institutions are

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[47] Bergman, Max, Teschemacher, Arora, Jyoti and Sengupta (n 33)
[48] Bergman, Max, Teschemacher, Arora, Jyoti and Sengupta (n 33)
[49] ibid

responsible and answerable for their actions, they are accountable to others for their conduct and use of resources.[50] The approach to corporate governance is considered to be successful when it is compatible and provides mechanisms towards accountability as accountability is a crucial aspect to any and every entity.[51]

The two major well recognised approaches to corporate governance are – "The Shareholder Theoretical Approach and The Stakeholder Theoretical Approach." The shareholder approach also known as the principal-agent model of corporate governance was propounded by Milton Friedman and focuses on the profit maximization of the shareholders who are considered to be the rightful owners of the company. On the contrary, stakeholder theory propounded by Edward Freeman, focuses on the stakeholders of the company and their profit maximization, however, there is an absence of stakeholder involvement in this approach. [52]

India is said to follow a stakeholder approach in its form of corporate governance, however despite the inculcation of these reforms, India in its true essence towards corporate governance gives importance to shareholder supremacy. Indian Corporate law has been inconsistent with its approach to corporate governance and this is due to the fact that during the period of 1850 to the early 1960's India merely followed the approach to corporate governance as followed by the English, which was shareholder-centric, further, in the late 1960's it diverged from the shareholder supremacy view due to the socialist wave and then again returned to the English ways for a couple of decades starting from 1991, but this time it was dictated by its own economic reason for enabling Indian companies to raise capital.[53] Since 2013 with the inclusion of new laws and regulations India is 'considered' to demonstrate that it is headed towards following a stakeholder approach in its corporate governance.[54] However, considering India's historical experience there is no guarantee that there will not be a fluctuation in its approach, therefore the lawmakers should implement stricter and stronger laws in relation to the stakeholder approach.[55]

[50] Tony Ike Nwanji, Kerry E. Howel, 'A Review Of The Two Main Competing Models Of Corporate Governance: The Shareholdership Model Versus The Stakeholdership Model' (2007) 5 Corporate Ownership & Control. <https://virtusinterpress.org/A-REVIEW-OF-THE-TWO-MAIN-COMPETING.html> accessed 2 June 2022
[51] ibid
[52] Nwanji and Howel (n 50)
[53] Umakanth Varottil, 'The Stakeholder Approach to Corporate Law: A Historical Perspective from India' [2018] Research Handbook on the History of Corporate and Company Law 381. <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3173953> accessed 2 June 2022
[54] ibid
[55] Varottil (n 53)

India has taken the right step in its approach to corporate governance by adopting the model of stakeholder theory, this is because the stakeholder theory focuses on the overall welfare of the society and the shareholders also form a part of the stakeholders but according to the shareholder approach towards corporate governance it only focuses on the profit maximization of the shareholder. However, the difficult part is to execute this approach its form of everyday governance. In order to ensure the smooth functioning of corporate entities and to cross the hurdles as discussed above, these challenges can be easily tackled by implementing the following suggestions:

(1) Stakeholder Grievance Remedial Mechanism that should be mandatorily conducted at the Company level.[56]

(2) A Due Diligence should be mandatorily conducted before carrying out of activities that involves concerns with regard to stakeholders.[57]

(3) Mapping a clear-cut picture in relation to the ambit of the stakeholder in The Companies Act, 2013, as it is the primary legislation in India with regard to corporate entities, and thereby creating a pathway for other regulators to make stakeholder specific laws in order to be properly regulated.

The approach towards governance of corporate entities by India by utilizing the stakeholder theory approach is considered to be a step towards the right direction of change. However, there are many challenges faced in the implementation of the same as there are pros and cons to every system of governance. Thereby to improve the functioning and in order to make it better than the already existing system, the above suggestions can be inculcated for the improvement and application of the stakeholder form of governance.

[56] Prasad M (n 38)
[57] ibid