Chapter 18
Corporate Governance:
The Catalyst for Economic Growth and Social Change

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ABSTRACT

In light of the increasing number of corporate frauds worldwide, there is a growing emphasis on corporate governance. These corporate misappropriations not only destroy shareholder value but also act as a detriment to economic growth and social change. Therefore, investors look for companies with better corporate governance to maximize their returns. Still, this aspect of corporate governance has been largely neglected in the existing studies. This chapter is therefore an attempt to address corporate governance and its effect on business performance in the context of economic growth and social transformation at the global level. It goes inside the black box of the financial matrix. The central issue that emerges is the criticality of key parameters in the corporate governance process for organisational performance. It is hoped that it will provide a new dimension to the existing body of corporate governance for global development with policy implications for the required growth and social change.

INTRODUCTION

The concept of corporate governance has become popular globally, particularly over the last decade in regard to economic growth and social transformation. Undoubtedly, bodies of literature in law and social sciences have always considered political and social factors necessary to firms' and economic growth (Fligstein & Choo, 2005). But, of late good corporate governance has become a priority for policymakers and investors for better overall performance. The empirical research on the subject also verifies the fact. "Better corporate governance is associated with better business performance and thereby higher stock market performance, (Claessens, 2006)." Claessens highlights how the financial crises in the Russia, Asia and Brazil in 1998 demonstrated the deficiencies in corporate governance which might endanger the stability of the global economic system. A few years later, corporate governance scandals in the US and Europe added to this and shattered the confidence of a common man in the corporate sector. This

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realization for better corporate governance has highlighted its importance as a key element for reaching economic performance and growth, increasing the investors' trust.

The corporate governance system across the countries varies according to the degree of ownership and control and the identity of controlling shareholders. On one hand, there are systems which are characterised by wide dispersed ownership (outsider systems), like US and UK. The basic conflict of interest here is between strong managers and widely-dispersed weak shareholders. On the other hand, there are systems which are characterised by concentrated ownership or control (insider systems), such as Germany and Japan, where the basic conflict is between controlling shareholders and weak minority shareholders.

To grow, an economy requires sound resource base, including natural resources and other resources. But, this is possible only when the country has congenial and fair environment which features sustainable scale, fair distribution of wealth, efficient allocation of resources, and high quality of life. Here, sound corporate governance becomes crucial as corporate sector is the real creator of wealth and the most important contributor to economic growth of any country. *Economic growth* is an increase in the production and consumption of goods and services. It is indicated by increasing gross domestic product (GDP). Economic growth of any country is linked with not only an increase in its productive capacity but also as an improvement in the quality of life of the people.

Any growth is meaningless if it is not is not backed by the society and is not instrumental in social change. The reason being is the economies changing for the betterment of society only last. *Social change is* a broad umbrella to encompass a range of typical social and civic outcomes from increased awareness and understanding, to attitudinal change, to increased civic participation, the building of public will, to policy change that corrects injustice.

Every economy calls for sustainable development. The concept of sustainable development is based on corporate governance which integrates the balance of key pillars of *economic and social pillars.* The economic pillar is based on the necessary retaining of ordinary capital with all the business activities performed, and use of only the generated profit. The social pillar involves people as individuals as well as the community. So, a company with sound corporate governance will adopt these two pillars as its strategic goal which in turn grows the company in the long run. The quality environment strongly impacts the quality of life of the population, which already bears upon the social sphere (Moldan, 2001).

This paper extends the above rationale of necessity of corporate governance for economic growth and social change, in particular to Indian perspective. It discusses how the corporate governance framework impacts the firm's overall performance including in the financial market, implied thereby leading to economic growth and social change.

BACKGROUND

Corporate governance has been associated with the "Agency conflict", i.e. principal-agent problem. As principal, shareholders expect the agents (managers) of the company to act in their best interest but in practice the situation is opposite. This gap leads to mis-governance (Berle & Means, 1932). For the last two decades, corporate governance has been an area of focus for all the economies globally on account of its increasing importance for economic growth and social transformation. Corporate are giving due importance to it regardless of whether they are involved in global operations or not.

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