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Adopting a Stakeholder Approach of Corporate Governance to Combat the Covid-19 Crisis

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1. Introduction

On January 10, 2020, the World Health Organisation (WHO) reported the worldwide outbreak, including China, where the first case was reported, of the emergence of a novel infectious disease (World Health Organisation, 2021). The novel coronavirus or Covid-19 posed a global threat to human health, reporting daily cases of massive infections and death worldwide. The transmissible nature of the disease forced countries globally to follow strict social or physical distancing protocols that resulted in disruption to everyday life.

Merriam-Webster (2020) defines a pandemic as a disease outbreak that significantly affects a large population across multiple countries. The wide geographical spread through transmission at a high rate of a contagious novel virus and the severe impact on a global scale made Covid-19 a pandemic within a short period.

The World Economic Forum (2020) mentions that as poverty increased to more than 100 million people, food wastage also significantly increased at the same time. The pandemic posed a severe threat to human lives, the social environment, and the economy. The global economy contracted by 3 percent in April 2020, a significant downfall in such a short period (International Monetary Fund, 2020). The crisis exposes the shortcomings in health and societal infrastructure concerning a pandemic disaster. The emerging markets are likely to face additional challenges on the economic front, such as the massive outflow of capital, weakening currency, high level of debt, and minimal fiscal support than the advanced nations.

The corporate sector in India is facing unprecedented challenges to run its daily operations smoothly. With sudden lockdowns and disruption of economic activities, operating cycles got prolonged. Demand for certain items diminished, and customer preferences changed drastically—this reduced revenue generation in specific sectors impeding the cash flow cycle. Organizations resorted to desperate measures such as lay-offs, pay cuts, allocation of resources to limited areas to keep their operations going. Therefore, it is interesting to discuss the governance of firms in the face of the pandemic.

For the industrial sector to survive the global crisis, it must adapt and build resilience to the situation. Transparent corporate governance mechanisms, robust internal control systems, and proactive regulatory bodies have a crucial role. It is essential to adopt resilient corporate governance to earn the waning confidence of the investors and other stakeholders. This article discusses how the stakeholder model of corporate governance is more effective than the traditional shareholders' wealth creation in tackling a pandemic crisis.

2. Adopting the stakeholder model of Corporate Governance

2.1. The Stakeholder Model

The Covid-19 pandemic is increasing the pressure on boards and top managers to run the organization sustainably. A firm's corporate governance should meet the needs of its various stakeholders and preserve its socially responsible image for long-term benefits.

The traditional theory of corporate governance, proposed by Friedman in 1970, suggests profit maximization for the shareholders as the sole purpose (Friedman, 1970). Friedman's theory emphasis the corporation as the private ownership of the shareholders who appoint agents to run the company on their behalf. Therefore, the agents must serve the interest of the principal and maximize their wealth. During the Covid-19 pandemic, the traditional theory seem inadequate as the crisis affected the vested interests of the community as a whole.

An alternative to Friedman's shareholder theory is the stakeholder theory proposed by R. Edward Freeman in 1984. The stakeholder theory posits that an organization should account for all individuals or groups interconnected with the organizational purpose. The concept of stakeholders includes shareholders, customers, employees, suppliers, governments, competitors, consumer advocates, environmentalists, special interest groups, and media (Freeman and McVea, 2001).

Therefore, the stakeholder theory is an approach to consider each group of stakeholders in the long and short-term, including the possibility that the continuing independence of the corporation might best serve these interests. The model focuses on optimizing the simultaneous needs of multiple stakeholders and helps the organization in building trust.

A stakeholder approach to corporate governance helps a firm remain proactive and adaptive during a crisis (Alpaslan et al., 2009). With the changing business environment, firms should aim towards an inclusive corporate governance mechanism that considers the interests of their employees, suppliers, customers, the government, the community, and the environment, both in the short and the long term. Their board of directors must illustrate the firm's accountability towards all groups with a vested interest in the company. The organization should run so that the needs of the stakeholders are at the center.

Stakeholder theory does not reduce the liability of the management towards the shareholders in any way. However, this theory increases their accountability towards others with a vested interest in the company. It does not imply the priority of one group (shareholders) but helps in understanding the prevailing crisis and with thoughtful consideration cater to those stakeholders that are of first concern. For example, some companies can choose to prioritize the well-being and safety of employees in the pandemic second wave. A few months later, when the number of cases reduces, they might prioritize eco-friendly policies. With this approach, no single group of stakeholders is superior to others, and shareholders are not the only primary concern of the organization.

The Indian corporate law, for several years, has recognized the importance of stakeholders' interest than merely protecting the rights of only the shareholders. For example, sections 529 and 530 of the erstwhile Companies Act, 1956 conferred the rights to preferential treatment to workers and creditors in terms of payment during insolvency or amalgamation. Further, section 166(2) of the Companies Act, 2013 specifies the duty of a director to deliver a better corporate purpose while maximizing the stakeholders' value. The new companies act requires directors to treat all stakeholders equally and take a holistic approach based on the stakeholder model theory of corporate governance.

However, shareholders' interest is pre-dominant, and other stakeholders often fail to assert their rights. Thus, organizations must adopt a more structured approach to develop a connection with their stakeholders. The primary concern involves identifying the multiple stakeholder groups associated with the corporate body and the adverse impact due to the pandemic.

2.2. Minimizing the impact of Covid-19 pandemic on stakeholders

The Covid-19 pandemic exposed the interdependence among stakeholders with the organization and the importance of a stakeholder approach for long-term sustainability. Firms should devise ways to minimize the adverse effect on the different groups of stakeholders. The organization must focus on understanding how each stakeholder might react in this pandemic and take necessary measures.

One of the significant roles of the corporate in the pandemic is to fulfill its responsibility towards civil society. The organizations must focus on fulfilling their role of corporate citizenship; an objective often overlooked in the shareholders' model approach of governance. Covid-19, a public health crisis, eventually affected the economy and financial sector, thus raising the alarm for corporates to reconnect with society at large. The advent of the pandemic left some firms with low demands, while few others faced enormous demands, and another group had to look for innovative ways to keep their operations going.

Recognizing the value of societal problems as business concerns, a few firms came forward to help in the relief efforts or public care and other philanthropic activities, recognizing the need of the hour to be stakeholder-centric. Some noteworthy examples include Tata Sons' pledge of Rs. 1000 crore for providing PPE kits and medical equipment, setting up healthcare facilities, and training and knowledge management of frontline workers and the general public (Bloomberg Quint Desk, 2020). Food delivery service aggregator, Zomato, set up the Feeding India fund to support their delivery staff and daily wage earners who lost their earnings during the pandemic. As of January 2021, Zomato provided over 123 million meal kits to starving families in India (Zomato,2021).

It is, therefore, the responsibility of the board of directors to pursue strategic policymaking to make the management realize that social issues caused by the pandemic are not standalone but are a concern for the business, too. The management must address the risk and opportunities from the large-scale societal problems and consider them part of their risk management program. Such endeavors might create a positive image among existing and potential investors. A stakeholder model is appropriate for creating such valued relationships with society at large.

Reports during the pandemic show a considerable pay gap among employees. In the light of the crisis, it became increasingly difficult for executives to attain revenue targets essential to achieving cash-based compensation or bonus stocks. The variable pay component linked to performance targets for the senior management reduced by 85% in 2020-21 (Umarji, 2021). In contrast, some companies chose to pay more to their top management, whereas the middle and lower levels faced entrenchment or pay cuts.

A stakeholder approach prompted the board and senior management of companies like Apollo Tyres and Larsen & Toubro to accept temporary pay cuts to show solidarity with job losses at the lower levels (Mukherjee, 2020). Other initiatives adopted by few organizations were helping the laid-off employees procure jobs elsewhere and voluntary lay-off schemes.

Deviating from the remuneration policies based on the agency theory of creating wealth for shareholders, the board should devise an optimum compensation for its employees and show support amidst this crisis. Although these are short-term initiatives, they provide a foundation for the organizations to focus on compensation policies across levels. The board must adopt retention programs and align payment structures with changing business conditions in the long run.

The supply chain and operating cycle were disrupted after the first phase of lockdown in March 2020 in India. Raw materials failed to reach the production plants as the movement was restricted. Due to a shortage of workforce and concerns about safety, production at factories came to a halt. The demand for non-essential goods fell significantly in the market. On a regional and global scale, disruption in the supply chain caused impediments in the cash flow cycle and increased financial liabilities of the organizations. There is a significant impact on the stakeholders involved, such as the suppliers or creditors.

Haydon and Kumar (2020) reflect that the severity of the Covid-19 pandemic varies across industries. While supply chain operations of non-essential services and products got hugely affected, the corporate sector and its suppliers strived hard to keep the essential services smooth. As the economy might face a third wave of COVID-19, corporates need to develop a resilient supply chain network. It is necessary to build a robust supply chain that might be resistant to future disruptions. It should develop an efficient workforce to communicate with the suppliers on a real-time basis. A dedicated planning and execution workforce could help reduce the gap between suppliers and the organization, increasing the system's efficacy. Corporations can use technological tools such as artificial intelligence and simulation to strengthen supply chain management.

Covid-19 pandemic has changed the demands and preferences of the customers, too. A significant shift in customer preferences is taking place from brick-mortar stores to online platforms. During 2020-21, e-commerce purchases surged by 28% than pre-pandemic in India (Singhi et al., 2021). Customer queries would differ with the switch to e-commerce platforms. Customers might be wary about the hygiene, timely delivery, maintenance of protocols while packing their goods, the quality of their purchases, and value for money. The pandemic has changed how customer purchases a product or service and their choice of products. For example, retail clothing brands experienced a fall in formal wear sales and a rise in home wear demands.
Hence, organizations must focus on customer-driven initiatives to address customers' concerns. They might train their sales staff for sales through digital platforms or interaction. With new channels of marketing, there exists severe pressure on management to strategize customer-centric issues. The organization must study consumer behavior and customize services for them.

The implication of the Covid-19 pandemic might be enduring on the financial market and corporate sector. The global financial markets bore the brunt of the pandemic. The first wave witnessed a rapid decline in stock prices and an economic downturn lowering investors' confidence. In India, too, during March 2020, the stock markets were highly volatile and investor sentiments negative. Post lockdown announcement, on March 23, 2020, the S & P BSE Sensex index witnessed an abysmal decline of 13 percent due to the weak sentiments over the spread of coronavirus. The magnitude of the stock price fall in March 2020 exceeded the decline of stock prices during the financial crisis of 2007-08 (Mazur et al., 2021). Two days later, with the news of government fiscal packages, the market showed positive signs of recovery. Volatile positive and negative moves projecting extreme economic conditions are not conducive to investments (Baker et al., 2020).

The corporate sector faces several constraints in meeting regulatory requirements now. For example, the fiscal year-end date in India, March 31, 2020, was within the lockdown period. As a result, audit firms could not efficiently carry out the physical verification of stocks during statutory audits, which usually takes place at the end of the financial year in March.

The uncertainty and desperate attempt to keep a firm's operations going and ensure profitability could motivate the managers to indulge in unethical behavior. Due to the unprecedented calamity, the operational challenges and financial crisis might pressure the board or management to indulge in fraudulent activities (Rezaee, 2005).

The economic meltdown due to the pandemic impedes growth, affecting a firm's ability to meet its forecasts. Therefore, to conceal the shortcomings, manipulation of financial reports is a viable option for most organizations. Further, the global economic environment is likely to experience a downturn, impacting both the developed and emerging nations. Extreme volatility in the climate might trigger bankruptcy cases, drop-in investments, and failure of specific industries dampening the investors' confidence.

The corporate bodies must evaluate the existing control system and place an internal control mechanism effective in the long run. Timely corrective actions could prevent financial or reputational loss. Also, an effective corporate governance structure focusing on stakeholders is beneficial to gain investor confidence in uncertain times. Connecting with its essential stakeholders such as employees or society at large would help create a positive image among investors in the long run.

3. Conclusion

This article provides a brief overview of the stakeholder theory approach and its relevance for running the affairs of an organization amidst the pandemic. When a business adopts a holistic and inclusive approach by reconnecting to all its stakeholders, it might sustain itself more successfully over the long term. The pandemic requires corporates to re-invent their values and purpose. A relook into a company's purpose beyond financial performance might help achieve better corporate governance.

Although the literature on stakeholder theory considers it as a cumbersome approach for management, in the current situation, inter-connectedness with the stakeholder's groups by the organization would not only help address the needs but portray a favorable image of the company in the minds of the society, an essential element for sustainability. The Covid-19 has exposed the corporate sector's shortcomings and the threat posed by human activities on nature. Corporate laws have included provisions that help create an inclusive environment, but in reality, corporate bodies mostly stay focused on shareholder wealth maximization.

Firms are gradually responding to the external environment pressure now and focusing on the environmental or social issues that could help them grow sustainably. Organizations appear better prepared for the third wave of the pandemic by stepping up vaccination among employees and collaborating with the government at various levels to reduce health risks and economic impact. The corporate approach should be, thus, towards better leadership that adopts multi-stakeholder models to tackle and survive the pandemic crisis.

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