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DELUSIONS ABOUT CORPORATE GOVERNANCE FROM SOCIAL RESPONSIBILITY - POINT OF VIEW -

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ABSTRACT

Recently, companies are expected to continue generating profits while maintaining the highest standards of governance internally. In reality it seems like a mission impossible. The author shows some blind alleys in recent professional literature. He deals with the inappropriate definitions of stakeholders together with the weakly defined purpose of corporations and their performance as well. Better solutions are proposed. They require quite big changes in theory and practice, especially in both education and political system.

Keywords: *corporate governance, social responsibility, sustainable development, value added, company's performance.*

1. INTRODUCTION

There are vigorous debates about corporate governance in professional literature. A special topic are discussions from social responsibility point of view. Some authors think that most of the business globally is carried out by corporations. They are therefore very influential in shaping the growth of economics of the world (e. g. Aneja, 2015, 155). The result is that economic interest of the corporations and the expectations of society sahould be in a mutual existence. It is reflected in several ideas of corporate governance, sustainable wealth creation, corporate philanthropy and advocacy for the goals of the community (Aneja, ibidem, Jamal *et al.,* 2008). It seems quite reasonable, but all of these ideas have some crucial weaknesses. One of them is the fact that debates on corporate social responsibility are becoming similar to the philanthropy. The second weakness are attempts to declare corporate responsibility from stakeholder point of view. Both deficiencies lead to the discussions about morality of capitalism (e.g. Penacchi, 2021) or to the emphasizing of human rights (e. g. Sharma, 2018). It will be discussed deeply in the continuation to show that such debates are directed to blind alley, without an important effect on both theory and practice.

2. DELUSIONS ABOUT STAKEHOLDERS

A relatively large diversity of stakeholder definitions in professional literature[1] is obvious, so it is useful to structure or classify them appropriately. In addition, the classification of stakeholders is important in terms of the content of reporting required by the IESBA Code in point 220 (IESBA, 2018) as well. One option is to classify stakeholders into internal (e.g., shareholders, management, employees) and external (e.g., business partners, creditors).Such a division is simple, but not suitable for a more detailed discussion and analysis of stakeholders. More detailed is the model, which divides stakeholders into investors, customers, suppliers, and employees (Boatright, 2000, 357). The same author suggests a division into investors, political groups, customers, employees, trade associations, suppliers, government, and communities as a more appropriate model (Boatright, ibidem). The problem with the above rankings of stakeholders is not only their number, but above all their diversity of interests. On this basis, conflicts between stakeholders can arise, which the corporation must take into account (e.g. Prindl, Prodhan, 1994). Clearly, it is essential that corporations manage and coordinate the different interests of stakeholders. The professional literature usually contributes to this by classifying stakeholders, but usually only in the form of a more detailed list of stakeholders' types,

[1] More about it in Bergant (2021).

such as: customers, partners, employees, trade union, local community, society, government, NGOs, associations, competitors, suppliers, investors , shareholders (Pohl, Tolhurst, 2010).

Some authors think about corporate social responsibility, in this way: "companies are legally responsible to shareholders and strategically responsible to stakeholders" (e. g. Brooks, Dunn, 2018). Although the separation of legal and strategic corporate social responsibility is in some ways contrary to the consistently understood principles of sustainable development, we must conclude that the essence is certainly the corporates' responsibility to stakeholders, which includes shareholders as well. It is therefore important to find out why the company should be accountable to stakeholders.

The main stakeholders' characteristics is that they bear some risk, connected with the corporation business. This fact offers a new (better) definition of stakeholders, namely: *stakeholders are those who contribute to risk management in the company's operations in creating value added.* This contribution means that the stakeholder assumes a certain part of the risk in the company's operations. At the same time, this fact also provides a substantive basis for justifying the company's liability to the stakeholders from corporate social responsibility (*CSR*) point of view.

From the point of view of risk-taking, stakeholders can be divided into:

1. Governors and management who, in addition to bearing the risk, also contribute to risk management through their decisions; these are mainly employees who are co-owners and partners or majority shareholders (active co-owners of the company's capital) and top management, but they can also be others (e.g. business partners who contractually assume part of the risks by participating in the joint venture or in the case of strategic outsourcing).
2. Non-governors, i.e. those, who bear a negligible small part of the company's risk and whose common feature is that they are directly or indirectly affected by better or worse results from the company's operations, but they cannot directly influence business decisions; however, they have the possibility of different types of control. Non-governors are:
   - Financiers or creditors to whom interest belongs;
   - Employees as non-co-owners as bearers of intellectual capital;
   - Trade unions;
   - Supervisory authorities within the corporation;
   - The state, to which the taxes belong;

- Minority shareholders and portfolio investors to whom dividends or other forms of participation in surplus value added belong (inactive co-owners of the company's capital);
- The narrower and also wider society in various organizational forms that may be affected by the association, for example through its environmental policy;

It should be emphasized that these groups are not static, but change, as their interest can change relatively quickly for a variety of reasons. This means that group members (individuals or associations) move from one group to another. Stakeholders' interest varies depending on how strongly they feel the risk they are exposed to. This feeling is more and more present with the development of civilization, especially informatics and media. It also increases the interest in greater influence in the corporate operations. The above definition of stakeholders is mainly principled, as they also differ according to which corporation (and its specifics) we have in mind. The final definition of stakeholders is therefore objectively conditioned by the concretely selected entity.

It logically follows from the word stakeholder that stakeholders should also participate (in the proportion to the risk taken) in the value added created within the corporation. This statement requires additional explanation in next section.

3. DELUSIONS ABOUT THE PURPOSE OF THE CORPORATION

The definition of the purpose of companies is a crucial starting point for the discussion of their governance. Unfortunately it is an area of many discussions without a clear results. There are two opposite sides. On one side, there are the authors, who argue that profit is not the only purpose and that organizations should make a drift from profit maximization to value maximization, because of considering also the stakeholders' interests (e.g. Freeman *et al.*, 2010, p. 24). On the other side, there are the authors, who still stubbornly defend shareholder value as a main purpose of organizations, especially on long-term (e.g. Edmans, Gosling, 2020). Hence, the dilemma still remains vital and unsolved. Such a situation diminishes the value of stakeholder theory and all efforts regarding the development of corporate social responsibility remain almost near to philanthropic principles (Bergant, 2020).

Therefore, "new eco-political theories of social responsibility will remain on paper because the power structure— the dynamics of the economic system —has not changed" (Adizes, 2020a). Adizes even named coronavirus pandemic as a missed opportunity to make strategic changes that humanity needs to survive (Adizes, 2020). The basis of power structure that Adizes mentioned, is obviously the corporate law that gives the right of deciding about the profit use to the owners of capital.

It is really astonishing that nobody mentions that this part of the law has not any economic or some other logic. Nevertheless, it results in the opinion, that "shareholders are the owners of the firm" (e.g. Henningfeld *et al.,* p. 17). It is purely arbitrary statement. In this way, the problem of possible predomination of shareholders' interests, remains not solved. This allows a position, where self-interested managers pursue their own interests at the expense of society and the firm's financial claimants (Jensen, 2002, p. 242). It means a new starting point for discussion about organizations' purpose.

It is therefore important to find out why the company should be accountable to stakeholders. Most important is the ethical principle of fairness enforced by the value-added law. Every contribution to the creation of value added should be properly evaluated and rewarded. The contribution to the creation of value added also means the contribution to the reduction of business risk (Bergant, 2017). The value-added law has to be considered. It means that a proper system of distributing value added among all stakeholders, who bear a risk, should be established. Otherwise, the entropy of all organizational systems will grow uncontrollably because of the value-added law, which says (Bergant, 2017):

1. Value added is the net outcome of the organizational system in managing the risk inherent to the system and belonging to risk holders in proportion to their contributions to the functioning of the organizational system (*the aspect of creating value added*).
2. The disproportionately high or disproportionately low participation of individual risk carriers in the value added (according to their work contribution) increases the entropy of the organizational system and threatens the realization of its sustainable development (*the aspect of value-added guidance*).

The value-added law is *a general law* because of its validation in *all* socio-economic systems (past, present and future ones), which are oriented towards sustainable development and all human associations, including families.[2] *It is valid and operates also for only two people and through the entire human history. The value-added law operates regardless of the wishes or activities of the people and regardless of the normative organization of the organizational system or its environment. It is, therefore, totally independent of the human will.*

The above statements offer a new (better) definition of stakeholders, namely: stakeholders are those who contribute to risk management in the

2 None of the partners in the family usually does not want to be exploited.

company's operations in creating value added. This contribution means that the stakeholder assumes a certain part of the risk in the company's operations. At the same time, this fact also provides a substantive basis for justifying the company's liability to the stakeholder from corporate social responsibility (*CSR*) point of view.

On the basis of the value-added law, the entropy of organizational systems is mainly the result of the imbalance between participants' contributions and their participation in value added. This imbalance is devastating because it works against cooperation and mutual trust, which is necessary in the context of interdependence (Judt, 2011, 57 and 80).

The contribution to the functioning of the organizational system (in different forms of managing the risk) is given by stakeholders of the organization. The participation in managing the corporate risk is at the same time also a criterion for the definition of stakeholder according to previous section.

The value-added law in its own way shows the shortcomings of various theories of a firm, including contract theory. An attempt of improvement presents a contracting theory of organization that sought to take into account the interests of all stakeholders (e.g., Scott, O'Brien, 2019, p. 312, Kálay, 2002). This attempt has remained halfway through, as it still assumes profit as basic information.

4. DELUSIONS ABOUT CORPORATE PERFORMANCE MEASURES

It is understandable that good governance leads to good corporate performance. Therefore, appropriate measures of corporate performance should be monitored. From sections above, it is clear that following profit instead of value added is not the right way. Profit cannot be a basis for sound stakeholder policy.

At the same time, corporate governance should consider long-term view. It means that only triple bottom line (e.g. Elkington *et al,* 1998) which encompasses economic, social and ecological is the right direction of corporate policy from social responsibility and sustainable society point of view. Therefore, traditional accounting should be improved as a basis of efficient and effective information system.

5. CONCLUSION

The possible conclusion out of previous sections is that there are possibilities to overcome the dilemmas about corporate governance, especially from stakeholders' and organizations' purpose point of view. It is very important from social responsibility point of view as well. The highest responsibility lies on academics and scholars who should find enough courage to overcome the indoctrinated opinion about the profit paradigm in capitalism.[3] Otherwise, we all will become witnesses of growing entropy and the decay of the society.

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[3] Namely some of them are still sure that there is no great need to change the law requirements (e.g. Freeman et al., 2010, p. 229).

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