

Good Governance and Social Responsibility

Lecture 1: Corporation and Corporate Governance

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Lecture Learning Objectives:

At the end of the lecture, you will be able to:

1. Define corporation
2. Identify and elaborate on the attributes of a corporation
3. Discuss the purposes of a corporation
4. Enumerate the different stakeholders of a corporation
5. Explain the duties of the Board of directors
6. Distinguish between multinational and transnational corporation
7. Describe how MNCs and TNCs affect the host countries

“Corporation: An ingenious device for obtaining profit without individual responsibility.”

Ambrose Bierce

What is a Corporation?

To better understand the term corporation, we need to revisit its definition as stated in the Corporation Code of the Philippines.

According to the Corporation Code of the Phils. “A corporation is an artificial being created by operation of law, having the right of succession & the powers, attributes & properties expressly authorized by law or incident to its existence.”

Artificial Being

- Which means that by fiction of law, a corporation is a juridical person whose personality is separate & distinct from its owners.
- Corporation has some of the rights that a natural person possesses.
- It can sue & be sued in court; it can own & dispose of property & it is supposed to be given independence by its owners in terms of existence.
- Corporations can also be convicted of criminal offenses; fraud is an example.

Created by Operation of Law

- Which means it will come into existence through a charter or grant from the state.
- It cannot exist by a mere agreement or a unilateral & self-declaration of existence.
- The functions of corporations are governed strictly & it has to do within the bounds of what is being provided in the corporate charter.

Right of Succession

- A corporation can continue to exist even in death, incapacity or insolvency of any stockholder or member.
- The corporation will not be dissolved even when there is transfer of ownership.

Powers, Attributes & Properties

Which means it is authorized to do activities within the purposes of its creation, it has its own traits & it operates based on what has been expressly provided in the charter including those that are considered incident to its existence as a corporation.

For example, a fishing company need not ask if they could put up a storage facility for this purpose. These are examples of implied authority being given occasioned by the giving of the express authority.

Stakeholders of a Corporation

Management/s

- This refers to the party given the authority to implement the policies as determined by the board in directing the course/business activities of the corporation (Securities and Exchange Commission (SEC), Code of Corporate Governance).
- This is the group of people running the day-to-day activities of the corporation.
- This team is composed of decision makers from the top to the bottom of the corporate hierarchy.
- They are the ones entrusted by the stockholders to do some maneuvering for the corporation to reach its destination.
- They are the decision makers who will shape the future of the organization.
- The decisions that will be made by these people may spell out failure or success of the corporation.

Examples of people who belong to this party are the board of directors, officers, and other managers that in one way or another influence on the way the corporation is being run.

Creditor

- This refers to the party who lends to the corporation goods, services, or money. Creditors may gain from corporation by way of interest for money loaned or profit for goods sold or services rendered thus it is important that in running the corporate affairs the concerns of the creditors should be taken into consideration.
- It is comforting to note that in the Philippine setting our laws are protective of creditors. This is evident in the fact that whenever there is a liquidation the priority of payment belongs to the outside creditors.

Shareholder/s

- This refers to people who invest their capital in the corporation.
- The people who in some cases are considered as the first believer of what the entity can do.
- These are the people who bet their money & assume the high risk of having their money going down the drain.
- Unlike creditors, shareholders being a part-owner of the entity who cannot demand payment from the corporation.
- Creditors on the other hand, can demand payment from the principal & the interest can go to court in case the borrowing corporation cannot pay its obligation.

Employees

- These are the people who contribute their skills, abilities & ingenuity to the corporation.
- They are the ones who invested their future in the company with full trust & confidence that the entity would make them secure.
- Running the corporation with high emphasis on employees is popular in the corporate world nowadays that when business owners decide to expand or diversify, they always cite the number of jobs being created. And, when these businessmen are confronted with business challenges, they always pose this question, “what will happen to the employees?”

- Employees and corporations have symbiotic relationships. In an ideal scenario, employees do what is best for the corporation so that the corporation can provide them with gainful and satisfying work.
- Good employees who can contribute would lead to profit; profit could mean additional benefits to workers.

Client/s

- The party is considered to be the very reason for the existence of the corporation.
- They are the buyers of the corporation's product or services for final consumption, enjoyment or maybe for the use in the production/creation of another goals.
- Clients or customers should be one of the paramount considerations in the operation of a corporation.
- It is important to note in this context that big businesses are directly or indirectly touching so many people's lives. Some of these consumers are so dependent on what these big corporations are producing, leaving them vulnerable to commercial exploitation. To balance best the interest of the customer, first there has to be unilateral and voluntary act of compassion by these businesses to consumers. The predatory instinct of corporations must be reduced if not eradicated by having a sincere and visible operating philosophy which always places clients on the equation not just plain and simple profit driven motives.

Government

- Has several interests in private corporations, the most apparent of which are the taxes that the corporations are paying.
- **Taxes** make government stay afloat & survive as highlighted in the lifeblood theory of taxation. Apart from taxes, corporate activities help the economy, in general, and the individuals, in particular. The existence of businesses means jobs.
- **Jobs** provide income to individuals in the form of salaries.
- **Salaries** translate to purchasing power.
- It is worth emphasizing that it is the duty & responsibility of the govt. to provide the people with the basic ways & means to survive & the govt. gets the biggest help from the corporations.

Aside from those mentioned, there are services offered by private corporations that somehow lessens the burden of the government, for example: health services, education, vital industries like power, water, and transportation. In developing countries like the Philippines, it can be expected that the government cannot provide these services to level of competence to the greater majority. Private corporations fill the gaps in helping the government in the delivery of these basic services to the people. The government is also a buyer of products of some corporations. Government also set standards and regulate important aspects of corporate activities. All these things make the government an important stakeholder of corporations.

Public

- Has a stake in corporations considering that the latter provides the citizens with the essentials such as goods, services, employment & tax money for public programs. The result of responsible or irresponsible conduct of these corporations can also affect the public in so many ways. For example,
- If a corporation is environmentally inconsiderate by giving too much emphasis to their profit objectives, it is the public that would bear the brunt of the consequences like pollution, calamities, diseases, and many other undesirable consequences.
- Another aspect being considered is the concerns of natural resources. There is great public interest in businesses that belong to the extractive industries like mining, logging, and petroleum exploration and extraction of exhaustible natural resources. There is nothing wrong with all these activities so long as what is due to the general public should be considered. In some cases, however, there is a problem of access to vital information and given that the locations of the operations of these businesses are in far flung areas then the issue of access is aggravated. That is why it can be said that sometimes there exists a “bureau-industrial conspiracy” which means that there is a connivance between the persons who decide on the part of the government and the representatives of the big businesses seeking government approval. This scenario leaves the people helpless in asserting their rights as stakeholders. These natural resources that they are trying to exhaust for profit belong to the people and it is but normal and fitting that whatever they do the interest of the public should be considered.

General Purposes of a Corporation

1. Early-Stage Survival

There are several theories on the aims & objectives of a corporation. However, for an entity which has just started, the main objective would be survival, especially during the early years of its existence. Corporation should aim first for the most basic. That is, how to gain momentum especially when its entity is during crisis, for it to withstand the hostile environment of commercialism.

2. To increase profit

According to Milton Friedman, the social responsibility of business is “to increase profit”. This is anchored on the argument that stockholders are the owners of the corporation and therefore, corporate profits ultimately accrue to them. Corporate executives and hired managers are the stockholders’ agents and should operate in the interests of their principal, the stockholders.

Stockholders are entitled to their profits as a result of a contract among the corporate stakeholders. A **stakeholder** in this perspective refers to employees, managers, customers, the local community (public) & the stockholders. Each cluster of stakeholders has a contractual relationship with the firm, since they receive the remuneration they mutually and freely agreed to, in a pre-established agreement or contract.

Based on the above, giving the corporation the authority to operate carries with it the idea that corporation should earn for the following purposes:

Specific Purposes of A Corporation

1. To serve its purpose of existence which is to make the stockholders happy.
2. To perform its contractual obligation to stakeholders embedded in the grant or authority to operate.

These include but not limited to the payment of taxes to the government, taking care of employees within the bounds of what is legal, giving back to the community and many others which is part of the implied agreement for its existence.

3. To offer vital services to the general public

There are services that are hard for the government to offer to the vast majority of people without the help of private enterprises. The government cannot even solve by itself the problem as basic as traffic. It is in this context that partnerships between the government and the private corporations be considered to deal with some problems. Typical example of this in Metro Manila area where traffic is almost intolerable, fortunately, the government got a big help from private investors in NLEX, SLEX, North rail, South rail, and other semi-private infrastructures and other mass transport system investors. Other services in which the government needs help is in the areas of power, water, education, and health services.

4. To offer goods & services to the mass market

Some corporations are run not only for the sole purpose of generating profit but also to provide service to masses. This endeavor will meet the needs of the lower-income-class group by offering them something at a price they can afford. For example, cheap and accessible transport service. Some might ask, what is the difference of this purpose from the previous one? **First**, they differ in the area of pricing. Pricing in vital industries is not market-dictated. The investors are given guaranteed returns to cover their investment risks. And most are government sanctioned and enjoy an almost monopolized if not fully monopolized environment. **Second**, they differ in the area of competition. In a perfectly competitive market, the services and goods are easily obtainable because there are lots of suppliers. In the less competitive vital industries obtained by government contracts, regulations and/or franchises, the service and goods are only provided by a few or worse, by one producer.

Shareholders, Bondholders & Directors

After getting a significant understanding about the corporation and its stakeholders, one needs to know the other players of the corporation. Shareholders, bondholders, and directors complete the cast when the corporation starts to operate.

- These are the parties which will be having various claims over the entity.
- **Shareholders** will be having their claim in the form of dividends.
- **Bondholder's** claims will be in the form of interest earned via long-term agreement.
- **Directors** will have their eyes on their salaries, incentives, stock options & bonuses.

To gain a better understanding, we need to discuss who they are and how they are related to the corporation.

Shareholders or Stockholders

- Are artificial or natural people that are legally regarded as owners of the corporation.
- Are bestowed with special privileges depending on the class of their stockholdings.

These rights may include:

1. The right to vote on matters such as elections of the board of directors.
2. The right to propose shareholders resolutions.

3. The right to receive dividends.
4. **Pre-emption right** which is the right to purchase new shares issued by the company to maintain its percentage of ownership in the company. This can also be called right to first refusal.
5. The right to **liquidating dividends**, that is the right to receive the company's assets during liquidation or cessation of business.

However, stockholders' rights to a company's assets come only second to the rights of the outside creditors of the company. This means that stockholders typically may receive nothing if after the company is liquidated, there is not enough money to pay its creditors. Shareholders play an important role in raising capital for organizations, the capital that is otherwise hard to be raised in a proprietorship or partnership form of business organization.

Shareholders are considered principals, and the directors and officers are considered agents under the agency theory in governance. As principals, they are expecting that things that the agents would do would be for the paramount benefit of the stockholders. Although directors and officers of a company are bound by fiduciary duties to act in the best interest of the shareholders, still the shareholders themselves deserve an independent third party that would attest on what the management team is doing. This is here where the external auditors would come into the picture to lend credibility to the reports prepared by management.

Bondholder/s

- Is generally defined as a person or entity that is the holder of a currently outstanding bond.
- A **bond** being a certificate of indebtedness by the issuing corporation provides some advantages on the holder of the said instrument. The holder has the complete authority to manage the bond in any way that he sees fit and advantageous to him. He can even sell them for it is an investment on his part.
- There are several advantages to being a bondholder rather than a shareholder of a company. One of the major advantages is that when the company goes through a process that involves the liquidation of assets, bondholders and other outside creditors are given priority over stockholders, which means that the bondholders will receive payments for the outstanding bonds before any of the stockholders receive theirs in relation to their outstanding shares of stock.

- Another advantage is that bonds are not exposed to the fluctuation of interest rates because whatever is the agreed interest rate when the bonds were issued it will be the one to be used throughout the life of the bonds. Interest rate is nailed so the bondholder need not worry. There is an element of predictability of income.
- They receive regular interest payments during the life of the bond computed at face value multiplied by the interest rate. This interest payment usually takes place every six months and will continue to go on until the maturity of the bond. Typically, the life of a bond would take as short as 5 years to as long as 25 years. The bondholder has a guaranteed return of the principal at some point in the future. This makes investment in bonds rewarding on the part of the investor who can afford to have their money in the hands of the investee for longer periods of time.

Board of Director/s

- Refer to the collegial body that exercises the corporate powers of all corporations formed under the corporation code (SEC Code of Corporate Governance). It conducts all business and controls or holds all the assets of such corporations. This body is formed by the stockholders, and they will act as the governing body of the corporation.
- The BOD will be headed by the chairman of the board who is considered as the most influential person in the corporation. The board's activities are determined by the powers, duties, and responsibilities delegated to it or conferred on it by an authority. These issues are typically detailed in the corporations by laws.
- Their powers, duties & responsibilities are written in the by-laws.

By laws normally specify the number of members of the board. It may also contain matters such as how the board members are to be chosen including the specifics on when and where they are going to meet to discuss things concerning the operation of a corporation.

Duties of the Board of Directors

1. Governing the organization by establishing broad policies & objectives

Examples of these broad policies are as follows: **investment policies** that will answer the question as to where to put excess money for additional revenue purposes; **diversification policies** that will answer the question as to what type businesses that the corporation will be getting into as additional lines of business in the near future.

2. Selecting, appointing, supporting & reviewing the performance of the chief executive

As stewards of the corporation, the board of directors is expected to be with the chief executive in the latter's direct or indirect dealings with the corporation.

3. Ensuring the availability of adequate financial resources

It is expected from the board that the survival and financially healthy functioning of the entity will be on the top of their agenda. With the coordination of people from the finance department, the BOD has to make certain that funds are available to finance the day-to-day activities of the entities.

4. Approving annual budgets

Another responsibility of the board of directors is to approve the annual budget, which can be described as the reflection of organizational program and plan into financial terms. The annual budget will more or less define the operations of the corporation in any given year.

5. Accounting to the stakeholders the organization's performance

One of the most critical duties of the board of directors is to account for the entity's performance to its stakeholders; more importantly, to the shareholders who are the owners of the corporation. They need to inform every stakeholder what went on at any particular given period. This can be accomplished by providing the reports on financial highlights, short and long-term plans, material investments during the period, including the financial statements duly audited by an independent auditing firm.

Multinational & transnational Corporations

- International corporations have several categories depending on the business structure, investment & product/service offerings. Multinational companies (MNC) and transnational corporations (TNC) are two of these categories. Both MNC and TNC are enterprises that manage production or deliver services in more than one country.
- They are characterized as business entities that have their management headquarters in one country known as the **home country** and operate in several other countries known as **host countries**. Industries like manufacturing, oil, mining, agriculture, consulting, accounting, construction, legal, advertising, entertainment, hotels, banking, and telecommunications are often run through TNCs and MNCs.

Multinational Corporation (MNC)

- Have investment in other countries but do not have coordinated product offerings in each country.
- They are more focused on adapting their products & services to each individual local market. Well-known MNCs are mostly consumer goods manufacturers and quick-service restaurants like Unilever, Proctor & Gamble, McDonalds and 7-11.

Transnational Corporation (TNC)

- Has been technically defined by the United Nations Commission on Transnational Corporations and Investment as Enterprises which own or control production or service facilities outside the country in which they are based.
- A transnational corporation is any corporation that is registered and operated in more than one country at a time.

A transnational corporation has its headquarters in one country and operates wholly or partially owned subsidiaries in one or more other countries. The subsidiaries report to the central headquarters.

Compared with MNCs, transnational corporations (TNC) are much more complex firms. They have invested in foreign operations, have a central corporate facility but give decision-making, R & D, and marketing powers to each individual foreign market. Most of them come from petroleum, I.T, consulting, pharmaceutical industries among others. Examples are SHELL, Accenture, Deloitte, Glaxo-Smith Klein, and Roche.

Many of them are owned by a mixture of domestic and foreign stockholders. Most TNCs and MNCs are massive with budgets that outweigh smaller nations' gross domestic product (GDP). For example, the combined 2011 GDP and sales revenues of top corporations (World Bank and Fortune Global 500 data), showed that the sales revenues of Riyal Dutch Shell, Exxon Mobil, Wal-Mart Stores, BP and Sinopec Group was ranked 25th, 26th, 27th, 29th and 30th respectively.

Thus, TNC and MNC alike are highly influential to globalization, economic and environmental lobbying in most countries. Because of their influence, countries and regional political districts at times tender incentives to MNC and TNC in form of tax breaks, pledges of governmental assistance or improved infrastructure, political favors and lenient environmental and labor standards enforcement in order to be at an advantage from their competitors. Also due to their size, they can have a significant impact on government policy, primarily through the threat of market withdrawal. They are powerful enough to initiate lobbying that is directed at a variety of business concerns such as tariff structures, aiming to restrict competition of foreign industries.

Corporations have various motives for establishing a corporate presence in other countries. One possible motive is a **desire for growth**. A corporation may have reached a plateau meeting domestic demands and anticipate little additional growth. A new foreign market might provide opportunities for new growth.

Other corporations **desire to escape the protectionist policies of an importing country**. Through direct foreign investment, a corporation can bypass high tariffs that prevent its goods from being competitively priced. For example, when the European Common Market (the predecessor of the European Union) placed tariffs on goods produced by outsiders, US corporations responded by setting up European subsidiaries.

Two other motives are more controversial. One is **preventing competition**. The most certain method of preventing actual or potential competition from foreign businesses is to acquire those businesses. Another motive for establishing subsidiaries in other nations is **to reduce costs**, mainly through the use of cheap foreign labor in developing countries. A transnational corporation can hold down costs by shifting some or all of its production facilities abroad.

Transnational corporations with headquarters in the United States have played an increasingly dominant role in the world economy. This dominance is most pronounced in the developing countries that rely primarily on a narrow range of exports, usually primary goods. A transnational corporation has the **ability to disrupt traditional economies, impose monopolistic practices, and assert a political and economic agenda on a country**.

Another concern with transnational corporations is **their ability to use foreign subsidiaries to minimize their tax liability**. The Internal Revenue Service (IRS) must analyze the movement of goods and services between a transnational company's domestic and foreign and then assess whether the transfer price that was assigned on paper to each transaction was fair. IRS studies indicate that US transnational corporations have an incentive to set their transfer prices so as to shift income away from the United States and its higher corporate tax rates and to shift deductible expenses into the United States. Foreign owned corporations doing business in the United States have a similar incentive. Critics argue that these tax incentives also motivate US transnational corporations to move plants and jobs overseas.

Textbook:

Good Governance & Social Responsibility, Dr. Christopher Biore, Dr. Roberto Gonzales, Prof. Jose Lemuel Caparas, Dean Nilo Burgos and Prof. Win Ballada, ASEAN (Academicians, Students, Educators and Alliance) Inc.

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