Company Secretary's contribution to Profit Centre – an economic analysis

By

Rupanjana De

FCS, LL.M, M.A. (Eco), EMLE

Practising Company Secretary, Kolkata

rupanjana.de@gmail.com

Couple of decades back, Company Secretaries used to come across the myopic views of many so called intellectuals who thought that the job of a CS is the same as that of a private secretary. With the passage of time as compliance requirements became more stringent, the pride of the position was rightly achieved. Like icing on the cake, Companies Act, 2013 has succeeded in removing the confusion by bringing a Company Secretary within the definition of a Key Managerial Personnel (KMP) in an organization alongside the Managing Director, Whole Time Director, Chief Executive Officer and Chief Finance Officer.

While we all know about the necessity of having a company secretary in an organization from the legal perspective, in the following article, I dwell upon the concept from an economic point of view.

Why organisations need a Company Secretary?

Laws continue to be enacted, and the regulatory environment has become more complex due to unacceptable conduct remediation. Consequently, entities continue to be compelled to demonstrate compliance with legal mandates through documented assurance assessments. In order to ensure compliance with all laws and legal mandates organisations need Company Secretaries

Responsibilities

Responsibilities of a Company Secretary are manifold. Broadly categorizing the following comprise his main role in an organization:

- Compliance Officer
- Secretarial Services
- Relationship Services
- Legal Officer
- Administrative Services
- Representation Services
- Finance, Accounts & Taxation Services
- Advisory & Consultancy Services
- Liasoning & Arbitation Services
- Miscellaneous Services

A little bit of Economics

- In economics, especially in contract theory, the term '**signalling'** refers to the message or information that one party (the *agent*) effectively conveys about itself to another party (the *principal*). Where no signal is sent to the market, asymmetric information leads to adverse selection / wrong selection. Similarly when a 'bad signal' is sent the market reacts in a negative manner.
- For a company the two most important SIGNALs to the market as of today are – financial performance and legal compliance. How well a company's operations are managed and how good it deals with legal mandates are the key factors in creating its goodwill not only in the primary or secondary capital market, but also with prospective employees and other stakeholders being Banks, Financial Institutions, Consumers, Public in general and so on.

How is Signalling relevant w.r.t. Company Secretaries?

A company that is well managed and has good governance system in place, which maintains compliance with all relevant provisions and mandates is one with good acceptance in the market.

It has Goodwill and very Strong Signalling Strength.

The compliance in such companies is essentially taken care of by a professional, a Company Secretary or a Secretarial Department.

This goes to imply that a company with good Signalling strength is essentially one with a team of Company Secretaries who ensure effective regular compliances.

BOTTOMLINE

A company with a Company Secretary or a Secretarial Department enjoys more Goodwill and has Stronger Signalling Strength.

Savings in Transaction Cost

- In economics, a **transaction cost** is a cost incurred in making an economic exchange or in simple terms, a cost incurred in a transaction
- Transaction costs are of three types -
- *Search and information costs* – These costs are incurred in finding out the required good or service available in the market with lowest price, best quality and so on.
- *Bargaining costs* – These costs are incurred in arriving at an acceptable agreement with the selected party to the transaction, drawing up an appropriate contract and so forth.
- *Enforcement costs* – These are costs incurred on ensuring that the other party sticks to the terms of the contract, and taking appropriate action in case of default.

Now let us illustrate this from the point of view of a Company Secretary (CS).

- *Search costs* – Companies employing CS incur this cost once, i.e., during recruitment. The cost for companies not recruiting a CS is recurring as every time there is a Compliance requirement, fresh search has to be initiated
- *Bargaining costs* – Like the previous one, this is also a 'One Time Cost', i.e. Salary Negotiation
- *Enforcement costs* – Enforcement costs are recurring as enforcement is a continuous process and the duty of a CS. But with regular 'On Time' compliance, costs incurred in penalties for default may still be saved

BOTTOMLINE – A Company Secretary helps organisations save on transaction costs

Agency Theory

- In Agency theory, an Agent manages the activities of a Principal for the benefit of the Principal.
- A Company is an Agent of various stakeholders (being the shareholders, Debenture holders, Govt., public and so on) who are essentially the Principal.
- A Company Secretary is the person who connects the Principal with the Agent and ensures that the Principal's interest in the company is maintained safe and secure through activities of the Agent. It is the duty of a Company Secretary to ensure the Management of a Company ensures compliance with all laws and free and fair view of the state of affairs of the company are passed on to the stakeholders

While considering the economics of the position of a company secretary, it has also to be acknowledged that efficient, diligent and disciplined company secretary with a good career record would be a nice means of signalling in the hands of the company to potential investors about its good corporate governance standards. Investors can thus have more reliance on such a company and it would be easier for the company to raise its capital from the market.

Few years back the Institute of Company Secretaries of India had introduced an award for companies exhibiting excellent corporate governance and the same was called the 'ICSI National Award for Excellence in Corporate Governance' and of late this award has gained much popularity and is much sought after by companies. Every year two awardees are selected by a selection committee consisting of the high ranked officials of the major stock exchanges of the country and representatives from the other major corporate and regulatory bodies. The selection criterion is the application of the triple bottom line approach, viz. fulfillment of the social, environmental and economic criteria. Companies that have added to social well being, that have taken steps towards improvement and maintenance of the environment and that have helped improving the economic scenario of the country apart from diligently following all regulatory compliances are the ones that are considered suitable for this award. Essentially it is the Company Secretary accompanied by either the Chief Executive Officer (CEO) or the Managing Director or any other Director who accepts the award. This shows the recognition of a company secretary in enhancing good corporate governance in India and at the same time it also provides a good measure of judging quality of corporate governance by the layman investors. For companies that do not qualify for the excellence award a corporate governance certificate by statutory auditors included in the annual report might do the necessary signalling to the shareholders. However, so said, it has also to be acknowledged that in countries like India, where the majority of investors are unaware about the quality of corporate governance in a company and at the same time totally unconcerned about the same, the fact that a company has an efficient secretary to steer it through good corporate governance, would hardly be any matter of significance and it would consequently lose its signalling strength. Thus, under condition of investor unawareness about corporate governance, only theoretically he remains a good signalling device.

The concept of dynamic efficiency, which is widely used in the analysis of economic organizations, refers to the capacity of a given system (a company or, at a higher level, a sector or industry) to innovate and survive in a changing and uncertain environment. This also has particular relevance to company law. The emphasis in the analysis of both technical and dynamic efficiency is on mechanisms for the efficient production of information, the management if risk and uncertainty, and incentives to change existing products, methods of production and forms of business organization which affect the rate of change of efficiency.

In Corporate Governance literature much emphasis is given to agency costs which arise from the separation of ownership and control between shareholders and managers. Agency costs can be thought as a subset of transaction cost and they include the costs of drafting appropriate contractual mechanisms for aligning the interests of the parties and the costs of observing, verifying and enforcing contractual performance. The essence of 'principal-agent' relationship lies in the asymmetry of information between the parties; the agent possesses the information to which the principal cannot costlessly gain access. The existence of informational imbalances of this kind mean that market based exchange can no longer function to ensure allocative efficiency, as it would for information (or for the diversification of risk in the absence of information) of the kind postulated by the fundamental theorems of welfare economics.

In the long-term economic relations the value of the parties' investments (whether of physical or human capital) is often tied up with the maintenance of the relationship in question, giving rise to an element of bilateral monopoly or 'asset specificity'. This means that the relationship is capable of generating an economic surplus or 'quasi rent' over and above what the parties could achieve through decentralized exchange under market conditions. The existence of quasi rents gives right not just to informational problems but also to issues of strategic action over the terms on which the surplus is to be divided. Strategic action essentially refers to opportunistic behaviour by one or other of the parties, aimed at seeking an advantage for themselves at the cost of the other; since no overall gain is made in the joint welfare of the parties, the result is a net social cost. The essential point is that the market cannot operate to solve these bargaining problems which arise ex-post the making of the agreements; a specialized governance structure to regulate the continuing exchange is therefore required.

Economic analysis of law has gained much popularity in the western countries recently. Much of the efforts of researchers in this field of study are aimed at … Corporate law is a set of terms available off the rack so that participants in corporate ventures can save the cost of contracting. There are lots of items, such as rules for voting, establishing quorums, and so on, that almost everyone will want to adopt. Corporate codes and existing judicial decisions supply these terms 'for free' to every corporation, enabling the venturers to concentrate on matters that are specific to their undertaking. Even when they work through all the issues expect to arise, they are apt to miss something. Corporate law, and in particular the fiduciary principle enforced by courts – fills in the blanks and oversights with the terms that people would have bargained for had they anticipated the problems and been able to transact costlessly in advance. On this view corporate law supplements but never displaces actual bargains, save in situations of third party effects or latecomer terms.