THE ECONOMIC TIMES

Sticking Close to the Law

Shareholder supremacy in companies is slowly, but surely, giving way to stakeholder supremacy

28 Dec 2019 Nishith Desai & Amit Singh

Growth of the networked economy has spawned a new category of entrepreneurs. They have been documented as 'regulatory entrepreneurs' in a research paper (bit.do/ fnczR) by Elizabeth Pollman and Jordan M Barry.

Until recently, the Indian economy witnessed licence raj, which created barriers to entry and encouraged rent-seeking and inefficiency by patronised centres of profit. The amalgamation of technological innovation and value creation by taking advantages of lacunae in the regulatory frameworks is a relatively newer phenomenon. The entrepreneurs of a past era used grey areas of law to primarily benefit themselves. The new-age ones, however, use law to create benefit for the public, enhancing their own value in the process.

Take the proliferation of mobile wallets. They provide significant efficiency and safety to users and received a major boost with demonetisation. Many of these firms rapidly scaled the valuation ladder without being shackled by regulatory requirements that bind traditional deposittaking non-banking financial companies (NBFCs) and banks.

Bike-pooling app companies like Quick Ride offer sharing of rides on two-wheelers, a service that monetises a sunk cost for the bike owner. Yet, there are no regulations that govern such a form of taxi service. The immense popularity of ecommerce platforms in India, where foreign-owned multi-brand retail was not permissible under law, is another case in point.

While some firms build their business around an aggressive interpretation of law, business models of some companies are built around the need for a change in the law itself. They aspire to rapidly gain scale, and then claim protection from the law, as companies that are 'too big to ban'.

Since they bring new access to public service, the public is co-opted into demanding a change in the law, or a favourable interpretation by the regulators, where ambiguities, or laissez-faire, exist. Uber is a classic case in point. Taxi service, across the globe, is a highly regulated industry, with strict norms around driver selection, fare calculation, number of taxis, etc. Yet, Uber has manoeuvred its way into most major towns and cities, forcing officials to change local laws to accommodate this phenomenon.

Cart Before the Horse

Google is building an autonomous car, perfectly aware that driverless cars are not yet legal across the world. Its business model presumes that laws, across the world, will be changed as a response to technological progress.

While enterprises have largely focused on changing local laws, sometimes even global efforts have been launched, as was the case of the Free Basics campaign by Facebook. Free Basics offered basic internet access for free to the needy, in return for allowing the service provider to charge, block or slow down certain sites or content. Such efforts are not always successful. Free Basics was launched in India, but was withdrawn after India amended its laws to uphold net neutrality.

Some have had mixed success. Companies dealing with cryptocurrencies slipped in through the cracks in laws that govern currencies, commodities, traded securities and payment technologies, before regulators stepped in. Yet, in some countries like Japan, these companies continue to flourish.
The common threads underlying many such enterprises are:

A platform-based, highly scalable model. The scale of operations and an engaged user base act as an insurance policy against regulatory action.

Visible reward structure for a concentrated user base that could potentially overshadow any diffused externalities to society. While some organisations have made great strides on challenges with regards to trust and safety, these could impose a cost on society. However, such costs get diffused over a very large base, compared to the highly visible benefits available to property owners and travellers. Interestingly, the old entrepreneurs were often insensitive to public interest, whereas the new ones tend to respond swiftly to public feedback by modifying their policies or business models, and often give away large part of their wealth through philanthropy.

Slowly, shareholder supremacy is giving way to stakeholder supremacy, where the objective is to create differentiated value for all stakeholders. It is no coincidence that companies like Google, Uber, Airbnb and Facebook that have, at times, operated in the grey zones, are also some of the most highly valued companies in the world. However, companies have also begun to be guided by the principles of ethics, responsibility and transparency in the absence of regulatory regime, thus enhancing stakeholder confidence.

The Business of Business

Breakthrough in technology could certainly act as an impetus to modify archaic laws, which may have been suitable for a different era. Besides providing tremendous opportunities for value creation, these could also open new frontiers for building business models around ethics and propriety, for instance, in the case of human cloning.

Laws have, at times, been blind, and will continue to have blind spots. Meanwhile, the future seems primed to witness an interesting interplay between innovation, value creation and regulation.

Desai is founder, Nishith Desai Associates, and Singh is co-head, enterprise technology & services investment banking, Avendus Capital