Relevance of Kautilya’s Insights to Corporate Governance and Management

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Abstract

There is a separation between owners and managers in a corporation. Managers, being utility maximizer, are likely to shirk and enjoy expensive perks. In the literature, these are termed as agency costs, conflicts of interest or moral hazard problem. Current approaches suggest legalistic measures to mitigate this problem. Kautilya’s conceptual framework is presented that not just mitigates, but eliminates this problem altogether. Secondly, it is shown that the current organizational structure, a relic of the past industrial economy, for corporate-governance and management is sub-optimal. Thirdly, Kautilya’s suggestion to hire three or four full time experts to enhance efficiency and creativity, which are essential to survival and growth of a business in today’s increasingly knowledge-based economy, is presented.

Keywords

Agency Costs, Principals’ Costs, Accountability-Authority Trade-Off, Culture of Grabbing and Suspicion, Corporate-Governance, Ethical Surplus

1. Introduction

In modern Corporations there is a separation between managers and owners. The managers might become lazy and also put their own interests ahead of the owners (shareholders). Two types of legalistic approaches have been proposed to mitigate the moral hazard problem. The principal-agent approach essentially focuses on devising incentive-based legal contracts to elicit effort. The other legalistic approach focuses on accountability of the agents’ actions to mitigate the moral hazard problem. There has been an intense debate between those who advocate shareholder (principal)-supremacy and others, who advocate Agent-supremacy. This debate has led to the realization that there is a trade-off between accountability and authority on the possibility frontier. [1] Zohar Goshen and Richard Squire (2016) argue that just like agency costs, there are principals’
costs also. They propose minimization of the sum of agency costs and principals’ costs for determining the division of control between managers and owners. Their suggestion does help in determining a mix of accountability and authority on the possibility frontier. A very brief review of these two approaches is presented in Section II.

Goshen and Squire identify four types of costs: agency costs consisting of conflict costs and competence costs and similarly principals’ costs consisting of competence costs and conflict costs. Kautilya’s objective was to avoid the avoidable costs. He believed agent’s conflict costs were avoidable costs and he suggested an effective way to eliminate them. He understood the distinction between constraints and restraints. Constraints are external to the person since these are imposed by the society and are less effective than the restraints since these are internal to the person. Kautilya put heavy emphasis on internal restraints to eliminate agent’s conflict costs. This is presented in Section III.

Limited liability and economies of scale by pooling resources were the two hallmarks of a corporation for an industrial economy. For example, no one could start a steel plant with some pocket change. On the other hand, in the current knowledge-based economy, pooling of information and knowledge is considered the key to survival and growth. Interestingly, Kautilya understood its importance even in his agricultural economy. Board of Directors is not known to enhance creativity. Kautilya would suggest replacing the Board with three or four full time experts. His organizational structure is also efficient since agent’s competence costs are virtually zero. His insights related to efficient management are provided in Section IV. Final Section contains some conclusions.

2. A Summary Review of Current State of Corporate Governance

Kautilya understood the principal-agent problem and suggested various measures to eliminate it. However, credit goes to Adolf A. Berle and Gardiner C. Means (1932) for highlighting the fact that there was a separation of ownership and control in public corporations. Since then two approaches: (a) principal-
agent and (b) agency costs have been proposed to handle the agency/ principal-agent problem. These are presented below in turn.

2.1. Principal-Agent Approach

All the research on principal-agent problem assumes that the CEO is competent but is lazy, that is, might not put in full effort. S/he is a utility maximizer and take care of the shareholders (or stakeholders) only to the extent that promoted his/her own interest. Various packages of incentives are suggested to motivate the CEO to reduce shirking and align his/her interest with those of the principals. Figure 1 captures the most salient feature of principal-agent approach.

Any point to the left of $E$, Marginal Benefit to shareholders from giving incentives to management > Marginal Cost of the incentive package to it, it is profitable to continue providing additional incentives. Similarly, any point to the right of $E$, marginal cost of incentives is higher than the marginal benefits to the shareholders, reduce the incentives. The benefits to the shareholders are maximized where Marginal Benefit = Marginal Cost of incentives.

It may be noted that the emphasis is primarily on eliciting effort and not on corporate control as such. More importantly, it may also be pointed out that the additional effort elicited through financial incentives, most likely would be still less than the potential effort. As an illustration, suppose, the effort level were 80% of the potential level before the provision of incentives. Provision of financial incentives might raise it to 90% implying that it would still be less than the potential level. It is also possible that sometimes financial incentives might not work at all. For example, the provision of stock options to management were introduced with an expectation that it would reduce shirking and diversion of assets from the corporation to personal gain. But instead led to abuses by back-dating the options and focusing on measures for boosting stock price at the expense of long run growth.

![Figure 1. Level of effort. (MB = marginal benefit curve of incentive package and MC = marginal cost curve of the incentive package. OE* = optimum level of effort.)](image-url)
2.2. Agency Cost Approach

Since the managers are not the owners, they are likely to shirk, that is, likely to put less than the desirable level of effort in managing the company, divert corporate resources to enjoy perks and use defensive measures to stop any value enhancing takeover. These are called agency costs (see below Goshen and Squire’s Matrix for a comprehensive definition of agency costs). [3] Arrow (1974) argues that an increase in accountability would come at the expense of authority. [4] Bainbridge (2008) accepts Arrow’s argument that there is a trade-off between accountability and authority but still advocates Agent-supremacy. [5] Brett McDonnell (2009) points out that any point on the possibility curve is equally good, implying that Bainbridge’s claim regarding Agent-supremacy is not justified. The debate between proponents of Shareholder-supremacy and those of agent-supremacy could not determine the appropriate mix of accountability and authority.

Zohar Goshen and Richard Squire (2016) significantly advance the analysis. They argue that just like the agency costs, there are principals’ costs. They explain, “And in terms of the problem, we distinguish between “competence costs,” which we define as “the costs of honest mistakes plus the costs of efforts to avoid such mistakes;” and “conflict costs,” which we define as “the costs of self-seeking conduct plus the costs of efficient efforts to prevent such conduct.” We refer to efficient efforts to prevent self-seeking conduct because a cost resulting from, for example, overspending on monitoring—the incurring of $100 in monitoring costs to prevent only $50 in misconduct—would constitute a mistake, and thus should be considered a competence cost rather than a conflict cost.” They classify agency costs into two categories as agency conflict costs and agency competence costs and similarly, principals’ costs are classified into principals’ competence costs and principals’ conflict costs. They provide the following matrix (with a slight alteration) of agency costs and principals’ costs (Table 1).

<table>
<thead>
<tr>
<th>Table 1. Synthesis: The control-cost matrix.</th>
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</thead>
<tbody>
<tr>
<td><strong>Figure One: Control Costs</strong></td>
</tr>
<tr>
<td>Principal</td>
</tr>
<tr>
<td>Lack of expertise</td>
</tr>
<tr>
<td>Inadequate information</td>
</tr>
<tr>
<td>Lack of intelligence</td>
</tr>
<tr>
<td>Poor emotional control</td>
</tr>
<tr>
<td>Coordination problems</td>
</tr>
<tr>
<td>Cognitive myopia</td>
</tr>
<tr>
<td>Agent</td>
</tr>
<tr>
<td>Lack of expertise</td>
</tr>
<tr>
<td>Inadequate information</td>
</tr>
<tr>
<td>Lack of intelligence</td>
</tr>
<tr>
<td>Poor emotional control</td>
</tr>
<tr>
<td>Overconfidence bias</td>
</tr>
<tr>
<td>Optimism bias</td>
</tr>
</tbody>
</table>

| Competence Costs                           |
| Collective-action problems                 |
| Reneging on promises                       |
| Rational apathy                            |
| Rational reticence                         |
| Holdouts                                   |
| Empty voting                               |
| Different horizons                         |
| Shirking (reduced effort)                  |
| Diverting (self-dealing)                   |
| Option backdating                          |
| Entrenchment                               |
| Merging for size                           |
| Merging for diversification                |
| Excessive or inefficient pay               |


1McDonnell, Brett H. (2009, p. 143) “Arrow, supra note 9, at 78 (‘If every decision of A is to be reviewed by B, then all we have really is a shift in the locus of authority from A to B and hence no solution to the original problem.’).”
They argue that there is a trade-off between principals’ costs and agency costs. According to them, minimization of the sum of principals’ costs and agency costs should determine the division of control between the principals and the agents and it is likely to vary from firm to firm. They define, “Let us define the “delegation substitution rate” as the ratio of the increase in expected agent costs to the decrease in expected principal costs produced by an incremental transfer of control rights from investors to managers in a firm:

Delegation rate of substitution = increase in expected Agent costs/Decrease in expected Principal costs”

For cost minimization, the rate of substitution should be =1.

That is,

Increase in expected Agent costs = Decrease in expected Principal Cost
Marginal cost (MC) = Marginal Benefit (MB)

This cost minimization approach could be used to determine the mix of accountability and authority also. Figure 2 captures the usefulness of their suggestion.

A couple of remarks are in order. Firstly, as the principals decrease their control, their competence costs decrease but not necessarily their conflicts costs, such as “Collective-action problems and different horizons” and actually might increase. Secondly, it may also be pointed out that minimization of costs does not mean that they are insignificant. In fact these may be pretty significant. Thirdly, shareholders are not the only stakeholders, knowledge workers have invested as much if not more in human capital as the shareholders have in physical capital.

Figure 2. Control costs. (MB curve indicates the decrease in principals’ cost and MC curve indicates increase in agent’s costs as the principals’ control/authority decreases. AB curves indicates the trade-off between accountability and authority/control. Principals have 100% control at point O. At equilibrium point c (MC = MB), Agent’s control = OC and the principals’ control = CB.)
3. Kautilya’s Ethics-Based Approach to Corporate Governance

Kautilya considered the public as the principals and the king as their agent (CEO), a salaried employee. Someone (I forgot the source) wrote that according to Kautilya, “a king is a loyal servant to his royal public”. Kautilya identified three types of CEOs (rulers): (i) the ethical, (ii) the Self-interested (utility maximizer) and (iii) the myopic and unethical. He linked the growth potential to the CEO-type. Table 2 captures his implicit conceptual framework on the relationship.

3.1. Kautilya on the Need to Have an Ethical CEO

Kautilya understood the usefulness of backward induction and used it extensively. He would invariably set-up his objective, such as bringing prosperity or providing national security and explore ways to realize it in the most effective and ethical way. In this case, his objective was to eliminate agent’s conflict costs, that is, the moral hazard problems. According to him, these costs could be eliminated only if the agent were ethical. Since an ethical agent would not shirk and also would not turn his office into a museum with expensive artwork/paintings. Kautilya [6] surmised the king as: “In the happiness of his subjects lies his happiness; in their welfare his welfare. He shall not consider as good only that which pleases him but treat as beneficial to him whatever pleases his subjects (1.19).” Drekmeier [7] notes, “Now the king must concern himself directly with the common good, an idea anticipated in the Arthashastra.”

There are at least two points worth noting. (i) The Pareto optimality condition is satisfied implicitly. Since the king does what is good for the public and he derives satisfaction from that, that is, both the king and the public are better off. (ii) It seems that Kautilya was trying to ensure that the social welfare function was not imposed or dictatorial, that is, the king does not impose his preferences on the public, rather respects the preferences of his subjects.⁴ Obviously, Kautilya did not want to sacrifice individual sovereignty.

Table 2. Kautilya on CEO-type and economic growth potential.

<table>
<thead>
<tr>
<th>Type of CEO</th>
<th>Agency Costs</th>
<th></th>
<th></th>
<th>Principals’ costs</th>
<th></th>
<th>Economic Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Conflict costs</td>
<td>Competence costs</td>
<td>Conflict costs</td>
<td>Competence costs</td>
<td>Conflict costs</td>
<td>Competence costs</td>
</tr>
<tr>
<td>Ethical</td>
<td>Zero</td>
<td>Almost Zero</td>
<td>Negligible</td>
<td>Zero</td>
<td></td>
<td>High</td>
</tr>
<tr>
<td>Utility-maximizer</td>
<td>Significant</td>
<td>Modest</td>
<td>Modest</td>
<td>Modest</td>
<td>Modest</td>
<td>Modest</td>
</tr>
<tr>
<td>Unethical</td>
<td>Significant</td>
<td>Significant</td>
<td>Significant</td>
<td>Significant</td>
<td>Significant</td>
<td>Negative/poor</td>
</tr>
</tbody>
</table>

⁴[12] Arrow (1973, p. 129) defines the axiom of “non-dictatorship” as “There is no individual whose preferences are automatically society’s preferences independent of the preferences of all other individuals.”
According to Kautilya, only an ethical agent would put principals’ interest ahead of his own interest. He (p. 145) stated, “A rajarishi [a king, wise like a sage] is one who: has self-control, having conquered the [inimical temptations] of the senses, cultivates the intellect by association with elders, is ever active in promoting the security and welfare of the people, endears himself to his people by enriching them and doing good to them and avoids daydreaming, capriciousness, falsehood and extravagance (1.7).” However, he (p. 145) wrote, “There is no need for such a king to deprive himself of all sensual pleasures and lead a life of total austerity so long as he does not infringe his dharma or harms his own material well-being.”

3.2. Utility Maximizer (Self-Interested) CEO

Kautilya understood the power of self-interest. He (p. 159) argued, “When a people are impoverished, they become greedy; when they are greedy, they become disaffected; when disaffected, they either go to the enemy or kill their ruler themselves.” Kautilya advised the king (CEO) that it was in his own interest to provide some acceptable standard of living to the people. He wrote, “Therefore, the king shall not act in such a manner as would cause impoverishment, greed or disaffection among the people; if however, they do appear, he shall immediately take remedial measures.”

3.3. Unethical CEO

According to Kautilya (p. 133), “A decadent king, on the other hand, oppresses the people by demanding gifts, seizing what he wants and grabbing for himself and his favourites the produce of the country [i.e. the king and his coterie consume more than their due share thus considerably impoverishing the treasury and the people.] (8.4).” He continued that such a king “fails to give what ought to be given and exacts what he cannot rightly take”; “indulges in wasteful expenditure and destroys profitable undertakings”; “fails to protect the people from thieves and robs them himself”; “does not recompense service done to him”; “does not carry out his part of what had been agreed upon”; and “by his indolence and negligence destroys the welfare of his people” (7.5). Actually, Kautilya and Chandragupta Maurya dethroned such a king.

Miller (1997) [8] notes, “As North argued, a ruler generally has incentives to take confiscatory actions which undermine property rights and contract enforcement, and sharply constrain the incentives for productive economic activity by his own subjects. The constitutional problem is to constrain the self-interested

[13] Kenneth Arrow (1968) notes, “Because of the moral hazard, complete reliance on economic incentives does not lead to an optimal allocation of resources in general. In most societies alternative relationships are built up which to some extent serve to permit cooperation and risk sharing. The principal-agent relation is very pervasive in all economies and especially in modern ones; by definition the agent has been selected for his specialized knowledge and therefore the principal can never hope completely to check the agent’s performance. You cannot therefore easily take out insurance against the failure of the agent to perform well. One of the characteristics of a successful economic system is that the relations of trust and confidence between principal and agent are sufficiently strong so that the agent will not cheat even though it may be ‘rational economic behavior’ to do so.”
activity of the ruler—to commit the ruler to constitutional constraints that are consistent with economic development.” He further adds that “Efficiency is inconsistent with self-interest by the ruler. In other words, this demonstrates that North’s historical observations about tension between profit-seeking rulers and efficiency for the society was not, in fact, accidental, but a manifestation of a logical inconsistency in mechanism design (G. Miller and Hammond 1994).”

Three remarks are in order. Firstly, both framing and upholding of constitution depend on the character of those in power implying that constitution is not a fool-proof device against the possible inconsistency between efficiency and self-interest. Secondly, the constitution of conscience is much more effective than the legal document in ensuring efficiency. Thirdly, according to Olson’s second law of invisible hand, even a bandit provides some minimum growth opportunities.6

Kautilya (p. 121) wrote, “The wealth of the state shall be one acquired lawfully either by inheritance or by the king’s efforts (6.10).” He (p. 231) added, “Water works such as reservoirs, embankments and tanks can be privately owned and the owner shall be free to sell or mortgage them (3.9).” He condemned an immoral and shortsighted king, who did not protect private property rights.

3.4. Creating Ethical Environment

Kautilya believed that if one entity resorted to undesirable practices, others had no option but to adopt similar practices to survive. That is, people would compete in giving bribes or cooking the books. He also believed that moral hazard problems due to agency problems and attempts to search for regulatory arbitrage (looking for gaps or wholes in law) could not be checked by any amount of laws. Existence of political and judicial corruption makes the field uneven and usually, it is at the expense of consumers and workers, diverts resources from productive uses to unproductive ones and makes businesses less competitive.

Kautilya wanted the king to be a role model, earn respect and rule through leadership and not through authority. He (p. 147) wrote, “If the king is energetic, his subjects will be equally energetic. If he is slack and lazy in performing his duties the subjects will also be lax and, thereby, eat into his wealth. Besides, a lazy king will easily fall into the hands of his enemies. Hence, the king should himself always be energetic (1.19).” He (p. 121) stated, “A king endowed with the ideal personal qualities enriches the other elements when they are less than perfect (6.1).” He (p. 123) added, “Whatever character the king has, the other elements also come to have the same (8.1).” Thus, according to Kautilya, a king (CEO) should be an impartial, ethical, far-sighted, foresighted, disciplined and energetic action-oriented individual.

6[14] Olson (2000) calls this “the second invisible hand”. He (pp 12-13) states, “This invisible hand—shall we call it as invisible hand on the left?—that guides encompassing interests to use their power at least to some degree, in accord with the social interest, even when serving the public good, was not part of the intention. This second invisible hand is as unfamiliar and perhaps counterintuitive as the first hidden hand was in Adam Smith’s time, but that does not mean it is less important.”
4. Kautilya on Efficient Corporate Management

Kautilya was an independent thinker. He was not a bureaucrat but understood the important role of an organizational structure. According to Drekmeier, Kautilya linked a man’s greatness to his organizing abilities. Drekmeier (p. 290) observes, “We may surmise that men began to conclude that remaking the world was within the realm of possibility. The ancient belief in the cyclical periodicity of time, the eternal return, was modified or displaced altogether by a sense of continuity and development approximating a historical attitude. Accumulated wealth and the military power and administrative efficiency it made possible could now be used for achieving ambitious, long-range political and social goals. The great man is, in fact, the great organizer. He creates the very conditions that make the hero obsolete, for he imposes an order that limits the unpredictable contingencies against which the hero struggles. The hero was made by his age; the organizer is the maker of his age. Men can now do things that earlier could be accomplished only by the gods.”

Kautilya’s objective was to maximize efficiency or minimize the agent’s competency costs. He suggested pooling of information and knowledge to arrive at a sound decision. According to Kautilya, if management is wisdom-based, no one would ever ask for any accountability (monitoring). Secondly, since in today’s knowledge-based economy, creativity is the mantra for having an edge. Board Directors are only part-timers and therefore, not likely to contribute to creativity. Kautilya would recommend a team of three or four full time highly qualified advisers for enhancing creativity.

The Board of Directors is supposed to reduce the scope for a potential for moral hazard since there is a separation of management from the owners (shareholders) of the company. The underlying assumption has been that irrespective of the fact that management were ethical and wise still it needed direction/supervision from the Board of Directors. If the management team were efficient and ethical, no Board of Directors would be needed. Similarly, if management were cooking the books, Board of Directors would not be in a position to detect inefficiency or fraud, implying it is a useless entity. [9] Eugene Soltes (2016, p. 315) points out, “Dennis Kozlowski, the former CEO of Tyco, described how infrequently he experienced such dissonance as chief executive. “When the CEO is in the room, directors—even independent directors—tend to want to try and please him,” Kozlowski explained. “The board would give me anything I wanted. Anything”.

Secondly, the world has changed and continues to change. Now intangible capital is becoming increasingly more important than the physical capital. The skilled employees have as much stake as the shareholders. The Board of Directors is just a relic of the past and for knowledge-based enterprises has lost its relevance.

Thirdly, according to Kautilya, it would be difficult to keep a secret if shared with more than four persons. That is, someone from a large number of Directors is likely to divulge the secret. He wrote, “[There should be no more than four
advisers] because, with more than four, secrecy is rarely maintained. [While, normally, the king should consult three or four advisers,] he may, depending on the nature of the work and the special circumstances of each case, take a decision by himself, consult just one adviser, or even two. The opinions of the advisers shall be sought individually as well as together [as a group]. The reason why each one holds a particular opinion shall also be ascertained (1.15).

Thus, according to Kautilya, as the number of advisers increased, the king received better council which increased the probability of success of a task but the problem of secrecy might become serious and hurt its chances of success. He (p, 200) also suggested, “No one who belongs to the side likely to be adversely affected by the project shall be consulted (1.15).”

Fourthly, unless the Board members become hands-on participants into corporate affairs, they will not know the internal working. In that case their role would change from supervisory to managerial. But the law does not allow that.

**Kautilya’s Ethical and Wisdom-based Model:** If management were ethical, farsighted, foresighted and wise, there would be no need for a Board of Directors, since there would be no problem of moral hazard. The shareholders would get maximum possible profit, workers decent wages and consumers be treated like real sovereigns.

### 4.1. Emphasis on Team Work

Kautilya (p. 177) observed, “A king can reign only with the help of others; one wheel alone does not move a chariot. Therefore, a king should appoint advisers as councilors and ministers and listen to their advice (1.7).” Clearly the phrase ‘one wheel alone does not move a chariot’ indicates a complementary nature of relationship between the king’s own abilities and the advice from the advisers, which may be critical in ensuring survival and progress of the kingdom. He (p. 196) explained, “Because the work of the government is diversified and is carried on simultaneously in many different places, the king cannot do it all himself; he, therefore, has to appoint ministers who will implement it at the right time and place (1.9).”

### 4.2. Pooling of Information and Knowledge

Kautilya stated, “Vishalaksha says ‘never can a single person arrive at the right decision. The work of government is dependent on [complete] knowledge—that which the king personally knows, that which is reported to him and that which he has to infer. To find out what is not known, to clarify doubts when there are alternatives, to obtain more information when only a part is known—all these can be done only with the help of advisers. Hence a king shall conduct his deliberations with advisers of mature intelligence. (As the saying goes:) ‘Despise no one, [but] listen to all views; for, wise man pays heed to all sensible advice, even those of a child’ (1.15).”

Kautilya (p, 120) described the qualifications of an adviser as: “A councilor or minister of the highest rank should be a native of the state, born in a high family
and controllable [by the king]. He should have been trained in all the arts and have logical ability to foresee things. He should be intelligent, persevering, dexterous, eloquent, energetic, bold, brave, able to endure adversities and firm in loyalty. He should neither be haughty or fickle. He should be amicable and not excite hatred or enmity in others (1.9)."

4.3. Maximizing Economic Growth

Kautilya (p. 149) suggested, “Hence the king shall be ever active in the management of the economy. The root of wealth is economic activity and lack of it brings material distress. In the absence of fruitful economic activity, both current prosperity and future growth are in danger of destruction. A king can achieve the desired objectives and abundance of riches by undertaking productive economic activity (1.19)."

4.4. Minimizing Threats to Prosperity

He (p 116) wrote, “In the interests of the prosperity of the country, a king should be diligent in foreseeing the possibility of calamities, try to avert them before they arise, overcome those which happen, remove all obstructions to economic activity and prevent loss of revenue to the state (8.4).”

4.5. A Summary

Kautilya’s approach to corporate governance is far better since:

1) There is no moral hazard problem implying that there are no agent’s conflict costs.
2) CEO is ethical, competent, far-sighted and foresighted.
3) CEO willingly accepts a minimum subsistence salary, that is, does not behave like greedy Grasso.
4) Most importantly, management by pooling information and knowledge raises both the probability of success and output of every carefully chosen project. Figure 3 may be used to capture the advantage of Kautilya’s approach over the existing approaches to corporate governance and management.

4.6. Cost-Minimization Approach

The growth potential of this approach most likely would be less than the principal-agent approach because there are no incentives to motivate the CEO to reduce shirking.

4.7. Kautilya’s Stakeholders’ Model

Kautilya did not believe in the zero-sum game, that is, if the employees were paid decent wages that did not mean the profit would be lower. An ethical CEO would take care of workers and consumers in a fair way. Kautilya argued that satisfied workers would produce much more than their compensation. Since there would be no shirking, stealing, quarrelling or colluding. An employer should learn about the need, nature and qualifications of each employee and compensate
Figure 3. Advantage of Kautilya’s approach. (OK = net surplus under Kautilya’s proposal, OP = net surplus under principal-agent’s incentive packages, OC = under cost minimization suggested by Goshen and Squire (2016). The difference between OK and OP = PK = the ethical surplus)

him/her accordingly. Kautilya believed that highly qualified individuals be paid efficiency (higher than market) wages to attract them and retain them. Whereas middle and lower level employees were risk-averse and would prefer job-security. Similarly, treating the consumers well would pay-off. Kautilya’s Ethics-based Model: Under this approach workers are more satisfied and work harder. Similarly consumers are more loyal.

5. Concluding Observations

Kautilya, being an empiricist, did not believe in fate and asserted that a person’s destiny was quite in his own hands. He counted on human ingenuity to devise an organizational structure and a legal structure to complement the ethical anchoring to alleviate the moral hazard problem and to impose punishment for any digressions. His goal was to eliminate forever the need for the Godly avatar by internalizing preventive and positive measures for imbuing governance with dharma. In Kautilya’s proposed organizational structure, there would be no agency conflict costs or competence costs since the agent is both ethical and efficient. There are no principals’ competence costs either. He tried to minimize principals’ conflict costs by advocating a stakeholders’ model.

[10] Williamson (1985: p. 47) characterizes the potential behavior of the other firm as: “calculated efforts to mislead, disguise, obfuscate, or otherwise confuse” and “seeking self-interest, but they do so with guile”. He does not realize that such behavior has created the trust deficit within the firm also. Legal contracts, to a large extent have crowded-out the conscience-based commitments. Precious resources are being wasted in devising precautionary measures to protect against perceived (often imaginary) cheating/renege. Kautilya believed that a Fiduciary duty could never replace the moral duty.

Measurement of the ethical surplus was beyond the scope of this paper. World’s GDP in 2015 was around $74 Trillion. Roughly speaking, if corporate profits were say 10 percent of the GDP and ethical surplus was 10 percent of the
profits, the magnitude of ethical surplus would have been $740 Billion. It would be a major contribution if future research could devise a creative methodology to measure Kautilya's ethical surplus.

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References

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