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Cultivating Consumer Trust through an Evolving Framework of Corporate Governance

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Abstract: Regulatory authorities presently require companies issuing securities to provide detailed and comprehensive disclosures. Such transparency enables prospective investors to evaluate and compare different investment opportunities, thereby facilitating informed financial decision-making. In contrast, the marketing and sale of most other goods and services are largely governed by the principles of commercial free speech, where disclosure obligations are relatively minimal. This article questions the traditional corporate law paradigm that places primary emphasis on maximizing shareholder wealth. It argues for a reconceptualization of corporate priorities by giving greater importance to consumer welfare, particularly in businesses that primarily serve consumer markets. The author suggests that consumers should possess informational rights comparable to those granted to investors in securities markets, thereby ensuring a more balanced decision-making environment. The article also draws attention to the asymmetry between investors and consumers in accessing relevant information. Investors often rely on financial analysts, professional advisors, and institutional expertise when making investment decisions. Consumers, on the other hand, typically navigate complex product markets without similar professional assistance. Although they are frequently exposed to extensive advertising and promotional messaging, consumers often lack access to the essential and reliable information necessary to make well-informed purchasing decisions. To address this imbalance, the article proposes expanding the scope of corporate governance to recognize consumers as key stakeholders within the corporate framework, consistent with the principles of stakeholder theory. It further argues that the accountability mechanisms embedded in corporate law provide a more robust and reliable framework for ensuring accurate product information compared to the traditional contractarian approach, which largely relies on market contracts and private arrangements.

Keywords: Corporate Governance, Stakeholders, Consumers, Enforcement

INTRODUCTION

Shareholders and their financial contributions played a pivotal role in driving the remarkable expansion of industrial enterprises throughout the twentieth century. Recognizing the crucial role they played and the difficulties inherent in safeguarding their interests solely through contractual arrangements, a system of corporate law and governance emerged. This system aimed to protect shareholders and their investments, incorporating various safeguards such as rights to information disclosure, examination, engagement, voting, fiduciary responsibilities, and dividends. Seen as fundamental to fostering a robust capital market, this legal structure underscored the importance of prioritizing the interests

of shareholders, leading to its identification as the shareholder primacy principle within corporate law. When corporations issue securities to the public, they are subject to a strict regulatory regime overseen by SEBI, which dictates the boundaries of permissible speech. This regime mandates standardized financial audits and reports, along with clear and straightforward disclosure of any material facts relevant to potential investors. However, when corporations offer other goods or services to the public, they enjoy greater freedom of speech under the principle of commercial speech, with constraints primarily limited to preventing misrepresentation and fraud. This raises the question: why are investors given greater protection compared to

consumers, and why does our legal system emphasize providing investors with more comprehensive information to enable their freedom of choice?

Explanation lies in the restricted scope of current corporate law. Consumers do not come under the domain of stakeholders in the corporate realm entitled to the same level of informational accountability as investors. Instead, consumers are perceived as comparatively powerless parties in a contractual relationship with the corporation, wherein the terms are typically dictated unilaterally by the seller. In the contemporary landscape, corporations selling goods or services to consumers often operate within the confines of traditional contractual arrangements, wherein they are only required to furnish consumers with information sufficient to ensure voluntary agreement, as mandated by contract law. In contrast, individuals purchasing securities are categorized as "investors" and are viewed as significant stakeholders in the corporate structure. When corporations offer securities to the public, they are subject to a stringent informational regime that necessitates regular and immediate disclosure of uniform information, presented in clear language, and supplemented by standardized financial audits and reports. This differential treatment reflects the distinct roles and levels of influence attributed to investors versus consumers within the corporate framework.

Current corporate law does not consider consumers as legitimate stakeholders of corporations, and are not subject to any specific duties or obligations. Corporate accountability primarily lies with the whole corporation or shareholders. Shareholders appoint board members, who typically focus on the financial performance of the corporation and are not typically involved in product disclosures or consumer relationships. While board members may authorize disclosures to investors in compliance with federal securities regulations, they are not directly accountable to consumers or responsible for product disclosures.

Regulatory frameworks tend to prioritize the interests of investors over consumers. Likewise, the Securities and Exchange Commission (SEC) offers information management services and establishes clear disclosure standards for investors, which are easily accessible through online platforms for comparing different investment opportunities. However, similar regulatory services do not exist for consumer products. Rights to information for investors are established before they make a purchase decision, whereas consumers' rights to information often depend on judicial decisions following incidents of misrepresentation, which occur post-transaction.

In legal literature, a corporation is often depicted as a hierarchical structure composed of shareholders, board members, and management, where each layer serves as an appointed agent of the previous one. Shareholders elect board members, who then choose a management team to oversee the corporation's assets on behalf of the shareholders. Much of corporate law scholarship is concerned with reducing agency costs inherent in this

structure, with the aim of maximizing shareholder value, which is considered the primary objective of corporate law. A substantial portion of this literature emphasizes disclosure requirements aimed at increasing shareholder participation and influence in the corporation's management.

However, there is a growing recognition of the need to consider consumers as corporate stakeholders and impose informational accountability on companies for providing them with information. This perspective is based on the understanding that investors are not the only ones contributing value to corporate production, and thus, corporations have obligations not just to investors but to other stakeholders as well.

Instead of perceiving the corporation solely as the property of its shareholders, the stakeholder theory views it as a network of relationships involving employees, suppliers, customers, financiers (including banks, bondholders and stockholders), and communities. According to this approach, the board of directors is responsible for managing and nurturing these relationships, as well as distributing resources and liabilities among the different stakeholder groups. Blair and Stout suggest a "team production" theory of corporate law, which describes corporations as legal entities that enable the collective production of goods or services through the contributions of all team members, including employees, suppliers, customers, financiers, investors, and others

Analyzing the Discrepancies Between Consumer Decision-Making and Investment Allocation

The process of choosing consumer products frequently involves mistakes and uncertainty. In contrast, investors typically approach distributing investments through a logical and structured method, often seeking advice from advisors or financial institutions. Consumer decision-making tends to be impulsive, influenced by emotions and cognitive biases. Companies often prioritize evoking emotions in their marketing efforts, sometimes omitting comprehensive product information. Techniques like bundling can further distort consumers' perceptions of products and services, obstructing rational decision-making. Vague and manipulative marketing strategies exacerbate consumers' difficulties in comparing and understanding product implications. Even when provided with comprehensive information, consumers may find it challenging to analyze due to information overload and limited understanding of corporate materials.

In investment scenarios, the primary risk for investors lies in the capital invested in their portfolios, although certain exceptions like structured products, derivatives, and short selling introduce additional risks due to increased leverage. Nonetheless, the predominant concern for investors remains financial in nature. Conversely, consumers encounter risks extending beyond the mere purchase price when acquiring goods. Nonetheless, the predominant concern for investors remains financial in nature. Conversely, consumers encounter risks extending beyond the mere purchase price when acquiring goods. Numerous consumer goods

carry potential health ramifications. Ranging from food and beverages to toys, apparel, vehicles, and electronic devices, consumers place their well-being and potentially their lives in the hands of sellers. Consequently, the potential risks associated with these products can outweigh their monetary cost. There exists a more stringent level of regulation overseeing product safety and quality assurance.

Typically, product safety falls outside the purview of corporate law, resulting in the directors rarely being held accountable for it. Addressing safety concerns regarding the product often falls within the domain of engineering personnel and is less directly linked to senior management, who typically oversee risks affecting investors. The potential dangers associated with products may far exceed their initial purchase price. Increased regulation is in place to ensure safety regarding the product and quality control. Although quality control measures aim to eliminate substandard products from the market, they may not necessarily facilitate consumers in choosing among the remaining acceptable options.

In the realm of corporate law, product safety falls outside its jurisdiction, sparing the board of directors from direct liability in this regard. The responsibility for ensuring product safety typically lies with the engineering staff, minimizing the involvement of senior corporate managers who are primarily accountable for risks impacting investors. Investment decisions are conventionally evaluated by comparing the anticipated return against the associated risk, allowing market prices to reflect the equilibrium between supply and demand, thus conveying true value to investors. However, consumer product selection is a multifaceted process, influenced by diverse considerations such as features, characteristics, and brand reputation. Marketing research suggests that, particularly in the realm of consumer goods, factors like brand name and packaging often carry equal or greater weight than price alone. Moreover, the relationship between price and perceived quality is not consistently clear. Consequently, while prices serve as a reliable indicator of value in the investment arena, they may not fully capture the value proposition for consumers.

Within the capital markets, institutional investors and investment advisors play vital roles, leveraging their specialized knowledge and analytical tools to assess diverse investment strategies, often drawing insights from corporate filings. While investment advisors offer guidance to the general investing public, institutional investors dominate transactional activity in these markets. In the consumer product sphere, a parallel role is assumed by consumer guidance society or the consumer unions. Similar to investment advisors and analysts, consumer unions capitalize on economies of scale to effectively assess and compare product information. Unlike individual consumers, these unions have the ability to perform detailed evaluations of products by gathering data, analyzing it, and presenting their findings in an organized manner. Consumers and their union's relationship can be compared to an agency relationship, where the union is tasked with obtaining

product information and conducting tests on behalf of its members.

A notable example can be Consumer Reports, a publication by Consumers Union, a 1930s nonprofit organization established in response to the rise of advertising in the media. For a nominal fee, consumers of United States could access websites or magazines offering impartial and professional summaries of product information, presented in a standardized manner. However, this comprehensive analysis is limited to a select range of brands and products.

Consumer Reports' or E-Commerce impartial product reviews cover only a selected number of categories and examine, then compare a subset of available brands within each surveyed product category. Some intermediaries in the consumer products market may be linked to the industries they assess, which can potentially undermine their objectivity and commitment to consumers as their main clients. Thus, while consumer unions or society provide a valuable service in the market for consumer product information, they do not fully overcome the challenges associated with it. In the consumer products market, addressing market failures is a challenge for intermediaries acting on behalf of consumers, unlike the analysts and investment advisors in capital markets who serve investors. This struggle is due to the inherent complexities and costs associated with obtaining reliable information

In India the Information Technology Act of 2000 stands as the primary legislative framework governing these endeavors. While the Consumer Protection Act, 2019 primarily safeguards consumer rights in India, additional legislations delineate consumer rights in specific domains. Typically, consumer rights face their greatest challenges when a small cohort of companies holds significant market sway. To prevent such monopolistic dominance, antitrust laws are enforced, ensuring that no entity grows excessively large to monopolize the market. In India, this regulatory function is fulfilled by the Competition Act of 2002, along with oversight bodies like the Competition Commission of India (CCI) and the Competition Appellate Tribunal (CAT).

Despite the presence of robust legislation, a notable gap remains in information costs between capital markets and consumer product markets. In capital markets, intermediaries benefit from extensive information furnished by federal securities laws' disclosure mandates, granting them access to thoroughly vetted and readily available data. On the other hand, in the consumer market, the stakeholders are required to bear the costs involved in researching, verifying, analyzing, and sometimes setting prices for product information.

Furthermore, India lacks an effective interface akin to the United States' EDGAR system. EDGAR, renowned for its plain English format, is widely acclaimed for its efficacy in managing information, meeting institutional requirements satisfactorily. It serves a pivotal role in mitigating transaction costs and facilitating transparent information dissemination across the market.

Institutions often favor companies with strong transparency policies, leading some corporate executives to adopt similar strategies to appeal to investors. Recent empirical studies even suggest that index funds, typically passive and cost-conscious, wield influence over disclosure practices.

Institutional investors highly value disclosures, leveraging their analytical prowess to decipher disclosed information and derive valuable insights. A comparative analysis of the U.S. bond and loan markets highlights how institutional investors obtain substantial information about syndicated loans through private arrangements, even when mandatory disclosure is not required. Conversely, comprehensive information about previous consumer experiences is limited in the consumer products market. For instance, in the food and beverage sector, shared consumer experiences often fail to provide insights into product ingredients and nutritional content. Intermediaries are motivated to conduct research only if it promises profitability. Since sellers usually offer products at lower costs, intermediaries lack the incentive to invest in reverse engineering food products to uncover their ingredients and nutritional value.

Corporate accountability regarding product disclosures serves to enhance competition among information providers and third-party traders while also reducing barriers to entry in the consumer market. Seller corporations, as providers of cost-effective and relevant information, can mitigate information asymmetry between consumers and sellers, thereby promoting a more competitive marketplace. Conversely, differences between capital markets and consumer product markets stem from their distinct structural characteristics. Capital market institutions benefit from public policies mandating their services, such as pension and provident funds offering tax benefits and social security, which incentivize the use of their professional services. In contrast, financial regulations restrict money management roles to certified and highly regulated institutions, contrasting with the consumer product market's broader accessibility. In contrast, consumers typically make decisions independently. Unlike securities trading, where intermediaries often play a role, consumers frequently shop for groceries and other goods without such assistance. This underscores a stronger case for consumer empowerment through informed consent and access to information compared to retail investors. Meanwhile, the capital market thrives on incentives like tax benefits and regulatory frameworks that support intermediary services. In contrast, incentives for developing intermediaries in the consumer products market are limited. Establishing mandatory information databases can lower entry barriers into the information aggregation market, potentially facilitating its growth and ensuring adequate support.

The Freedom to Depart

Corporations grant their stakeholders three fundamental rights: exit, voice, and loyalty. The right to exit is particularly relevant here. Investors in publicly traded companies can exit their investments relatively easily selling their shares on stock exchanges or over-the-counter markets, effectively ending their association

with said corporation. However, consumers of mass-market products and services often encounter significant barriers when trying to alter their consumption habits. These barriers can include costs, contractual limitations, and social or logistical challenges, making it difficult or prohibitively expensive for the typical consumer to exercise the right to withdrawal. For example, switching childcare providers at a preschool, changing bank account services, or switching media and cellular service providers can all involve substantial costs. In such cases, the high costs associated with exiting limit its potential effectiveness as a tool for holding management accountable or driving necessary reforms, even in competitive markets with strong competition.

Regulatory Measures: Oversight and Enforcement

Investors benefit from robust protection of their informational interests through the Securities and Exchange Board of India (SEBI), a powerful regulatory agency empowered to dictate the substance, format, and timing of disclosures. In contrast, consumers depend on contractual foundations for their informational needs. Product information is dispersed across numerous sources with varying degrees of credibility and influence, and is presented in multiple formats and languages. Cost of collecting all kind of information should be borne by interested parties. Corporations, which have this information and can easily provide it, often choose to use commercial messaging that mixes emotional appeal with ambiguous branding or inundates consumers with too much information. No single authority exists to mandate comprehensive product information for consumer benefit. As a result, consumers' options for recourse are limited to claims of contractual misrepresentation or fraud. This requires lengthy and expensive legal proceedings to seek redress, often placing the burden on consumers to prove significant harm. Given the dispersed nature of consumers, pursuing such claims is typically impractical.

Without mandatory disclosure standards, each seller would present information according to their own terms, language, and format. This would create a market where sellers lack credible disclosure capabilities and technology, leading to inadequate public assurances of product quality. Following Akerlof's model of the market for lemons, this scenario would cause consumers to only consider and pay fair prices for average-quality goods, driving higher-quality products out of the market. Conversely, market failures in providing product information incentivize information overload. Sellers are motivated to provide more information as long as the cost does not exceed their expected benefits. Since sellers profit when consumers switch brands, they often supply additional information aimed at promoting brand switching, resulting in losses for competitors and society as a whole. This imbalance can lead to information overload, where the losses to competitors surpass the consumer surplus from switching brands. Additionally, the tendency to use abstract and vague commercial language exacerbates the possibility of information overload. Generally, competition focuses on easily observable product characteristics, encouraging sellers to invest in brands and signals rather than detailed technical

descriptions of product attributes, as these factors heavily influence consumer choices.

This phenomenon is a broader application of the market equilibrium concept from Akerlof's lemons model. If vague and abstract commercial speech is more noticeable and memorable to consumers, sellers lack the incentive to educate consumers about the true, detailed nature of their products. Consequently, sellers refrain from investing in consumer education. This creates an information environment that promotes superficial product differentiation and premium branding, leading to higher prices for functionally equivalent brands.

In the consumer product market, the extensive use of boilerplate terms and standardized contracts further complicates product information through increased complexity and information overload. These standardized contracts impose high transaction costs on well-informed consumers. According to Gilo and Porat, sellers achieve several objectives through this artificial complexity and information overload, including segmenting consumers and implementing price discrimination, maintaining cartel stability and inhibiting competition, presenting a consumer contract facade that conceals its true nature from potential consumers and third parties, and establishing a credible signal of non-negotiability that serves as a barrier to negotiation.

Balancing Hierarchy: Corporate Obligations in Consumer Information Provision

Having affirmed that consumers are rightful members of corporations in need of enhanced product information, this article now outlines foundational norms for corporate disclosure. Current accountability measures in contract and consumer law grant freedom of commercial speech but rely on retrospective court-imposed liability for fraud and misrepresentation. This reactive legal framework is deemed insufficient. This section proposes proactive measures of responsibility that align with the duty of corporations when delivering goods or services to consumers.

When exploring the appropriate legal framework to establish standards of corporate accountability for consumer information, it is helpful to compare contract/consumer law and corporate law. While both govern interactions among private parties in the marketplace, they follow different legal paradigms. Within a corporate law framework, accountability is proactive, ensuring discussions on adequate product disclosures occur before sales transactions. This approach prioritizes consumer rights to informed decision-making and aims to prevent disputes beforehand. In contrast, contract law typically addresses issues such as fraud and misrepresentation after the fact, relying on court interpretations post-sale.

Corporate governance, particularly through policies set by boards of directors, provides a forward-looking strategy. These policies are specific, precise, and establish normative guidelines prior to product offerings. Boards of directors, as internal governing bodies, possess comprehensive insights into corporate operations,

product specifics, and the interests of various stakeholders. They have ready access to detailed information about product features, risks, and stakeholder concerns, which courts may lack. Given the diverse array of products offered by most corporations, decisions regarding product information are better suited to boards of directors than courts, which may not be equipped to handle frequent, similar decisions. Empowering boards of directors to fulfill their role as mediators within corporate hierarchies facilitates clearer communication among stakeholders, ensuring a shared understanding of rights and responsibilities and promoting effective organizational collaboration. Boards of directors traditionally owe accountability to the company's shareholders, or in some cases, to both the company and its shareholders. However, recent trends in international corporate governance indicate a shift away from strict shareholder primacy towards greater consideration of other stakeholder interests. For instance, India is also lacking towards the concrete implementation of the mandates of Stakeholder Relationship Committee. It is evident that assessing the value of establishing committees such as the Stakeholder Relationship Committee (SRC) and the Board of Directors (BoD) is essential for demonstrating their worth to the company's stakeholders.

Conclusion

To improve how companies communicate with consumers, there's a critical need to overhaul disclosure practices beyond just preventing fraud. Product information must be easily accessible, accurate, comprehensive, and timely, enabling fair comparisons with competing products. Corporations themselves should be mandated to disclose this information under clear guidelines emphasizing clarity and material relevance. Enforcement options, whether through private tools akin to securities law enforcement or a public agency modelled after it ensures consistent and transparent disclosure practices. This approach aims to empower consumers with better information and accountability in corporate product communication.

This article argues that consumers should be treated as important stakeholders with rights to clear and comprehensive product information, similar to how investors are treated. It highlights deficiencies in the current system, which frequently falls short in equipping consumers with the essential information needed to make informed decisions effectively. By proposing a shift in perspective within corporate law, the article suggests that companies should be legally obligated to disclose product details in a straightforward and accessible manner, ensuring consumers have the information they need to make educated decisions. This approach aims to enhance consumer rights and improve accountability in corporate product disclosures.

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