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*Research Article*

# Using AI on Corporate Governance

**Somnath Sharma**[1*] **Vivek Shukla**[2] **Hemant Sharma**[3]

[1,2] Law Department, Amity University, Gurugram, Haryana, India

[3] Independent Advocate

**Corresponding Author:** *Somnath Sharma

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## Abstract

The paper examines the scope of using artificial intelligence in corporate governance for the achievement of a healthy corporate world and to curb corporate scams. This paper not only discusses the advantages of artificial intelligence but also the challenges, which are potential threats of using an AI, such as legal responsibility, biased decision-making, etc. The paper also concluded on the future aspects of using AI in corporate governance. This paper does not recommend technological singularity [1]. The paper discussed the mutual replacement of AI and humans in the corporate world for the creation of value. The concept of "AI in the loop" can be valuable for the corporate future.

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**KEYWORDS:** Stakeholders, Governance, SEBI, Artificial Intelligence, Legal Responsibility

## 1. INTRODUCTION

The crucial resource for a business to flourish is the trust of the investors in the corporate sector. This trust is not built in a single day but through the hard efforts of long decades of great corporate governance. However, the trust is demolished in a single incident of corporate scam, which is a result of poor corporate governance in the organization. Therefore, it is the foremost requirement to segregate poor and good corporate practices to build and develop the trust of not only the investors but also all stakeholders.

An issue of corporate governance occurs when external investors seek to manage a company in a way that differs from its executives. Dispersed ownership makes the situation worse, causing conflicts of interest and a collective action problem among investors. Studies on corporate governance primarily center on addressing this issue of collective action through five methods. [2]

1. Some ownership concentration among major investors
2. Hostile takeovers and proxy voting.
3. Control concentration within the board of directors
4. Linking managerial interests with investors through executive compensation and
5. Enforcing CEOs' fiduciary responsibilities through class-action lawsuits.

Many countries support ownership concentration by large shareholders, potentially resulting in collusion against small investors and decreased market liquidity. Some countries restrict the influence of big shareholders and depend on boards to safeguard the interests of smaller shareholders, although boards are frequently perceived as not ineffective. The primary difficulty lies in overseeing major shareholders to maintain a balance between managerial freedom and safeguarding small shareholders [3].

**Directors**

Director roles in companies are reserved exclusively for natural persons, as artificial entities such as corporations and firms are not eligible for these positions. The term 'director' [4] is not comprehensively defined in the definition clause, and only a holistic understanding of the Act [5] would explain the roles and responsibilities bestowed on directors. The Company's Act is completely silent about any professional or academic qualification requirements for directors.

The listing clause 49 issued by SEBI in 2004 mandates the strength of independent directors on the board as one-third in case the chairman is a non-executive director and half when the chairman is an executive director. An independent director is a non-executive director who lacks financial ties with the company, its promoters, directors, or senior management that may impact their independence. They have no connection to the company's promoters or management, haven't served as an executive in the last three years, and have had no dealings with specific firms linked to the company. They also must not have any important connections as a supplier, service provider, customer, lessor, or lessee with the company and cannot be a major shareholder [6].

However, a new trend of the involvement of algorithms in company management is increasing. The Hong Kong-based firm included VITAL (Validating Investment Tool for Advancing Life Sciences) on the board as a robo-director. According to some reports, the algorithm was given the right to "vote on whether the firm invests in a specific company or not," just like the other human board members [7]. Vital was initially not granted an equal vote on all financial decisions made by the company. Legally speaking, it has not even acquired the status of corporate director under the corporate laws of Hong Kong [8]. This law is bypassed by giving VITAL an observer status.

**Artificial Intelligence**

Artificial Intelligence (AI) is a vast field of computer science focused on creating intelligent systems capable of tasks typically requiring human intelligence. It involves developing machines that can *think, understand, and act independently*, replicating certain aspects of human behavior. AI systems can solve complex problems, analyze data, learn from experiences, and make decisions with efficiency and accuracy [9]. This will save time and be a more cost-effective, accurate, and gentle approach to customer dealing. This situation may lead to a situation where we will lose the finished touch of humans [10]. Quoting the director of "MIT Initiative on the Digital Economy, Erik Brynjolfsson, it was mentioned in this thesis [11] that by 2030, the world will become a better place through the power of AI. The author wrote that the question is not "What will happen?" but "What will we choose to do?" The world shall work aggressively to make sure that technology matches our values. This needs to be done at all levels, from government to business to academia and to individual choices [12].

The performance gap between AI machines and human beings is the understanding perception of thinking, learning, autonomous problem solving, decision making, and advising.

**Corporate problems**

In every corporate scam, the internal management system breaks down in terms of transparency and misstatement of financial irregularities. The board members of such corporate scams had the tendency to hide irregularities, collusion, and fraud for future wrongful gains and hoped to make good the irregularities done at present in the future. However, when such an idea fails, it results in corporate scams and loss of the investments. Corporate governance does not fail on the revealing of corporate scams but on the very outset of starting the practices for wrongful future gain. This very modus operandi needs to be struck against for better corporate governance.

By the directive issued by SEBI, the board of directors, including independent directors of the company, is to be evaluated based on criteria established by the company's nomination and compensation committee. The performance of each director will be subject to assessment. Thereafter, the Companies Law incorporated the mandatory requirement of board evaluation, and then SEBI in 2017 issued a notice to encourage the board evaluation as a moral duty of the company, building trust of investors. However, this evaluation can again be worthless if the board dreams of wrongful gains with the investor's money. All procedures are within the company through different committees. The failure of corporate governance does not arise if the committees work properly, but when the committees themselves look to gain undue advantage of growth, the whole idea of evaluation fails. It is more like when the auditors fail to audit the financial data intentionally, the scam becomes a reality.

**Research questions**

1. Can AI replace the directors on the board?
2. Is replacing directors with AI good for corporate governance?

## 2. LITERATURE REVIEW

It can be stated that corporate law is similar in its foundations in the different legal systems around the world. Therefore, the

duties of the directors are similar in the different legal systems. One of these duties is the fiduciary duty of due diligence. For the fulfillment of due diligence, the board of directors is required to consider each and every factor available for proper governance. There are no restrictions on any director to use any tool for informed decision-making. Hence, the directors must have and ought to use the AI tools in the informed decision-making process in the board meeting. This category is known as assisted AI, as explained in the AI taxonomy of Anand Rao.

The key conflict within the first agency relationship has appropriately been described by Adam Smith in his magnum opus, 'The Wealth of Nations': "The directors of such companies," he wrote, "being the managers rather of other people's money rather than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which partners in a private company watch over their own. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company." [13]

AI is only able to replace a human director if two conditions are met.

First, it must be technologically conceivable for an AI system to conduct both the administrative work and judgment work of directors. In this respect, management literature acknowledges that, on the one hand, administrative work could be placed in the hands of AI. Judgment work, on the other hand, requires creative, analytical, and strategic skills, and it is debated if AI will ever achieve them. It is also uncertain if AI is able to balance stakeholder interests.

Second, AI must fulfill the eligibility requirements for directors imposed by corporate law. Most corporate systems presuppose that only natural and legal persons may be appointed as directors, while AI is neither of those. In spite of the apparent impossibility of appointing AI as a director, prominent scholars contend that algorithmic entities (*i.e.,* shareholderless entities governed by an autonomous system) can be created in countries with flexible regulatory standards [14]. To be more precise, artificial intelligence can reduce uncertainties of any kind (not just about the future) by making predictions, that is, by translating large amounts of data into small, manageable chunks [15]. As artificial intelligence could support or replace any human being in a corporate body, it is therefore most likely to be employed where the most complex decisions need to be taken within corporations. [16]

Current corporate governance best practices are predominantly based on human agency conflicts, which will not necessarily occur when the goals of the AI system are set in favor of the shareholders. Moreover, robo-directors earn no money nor work towards the objective of doing so, with the consequence that pay-for-performance regimes will be of no use to make AI pursue the corporate interest [17].

There is no dilemma about whether directors can delegate their function or not. This is a well-established agency principle applied in corporate law with modifications in different jurisdictions. However, delegation to a machine requires clarification since a machine is not a legal personality.

The assisted delegation to artificial intelligence must not be prohibited. In assisted delegation, the decision-making power remains with the human director, therefore helping management of the company and restricting the core delegation of core management decisions, which is, of course, yet to be defined in various jurisdictions. Corporate law, however, requires directors to act on an informed basis. If artificial intelligence has superior information processing capabilities due to its ability to make predictions by translating large sets of data into small, manageable chunks, then the duty to act on an informed basis may well evolve into the duty to obtain such predictions made by artificially intelligent devices [18].

Section 2(49) of the Indian Companies Act defined interested director as a director who is in any way, whether by himself or through any of his relatives or firm, body corporate, or other association of individuals in which he or any of his relatives is a partner, director, or a member, interested in a contract or arrangement, or proposed contract or arrangement, entered into or to be entered into by or on behalf of a company. Section 2(60) of the same provides for ―officer who is in default‖; for the purpose of any provision in this Act that enacts that an officer of the company who is in default shall be liable to any penalty or punishment by way of imprisonment, fine, or otherwise, it means any of the following officers of a company, of whose clause (iv) and (v) include the term "person" under immediate authority or who advised the board.

Once robo-directors enter the boardroom and are able to vote in board decisions, corporate law will have to cope with novel, unprecedented types of legal questions [19]. An AI system cannot be held liable and does not have its own interests, although inherent biases of its controllers may be reflected, as AI is only as good as its inputs and programming. The system can be programmed to pursue the interests of its principals, yet there is no guarantee that it will follow all applicable legal rules and have a reasonable aversion to risks and losses. As a result, rule-compliant behavior will need to be embedded in the algorithm's code beforehand. The latter calls for cutting-edge *ex ante* regulatory strategies, such as abstract coding requirements for appointed robo-directors and the regulation of corporate objectives, which will implicate far-reaching changes to the anatomy of corporate law.

The audit committee needs to consist of at least three directors, the majority of whom must be independent. All members are required to have financial knowledge, and at least one member must possess accounting skills. Being financially literate entails the skill to comprehend fundamental financial documents. Skills involve professional certification and a finance or accounting background. The audit committee's chairman must be a director who is not influenced by others. The chairman is required to be present at the annual general meeting to respond to any questions from shareholders. The committee might ask executives, especially the finance department head, to attend meetings. It is also possible to have meetings without the presence of executives. The company secretary acts as the secretary for the committee.

## 3. RESEARCH METHODOLOGY

The research paper is developed using both the methods of qualitative and quantitative data and doctrinal and empirical research.

**Research Results**

The empirical results of a survey of small sample data of 40 individuals yielded the following results:

## 4. RESULTS

**Research Results Summary**

A small-scale empirical survey of 40 individuals was conducted to explore public understanding and perceptions regarding AI's role in corporate governance. The responses were measured across various variables, including knowledge levels, perception of AI's role as a director, and the potential of AI in curbing scams.

**Key Variables & Findings**

**1. Age Distribution**

1. The majority (70%) were aged between 18 and 30.
2. Only 5% were aged 40–50.
3. Indicates that the younger demographic is more engaged in conversations around AI and governance.

**2. Knowledge of AI (K AI)**

1. 65% had basic knowledge of AI.
2. 27.5% had mid-level knowledge.
3. Only 2.5% reported advanced knowledge.
4. Suggests that while AI is known broadly, deep understanding remains limited.

**3. Knowledge of Corporate Governance (KCG)**

1. 62.5% had basic knowledge.
2. 15% had a deep understanding.
3. 15% did not know at all.
4. Shows a similar trend of superficial understanding as with AI.

**4. Can AI Replace Directors?**

1. 57.5% (No): Most respondents do not believe AI should replace human directors.
2. 5% (Yes): Very few fully support AI replacement.
3. 22.5% (Recognized): Some acknowledge AI's potential role but not full replacement.
4. Indicates skepticism and caution towards AI-led boardrooms.

**5. Is AI a good independent director (I.D.)?**

1. 45% (No): Almost half feel AI is not suitable as an independent director.
2. 25% (Maybe): A significant portion is open but uncertain.
3. 15% (Yes): Minor support for AI's suitability as I.D.
4. Reflects concerns about AI's independence, ethics, and accountability.

**6. Stakeholder vs. Shareholder Perspective**

1. 72.5% support stakeholder-centric governance, suggesting broader trust and ethical concerns influence decision-making.
2. Indicates alignment with stakeholder theory, which may favor cautious integration of AI.

**7. Can AI Help Curb Corporate Scams?**

1. 37.5% (Yes) and 30% (Maybe): The majority believe AI could help prevent scams.
2. Only 17.5% said no.
3. Indicates optimism in AI's capacity for data analysis, fraud detection, and internal audits.

**Interpretation & Insights**

1. General awareness exists, but technical and governance depth is lacking.
2. While AI is seen as useful in assisting corporate governance, people resist full replacement of human directors.
3. There is hope in AI's role in compliance and transparency, but concerns around trust, ethics, and bias remain critical.

**Frequency Tables**

**Table 1:** Frequencies for Age

| Age | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|
| 18-30 | 28 | 70.000 | 70.000 | 70.000 |
| Below 18 | 1 | 2.500 | 2.500 | 72.500 |
| 30-40 | 9 | 22.500 | 22.500 | 95.000 |
| 40-50 | 2 | 5.000 | 5.000 | 100.000 |
| Missing | 0 | 0.000 | | |
| Total | 40 | 100.000 | | |

**Table 2:** Frequencies for K (AI)

| K (AI) | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|
| Basic | 26 | 65.000 | 65.000 | 65.000 |
| mid | 11 | 27.500 | 27.500 | 92.500 |
| nil | 2 | 5.000 | 5.000 | 97.500 |
| Advanced | 1 | 2.500 | 2.500 | 100.000 |
| Missing | 0 | 0.000 | | |
| Total | 40 | 100.000 | | |

Where K (AI) denotes knowledge regarding the AI by the persons taking survey

**Table 3:** Frequencies for K (CG)

| K (CG) | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|
| nil | 6 | 15.000 | 15.000 | 15.000 |
| Admin. work | 3 | 7.500 | 7.500 | 22.500 |
| basic | 25 | 62.500 | 62.500 | 85.000 |
| deep | 6 | 15.000 | 15.000 | 100.000 |
| Missing | 0 | 0.000 | | |
| Total | 40 | 100.000 | | |

Where K (CG) denotes knowledge regarding the Corporate Governance by the persons taking survey

**Table 4:** Frequencies for AI replacing the Director

| AI replaces Director | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|
| No | 23 | 57.500 | 67.647 | 67.647 |
| yes | 2 | 5.000 | 5.882 | 73.529 |
| recognized | 9 | 22.500 | 26.471 | 100.000 |
| Missing | 6 | 15.000 | | |
| Total | 40 | 100.000 | | |

**Table 5:** Frequencies for AI as Good as I.D.

| AI good as I.D. | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|
| No | 18 | 45,000 | 52.941 | 52.941 |
| Maybe | 10 | 25,000 | 29.412 | 82.353 |
| yes | 6 | 15.000 | 17.647 | 100.000 |
| Missing | 6 | 15.000 | | |
| Total | 40 | 100.000 | | |

Where I.D. denotes Independent Director

**Table 6:** Frequencies for Stakeholder or Shareholder

| Stakeholder or Shareholder | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|
| Stakeholder perspective | 29 | 72.500 | 85.294 | 85.294 |
| Shareholder | 5 | 12.500 | 14.706 | 100.000 |
| Missing | 6 | 15.000 | | |
| Total | 40 | 100.000 | | |

This table shows the opinion regarding the opting for Stakeholder Theory or Shareholder Theory by the persons taking the survey

**Table 7:** Frequencies for AI curbs Scam

| AI curbs Scam | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|
| No | 7 | 17.500 | 20.588 | 20.588 |
| Yes | 15 | 37.500 | 44.118 | 64.706 |
| Maybe | 12 | 30.000 | 35.294 | 100.000 |
| Missing | 6 | 15.000 | | |
| Total | 40 | 100.000 | | |

This table shows the frequencies of whether AI can or curbs the corporate scam.

**Pie charts**

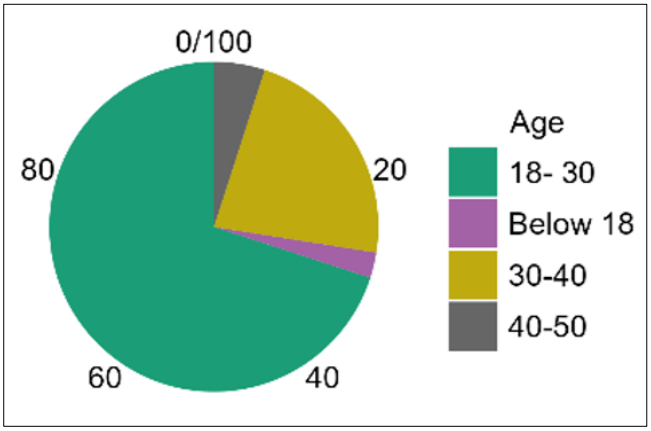


**Chart 1:** Age

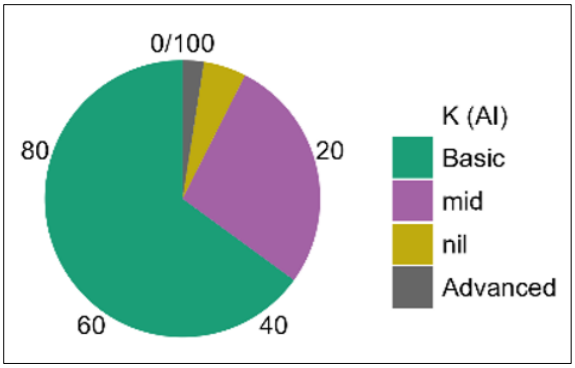


**Chart 2:** K (AI)

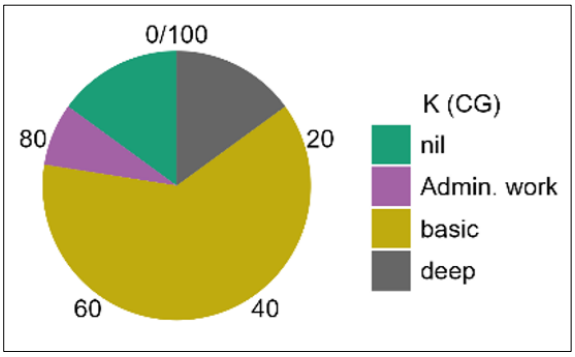


**Chart 3:** K (CG)

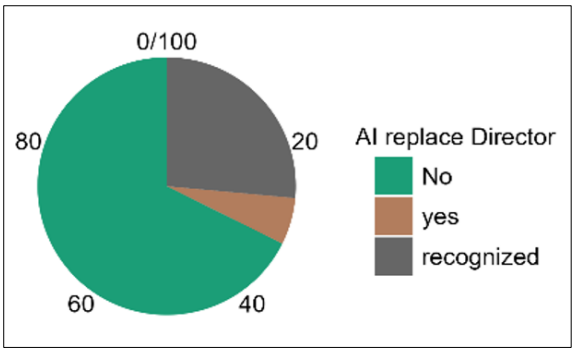


**Chart 4:** AI replaces director

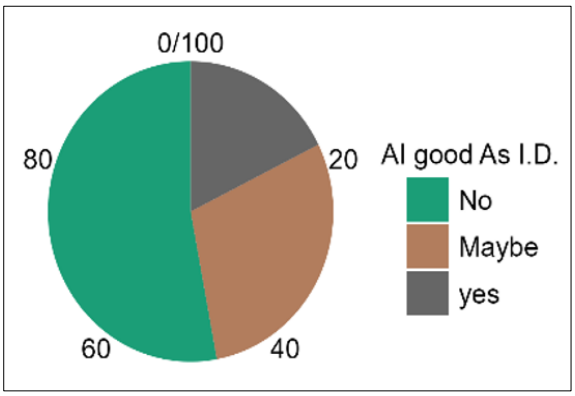


**Chart 4:** AI as Good as I.D.

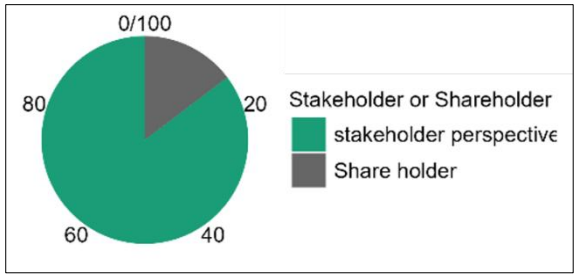


**Chart 5:** Stakeholder or Shareholder

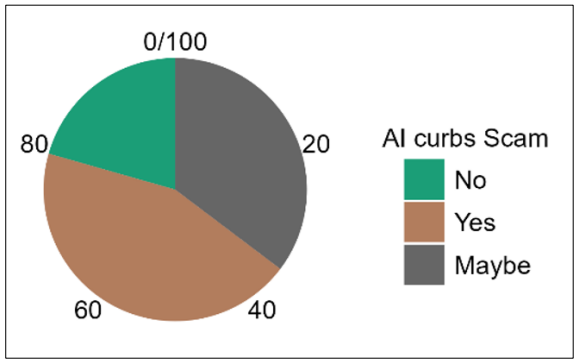


**Chart 6:** AI curbs Scam

## 5. CONCLUSION

The use of AI should not be a check box, as it is seen in the inclusion of women on the board of directors when Section 149 of the Companies Act, 2013, was amended to include a woman director. The AI shall find its place in boardrooms firmly and voluntarily and shall not be a mere mandatory compliance procedure ending in the "check the box" regime.

The biggest problem of AI is the output through a biased input. However, the researcher contends that this problem is not a technological problem but a human problem because biased data is fed by humans, and only humans can correct it. Therefore, AI governance through humans must have an ethical technical team selected by shareholders, which would be responsible for data review. Computational progress and digitalization will therefore inevitably lead to corporate directors being supported—if not replaced—by artificial intelligence.

The more artificial intelligence spreads in corporate boardrooms, the more its use will develop into a widely accepted standard of directors' behavior. In a very similar vein, the governance of artificial intelligence is likely to develop as an additional task for the board of directors

### Suggestion

The discussion in this video [20] is about the compliance regime and its problems. The dilemma regarding the compliance is that the regulations are questionable, and regulations, in fact, are a hindrance to the board's business. This is true in the sense of human capabilities that regulatory provisions are difficult to comply with; however, the AI would be a more feasible person to comply with the regulations.

This video [21] also discussed the appropriate compensation for independent directors, and therefore two approaches were disclosed:

1. Market-Based Approach
2. Marxist Approach.

However, in both the approaches it is difficult to analyze the independence of the independent directors. There is no practical factor available to distinguish and determine the independence. In fact, financial independence criteria is itself a vague method. In this scenario, the AI models or systems can be more reliable and independent than the humans subject to review of data input for bias.

If AI can be placed in the boardrooms for making decisions, it will attract a change of the corporate law altogether. The law shall then recognize the AI as a legal person and constitute a technical team for AI governance. The second choice could be a review of the decisions of the AI by executives of the corporation and making it mandatory to provide reasonable reasons if the decision by the executives is different from the predictions of the AI.

Therefore, the researcher is of the view that AI in corporate governance can help in decision-making, but the use shall be first on a pilot project basis in small companies in spirit rather than in compliance and in a free manner. The corporate world must be encouraged to develop and inculcate AI technologies in corporations step by step. However, the presence of humans is a must, and therefore every decision of AI shall be reviewed.

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