CHAPTER V
SUMMARY AND CONCLUSIONS

Governance reforms have become the cornerstone of corporate sector development in India in recent years. With the opening up the economy for foreign investment and capital, the design of a well laid out governance structure has become increasingly important for corporate sector growth. A large number of corporate governance reforms have been implemented in India starting with the implementation of clause 49 in the listing agreement, its revision from time to time and introduction of number of reforms in the New Companies Bill 2009. It is envisaged that institution of these reforms is likely to lead to better governance of Indian companies.

This chapter highlights the summary of the study and conclusions that be drawn from the same along with contribution of the study and scope for further research.

5.1. Summary and Conclusions

The results generated from the study can be summarised under three main heads namely ownership and performance, role of governance index and its association with performance and lastly, board characteristics and performance.

5.1.1 Ownership and performance

The study puts forward that ownership pattern does have a bearing on performance of the firm and the nature of relationship depends upon the nature of shareholder. Therefore, various shareholders are divided into three groups namely promoters, public institutional and public non-institutional.

Promoters’ shareholdings

- The general functional form of the relationship between promoter shareholding and performance is quadratic, that is performance first increases and then decreases as the ownership stake of promoters increase in
the telecom sector companies. This is a slight diversion from some previous studies promulgating a cubic relation between insider ownership and firm value in India. It may be possible that such a relationship is typical to the sector under study whereby firm value first increases with increase in promoter shareholding as at lower promote stakes outsiders, who are the dominant shareholders in the case may be effective in monitoring management and fear of takeover due to smaller promoter stakes also induces insiders for better performance and protect themselves from takeover bids. As the promoters stake increases beyond certain limit the performance shows negative impact as now promoters are in a position to control management and are in a position to pursue personal gain at the cost of other stakeholders and agency costs increase.

- The diversion from previous studies occur at very high promoter stakes whereby earlier research predicts an alignment of interest between firms performance and insiders gains, no such relationship exists in the sector under study as depicted by the sample companies. Lower performance at high promoter stakes shows that the sector is suffering from the agency problem of minority exploitation by dominant promoters. It is not a typical owner versus manager problem as in developed countries it’s more of an owner versus owner problem. As the stake of promoter reaches higher levels, entrenchment effect is significant and channelling of funds to promoter launched private subsidiaries is common. Minority shareholders are either oblivious to such channelling or are not in a position to induce management to avoid such channelling. The primary work also showed that most of the respondents were of the view that Indian boards are not able to protect the minority shareholders adequately. Therefore, it is suggested that some mechanism is introduced by the regulators to have a minority shareholders director on board to protect their interest.

- Presence of foreign promoter enhances firm value. Foreign promoter not only brings in sufficient capital but also advantages in the form of technical and managerial expertise which may be missing in the domestic
environment. Telecom is a technically dynamic sector with new and new innovations being introduced in a relatively short period of time. In such scenario foreign collaborations are definitely advantageous to the firm whereby the firm has cost effective access to innovation across national boundaries. Moreover, it is observed that foreign collaborators appoint their nominees on the board of directors which also benefits firms by exposing the boards to international board room culture and expertise.

- Performance of a firm is affected by its ownership structure; firms having a greater than 50 percent stake of promoters outperform the firms with a lesser stake. Given the high correlation between promoter stake and size of firm, it is possible that firms gain by economies of scale and show better performance with a more than 50 percent promoter stake. Larger promoter stakes are generally held by corporations providing greater access to funds for initial investment and hence lead to larger scale of operations.

**Public shareholding**

- Public shareholdings in the form of institutional investments contribute positively towards performance. Institutional stakeholders are better organised than public at large which invests as disbursed shareholders and hence are in a better position to monitor management. So, the combined effect of all kinds of institutional shareholdings like mutual funds, insurance companies, FII’s, public financial institutions is positive on firm performance.

- Presence of investments by financial institutions in a firm increases credibility as apart from monitoring aspect discussed earlier, these institutions do make certain checks on the companies before investing in them. So their investments are an indication that the company does meet their investment criteria which is reflected in higher performance measured by market based measures signalling that market provides premium for such shareholdings. When accounting based measures are used, no such relationship is present indicating that no benefit for such investments exists.
when book values and accounting measures are used to measure performance.

- Investments by foreign institutional investors is one of the most significant components of institutional shareholding and their stake positively effects performance. This may be because they are better equipped than their indigenous counterparts to assess and monitor management or maybe they track companies with better performance and invest in them thus having a positive association with performance.

- Domestic financial institutions do not have any significant impact on performance of firms. Another observation is that though the effect of public financial institutions on performance is insignificant, it is a positive association as against some previous work\(^2\) citing lack of incentive to monitor and pursuance of non-profit motives by these institutions as reasons for a negative association with performance in the Indian context. Mutual funds and insurance companies investment is also not large enough to serve as a monitoring device individually.

**Public shareholding non-institutional**

- Corporate shareholdings are present in two forms, one, when the corporation is a promoter and two, when the shares are held as an investment. Overall presence of corporate shareholdings has a positive association with performance but on further breakup of the same, only corporate promoters contribute to this relationship. Firstly because their stakes are higher than those of corporate investments and secondly, they do take active part in management and monitoring the firm through their representatives on board. Corporate investors, both domestic and foreign are not having any significant relation with performance particularly because of their smaller stakes and also because exit route is much easier for them than that of promoters in case the performance of the company is not satisfactory. Thus, there is lesser incentive for them to monitor management or improve firm performance.
• Individual and HUF shareholdings have no relationship with performance. Given the fact that these shareholdings are widely scattered and shareholders are unorganised making them weak monitors of management, the association is predicted to be negative in some previous research, though the current study also shows a negative association but this association is too weak to be called significant. Therefore, presence of these shareholdings has no bearing on the performance.

5.1.2 Governance index and performance

• The average compliance disclosure for the sector is about 49.85 percent on an 84 point score, though companies comply with most of the mandatory requirements for the fear of penal action yet when non-mandatory variables are assessed the disclosure level is quite low. The maximum score of CG_Index is 68 percent, this belonged to a service provider and minimum score is 36 percent which belonged to an equipment company. Therefore, the companies make a compliance disclosure of around fifty percent of the desirable practices on an average. Though this disclosure level could be higher if only mandatory disclosures under clause 49 are considered but doing the same would be depicting a more rosier picture of the scenario as it is time companies should be proactive in going beyond the mandatory norms and pursue some self governance.

• The researcher observed that barring four companies, none of the sample companies had formed a nomination committee. This means that selection of board members is done by the management and no formal search procedure with terms of reference is disclosed by the companies. Only four companies disclosed information regarding term limits and age limits for directors, fifty percent companies had a written policy to prevent insider trading and only eight companies made disclosures about company’s policies and endeavours towards Employee Health and Safety Measures, HRD, CSR and Industrial Relations.
• Telecom service providers are subject to stricter regulatory norms vis-á-vis the equipment sector given the fact that they use a valuable natural resource in the form of spectrum for their functioning. Regulatory authorities are more vigilant in overseeing the functioning of service providers because of which telecom services companies seem to be better governed than equipment companies as the mean compliance disclosure index of services sector is greater than that of equipment sector.

• Telecom services outperform equipment sector as the average performance of the sector measured by Tobin’s Q is higher than that of equipment sector, however there is no significant difference in accounting based measure ROA. It may be inferred that market gives greater premium to service sector as compared to equipment sector.

• Telecom services sector is found to be larger in size than equipment sector, reason being the fact that apart from huge initial capital investment for establishing networks, overheads and maintenance cost are also higher for the services sector. Strong entry barriers in the form of spectrum allocation requirements and cut throat pricing by service providers, makes it difficult for small players to survive in the long run. The equipment sector has lesser entry barriers and companies can operate at a smaller scale also.

• On average equipment sector is significantly older than service sector, entire telecom industry was a government monopoly till mid 80’s. Equipment sector opened up for private players in mid 80’s and services were liberalised in 1992 and a large number of players entered the ground quite late.

• Corporate governance compliance disclosure positively contributes to performance. A number of variables included in the index were voluntary, a higher disclosure signals transparency and better governance which is perceived as valuable by the market, prospective investors perceive a well governed company as less risky for their investment and may be willing to lend capital at a lower cost. This should act as an incentive for corporations to undertake various governance reforms even if doing so requires allocation of additional resources for the purpose.
5.1.3 Board characteristics and Performance

**Board independence**

- Subject to vagaries of inaccurate reporting, 11 observations (9.8%) did not have a minimum of 33 percent independent outside directors and 6 observations (5.35%) did not have a minimum 33 percent of non-executive directors and hence did not comply with clause 49 of the listing agreement.

- Presence of independent chairman is negatively correlated with the number of independent directors indicating that firms with independent chairman are hesitant to keep a higher proportion of independent directors also on the board for the fear of dilution of control. This situation becomes even more relevant for family owned firms whereby the controlling family doesn’t want to dispense with its control or too much monitoring by too many outsiders on the board.

- Board independence measured by proportion of independent directors and independence of chairman has significant positive relationship with financial performance. This evidence finds support in agency theory which promulgates independent directors as an instrument to monitor self serving behaviour of managers and check agency costs. Resource dependence theory also supports more independent directors due to networking advantages they bring to the corporation. Therefore, it may be interpreted that injection of independent directors on insider dominated boards can increase performance. The respondents of primary survey also opined that company benefits from the experience and expertise of independent directors.

**Board size**

- Board size is highly correlated to the size of the firm implying that larger companies see the need of greater pool of knowledge and skill which is translated into appointment of more directors by these firms.

- Firms in telecom sector have a mean board size of around 8 directors with a minimum of 4 and maximum of 16 directors, audit committee has an average
4 directors and remuneration committee and shareholder grievance committee have 3 directors on an average.

- Board size has a positive association with performance implying that larger boards bring in a greater pool of knowledge and skill as compared to smaller boards and improve decision making ability of the board reaping benefit for the firm in terms of performance as put forward by resource dependence theory. Since the point estimate of market based performance measure came out to be significant vis-à-vis accounting based measure this means that stock market perceives larger boards more important and provides a premium for the larger pool of knowledge and monitoring ability brought in by large board size and accounting based ratio rather discounts the same.

- The results contradict those of some previous studies but the average board size in the current sample (eight) is less than that of some of these studies (twelve) it’s possible that the relation is inverse U-shaped whereby performance is positively associated till a certain board size and thereafter the relation becomes inversely related.

- Size of the audit committee of companies in Indian telecom sector has no association with performance, it may be because the minimum size prescribed by law is sufficient for effective discharge of its functions and hence no premium exists for a larger size of the committee. In fact the relationship, though not significant, is negative implying that more directors on the committee may interfere with group dynamics, add to indecisiveness, and inhibit committee’s performance.

- More directors on remuneration committee and shareholding committee do correlate positively with performance; it may be because this can have a signalling effect of active protection of shareholders rights and monitoring executive compensation by the board. Therefore, providing premium in the form of higher firm value.
Summary and Conclusions

Board activity

- Board meetings and attendance are not related to performance in all estimates, it may be possible that the relationship between the number of meetings and performance is more complex than a mere linear form. It also indicates that the minimum number of board meetings prescribed by law in India might be sufficient for adequate functioning of business and no premium is available for additional meetings. In fact negative coefficients indicate that larger number of meetings may be signal of poor performance.

- It is possible that there is a lag effect in the relationship that is, board responds to poor performance by more frequent meetings but the impact of these meetings on performance is depicted in the results of succeeding years rather than the current year.

- Committee meetings and attendance are also not related to performance again indicating that either the members are not effective in contributing towards the deliberations or the minimum number of meeting prescribed by law are sufficient and no benefit occurs for excessive meetings.

CEO Duality

- Duality seems to have no impact on performance that is the firms with boards whose chairman is not the CEO or an executive director do not outperform the firms with duality of leadership. This may be because, though CEO and chairman are different people, they may have close associations and work together as a team rather than stand alone individuals. Absence of duality cannot be interpreted as independence of chairman. As discussed earlier it is independence of chairman that is of greater importance in the sector under study and in many companies though the CEO and chairman are different people the chairman is the promoter director and hence is not truly independent enough to check agency costs. Therefore, the perception that CEO duality has a detrimental effect on performance is not supported in Indian telecom sector as reported with this sample. The primary survey also supported this result as there was no common consensus among respondents on duality implying that there is no common opinion in sector
regarding benefit of having a separate chairman and CEO.

- 50 percent companies had separation between CEO and chairman.

- Duality is not correlated with size that is, common notion of larger firms seeking separate chairman and CEO to handle higher volume and complexity of operations is not supported in the study with the sample companies in telecom sector of India.

**Busyness of Directors**

- Resource dependence theory’s contention that multiple board appointments of directors generate benefits in the form of environmental linkages and enhance firm value is not supported by the study. Busyness seems to lower the effectiveness of directors as corporate monitors and they fail to provide adequate services and value to firm. This may be due to the fact that there is limited pool of outside directors with the right skill set and expertise in the country, diluting the efficacy of the perceived benefits of busyness as propounded by the resource dependence theory.

- It is possible that the busy directors in the Indian telecom sectors may not possess necessary environmental linkages in the form of networking contacts and reputation that are crucial to generate benefits for the firm. The problem may be more severe in firms where greater ownership rights are vested with the promoter and family members, whereby they may hesitate to appoint the “right people” as independent directors for the fear of lack of control which may come hand in hand with such appointments.

- It may be suggested here that keeping in mind the limited number of expert resource persons to serve as directors on boards of companies, the suitable regulatory authority may rethink the limit on the number of directorships an individual can hold.

- Multiple appointments themselves may be within the group firms reducing the plausibility of reaping benefits of networking with external environment through board interlocks. Hence leading to an insignificant relationship with performance.
5.2 Contribution of the study

- The study adds to the current literature on corporate governance and its various components along with their relationship with firm performance. It fills the gap in research in two ways. Most of the studies undertaken so far in India have focused on large listed companies like BSE500, BSE200 etc. The current study covers large as well as medium and small firms differentiating it from earlier research work in the area. Moreover, given that there are very few sector specific studies and there is no study covering corporate governance of the sector undertaken by the researcher, enabling this study to contribute to the existing literature in its own unique way.

- The study has covered corporate governance parameters in a much more comprehensive way vis-á-vis previously available works in India and has covered almost all the listed companies of the sector. Such a cohesive representation enables the research findings to be generalised to telecom sector in India.

- The researcher believes that the CG_ Index constructed in the study can be useful to a wide range of corporate governance participants. To begin with, it can be helpful to regulators to judge how the corporate governance reforms are working. Second, the index can be helpful to companies to realize the benefit of adopting good governance practice - the Index can work as a rating tool. Finally, the index can be helpful to investors to pick well governed companies. Above all, the extensive database that is created in the process of creating the Index will provide valuable information for conducting further research in various fields of governance in telecom sector of the country.

5.3 Scope for further research

No study is complete in all respects and there is always a scope to explore further and improvise. The current study can be further extended in the following areas:
• A cross country comparison can be undertaken whereby governance of Indian telecom sector can be compared with that of some other countries both in developed as well as other emerging economies.

• A comparative analysis of two or more sectors within India can be undertaken to look into the role played by sectoral dynamics in the field of corporate governance.

• An in-depth analysis for background, role and remuneration of directors with their effect on companies can be undertaken.

Endnotes:


3 Yermak,1996; Van den Berghe and Levrau, 2004; Eisenberg et al., 1998.