Chapter 3: Corporate Governance Indicators and Firms Value

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3.1 Introduction of Corporate Governance in India:

Corporate Governance of the business entities, financial institutions and even State owned enterprises has currently become an immensely debated issue worldwide. This is because of the removal of cross border boundary barriers through liberalization, privatization and globalization (LPG) that increased cross border flow of funds’ requirement with enhanced levels of accountability and transparency to invoke greater trust from the investors. The reliability of sources of funds for investments in the corporate has increased more on Private and scattered capital. Private Equity and Investment Advisory Firms, in the post LPG reforms, not only act as financial investors but also at times advise the companies on operational matters like diversification, shifts in business focus, talent search, etc. Although the inherent dissimilarities in their ownership structures and management practices, majority of firms today are staring out for private equity from international investors. In fact, this is increasingly directed and supported through Institutions who act as intermediaries. Funds to be invested in any form seek acceptable returns wherever they are deployed. In the process of minimizing and diluting the density of investment risks and protection issues, the standards adopted for corporate governance by companies have a measurable role to play.

The Institutions would consistently evaluate the borrowers applying the same tests of security and rate of return wherever they divert and invest their funds in the global market. This instigates for convergence of corporate governance regulations and standards which is intricate due to the divergent nature of firms across developed and emerging economies. What can be expected out of companies of irrespective ownership patterns or state owned enterprises is that they should be asked to follow the basic pillars those are of basics and standard one among the corporate governance identified by OECD – Fairness, Transparency, Accountability and Responsibility. The requirements of gaining trust of their investors or fund managers of the corporations would only be satisfied by having been open about their objectives and the way they would be going about achieving these objectives. Resources flow to companies always aspires for safety and protection to be taken care by every corporation that establishes trust among the suppliers of the resources. Hence the principles of
Transparency and Disclosures are the key to investor confidence which in turn is an important element of the firm’s long term financial performance.

Empirical work and study on corporate governance systems in the academic and applied field emphasize on the importance of setting background for corporate governance issues that can arise in reality and impact on the performance of the corporate. Five aspects that need to be considered are the striking a balance between outside and inside directors; promoting insider (i.e., managers and directors) shareholding; keeping the size of the board reasonably low; encouraging ownership concentration; and encouraging the firm to have a reasonable amount of leverage in the expectation that creditors might take on a monitoring role in the firm in order to protect their debt holdings. The connection between corporate governance and firm performance has been the subject of an important and ongoing debate in the corporate finance literature. The debate goes back to the Berle and Means (1932) thesis, which suggests that an inverse correlation should be observed between the weakness of shareholdings and firm performance. Their view has been challenged by Demsetz (1983), who argues that the ownership structure of a corporation should be thought of as an endogenous outcome of decisions that reflect the influence of shareholders and of trading on the market for shares.

LPG restructuring since early 1990s has leaded to the sustained revolution of Indian financial sector into a sophisticated, diverse and flexible system along with the culmination of extensive, well sequenced and coordinated policy measures. Concurrently, capital markets in India commenced to the juncture extensive changes. The Securities and Exchange Board of India (SEBI) was established in 1992 with a mandate to protect investors and conduct improvement drives into the micro structure of capital markets. In fact, on almost all the operational and systemic risk management parameters, settlement system, disclosures, accounting standards, the Indian capital markets are at par with the global standards (Bajpai, 2004). These positive dynamics have led to a sustained surge in India’s capital markets. The corporate governance practices in India has shown a marked improvement in the areas of board structure and processes, disclosure norms and compliance, redressal of investor grievances, transparent management, etc. This has increased the inflow of
foreign capital and recognition of higher investors’ confidence and that the market
take notice of well-governed Indian firms in the global market in the all aspects. The
Narayana Murthy Committee also asserts the aim of good corporate governance as
enrichment of long-term value for its shareholders and all other partners. Most of the
Indian firms, who have been succeeded in their fields, have been following to the
same philosophy of corporate governance i.e. enhancement of long-term shareholders’ value keeping in view the interest of other stakeholders too. Beyond
this, there are many Indian firms believe and practice their corporate governance with
the philosophy accepting the economic, social and environmental aspects in their
company’s management and functioning. Most of the Indian firms believe and
practice the philosophy of corporate governance with transparency, fairness,
disclosure and accountability to be established and involved by their management and
board of governance.

3.2 Concepts of Corporate Governance Indicators:
In a nut cell, corporate governance establishes the relationship, among various
primary participants of the firms those are shareholders, directors, and managers, in
formulating the directions and performance of their firms. In a broader sense, it
delineates the rights and responsibilities of each primary stakeholder and the design of
institutions and mechanisms that induce or control board directors and management to
best serve the economic interests of shareholders along with safeguarding the interest
of other stakeholders of a firm. Many of these other stakeholders also play a role in
monitoring the behavior of the board of directors and management. The most
influential stakeholder of a firm having larger control over the governance of the firm
is the board of directors that is the ‘soul’ of the firm – the foundation of all business
decisions and the origin of corporate culture of a single whole corporate entity. The
essence or attributes of good corporate governance include ethics, managerial
discipline, board independence, protection of shareholders’ rights, fairness,
transparency, board responsibilities, accountability, social awareness and
responsibility, and environmental caretaking. These are the major and widely utilized
attributes for measuring the corporate governance score in any corporate by most of
the corporate governance rating agencies worldwide. One major corporate governance principle of OECD is to “focus on the company rather than on one group of people.”

Until the emergence of corporate governance theories origin to the western countries, our conceptions, about the corporate governance, have been surrounding the set of legislations, norms, regulations, guidelines of some of the laws and acts to be practiced and complied diligently by the companies. However, the governance is more than just board processes and procedures outlined under these laws and acts. This involves unique set of relationships between a firm’s management, board, shareholders (the principal owners of the firm) and its other stakeholder. In modern days, corporate governance is concerned with ‘shareholder democracy’, with agent (board) elected by and accountable to principals, and the firm operated in a transparent fashion in the principal’s best interest. Good corporate governance should provide proper mechanisms of monitoring on management by the board and monitoring on the board by shareholders.

The shape of firms’ corporate governance practices are innermost to few indicators outlined in the corporate governance principles and codes established by varied bodies and regulatory frameworks setting organizations like the OECD, the SOX Act, the World Bank, the CII, the SEBI, the Companies Act, many other acts and different committees like Narayana Murthy Committee, Naresh Chandra Committee, Irani Committee, etc. These indicators of corporate governance are summarized as under.

### 3.2.1 Board of Directors & It’s Size:

The first argument to address the problem of agency is concerned to the board size. National Association of Corporate Directors (NACD) highlights in its Key Governance Principles, 2009 that the board of directors is the central mechanism for oversight and accountability in the corporate governance system. The board is charged with the direction of the corporation, including responsibility for deciding how the board itself should be organized, how it should function, and how it should order its priorities. There are arguments in favour of small board size. First, Yermack (1996), in a review of the earlier work of Monks and Minow (1995), argues that large boardrooms tend to be slow in making decisions, and hence can be an obstacle to change. A second reason for the support for small board size is that directors rarely
criticize the policies of top managers and that this problem tends to increase with the number of directors (Yermack, 1996; Lipton and Lorsch, 1992). Yermack (1996) examines the relation between board size and firm performance, concluding that the smaller the board sizes the better the performance, and proposing an optimal board size of ten or fewer. John and Senbet (1998) maintain that the findings of Yermack have important implications, not least because they may call for the need to depend on forces outside the market system in order to determine the size of the board.

The statutory requirement of minimum number of three directors on the board of any Indian Public Company entails different set of members to be included as directors in the board in typically family managed companies as well as nominee members from the financial institutions from where the debt capital is raised. The study of top 100 BSE companies’ corporate governance practices conducted by Prof. Anilkumar shows that the average board size of the companies in the sample has reduced from 10.74 in 2001 to 9.85 in 2005 perhaps to comply with independent directors to be introduced in the board. This study divulges the size of board enlarged slightly up to 9.88 in 2010. Palanisamy Saravanan, 2012 observed that there is a strong positive correlation between firm value and board size.

3.2.2 Board Structure:
The board structure may be categorized either as a Unitary or as a Dual. The former one is portrayed by a single board, whose directors are elected by the shareholders. This board is headed by a chairman and has combination of executive and non-executive directors. This board is responsible for all aspects of activities of the company starting from decision making till the monitoring of company management. This board structure is adopted and prevailed in many of USA, UK as well as other Commonwealth countries including India. The dual board structure is also known as two tier board, having supervisory board and management board separately. The supervisory board is generally elected by the shareholder and employees. The supervisory board, then after, has to appoint and supervise the management board of the company. This board is also responsible for developing corporate strategy and policy. The management board under this dual board system has senior executives as the members of this board duly appointed by the supervisory board. This board is
largely responsible for the day–to–day affairs of the company. This board structure is adopted and prevailed in Germany, Denmark, Netherland, Austria and some of the Continental European countries. In the study of Dr. Paramjit Kaur et al, 2008, it is found that the higher level of Indian Promoters’ ownership patterns leads to higher corporate performance.

3.2.3 Board Composition:
The board composition is perceived to make an impact on the role of the board, particularly on the strategy formulation, designing of compensation policy of the management and monitoring and directing the management of the firm. The composition of the board may take place as one of three forms: all executive directors, all non-executive directors, and mix of executive and non-executive directors. The first form is normally adopted by the family managed closed or private companies where the family members play the dual role of director as well as managers too. The second form having entirely non-executive directors is generally adopted in not for profit or NGO kind of companies. The mix kind of board composition prevails in numerous corporate firms throughout the world. The composition of board members is also proposed to help reduce the agency problem (Weisbach, 1988; Hermalin and Weisbach, 1991). A positive relationship is expected between firm performance and the proportion of outside directors sitting on the board. Unlike inside directors, outside directors are better able to challenge the CEOs. It is perhaps in recognition of the role of outside directors that in the UK a minimum of three outside directors is required on the board; in the US, the regulation requires that they constitute at least two-thirds of the board (Bhagat and Black, 2001). Empirical evidence has grown but the results are very conflicting. Studies by Weisbach (1988), Mehran (1995) and Pinteris (2002) have produced evidence in support of a positive role for outside directors on firm performance. John and Senbet (1998) in a survey of corporate governance reported that the work of Fosberg (1989) was in support of this positive role. Other works have reported no evidence of a significant relationship between firm performance and the proportion of outside directors on the board (Bhagat and Black, 1999, 2000; Hermalin and Weisbach, 1991; Yermack, 1996; and Metrick and Ishii, 2002). In fact Weir and Laing (2001) reported a negative relationship.
John and Senbet (1998) stress the role of committee structure as a means of increasing the independence of the board. They refer to the work of Klein (1998) and argue for the need to set up specialized committees on audit, remuneration and appointment. Unlike the preceding argument in support of board structures, Laing and Weir (1999) play down their importance, stressing instead the importance of business experience and entrepreneurship. According to them, firms managed by dynamic CEOs tend to perform better than other categories of firms. On the assumption that foreign firms are managed by more experienced CEOs, Estrin et al. (2001) test whether foreign firms perform better than domestic ones in Bulgaria, Romania and Poland. Using panel data for the three countries for the period 1994–1998, they find that irrespective of the estimation technique, foreign firms perform better than private domestic firms. They attribute this finding to the possibility that foreign firms might have some superior knowledge, which leads them to be more efficient. A common theme running through the two studies is the important role that the experience and skills of chief executives could play as a means for improving firm performance.

3.2.4 Insider Shareholdings:
The third mechanism proposed to deal with the agency problem is the use of insider shareholding. Controlling shareholders should take the corresponding responsibilities when they exercise any influence toward corporate management other than the exercise of voting rights. OECD Principles of Corporate Governance, 2004 emphasizes on prohibiting the Insider Trading and Abusive Self-dealing. It also enlightens that members of the board and managers should be required to disclose any material interests in transactions or matters affecting the corporation. Several researchers (De Angelo and De Angelo, 1985; McConnell and Servaes, 1990; Loderer and Martin, 1997; Nor et al., 1999; Yeboah-Duah, 1993) have undertaken research on this aspect, reporting very conflicting results. In particular, McConnell and Servaes (1990) find a significant curvilinear relationship between insider ownership and firm performance. While Loderer and Martin (1997) find no significant relationship, Nor et al. (1999) reported a non-linear relationship, drawing conclusions contrary to those of Yeboah-Duah (1993).

3.2.5 Ownership Concentration:
The fourth element of governance mechanism examined in this study is ownership concentration, which refers to the proportion of a firm’s shares owned by a one or given number of the largest shareholders. A high concentration of shares tends to create more pressure on managers to behave in ways that are value-maximizing. In support of this argument, Gorton and Schmid (1996), Shleifer and Vishny (1997), Morck et al. (1988), and Wruck (1989) suggest that at low levels of ownership concentration, an increase in concentration will be associated with an increase in firm value, but that beyond a certain level of concentration, the relationship might be negative. Other studies such Renneboog (2000) reported results not totally in agreement with the hypothesis of a positive relationship. Using a set of variables suggested by Agrawal and Knoeber (1996), the author reported no evidence to support the hypothesis of a positive relationship between firm performance and ownership concentration. Holderness and Sheehan (1988) find little evidence that high ownership concentration directly affects performance.

Rajie George Pallathitta, 2005 finds that foreign ownership positively affects firm performance, and is consistent with that of prior studies. Even in this study of Rajie, the variable representing domestic corporate ownership (DOMC) is positive and significant regardless of the performance measure used. However, the study of Dr. Paramjit Kaur et al, 2008 highlights the opposite outcomes with ownership concentration has no significant influence on company performance.

3.2.6 Chairman & CEO of the Board:
A considerable amount of attention has been devoted to the critical role of board’s ability to monitor managers and remove non-performing CEOs. Jensen (1993) shows a deep concern with regard to the fact that a lack of independent leadership makes it difficult for boards to respond to failure in top management. In this regard, Fama and Jensen (1983) also argue that the concentration of decision management and decision control in one individual hinders a board’s effectiveness in monitoring to management. It has also been noted that, when CEO doubles as board chair, it lends to leadership facing a conflict of interest thereby increasing agency problems (Berg & Smith, 1978; Brickley et al., 1997). It is therefore suggested that the two positions should be occupied by two persons. The direction of impact of this variable on firm
performance also seems inconclusive. Sanda et al. (2005) show a positive relationship between firm performance and separating the functions of the CEO and board chair while Daily and Dalton (1992) have found no relationship between CEO duality and firm performance. Nonetheless, it must be indicated that, when a CEO doubles as board chair, it affords the CEO the opportunity to carry out decisions and projects without undue influence of bureaucratic structures and in this regard it is expected that CEO duality should have a positive relationship with performance (Rechner & Dalton, 1991). We measure CEO duality as a dummy (equals unity when a CEO doubles as board chair and 0 otherwise) and expect a negative coefficient. The CII task force on corporate governance, 2009, keeping in the ground realities of Indian Firms in mind, also recommended separating the office of the Chairman from that of the CEO. Corporate Governance Voluntary Guidelines, 2009 also underlines that “to prevent unfettered decision making power with a single individual, there should be a clear demarcation of the roles and responsibilities of the Chairman and the MD/CEO of the board. The guidelines also affirm to maintain the balance of power by separating the offices of Chairman and CEO.

3.2.7 Board Committees:
All codes of good practice in corporate governance and stock exchange listing rules require listed companies to constitute a separate audit committee, remuneration committee as well as nomination committee of the board of directors majorly comprising of independent directors. The audit committee of the board should be set up to enhance the credibility of the financial disclosures and to promote transparency. The remuneration committee has to decide the remuneration of non-executive directors of the board. The nomination committee has to ensure the identification of the efficient and qualified members of the board.

3.2.8 Auditors of the Firm:
Each company’s Audit Committee has to regard and identify the details of auditor of the firm. The audit committee of the company should discuss with the auditor about the annual work programme and the depth and detail of the audit plan to be undertaken by the auditor, examine and review the documentation and the certificate for proof of independence of the audit firm, and recommend to the Board, with
reasons, either the appointment/re-appointment or removal of the statutory auditor, along with the annual audit remuneration.

3.2.9 Board Procedures & Meetings:
Board Meetings are official gatherings of the board of directors to exercise the power of it and leading to the strategy and policy decisions on the management of the company. The board meeting should be conducted in a proper manner for the appropriate functioning and operation of the company. All the resolutions and submissions are passed and approved by proper circulations in the board meetings for day to day affairs as well as major policy decisions of the company management and functioning. Most board meetings should be held at the corporate office of the company. Ahead of the board meetings, the board procedure furthermore includes functioning in the meetings and recording of its activities in the governance of the company. The shareholders of the company, in a general meeting, may not refuse any decisions taken by the board in meeting, when such refuse is inconsistent with the Articles of Association of the company.

3.2.10 Remunerations of Directors:
Remuneration Policy for the members of the Board and Key Executives should be clearly laid down and disclosed priorly. The companies should ensure that the level and compositions of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully. The relationship of remuneration to the performance as well as additional incentive schemes should be designed and cleared appropriately. Companies have a separate Remuneration Committee of the Board.

3.2.11 Compliance of Corporate Governance:
The Revised Clause 49 codes of SEBI enlightens that each company shall obtain a certificate from either the auditors or practicing company secretary regarding compliance of conditions of corporate governance as stipulated in this clause and annex the certificate with the directors’ report, which is sent annually to all the shareholders of the company. The same certificate shall also be sent to the Stock
Exchanges, wherever its stocks are listed, along with the annual reports filed by the company.

3.2.12 Disclosures:
Generally the issue of disclosure is regulated by any country’s corporate laws and regulatory frameworks. This has been discussed in detail in the previous chapter. As shown in the previous discussions, the codes and guidelines of most countries keep obligation of financial reporting on the board of directors and circulating the same to most of the stakeholders publicly. In India, the Companies Act, 1956, the SCRA, 1956, Listing Agreement and Clause 49 and the SEBI regulations govern the disclosure practices of the Indian Corporate. The companies are required prepare and circulate the annual report among the shareholders, managements, employees, financial institutions, stock exchanges, MCA and ROC. Disclosure, however, doesn’t extend to the level of ultimate beneficiary and the structure of business groups. Disclosure practices vary from company to company and from industry to industry.

3.2.13 CEO CFO Certification:
The CEO (either the Executive Chairman or Managing Director) and the CFO (Finance Director or otherwise) of all listed companies as well as limited companies whose paid-up capital and free reserves exceeds ₹ 10 crore or whose turnover exceeds ₹ 50 crore, should certify that they have reviewed the balance sheet and profit and loss account and all schedules and notes on accounts of their company and these statements don’t contain any material untrue statement of omit any material fact nor do they contain statements that might be misleading.

3.2.14 Whistle Blower Policy:
Narayana Murthy Committee, 2003 recommended that the personnel who observe an unethical or improper practice (not necessarily a violation of legislation) should be able to approach the audit committee without necessarily informing their superior and companies should take measures to ensure that this right of access is communicated to all employees through means of internal circulars, etc. The employment and other personnel policies of the company should contain provisions protecting ‘whistle blowers’ from unfair termination and other unfair prejudicial employment practices.
SEBI in its Revised Clause 49 Codes emphasizes that the mechanism could also provide for adequate safeguards against victimization of employees who avail of the mechanism and also provide for direct access to the Chairman of the Audit Committee in exceptional cases.

3.3 Impact of Corporate Governance Indicators on Firms Value:
Varied studies have been undertaken until now focusing on developed, semi developed and emerging world economies and revealed that well governed corporate have indexed with better performance in their commercial outcomes and financial terms. Thus adoption of best practices in the Governance of Corporate has laid-down better foundation for themselves by impacting positively on various performance measures and improvements of the Firms across the globe in different economies. The ownership structures of a large majority of the firms those are listed on Indian Stock Exchanges are concentrated within the promoting families. Therefore, majority of the corporate decision making and operational aspects of the firm is exerted with the greater influence of the promoters’ family and groups over the management and functioning of the firms. This state of affairs leads the small investors to be contented only with return on their investment. This also keeps the concern for the welfare of other stakeholders in the company like suppliers, consumers, employees and even Society at large in a limited form and pace.

Until and unless, the firm does financially and operationally well, its’ promoters or the controlling groups don’t get adequate motivation and inspiration to initiate for superior corporate governance practices within the firms. So this is a cyclical process between the corporate governance and firms’ performance. The issues of corporate governance and its impact on the firms’ performance has yet to be researched well in the Indian context though abroad innumerable studies have been carried out on this subject. Major lacuna among the shareholders fraternity about the sufficient knowledge of good governance practices, the deficiencies in the majority of monitoring mechanisms of regulatory agencies with respect to the compliance of the governance norms and provisions and its’ impact on the firms’ performance is the scorching issue to be elicited and studied well. Whatever researches and studies
undertaken till now have firmly demonstrated that effective implementation of corporate governance practices in a long term sustainable manner is expected to benefit all stakeholders including the controlling shareholders and would result in higher firm valuations in the long run. Better Financial Performance and Firms Valuation duly impacted by corporate governance have been seen in following variables of the firms.

3.3.1 Improved Operational Performances:
Various researches have proved that the best practices in Governance lead the firms to have improved operational performance in overall terms. This has mainly impacted and established with improved access to external financing resulting in greater efficiencies due to greater knowledge of investors with regard to the company’s strategies. Availability of capital at lower cost is another indicator of improved operational performances of the firms. Improved operational performance through more efficient management and better asset allocation has also been achieved by best governance practices of the firms.

3.3.2 Competitive Advantages:
Good governance of a corporation leads to value creation of the products and facilitating of more services of these products to their buyers and consumers. This always raises the standards of the products competitiveness and corporate competitive advantages among its entire industry fraternity. An effective board and the governance of the corporate should be the one that craft strategies that fit the business environment and make the corporate flexible to accommodate its strengths, weaknesses, opportunities and threats for competing the future. Infosys Technology Limited has been the best example of consistently enhancing its performance and being forerunner in espousing global governance standards. Many other Indian firms established their new milestones in varied areas few are named like: Tata Sons, Dr. Reddy’s Laboratory, Godrej, Wipro, ITC, Karnataka Bank, State Bank of India, etc.

3.3.3 Higher Returns on Investments:
Research by Sung Je Byun of Columbia University in 2006 concluded that firms with superior corporate governance practices had higher Return on Equity (ROE) and
better Return on Assets (ROA) and Return on Capital (ROC). For top rated companies the ROE was 14.35 percent while for the bottom level companies it was 9.20 percent. ROA of top rated companies was also higher at 4.81 percent compared to 3.46 percent for the bottom based companies. ROC was also better at 10.26 percent compared to 6.69 percent.

3.3.4 Increased Capital and Assets Blocks:
A Credit Lyonnais South Asia (CLSA) 20015 study of 100 largest emerging markets, has shown that best corporate governance practices in emerging markets had 8 percentage points higher EVA than the average of all firms in the country. EVA and MVA are influenced to a great extent by most of the governance variables (Coles et al., 2001). Effective corporate governance mechanisms ensure better resource allocation and management, raising the return to capital.

3.3.5 Improved Profitability:
An ABN/AMRO Study of Brazil based firms with Corporate Governance Ratings showed that their P/E ratios were 20 percent higher, ROE at 45 percent higher and net margins 76 percent higher than those with below average Corporate Governance Practices. A Study by L Brown and M Caylor of Georgia State University in 2004 has shown that well governed companies outperformed poorly governed ones by 18.7 percent in terms of ROI and 23.8 percent for ROE.

3.3.6 Higher Firm Valuation and Capital Performance:
N. Balasubramanian et al (2008) examine whether there is a cross-sectional relationship between measures of governance and measures of firm performance and find evidence of a positive relationship for an overall governance index and for indices covering shareholder rights and disclosure. Properly designed mandatory corporate governance reforms increase share prices in emerging markets such as India (Black and Khanna, 2007).

3.3.7 Reduced Corporate Investment Risk and Scams:
The study by Brown and Caylor12 referred above also concluded that well governed companies had a share price volatility which was 5.6 percent below average. This
leads to have reduced corporate investment risks and less possibility of the firm getting infectious in any corporate scandals.

Companies with good corporate governance practices are known to incorporate effective risk management systems and are hence better equipped to cope with crises. A Study by J Derwall and H Vervijmeren, ‘Corporate Governance and the Cost of Equity Capital: Evidence from GMI’s Governance Ratings’ in 2007 for US companies and H Ashbaugh Skaife and Ryan la fond 200613, concluded that firms with better governance present lower agency risks resulting in shareowners’ and lenders’ willingness to provide capital at a lower cost to the company.

3.3.8 Amplified Faith among Corporate Investors:
The emergence and adoption of LPG gave a free rein to the global capital flow among diverse economies. The capital needs of the companies could not meet within the boundary of its country of domicile. This has internationalized the world capital market. This has made more crucial and significant to win and retain the confidence and the faith among corporate investors. In this global competitive scenario, the significance of good corporate governance in attracting investors and amplifying their faith has gained a momentum. Many empirical researches and studies have led to the increasing recognition of good corporate governance enhances the firm performance and ultimately boost ups the investors’ confidence.

3.4 Importance of Present Study on Corporate Governance and Firm Performance:
Looking to the post 1997 East Asian Financial Crisis, it is felt that corporate governance became a highly salient topic amongst the corporate fraternity in the Asian Continental. The crisis revealed the weakness of corporate governance and financial institutions in emerging markets. The crisis showed that East Asia had to rise up to the corporate governance challenges. This had led to the scorching need to introduce practices more aligned with the OECD and other Global Principles of Corporate Governance in Asian Corporate World too. However the corporate governance principles have been formulated in the western part of the globe, their
applicability and connotation is universal and for all corporations in every corner of the globe. Dr. Jesus Estanislao stated that “This is what corporate governance imposes on all of us, the duty of being transparent, the duty of being socially responsible, the duty of being fair, and the duty of being accountable, not only to shareholders that invest their money in a corporation, but also to the society taken as a whole. Whether those duties apply only to the United States or Europe and not to China or the Philippines certainly should not be a matter of debate.”

Good Governance of the corporate emerges good perspective on economic growth and risk of non-transparent practices lead them towards investment prosperity and overall success. That is how, Adam Smith in ‘Wealth of Nation’ has rightly affirmed that, “being the managers rather of other peoples’ money that their own, it cannot be well expected that (the directors) should watch over with the same anxious vigilance with which the partners in a private copartner frequently watch over their own. Negligence and profusion, therefore, always prevail.”

It was aligned with these surroundings of the prevailing Corporate Governance scenario in India and the practices adopted by listed companies with the Indian stock exchanges, that the present study was conceptualized. As it has been seen in the preceding chapters, a series of studies about the code and principles corporate governance across developed and developing economies in USA, Eastern Europe, Brazil, and East Asia, etc. have concluded that superior corporate governance standards are required to be set and complied with for greater influence on the long term equity performance of listed companies. Through various in detail researches, it has been affirmed that investors including global institutional investors are willing to pay significantly higher premiums for shares of well governed companies. Better governed companies also have higher valuations, reduced share price volatility and rapid growth in corporate functioning. Considering these and several other benefits, it was necessary to bring into focus the importance of good governance in our listed firms.

Secondly, our regulatory framework for Corporate Governance is still being evolved. The Companies Amendment Bill, 2012 has been enacted and released recently. The
debate whether too much regulation leads to indifference and thus evasion is still enduring in Indian corporate spheres. Compliance with regulatory norms apart, adoption of better governance standards as well as the beyond compliance should be a voluntary process and originate from within the board rooms of the corporate firms themselves. Understanding the impact of effective corporate governance practices and higher ethical standards, on the long term financial performance of firms is important for promoters of Indian Firms irrespective of its formation in either of sphere. It requires to be acknowledged that good governance adds value by improving the firm’s performance in the course of more competent and apparent management and better asset allocation. This could provide a strong motivation for strengthening the governance mechanisms in these firms. This study, therefore attempts to construct a model for a healthier apprehension of the long term outcomes of good governance standards and the requirements to reinforce the compliance processes adopted by listed and even unlisted companies in India.

This research is an attempt to examine the extent to which the suggested mechanisms might help reduce the agency problem in a developing stock exchange such as that of India, where there is a yawning gap between theory and evidence. This study aims to provide additional insights into the relationship between governance mechanisms and firm financial performance in India. Our focus is on the five dimensions of corporate governance, abstracting from other dimensions such as incentive schemes. In the study an attempt will also be made to know the view of corporate executives of India towards the relationship between market value of the firm and corporate governance. It is hoped that the evidence would serve as important quantitative information into the cauldron of policy as well as add to the existing body of empirical literature from a developing stock exchange such as that of India. The need for a study of this kind is even more important in an environment like India’s, which is characterized by growing calls for effective corporate governance, particularly for public limited liability companies. This call is understandable in view of the importance of effective governance at both microeconomic and economy-wide levels. At the level of the firm, it offers the promise of a fair return on capital invested through improved efficiency (Metrick and Ishii, 2002). It also has some implications for the ongoing privatization programme that the Government of India is currently undertaking. Grosfeld
(2002), citing the works of other scholars, indicated that the effectiveness of privatization is greater when corporate governance works well. Moreover, by helping to promote firm performance and the protection of stakeholder interest, corporate governance encourages investment and stock market development, which Demirguc-Kunt and Levine, (1996) have associated with improved macroeconomic growth. Further, evidence in the work of Klapper and Love (2002) suggests that firm-level corporate governance provisions matter more in countries with weak legal (or regulatory) environments, implying that “firms can partially compensate for ineffective laws and enforcement by establishing good corporate governance and providing credible investor protection”.
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END OF CHAPTER - III