CHAPTER 4

CORPORATE GOVERNANCE AND FIRM'S PERFORMANCE

Having analyzed the Governance practices of Indian companies, an attempt is made in this chapter to measure the corporate governance rate of the sample companies. It subsequently examines the structure of Corporate Governance and its effect on the performance of the company. This chapter develops theory and propositions concerning the board composition, structure and its effect on the performance of the firm.

Even though the thesis is that those who govern are in-charge of and directly responsible for the results of activity or inactivity in different areas of operations, the cause and effect relationship between their decisions, actions and the results are not easy to perceive, detect and rectify.

Corporate Governance essentially relates to the quality, attitudes, and morals of the corporate leaders. It has been hypothesized that these issues do create value, a value more permanent and important for a company in the long run. The hypothesis is supported and constructed based on following academic theories.

4a. CORPORATE GOVERNANCE: MAXIMISING SHAREHOLDERS VALUE vs. STAKEHOLDERS VALUE

The very objective of corporate governance is to maximise shareholders value which is economic in nature. The CII publication\(^1\) on desirable corporate governance quotes as follows: A code in nature limits the objective of good corporate governance to maximising long-term shareholders value. The reason given is that such is the global consensus. Since shareholders are a residual claimants, this objective follows from the premise that in well-performing capital markets and financial markets, whatever maximizes shareholder value must necessarily maximize corporate value, and best satisfy the claims of creditors, employees and the state.

The other way of looking at corporate governance is from the contribution of corporate governance to the efficiency of a business enterprise, and the creation of wealth to the country’s economy.
For most people, "maximising shareholder value" means an appreciation in share prices and rapid capital gains. Bishan Sahai² mentions that the big bull can surely provide these as well as even better than chasing after ethereal concepts like corporate governance!

The viability of a company does not depend on giving one interest priority over others; profitable business, especially in the long run, is dependent on a plurality of participants. The company is a mini-community; it cannot exist and flourish without taking care of all groups who belong to the community.

It can be agreed that shareholder value is paramount because shareholders are owners of the company. But this is not a valid construction either in law or in concept. In legal terms, what a shareholder owns is a freely transferable scrip which carries rights and obligations independent of those of the company to which it pertains; he is not a co-owner of the company or any of its assets in any sense nor can he be called upon to share its liabilities or be used for their fulfilment, as an owner would. In concept, a company is not just a collection of credentials, its image and reputation, its relationships, the fund of knowledge and skills of its people are the things that add value and create wealth³.

Peter F Drucker⁴ points out that term "free enterprise" was indeed coined forty years ago to assert that the shareholders interest though important is only one interest, and that the enterprise has functions well beyond that of producing returns for shareholders.

4b. AGENCY THEORY AND CORPORATE GOVERNANCE

One more concept that support the relationship between the governance and profits is the Agency Theory. Agency theory has become a popular framework for studying governance issues, and evolved from risk sharing research in economics. Agency theory implies a well-known trade-off between risk bearing and efficiency. The unit of analysis in an agency model is the relationship between a principal and client; and the focus of the theory includes causes and consequences of goal divergence between the two parties, an agency problem is said to exist when an agent has established goals which conflicts with those of a principal.
In the modern corporation, owners provide investment capital in return for stock, and professional managers carry on the business based on their decisions about how best to employ the capital. Managers as agents for shareholders will tend to be less vigilant in pursuing owners interest than if they themselves were the owners. As explained by V.K.Bhalla managers pursue their own interests, at least sometimes, at the expense of the shareholders. The board of directors provides a functional response by downgrading performance based on strategic decisions to best interests of the shareholders.

Due to diffused ownership in publicly held firms, the board of directors serves as the proxy for individual shareholders, and is responsible for representing their interest.

Excessive level of executive compensation, and wealth-diluting mergers and acquisitions are generally viewed as symptoms of agency problem. Such problems are likely to occur when a key-decision maker has a minimal financial interest in the outcome of his decision. In spite of the agency problems created by the separation of ownership and control, ownership dispersion may be optimal for large companies because individuals cannot bear the large risks involved.

Even then one would not assert that corporations would be equally or better situated if management were not governed. An active and independent board of directors working for shareholders clearly benefits the corporation by reducing the agency problem that arises from the separation of ownership from control in the modern corporation. It does so by acting as agent for owners in controlling a management whose principal motive is not to maximise value but rather enhance its own position. Any resulting change in management’s behaviour should result in increased returns to the owners as residual claimants.

But in spite of the increasing important role of the board and, specifically, independent directors – there remains reluctance to conclude that the activist board is in fact the solution to the agency problems. It cannot be concluded from the historical studies that there is a significant relationship between good performance and good governance. This failure to detect a relationship may be largely the result, however, of looking at performance and governance through a rear – view mirror. Throughout much of the past half century, the board of directors as an institution has in fact been passive and point of irrelevance when compared to corporate performance. There has been a significant disparity between board duties as formally described and as actually practiced.
The boards were passive, by itself led to the adoption of various other remedies for the agency problems. These remedies, however, in turn failed to completely resolve the problem. The remedies include using shareholders pressure, media scandal, and litigation against directors as mechanisms for making management work more in the interests of the shareholders.

Shareholders pressure and media attention have been insufficient motivators for management to undertake just those investments that are expected to achieve the highest possible returns to investors over the long term rather than the highest rate of corporate growth. Nor has the threat of litigation been sufficient, given that the court system is slow, often makes counterproductive decisions, and the associated costs are likely to outweigh the benefits.

4c. ETHICS, PROFITS AND CORPORATE GOVERNANCE

The corporate governance associated with better business ethics contributed to help the corporations to earn better in the long run. Thomas Donaldson, in the article 'Ethics and Business: a New Look' (Corporate Ethics) writes that the most investigated research topic in business ethics in the United States is the connection between being ethical and being profitable. Of these surveys, the vast majority shows that there is a clear correlation between having an ethical reputation and doing good business. A research paper presented in the California management review shows that over a seven-year period, most corporations, which showed the highest concern for ethics, also tended to show the highest growth and profits. A landmark study done by Johnson & Johnson, which tracked companies over a 35-year period from the 1950 to 1980 clearly shows that the company’s ethical reputation influences the high stock market value of its shares. One thing seems clear, and that is that it certainly doesn’t hurt to be ethical.

Chairman James Burke, Johnson & Johnson once told – ”I have long harboured the belief that most successful corporations in this country, the ones that have delivered outstanding results over a long period of time, were driven by a simple moral imperative – serving the public in the broadest possible sense is better than fighting against their competition.”

In the famous Tylenol crisis when Johnson & Johnson withdrew $100 million worth of its products from the market, because three capsules were found laced with cyanide, they were faced with the possibility not only of the loss of the
product but also of their reputation and market share during the six weeks that took for them to replace the capsule with tamper-proof pills. They, nevertheless, did not hesitate to act not only to eliminate the slightest possibility of any further poisonings, but also to alleviate widespread public anxiety. In other words, the company incurred a huge loss in order to protect the public safety and also to bolster the people’s emotional security.

James Burke reacted: “we learned that the reputation of the corporation ... provided a reservoir of goodwill among the public, the public, the people in the regulatory agencies and the media which was of incalculable value in helping to restore the brand.”

Corporations also, perhaps there can be no argument on this issue. However, for transition economy like India where big corporations exist only in the public sector, such conclusion, without proper examination, may not sound convincing.

In the Indian context, the business owners and the professionals working in these firms are facing this conflict in the aftermath of reforms. Most of them have succeeded not because of competence in terms of market competitiveness but because of their capacity to use the system to derive the maximum benefit.

In this scenario, understanding of the concept is not enough; confidence of the relationship between corporate governance and success is necessary.

4d. CORPORATE GOVERNANCE TO AID IN SURVIVAL AND GROWTH

The most important objective of a corporate concern should be long-term survival and growth. Any business approach can be termed good only if it takes care of the long term also.

Very high profitability cannot sustain in the long run where information flows freely, markets are free and innovations is continuous, unless the organisation is visionary, reactive as well as proactive.

The long-term survival motive necessitates that the interest of all stakeholders are taken care of. The entire credit for the growth and survival of business cannot go alone to capital and enterprise. Role of externalities and social responsibility of business is also to be appreciated for the long-term survival.
Mr. Rajesh K. R. Jain stated that “In the Indian context, an analysis of long-term survivors – the house of Tata, the house of Bajaj, the Murugappa house etc, points to the fact that companies which have followed good practices and who have cared for the environment are the one who have survived in the long run”.

4e. CORPORATE GOVERNANCE AND VALUE CREATION

Corporate governance envisages making value creation a core competence of the company. Only a value based management consisting of an accountable board of directors, strong CEO leadership, ambitious performance goals, and high expectations for change, have resulted in strategically placed, well performing and value-creating corporates.

Great companies have all struggled in recent years despite some enormous competitive advantages of assets, technology and functional skills. Mishra K. C. mentions “Corporate governance has to be accepted as a fundamental fiduciary responsibility of corporate managers and the board of directors. The measurement approach to corporate governance would enable board to recognize that despite good projections, the company’s increasing cost of capital, rising investment requirement per Rupee of sale and lower margins on sales are clear signs of value erosion due to bad corporate governance”.

Most preachers of corporate governance have focused on a model code. They do not have the number to communicate or estimate the scale of corporate governance. Observance of a code can only be monitored on-line.

There may actually emerge a situation of governance trap for business. Corporate governance should not be a cause of worry like a new terror creeping into boardrooms and executive suites around the corporate world. It should be rational, normative, productive and measurable asserts, Mishra.

Yerram Raju states that there is considerable debate about what actually constitutes corporate governance. Its key elements, however, concerns the enhancement of corporate performance through supervision or monitoring of management performance and ensuring accountability of management to shareholders and stakeholders as set out above.
Most of the business entities including the Fortune 500 companies have come into existence as a result of the entrepreneurial instinct of a person willing to take all the risks necessary to make him earn some profit. Justifiably, success is rewarded with profits.

Profit maximization, wealth creation, optimum utilization of scare resources and continuity are the answers to the 'why' aspect of the existence and growth of the firm. Issues like corporate governance, corporate ethics, value based management, social responsibility of business and stakeholders concepts, all answer the 'how' aspect of the existence of the firm\(^{16}\).

In the coming decades freedom and receptivity to change will matter even more than it did in the past because knowledge is to be the determinant of growth and economic wealth.

Shareholders value has two aspects – short-term and long-term. The business owners and managers generally work the pressure of immediacy. As such, profit becomes their primary concern. On the other hand, management scholars point out that for business to grow and for creation of long-term shareholders value, business strategists have to formulate policies in such a manner that the business becomes employee driven (byway of providing personal and career satisfaction) and consumer driven (in the form of a quality product or service at an attractive price.

However, over 80% of the reporting parameters used to manage the company are designed to gauge returns to shareholders. Most management decisions are therefore biased towards delivering short-term value to them. An income statement or balance sheet does not reveal about the company's ability to create value for customers and employees or shareholders.

4f. **GOOD GOVERNANCE AS A PRE REQUISITE FOR EXCELLENCE**

Corporate governance and excellence are very closely connected concepts and in the long run it is difficult to achieve excellence without good governance. Good governance is the means to the larger end of corporate excellence. As we move towards the knowledge society, we witness the center for power shifting towards the consumers and the knowledge workers, and away from the owners/sharholders. The links between governance and excellence are likely to be much stronger in the future.
Corporate excellence and good governance are so intertwined that achieving one without the other is unimaginable. Well-governed companies produce distinctively excellent performance. Good corporate governance is a source of competitive advantage and critical to economic and social progress. According to Kulkarni. B.K\textsuperscript{17} adherence to good governance practice provides stability and growth to the companies; builds confidence, reduces perceived risks and thus the cost of capital, promotes stability and long-term sustenance of stakeholders relationship, adds to the position and status of the corporate and finally facilitates relationship with other corporates whose governance credentials are exemplary. This chapter attempts to relate the excellence with good governance.

4g. BOARD COMPOSITION AND COMPANY PERFORMANCE

An increasing amount of international evidence is now emerging on a number of corporate governance issues relating to board structure and corporate performance.

However Prior Research seems not to have provided theoretical and empirical evidence of the effect of corporate governance on firm’s performance. Board composition has been subject of extensive research as a determinant of company performance and research provided evidence that the ability of boards to perform their strategies, governance and institutional functions depends largely on their composition. However there is no general consensus explaining the link of variations in board size and the type of membership with company performance. This lack is attributable to the presence of “unidirectional, casual relationships” between corporate financial performance and board composition.

The professional board is an active monitoring organisation that participates with management in formulating corporate strategy, develops appropriate incentives for management and other employees, and judges the performance of management against the strategic plan.

The following are acceptable surrogates for direct observation of effective behaviour by professional boards in an analysis by Vinesh Kathuria\textsuperscript{18}:

- Independent board leadership is essential, whether through a non-executive chair or a lead directors, so that directors are able to act without relying solely on initiatives from a management chairman;
• Periodic meeting, without management, of the independent directors to provide the opportunity for the directors to evaluate management against the strategic plans for corporate performance; and

• Formal rules or guidelines establishing an independent relationship between the board and management.

Each of these surrogates departs from the traditional system that allows the board to be dominated by management, and the presence of any one of them suggests that traditional board culture has been displaced in favour of an independent and professional approach in board decisions. Thus, for the purpose of this study, it is assumed that when the board is independent it can serve as the "grain of the balance" that tips the scales in favour of better corporate performance.

4h. FIRMS PERFORMANCE IS MONITORED BY REPUTED AGENTS AND ACTIVIST SHAREHOLDERS

Developed markets increasingly feature a dense network of reputed agents who significantly reduce monitoring costs. They include accounting and auditing professionals, lawyers, investment bankers and analysts, credit rating agencies, consumer activists, environmentalists and media, keeping an eye on corporate performance and directors behaviour, these reputed agents can exert pressure on companies to disclose relevant information, improve human capital recognizes the interests of outsiders and otherwise behave as good corporate citizens. Some can also put pressure on companies through their influence over public opinion. Investors and activist shareholders have also championed governance reforms.

According to Paul W. MacAvoy through out the 1970s and 1980s management-dominated corporations pursed growth and diversification strategies that expanded corporate size for its own sake, but provided limited returns to investors.

The resulting low returns to investors in turn prompted a new activism. Board members had to respond to increasing pressures from

• Institutional shareholders, primarily large public pension funds;

• Active investors, particularly takeover firms;
• The courts, whose decisions called for directors to take more responsibility for investors.

Further more attacks by the media ultimately raised directly concerns for their responsibility and, indeed, their own reputations. Essentially, the response has resulted in active monitoring of the management.

4i. CORPORATE GOVERNANCE AND CORPORATE PERFORMANCE

Anything that exists can be quantified. Those quantifiable get measured. Corporate governance can be measured by value imperatives. In the absence of a normative and measurable approach, corporate governance may creep into boardrooms and executive suites as an instrument of terror, argues the Mishra.K.C and offers two measurement options – Balanced Score Card and Economic Value Added.

At the end of every statutory period, thousands of executives and analysts, and money managers around the world wait anxiously for hard numbers that will move markets, slash or increase payrolls and drive expansion. Traditional performance measures like return on investment, stock prices and quarterly earnings have long been paramount. But things are changing or about to change. Today, managers are taking a hard look at the value of intangibles like customer satisfaction, intellectual capital, employee loyalty, and corporate governance.

Irrespective of differences between various forms of corporate governance, all forms recognize that good corporate practices are must and – at the very least – satisfy two sets of claimants: creditors and shareholders (Goswani et al, 1996).

World over, academicians and research scholars in the field of corporate governance are busy to establish a correlation between corporate governance and its reflection on the bottom-line. In the success oriented world of business, meaningful acceptance of any practice cannot be achieved in the true sense unless this relationship is established. Managerial efficiency is measured in terms of money only.

It is heartening to see that in almost all the success stories of the present times, the level of corporate governance has been very high. Ranbaxy, Wipro and Infosys have done a wonderful job for the cause of corporate governance and the best part is the magnitude of their success has started influencing the minds of Indian business owners.
But one more controversial question is “to be successful, is being good enough?” Good practices are necessarily the one of the needed conditions. Host of other qualities are needed to make a true success story, the most important being competitiveness. Corporate governance basically acts as an enabling platform.

Moreover, success and goodness is not the same thing. In the short run, one can be successful despite not being good. Moreover perception of success is also subjective.

A recent study¹²³ conducted by the Organisation for Economic Cooperation & Development (OECD) reflects that non-financial performance data is relevant to shareholder evaluations and investment decisions. These most valued non-financial data include execution of corporate strategy, management credibility, quality of corporate strategy, innovativeness and ability to attract employees.

According to the OECD, most companies are well aware that the facts and figures contained in the financial reports fail to capture fully the ‘essence’ of their operations. This fact is particularly evident in the case of companies whose book value is markedly different from the market value.

Intangibles like the accumulated know-how and experience of the employees, research and development, customer satisfaction, the working environment will play a greater role in attracting capital and retaining investors in the years to come. (The Economic Times, 24 June 1999)²⁴.

In a predominantly success oriented world, Money and profits are the barometers of success. The evolution of boards from managerial rubber-stamps to active and independent monitor has been in large part the result of efforts to address or avoid serious problems with corporate performance associated with managerial entrenchment.

The determinants of corporate performance – strategic, managerial, and environmental – are complex and in the last decade some or all of them may have offset the positive effect of board activism. Additionally, from outside the corporation looking in, it is difficult to determine whether active boards have actually had to make decisions that could improve managerial performance. Given these complications, it is understandable that numerous attempts to determine whether board activism improves performance have not resulted in consensus.
One needs to compare the benefits of introduction of better corporate governance against its costs in terms of restricting the freedom of professional management.

A three-member committee2 has studied the corporate governance system at selected thirty large Indian corporations. Their inferences were.

- Profits have no relation with the kind of corporate governance model followed in the sample companies.
- Directors in most of the companies are found ineffective in monitoring the management’s performance.
- Corporates were divided on an issue – whether government should dictate the corporate behaviour or not.
- Indian corporate sector offers both best and worst kind of corporate governance model.

Results show that better corporate governance in Indian boards is driven more by its collective conscious than by stakeholder demands or market forces.

Few authors have ventured an investigation into the comparative performance of businesses operating under the rules of the divergent systems. Mostly, in discussions of international comparisons, reference is made to national economic performance.

The additional discovery is that this relationship between corporate governance and corporate performance appears to be contingent on type of performance measure (present for return on asset measures of performance but not for return on equity measures).

4j. CORRELATION BETWEEN DIFFERENT CORPORATE GOVERNANCE PRACTICES AND FIRM’S PERFORMANCE

For good performance ‘neither efficiency nor quality were necessary’. The so called ‘professional managers’ and ‘independent auditors; did not help much. Many of them became willing or unwilling partners in poor corporate governance. The main focus was on ‘performance’, being narrowly defined. So long as operations
remained profitable, lenders, principal investors, auditors and boards did not look at finer aspects of performance such as the quality of earning and soundness of accounting practices. Creating accounting and weak supervisions ensured that by the time problems surfaced it was too late for preventive actions.

According to a recent study conducted by Andrew of Emory University Goizueta Business School and Karen Bishop of the Menderson Graduate School of Business at the University of Alabama, "A company's bad stock performance was more likely to correlate with board departures. Secondly directors who lost their jobs, as CEO's were significantly more likely to leave other company boards as well. Interestingly, poor performance seemed to have nothing to do with it. "Invitations to join boards seems to come through connections rather than demonstrated merit in running firms."

The key to better corporate governance in India today lies in a more efficient and vibrant capital market argues K.R.S.Murthy (1997). His argument, however, assumes a significant correlation between financial performance and good corporate governance.

Mr. S. H. Khan, former chairman of the Industrial Development Bank Of India, quoted a study on corporate governance of 30 companies which found that companies with low promoter shareholding and chairman from outside the promoter group were having more effective corporate governance practices and the presence of outside directors was said to have helped corporate performance (The Economic Times, Mumbai Bureau, 1998).

"In principle, weak monitoring of diffused shareholders enhances the incentives for incumbent management. Similarly, it may be expected that gains to investors will be obtained from turning around under performing companies through the replacement of inadequate management and governance by new entrepreneurs and active investors. However, it is important to recognize that incoming managers are faced with varied problems. Whilst incumbent managers may know the real internal state of affairs, incoming managers may not identify problems fully. As a result, the control mechanism introduced by the commitment to meet the cost of serving external finance may lead to sub-optimal decisions."

There is continuing academic and professional interest on the impact of joint chairman / chief executive appointments (CEO Juality) on corporate performance.
The empirical evidence presented in the previous studies, focused on levels of association (correlations) between different variables of Corporate Governance. In all these studies attempt is made to isolate the average cross-section impact of governance variables on corporate performance.

Other evidence from Jinesh Panchali documents the relationship between corporate performance and shareholding pattern in general and ownership of financial institutions in particular; that reveals the following:

- Ownership of corporate bodies was found negatively related with growth but positively related with profitability.

- Public ownership also did not show any significant relation with any of the performance variables.

Attempts to link board governance to corporate performance have produced inconclusive results. Most research studies have been based on methodology that links elements of board structure to financial measures of corporate performance or to a single corporate event. For example, early studies focused on whether the percentage of non-management directors on a board correlated with frequency of CEO replacement, response to takeover bids, or variations in stock price. Their results disagreed in their statistical significance—and, in some cases, even on the positive or negative character-of the relationship. But, as these results suggest, it is not to think that any single structural characteristic of a board, without further analysis of its implications for board activism, can correlate with better corporate performance.

Small pieces of limited research mentioned above warrants a detailed and rigorous research in the area of corporate governance in Indian context.

In this context it is hypothesized that an active board works to enhance the corporate performance. To test this hypothesis:

- It is attempted to rate corporate governance of sample companies taking wide range of governance variables into account.

- Correlate these ratings with higher (or lower) earnings performance of the company.
Corporate Governance rating is a new concept Worldwide and the process is evolving. In the Indian market, a beginning has just been made with the recent announcement of the first corporate Governance rating given by ICRA relating to Multi National Company - Indian Tobacco Company (ITC Limited)

In India ICSI instituted a national award for a best governed company annually. The initiatives aiming at promoting corporate Governance through this Award are:

- To recognize leadership efforts of corporate boards in practicing the corporate Governance principles in their functioning.

- To recognize implementation of innovative practices, programmes and projects that promote the cause of corporate Governance.

- To enthuse further the corporates in focusing Corporate Governance practices in Corporate functioning; and

- To encourage implementation of Corporate Governance norms in true letter and spirit.

The companies, which had to comply with the statutory requirements as on 31st March, 2001 including Group A of BSE and S&P CNX Nifty Companies, are considered eligible for the award based on the following sources:

- Published latest Annual Reports along with a copy of notices of the companies available for analysis up to 30th October, 2001.

- Any other document which may be required in respect of eligible companies.

Selection criteria:

- Annual Reports along with the copy of notices of the companies which had met the criteria of corporate governance statutorily as well as in true letter and spirit.

- On the basis of information received from the companies to whom questionnaire were sent.

- Allocation of marks will be on the following basis:
a. Statutory compliance 20%

b. Compliances of corporate Governance norms in full letter and spirit- 50%

c. other criteria such as investor friendly procedures and practices useful for the investor and society at large-30%

In India Credit Rating Information Services Agency Limited (CRISAL) is engaged in Corporate Governance rating in collaboration with S&P. Standard & Poor's has constructed a methodology to evaluate Corporate Governance Standards of individual firms, which is a synthesis of principles of Corporate Governance practices proposed by a number of international organizations and Corporate Governance specialists.

Corporate Governance Score of a company expresses an opinion about the extent to which a company adopts and conforms to codes and guidelines of good corporate governance practices.

The extent to which, a company has adopted and conformed to codes and guidelines of corporate governance best practices will be reflected by the award of Corporate Governance Score (‘CGS’) on a scale from CGS - 10 (highest) to CGS - 1 (lowest).

In addition, scores from 10 (highest) to 1 (lowest) will be awarded to each of four individual components that together contribute to the overall CGS. The individual components considered by S&P are:

1. Ownership Structure and Influence: Transparency of ownership, concentration and influence of ownership.

2. Financial stakeholders relations: Regularity and information of shareholders meetings, voting and shareholders meeting, procedures and ownership rights.

3. Financial Transparency and Information Disclosure: Type of public disclosure standards adopted, timing of and access to, public disclosure, independent standing of auditor.
4. **Board and Management Structure and Process:** Board structure and composition, role and effectiveness of board, role and independence of outside directors, board and executive compensation, evaluation and succession policies.

Their Analysts will examine a number of company documents including the Following:

- Company annual and intra year reports.
- Company charter / by laws.
- Filings with Government Regulatory Agencies.
- Records of recent shareholders meetings (past three years), general and extraordinary.
- Minutes of recent board meetings (past three years).
- Disclosure of new share issuance (including options) at the company or the subsidiary level.
- Identification of key shareholders (over 10%) and creditors.
- Records of any penalties, fines or other violations relating to abuse of shareholders rights on public records, including pending items.
- Disclosure of board structure and composition.
- Disclosure of company auditor.
- Disclosure of major scale transactions in past three years (over 10% of company net assets).
- Identification of share registrar.

Analysts of CRISIL will meet officers of the company and other relevant individuals including the following people:

- Chief Executive
- Finance Director
• Company Secretary / Corporate Counsel

• Board Directors (particularly the Chairman and independent directors)

• Shareholders relations personnel

• Key shareholders and creditors

• Company's auditor.

On the advice received from SEBI, Credit rating agency ICRA\textsuperscript{32} developed a rating methodology and rated 2 Indian companies so far. The emphasis of ICRA rating is on Corporate business practices and quality of disclosure standards that address the requirements of the regulators and are fair and transparent for its financial stakeholders.

The key variables that are analyzed while arriving at the Corporate Governance Rating for a corporate entity as per their methodology are as follows:

• Shareholding structure.

• Governance structure and Management processes.

• Board structure and processes.

• Stakeholders Relationship.

• Transparency and Disclosure.

• Financial Discipline.

ICRA's\textsuperscript{33} Corporate Governance Rating exercise involves perusal of various corporate documents like Board Notes, Agenda papers, Minutes of Meetings, Statutory Returns Submitted to the Registrar of Companies, the Stock Exchanges, and the Securities and Exchange Board of India (SEBI), Annual Reports, disclosures in the website, etc. Additionally, their Corporate Governance Rating process involves meeting key officials of the corporate being rated, its statutory auditors, Directors (including independent directors) on the board, and some institutional investors. Each of these variables is scored on a set of parameters and a composite score using a proprietary model was developed by ICRA.
The ICRA's rating methodology is designed to take a holistic view of the different aspects of a company's business policies and practices that are relevant to corporate governance. "ICRA does not carry out an audit, nor is its rating to be interpreted as an indicator of statutory compliance by the rated company" says Mr. Anjan Deb Ghosh.

A corporate entity does not carry on its business perpetually to demonstrate excellence in Corporate Governance. Good Corporate Governance is the means and not an end by itself. Ultimately, the business has to create Wealth and distribute it fairly and equitably among its diverse groups of stakeholders. It is logical for stakeholders to call for a replacement of general perceptions of corporate governance with independent analytical evaluation.

Corporate Governance talks about essentially qualitative and subjective issues, and therefore, may not be easily amenable to clear-cut objective analysis. There are certain specific statutory and regulatory requirements governing the management of corporate entities, which also define the codes and standards with particular orientation towards protecting the interests of diverse stakeholders. The Cadbury Committee's Recommendations, the OECD principles, the confederation of Indian Industry (CII) code, the securities and Exchange Board of India directive through clause 49 of the listing Agreement, and the recent changes in the companies Act provides the guiding principles of Corporate Governance.

With these rules and regulations an analytical framework was developed in this chapter within which a corporate entity's quality of Corporate Governance is assessed.

Corporate Governance Rating is meant to indicate the relative level to which an organisation accepts and follows the codes and guidelines of corporate governance practices. The corporate governance practices prevalent in an organisation reflect the distribution of rights and responsibilities among its different participants, such as the Board, Management, Shareholders and other financial stakeholders, and the rules and procedures laid down and followed for making decisions on corporate affairs.

Rating process adopted in this chapter is an attempt to assess the corporates compliance with Statutory regulations as laid out in clause 49 of the Listing Agreement.
Conformance by a corporate entity to the requirements of rules, procedures and codes as prescribed by the appropriate statutory and/or regulatory authorities is the minimum in the benchmarking the Governance process. The sets of variables that have been identified are drawn from different guidelines, codes of governance and committee recommendations on the subject. These variables reflect the distribution of rights and responsibilities among the constituents of the corporate management including the shareholders, the board of directors, the executive management, and, of course, the committees constituted for specific purposes.

The index of 110 points was developed to include the various mandatory, non-mandatory requirements spelt out by clause 49 of listing agreement.

Voluntary investor friendly practices adopted and disclosed by companies, adherence to other committee's recommendations like Cadbury committee code, OECD code, etc. were also included in the index.

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<th>Requirement Type</th>
<th>Points</th>
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<td>Mandatory requirements</td>
<td>64</td>
</tr>
<tr>
<td>Non-mandatory requirements</td>
<td>18</td>
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<tr>
<td>Voluntary practices</td>
<td>28</td>
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Each provision of requirement if adhered was given 1 point in the corporate governance score. However, certain aspects like percentage of directors attendance in board meetings, AGM and composition of independent directors were proportionately given points based on a slab system. (For example: - 100% attendance 4 points, 75-100% of attendance 3 points ). The total of this composite score has been taken as the corporate governance rate of that company.

The major parameters included in the index are as follows:-

2. Definition of Corporate Governance Policy.
3. Composition of MED.
4. Composition of Independent Directors
5. Shareholders information
6. Means of Communication
7. Management Discussion Analysis
8. Directors Remuneration & Disclosure
9. Share Transfer Committee
10. Shareholders Grievances Committee.
11. Audit Committee.
12. Remuneration Committee.
13. Directors Meetings.
14. Attendance in Board Meetings.
15. Directors Attendance in Annual General Meeting.
16. Company has NEC.
17. Separate Managing Director and Chairman.
18. Separate Office for NEC Chairman.
19. Profile of all directors given.
20. Details of Re-appointing Director.

The Total Corporate Governance Score Computed for 100 sample companies is presented in the table 4.1

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<thead>
<tr>
<th>CG RATE</th>
<th>NO. OF COMPANIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 50</td>
<td>11</td>
</tr>
<tr>
<td>50 -75</td>
<td>68</td>
</tr>
<tr>
<td>Above 75</td>
<td>21</td>
</tr>
</tbody>
</table>

Table-4.1

Corporate Governance Rate (CGR)
4. METRICS OF CORPORATE PERFORMANCE

Having rated the Corporate Governance practices of the sample companies it has been hypothesized that such companies exhibit better economic performance on an average than other companies. To test this hypothesis an attempt is made to check the association between value creation and Corporate Governance Rate. Simply put, the extent to which NED can play their role is determined by the quality of disclosures that are made by the Management to the board. It is better to accept a quantitative proxy to measure governance. No measurement may be perfect to quantity a qualitative dimension but a good measurement can always show the direction of movement.

According to OECD\(^3\) only companies with credible corporate Governance practices would be able to attract Long-term capital. However, Financial theory is yet to establish the linkage. Some empirical evidence is available from Mckinsey\(^3\) Investors opinion Report - 2000. The survey covered a sample of 188 companies in 6 emerging markets to test the link between market valuation and Corporate Governance. It is established in this study that companies with better Corporate Governance command higher price to book ratio. The key findings of this survey are follows:

- Most of investors say that board practices are at least as important as financial performance.
- Most of the investors would be willing to pay more for the shares of a well-governed company.
- Most of the investors who hold stocks longer believe that good Corporate Governance practices is linked to long-term performance.
- Good Corporate Governance practices can unlock hidden value in under performing stock.
- Investors who manage money for high net worth place more emphasis on Corporate Governance practices.

When the financial ratios are calculated out of 100 sample companies, 15 companies which were making losses during the period (1998 to 2001) and had negative ratios were excluded. Thus the total number of companies for the purpose of analysis were 85 in number.
ECONOMIC VALUE ADDED (EVA)

Analysts of performance use a variety of measures to evaluate corporations. Measurers that are central to fulfilling goals for investors and ensures company access to capital, include revenues, earning and returns to investors. Measures of shareholders returns include earning per share, dividend yield, as well as a relatively new measure, "Economic value Added" - EVA. Each of these measures yields valuable information. Few authors have ventured on investigation into the comparative performance of business operating under the rules of the divergent systems.

The Economic Value Added (EVA) proportion to total assets and return on total assets were computed to study the relative overall performance of the company. To evaluate the returns to share holders, return on equity and earnings per share were chosen. Average market prices and dividend yield were calculated and compared to trace out the external factors that influences the performance of the companies.

As has been adopted by Paul. W.Macavoy\(^3\), in the Active Board of Directors and its effect on the performance of the large publicly traded corporation" the EVA has been used to study the financial performance of the sample companies. It provides a matrix that is widely accepted as representing a company's ability to generate economic profits and thereby create wealth for shareholders. Economic value added is "residual Income" - what remains after a charge for the cost of all Capital employed in the business. As an indicator of corporate performance the principal advantage of Economic value added over conventional accounting measures is that it holds management accountable for the cost of equity capital - a cost that does not appear on the income statement.

Companies Raise capital to make a product or render a service. They sell it in the market at an operating profit. Then they pay the cost of that capital. Shareholders get the difference. If difference arises out of improper corporate Governance, shareholders money is at stake in future.

Positive Economic value added year after year, can be earned only out of good Corporate Governance. The cost of borrowed capital was shown in the expense statement of the company. But cost of shareholders equity capital is more expensive as it takes the business risks as also average risk of giving guarantees to defray the cost of borrowed capital. If there is bad Corporate Governance, business risk
increases and with it the cost of equity. In effect economic value added comes down. So, legitimately economic value added can be a proto type to measure the soundness of Corporate Governance. This school measurement opines Corporate Governance and shareholders value to be convertible.

For the purpose of analysis, EVA of the sample companies was computed by deducting the dividend paid from the accounting profits for each year for a period of 3 previous accounting years. Then the average EVA for 3 years was computed. This average was compared with the computed corporate governance score of the sample companies. Table 4.2 presents the correlation analysis of the corporate governance rate and the Economic Value Added.

**TABLE - 4.2**

RELATIONSHIP BETWEEN CGR AND EVA

<table>
<thead>
<tr>
<th>CORPORATE GOVERNANCE RATE OUT OF 110</th>
<th>Pearson's Correlation</th>
<th>Economic value added</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>0.133</td>
</tr>
<tr>
<td>Significance (2-Tailed)</td>
<td></td>
<td>0.226</td>
</tr>
<tr>
<td>N</td>
<td></td>
<td>85</td>
</tr>
</tbody>
</table>

As per the table 4.2 correlation was not significant between the corporate governance and the EVA when computed as an absolute measure.

EVA AS A RELATIVE MEASURE.

For the purpose of comparing company performance, absolute measures are not meaning full for companies of different sizes. The larger company was identified, as the better performer even though its ability to generate larger amounts of Economic value added may be a function of size alone rather than superior managerial efficiency. Scott. W.Barnhart\(^36\) in "Board Composition, Managerial Ownership, and firm performance: An empirical Analysis", computed EVA as a relative measure where the firm size is controlled with the total assets. Following the same method, to account for the differences in size when evaluating corporate performance, the proportion of Economic value added to Total assets is calculated each year for 3 years. Then 3 years average was computed which is compared against the CGR in table 4.3.
The analysis reveals that there is significant correlation between CGR and the EVA. This is in conformity of our hypothesis that there is positive impact of corporate governance on the economic performance of the company.

**RETURN ON TOTAL ASSETS (ROTA)**

The different measurers of performance can yield substantially different findings in organizational studies. However Return on Assets is a specific measure of organizational performance, which explains the pattern of results.

Return on Total Assets is a ratio measure of performance which is a comprise of two indicators total assets and net income parallel in many respects to the distinctive interests and capacities of inside and outside directors. Insider's greater knowledge of company affairs and internal operations is compatible with a focus on assets allocation strategies and attainment of related efficiencies, therefore, makes return on assets stronger through the control of working assets. In contrast outsiders greater knowledge and experience with external affairs seem more consistent with the formulation of environmental strategies, leading to strengthened return on Assets through the enhancement of income sources and streams. Thus the composition of performance of the Board will have a positive effect on return on Total Assets through different avenues of cause and effect.
Return on Total Assets was adopted by John. A Wagner in 'Board composition and organizational performance: Two studies of Insides/outside effects'. The same ratio has been chosen as a measure of organizational performance to explain the pattern of results. It is computed by dividing the profit after tax by total assets for each of the sample companies for 3 years starting from 1999. Then the 3 years average return was computed and its association with corporate governance rate was checked. The analysis presented in table 4.4. reveals the high level of significance of correlation between corporate governance rate and return on total assets.

TABLE - 4.4

RELATIONSHIP BETWEEN CGR AND ROTA

<table>
<thead>
<tr>
<th>CORPORATE GOVERNANCE RATE OUT OF 110</th>
<th>Pearson's Correlation</th>
<th>Return on Total Assets (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>.288 (**)</td>
<td></td>
</tr>
<tr>
<td>Significance (2-Tailed)</td>
<td>0.008</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>85</td>
<td></td>
</tr>
</tbody>
</table>

RETURN ON EQUITY (ROE)

A report prepared by a investor's forum in Malaysia suggests that quality of corporate Governance has become an investment barometer. This report entitled 'saints and sinners - who's got religion?' examines and ranks 495 companies in 25 markets across 18 global emerging markets on their corporate Governance scores. According to the report better-governed companies have higher return on Equity (ROE), higher economic value added and higher price to book premium.

It is found in most of the international studies, that the relationship between CG and corporate performance appears to be contingent on type of performance measure - present for return on Assets - but not for return on Equity measure. In a analysis by credit Lyonnais securities study (CLSA) a sample of 400 companies is considered and the findings are as follows:
"While studying the correlation between corporate governance scores and financial performance – it was found that there appears near perfect correlation between corporate governance and return on equity. For the purpose of analysis the return on equity was calculated for each year from 1999 to 2000. the profits available to equity share holders was divided by the equity share holders funds to arrive at return on equity. Later 3 years average of return on equity was computed for all the 100 sample companies. the corporate governance rate of these companies was compared with the return on equity with the help of Pearson's co-efficient of correlation. The table 4.5 presents the correlation of return on equity and corporate governance rate. The analysis reveals that there is highly significant correlation between the corporate governance rate and return on equity."

**TABLE - 4.5**

<table>
<thead>
<tr>
<th>CORPORATE GOVERNANCE RATE OUT OF 110</th>
<th>Return on Equity (%)</th>
<th>Pearson's Correlation</th>
<th>Significance (2-Tailed)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>.356 (**)</td>
<td>0.001</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N           85</td>
<td></td>
</tr>
</tbody>
</table>

**EARNINGS PER SHARE (EPS)**

In all these studies the measures of performance explored are return on capital employed, return on Equity, Earnings per share and Market prices. Reliable measurements are half the battle while the real challenge is actually linking quality aspects of corporate Governance with financial performance. In the present study, the following measurements of performance have been chosen that aid in discharge of accountability.

If the objective of corporate Governance is maximising shareholders benefits, then it should have reflection on improved return on Equity and earning per share. Earnings per share has been calculated which is a variable adopted by John. A Wagner\(^4\) in his research study. Better Governed companies should have higher earnings per share compare to peer group. To test this earnings per share had been computed.
The profits available for the shareholders were divided by the number of equity shares to obtain the earnings per share. The three years average EPS is compared with CGR. Table 4.6 reveals that there is no significant relationship between CGR and EPS.

**TABLE - 4.6**

**RELATIONSHIP BETWEEN CGR AND EPS**

<table>
<thead>
<tr>
<th>CORPORATE GOVERNANCE RATE OUT OF 110</th>
<th>Earnings per share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson's Correlation</td>
<td>0.034</td>
</tr>
<tr>
<td>Significance (2-Tailed)</td>
<td>0.0756</td>
</tr>
<tr>
<td>N</td>
<td>85</td>
</tr>
</tbody>
</table>

**AVERAGE MARKET PRICES**

However all the accounting measures have been based on the profits reported by the companies themselves. In credit Lyonnais Securities Study\(^\text{43}\) (CLSA) it was found that

- There is also a strong correlation between corporate Governance and average share price performance. The correlation is stronger in case of average market prices over 5 years period compare to 3 years averages.

- Investors believe that corporate performance in the long run is correlated with Corporate Governance rate.

- Financial reports and other disclosures can be trusted.

- Well governed companies mitigate non-business risks.

Yet another evidence can be traced from the business week ranking of best Boards from 1996\(^\text{44}\). It was stated in their study that the stocks of companies with the best boards out performed the worst by 2:1. It was also mentioned that after slow down in 2000, the best boards scored 51% compare to the worst boards - 21.7%. Mckinsey\(^\text{45}\) investor's opinion Report 2000 has also concluded that there is a strong correlation between corporate Governance and average share price performance. Following the same to assess the investor's perceptions and evaluation of the company, the stock
A stock performance measure was used as a financial performance indicator for many reasons. The stock market valuation of a firm is the present value of future expected cash flows to its shareholders. First unlike performance measures based on accounting data stock based performance measures are not influenced by firm specific financial reporting rules. Second, the use of a stock-based performance measure is consistent with an important principle in corporate finance – that is, a firm's manager should act in order to maximise the market value of the firm. Finally an interest advantage of using stock market data in performance comparisons is that they provide an explicit means for controlling for differences in risks, since investors will assign a lower present value to risky cash flows.

Hence, average quarterly market prices have been calculated for 4 quarters in a year taking the highest and lowest prices in that quarter. Then annual average prices have been calculated for a period of 3 years for all 100-sample companies. Finally three years average price has been considered as a measure of financial performance. Share prices have been collected from Bombay stock exchange, web site (BSE india.com) and NSE Web site (nseindia.com).

Pearson's coefficient of correlation was computed to check the association between Corporate Governance Rate of the companies and the of the organisation. Table 4.7 reveals the highly significant correlation between corporate governance rate and the market prices.

**TABLE – 4.7**

<table>
<thead>
<tr>
<th>RELATIONSHIP BETWEEN CGR AND MARKET PRICES</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CORPORATE GOVERNANCE RATE OUT OF 110</strong></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

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DIVIDEND YIELD

Dividend yield is compared to analyse shareholders returns. Dividend yield is measured based on dividends and share price appreciation to reflect not only the performance of the company in that period, but also changes in the markets expectations about future operating and share price performance.

Dividend paid and appreciation in the market price was added together. This total was divided by the market price of the company on the closing date of the accounting year. Dividend yield was thus calculated for 3 years for all the sample companies. The 3 years average dividend yield was used to assess the effect of corporate governance rate on financial performance. Table 4.8 reveals that correlation between corporate governance rate and dividend yield was not statistically significant.

TABLE – 4.8
RELATIONSHIP BETWEEN CGR AND DIVIDEND YIELD

<table>
<thead>
<tr>
<th>CORPORATE GOVERNANCE RATE OUT OF 110</th>
<th>Dividend yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson's Correlation</td>
<td>.128</td>
</tr>
<tr>
<td>Significance (2-Tailed)</td>
<td>0.242</td>
</tr>
<tr>
<td>N</td>
<td>85</td>
</tr>
</tbody>
</table>

So it can be generally concluded that based on the sample study the better-governed companies also exhibits better financial performance.

CGR based on mandatory and non-mandatory provisions

In table 4.9 a &b the total Corporate Governance score of 110 points were Sub-divided in three groups - group 1.M rates the companies on the basis of mandatory requirement, adherence group 2.M rates on the basis of fulfillment of non-mandatory requirements and the third group 3.OP on the basis of adaptation of investor friendly practices.
## TABLE - 4.9

**CGR BASED ON MANDATORY REQUIREMENTS**

<table>
<thead>
<tr>
<th>CORRELATIONS</th>
<th>Economic value added</th>
<th>Economic value added / Total Assets</th>
<th>Return on Total Assets (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CORPORATE GOVERNANCE 1 - M</strong></td>
<td>Pearson's Correlation: 0.097</td>
<td>221(*)</td>
<td>262(*)</td>
</tr>
<tr>
<td></td>
<td>Significance (2-Tailed): 0.375</td>
<td>0.042</td>
<td>0.016</td>
</tr>
<tr>
<td></td>
<td>N: 85</td>
<td>85</td>
<td>85</td>
</tr>
<tr>
<td><strong>CORPORATE GOVERNANCE 2 - NM</strong></td>
<td>Pearson's Correlation: 0.056</td>
<td>0.087</td>
<td>0.054</td>
</tr>
<tr>
<td></td>
<td>Significance (2-Tailed): 0.609</td>
<td>0.431</td>
<td>0.622</td>
</tr>
<tr>
<td></td>
<td>N: 85</td>
<td>85</td>
<td>85</td>
</tr>
<tr>
<td><strong>CORPORATE GOVERNANCE 3 - OP</strong></td>
<td>Pearson's Correlation: 0.158</td>
<td>0.14</td>
<td>287(**)</td>
</tr>
<tr>
<td></td>
<td>Significance (2-Tailed): 0.149</td>
<td>0.2</td>
<td>0.008</td>
</tr>
<tr>
<td></td>
<td>N: 85</td>
<td>85</td>
<td>85</td>
</tr>
</tbody>
</table>

Correlation is significant at the 0.05 level (2-tailed)
Correlation is significant at the 0.01 level (2-tailed)

---

**TABLE - 4.9 (Contd.)**

<table>
<thead>
<tr>
<th>CORRELATIONS</th>
<th>Return on Equity (%)</th>
<th>Earnings per share</th>
<th>Average Market Prices</th>
<th>Dividend yield</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CORPORATE GOVERNANCE 1 - M</strong></td>
<td>Pearson's Correlation: 0.276(*)</td>
<td>-0.007</td>
<td>0.245(*)</td>
<td>0.076</td>
</tr>
<tr>
<td></td>
<td>Significance (2-Tailed): 0.011</td>
<td>0.951</td>
<td>0.024</td>
<td>0.49</td>
</tr>
<tr>
<td></td>
<td>N: 85</td>
<td>85</td>
<td>85</td>
<td>85</td>
</tr>
<tr>
<td><strong>CORPORATE GOVERNANCE 2 - NM</strong></td>
<td>Pearson's Correlation: 0.179</td>
<td>-0.016</td>
<td>0.16</td>
<td>0.079</td>
</tr>
<tr>
<td></td>
<td>Significance (2-Tailed): 0.102</td>
<td>0.883</td>
<td>0.143</td>
<td>0.474</td>
</tr>
<tr>
<td></td>
<td>N: 85</td>
<td>85</td>
<td>85</td>
<td>85</td>
</tr>
<tr>
<td><strong>CORPORATE GOVERNANCE 3 - OP</strong></td>
<td>Pearson's Correlation: 0.359(**)</td>
<td>0.174</td>
<td>0.553(**)</td>
<td>0.149</td>
</tr>
<tr>
<td></td>
<td>Significance (2-Tailed): 0.001</td>
<td>0.112</td>
<td>0</td>
<td>0.173</td>
</tr>
<tr>
<td></td>
<td>N: 85</td>
<td>85</td>
<td>85</td>
<td>85</td>
</tr>
</tbody>
</table>

* Correlation is significant at the 0.05 level (2-tailed)
** Correlation is significant at the 0.01 level (2-tailed)
The Corporate Governance 1M is out of a total score of 64 points. Corporate Governance 2 NM is for a total score of 18 points and Corporate Governance 3 is out of 28 points. As per table 4.9 the significant correlation was observed with Corporate Governance based on Mandatory requirements and voluntary practices. Non-mandatory requirements suggested by Birla committee and by clause 49 of listing requirements have not gained prominence and were not adopted by the companies. This evidence establishes the fact that corporate governance enforced through formal rules and regulations is only able to catch the attention of the companies.

Grading of the companies based on the CGR

Table 4.10a & b divides the companies into 3 groups the companies with a total Corporate Governance score (out of 110) of 75 and above form category A, with score of 50 - 74 form category B, and less than 50 form category C. Significant correlation was found, in case of 'A' category of companies where Corporate Governance is above 75. That is better-governed companies were also better performers and vice versa. In other words better performing companies were also adopting better Corporate Governance practices.

**TABLE - 4.10**

<table>
<thead>
<tr>
<th>CORPORATE GOVERNANCE RATE OUT OF 110</th>
<th>Economic value added</th>
<th>Economic value added / Total Assets</th>
<th>Return on Total Assets (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>75 AND ABOVE</td>
<td>Pearson's Correlation 0.052</td>
<td>0.083</td>
<td>0.534(*)</td>
</tr>
<tr>
<td></td>
<td>Significance (2-Tailed) 0.822</td>
<td>0.722</td>
<td>0.013</td>
</tr>
<tr>
<td></td>
<td>N 21</td>
<td>21</td>
<td>21</td>
</tr>
<tr>
<td>50 - 74</td>
<td>Pearson's Correlation 0.103</td>
<td>0.196</td>
<td>0.053</td>
</tr>
<tr>
<td></td>
<td>Significance (2-Tailed) 0.459</td>
<td>0.156</td>
<td>0.701</td>
</tr>
<tr>
<td></td>
<td>N 54</td>
<td>54</td>
<td>54</td>
</tr>
<tr>
<td>LESS THAN 50</td>
<td>Pearson's Correlation 0.264</td>
<td>0.028</td>
<td>-0.425</td>
</tr>
<tr>
<td></td>
<td>Significance (2-Tailed) 0.461</td>
<td>0.939</td>
<td>0.221</td>
</tr>
<tr>
<td></td>
<td>N 10</td>
<td>10</td>
<td>10</td>
</tr>
</tbody>
</table>

Correlation is significant at the 0.05 level (2 - tailed).
Correlation is significant at the 0.01 level (2 - tailed).

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TABLE - 4.10 (Contd.)

CGR GRADE AND PERFORMANCE

<table>
<thead>
<tr>
<th>CORPORATE GOVERNANCE - RATE OUT OF 110</th>
<th>Return on Equity (%)</th>
<th>Earnings per share</th>
<th>Average Market Prices</th>
<th>Dividend yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>75 AND ABOVE</td>
<td>Pearson's Correlation</td>
<td>.590(**)</td>
<td>.661(**)</td>
<td>.771(**)</td>
</tr>
<tr>
<td></td>
<td>Significance (2-Tailed)</td>
<td>0.005</td>
<td>0.001</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>21</td>
<td>21</td>
<td>21</td>
</tr>
<tr>
<td>50 - 74</td>
<td>Pearson's Correlation</td>
<td>.321(*)</td>
<td>0.013</td>
<td>0.121</td>
</tr>
<tr>
<td></td>
<td>Significance (2-Tailed)</td>
<td>0.018</td>
<td>0.927</td>
<td>0.385</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>54</td>
<td>54</td>
<td>54</td>
</tr>
<tr>
<td>LESS THAN 50</td>
<td>Pearson's Correlation</td>
<td>-0.144</td>
<td>0.027</td>
<td>-0.701</td>
</tr>
<tr>
<td></td>
<td>Significance (2-Tailed)</td>
<td>0.692</td>
<td>0.941</td>
<td>0.024</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>10</td>
<td>10</td>
<td>10</td>
</tr>
</tbody>
</table>

* Correlation is significant at the 0.05 level (2-tailed).
** Correlation is significant at the 0.01 level (2-tailed).

Differences Among Three categories of sample companies

Table 4.11 presents analysis of variance (ANOVA) among these three categories of companies. The Analysis reveals that the variance is significant relating the return on Assets, return on equity and Market prices among the various groups of companies.
TABLE - 4.11
SIGNIFICANCE OF DIFFERENCES AMONG CGR GROUPS

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>Significant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic value added</td>
<td>.452</td>
<td>.638</td>
</tr>
<tr>
<td>Economic value added / Total assets</td>
<td>1.762</td>
<td>.178</td>
</tr>
<tr>
<td>Return on total assets (%)</td>
<td>3.465</td>
<td>.036</td>
</tr>
<tr>
<td>Return on equity (%)</td>
<td>5.453</td>
<td>.006</td>
</tr>
<tr>
<td>Earnings per share</td>
<td>.319</td>
<td>.728</td>
</tr>
<tr>
<td>Average market prices</td>
<td>4.858</td>
<td>.010</td>
</tr>
<tr>
<td>Dividend yield</td>
<td>1.130</td>
<td>.328</td>
</tr>
</tbody>
</table>

Size of the company and effect on corporate governance

To find out whether Corporate Governance rating score is related to the size of companies - the 85 companies have been grouped under three categories based on the value of their total assets.

1st group consists 11 companies having less than 100 crores of assets. 2nd group consists of 44 companies which have 100 crores of assets. 3rd group consists of 30 companies, which have total assets of more than 100 crores.

The analysis did not exhibit any significant variance in the relationship of CGR with different financial parameters among different size groups of the company.
Life span of the company and corporate governance

85 sample companies were sub-divided into 4 groups based on their life span. One of the factors that matters in Corporate Performance is the company's current position in its life cycle. In respect of board practices newer companies are likely to adopt easily the new demanding professional practices and are likely to realize better economic performance than that of older companies.

For the purpose of analysis, the companies up to 10 years of age was considered as group - 1, between 11 and 25 years group - 2, 26 years to 50 years group - 3, and above 50 years group - 4. However significant variance in the relationship between CGR and the financial parameters of the different groups of the companies based on life span was not found.

Corporate Success cannot be measured only through financial performance. Corporate excellence has been defined in different ways. Some commonly accepted measures of excellence in the received literature are profitability, satisfied stakeholders, and revenue/profit growth, growth in market share as also stock market capitalization. The Corporate Governance is concerned with monitoring enterprises to improve the organizational effectiveness. It now attempted to study the effect of corporate governance on organizational effectiveness.

ORGANIZATIONAL EFFECTIVENESS

Evaluating an organization not only through material objectives but also through the means by which it achieved the end is Organizational Effectiveness. The concept of organizational effectiveness refers to the worth or success of an organization. It is functional rather than a structural concept since it deals with the question of how far an organization has been successful in attaining its goals. That is, organizational effectiveness should refer both to the organizational means and ends.

Bamard\(^\text{46}\) (1938) holds that an organization can persist only under two conditions: (i) it must be "effective"; that is, must accomplish the objectives of the system; and (ii) it must be "efficient", that is, must satisfy individual motives, which is a
condition for their cooperation. Effective organizational functioning can be subsumed under three heads: (i) high output with quality (ii) organizational flexibility as determined by its ability to absorb and assimilate externally or internally induced changes. For an industrial organization it refers to its ability to successfully adapt itself to changes in methods, equipments, procedures, fluctuation in sales, consumer preferences, etc.; and (iii) the absence of intra-organizational strain due to conflict or tension between organizational sub-groups, and also its ability to maximise its member potential by development of their skills and abilities.

In measuring effectiveness, however, the operational indices of these criteria will vary from organization to organization. An organization can thus be regarded as a social system and its effectiveness refers to the extent to which it can attain its objectives by virtue of the reasons and means it possesses, without incapacitating itself in the process or placing undue strain on its members.

A Corporation is a mechanism established to allow different participants to contribute capital, Expertise and labour for the maximum benefit of all of them ... (Monks and Mellows)47.

Primary Participants in a Corporation:

1) Shareholders
2) Creditors
3) Suppliers
4) Employers
5) Customers
6) Investors

The study of Corporate governance is the study of the inter-relationship between the above participants and the corporation. It refers to the systems and procedures adopted and followed that ensure all stakeholder share equally in the success (of failure) of a firm ..... (Moody's)48.
The stakeholders assess the company performance from different dimensions.

- Shareholders expect the company to maximise the wealth of the company and to pay them better return on their investment.
- Depositors and Debenture holders look for prompt payment of interest and principal amount.
- Suppliers demand prompt settlement of dues and wish to develop long lasting relationship.
- Satisfied employees contribute to the organizational effectiveness through the job involvement, ethical behaviour and productive performance.
- Further the ethical conduct of the promoters and employers provoke loyalty among the employees and motivate them to contribute for effective governance.
- Customers look forward for product performance and quality service questions expect fairness of trading.
- Financial institutions demand good company performance, qualitative management and prompt reporting and disclosures.
- Regulatory agencies look for compliance of legal provisions and rules.
- It is equally challenging for the organisation to build up the public image.

Maximizing Internal effectiveness of the organisation is an essential element for good governance. The following are the factors that promote internal effectiveness.

1) Optimum utilization of resources is organisation.
2) Team spirit and Co-ordination
3) Transparency and disclosures
4) Product innovation and new business creation
5) Adoptability to changing Condition
6) Pro-activeness of management
Considering these factors a questionnaire has been drafted and circulated among the sample companies to assess and rate organizational effectiveness in their Organisation. The company Secretaries is asked to rate their organizational effectiveness on a 5-point scale, out of 100 sample companies only 25 of them replied and responded to this questionnaire. Most of the respondents have placed their company on 4th or 5th point of the scale. So, for the purpose of analysis the two points Covering low and high effectiveness have been considered based on which organisation effectiveness score of each company has been computed.

The table-4.14 presents the correlation between corporate governance rate and organizational effective score of the respective company.

**TABLE – 4.12**

<table>
<thead>
<tr>
<th>Corporate Governance Rate</th>
<th>Pearson’s Correlation</th>
<th>0.425*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Significance(2-tailed)</td>
<td>0.034</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>25</td>
<td></td>
</tr>
</tbody>
</table>

Correlation is significant at the 0.05 level (2-tailed)

The significant correlation presented in the table establishes the fact that the companies with better governance enjoy high organizational effectiveness.

Further Chi square test is adopted to study the association of CGR with organisational effectiveness. The CGR was subdivided in two groups - first group consists of companies with CGR score of 70 and above second group consists of companies with CGR score of less than 70. The organisational effectiveness was subdivided in to three groups the first group consists of companies with OE between 30 to 35 points, 2nd group between 35 to 40 points and third group above 40 points. Table 4.15 present the Chi square analysis.
The table 4.15 reveal that the association between corporate governance rate and organisation effectiveness is statistically significant.

4m. **CONCLUSION**

An attempt is made in this chapter to test the hypothesis that the better Governed companies also enjoy better corporate performance. For this purpose the 100 sample companies were given a Corporate Governance rate based on the various Governance practices adopted by them. The financial performance of the sample companies was measured through the selected financial parameters. For this purpose three years average performance was considered. Then a comparison is made between the Governance rate and the performance of the company. Pearson's coefficient of correlation was computed to test the association between the Governance rate and performance measures.

- The hypothesis that the companies who adopt better Corporate Governance practices enjoy better corporate performance was statistically proved. More precisely, significant correlation is observed between Corporate Governance and Economic value added, return on Total Assets and Market prices.

- While comparing Corporate Governance rate based on Mandatory, Non-Mandatory and voluntary practices, correlation was significant in case of Corporate Governance based on Mandatory requirements and voluntary practices.

- Correlation was strong between Governance and performance in case of highly rated companies establishing the fact that highly rated companies were also high achievers.

- Correlation was also significant between corporate governance rate and organizational effectiveness score. This analysis concludes that better governed companies possess high organizational effectiveness.
NOTES AND REFERENCES


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