LINKING CORPORATE GOVERNANCE REFORMS AND COMPANY PERFORMANCE: A REVIEW

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ABSTRACT

Based on agency theory, there should be a positive relationship between corporate governance practices and company performance. The present study has considered this important aspect of corporate governance which tells its ability to enhance financial performance resulting in creation of wealth. A plethora of research in the area of corporate governance has focused on understanding the relationship between governance variables and firm performance. It has attracted considerable attention over the past decades, leading to recommended codes of practice, conceptual models and empirical studies. But what actually constitutes good corporate governance is still an important question. It takes into consideration the structure and processes among the board of directors, shareholders, top management and other stakeholders, and involves the roles of the stewardship process and exercising strategic leadership, and the objectives of assuring accountability and improving performance (Cadbury Committee, 1992; Shleifer and Vishny, 1997; Dunlop, 1998; Sternberg, 1998; OECD, 1999).

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INTRODUCTION

In the words of Cox[i] , “Happy companies have robust growth in revenues, strong balance-sheets, and healthy profits that reflect genuine business success, not phony bookkeeping. And they share other important traits as well. They abide by high ethical standards, which is a key to their solid success. They don't obstruct the flow of information to shareholders, but rather view the shareholder as the ultimate owner and the ultimate boss. They choose directors on the strength of their abilities, character, and capacity for independent judgment. And their internal controls work well, so that the company's executives can take immediate corrective action when something goes wrong.”

Undoubtedly, a lot of stress has been given on maintaining high ethical standards, thinking beyond the business, observing transparency for shareholders, bringing independent judgement and accountability from directors as well as management. This is how corporate governance has been defined since long, with the literature consistently boosting the fact that it actually leads to hike in revenues and business success. Governance is as old as human civilization. It means the process of decision -making and the process by which decisions are implemented. The institutions of governance provide a framework within which the social and economic life of country is conducted. Corporate governance concerns the exercise of power in corporate entities. The Organisation for Economic Co-operation and Development (OECD) provides the most authoritative functional definition of corporate governance:

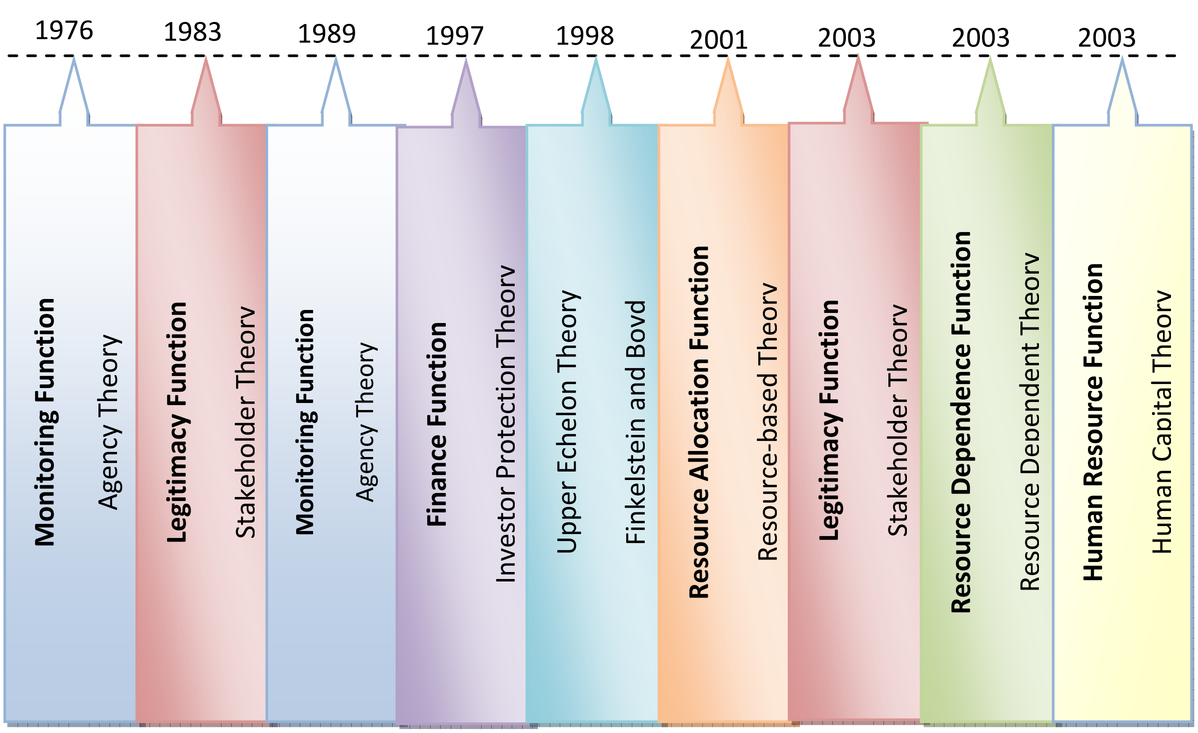
"Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance."

LINKING CORPORATE GOVERNANCE AND PERFORMANCE

Better corporate governance is likely to improve the performance of firms, through more efficient management, better asset allocation, better labour practices etc (Claessens, 2006). Corporate governance has various effects on a firm (Lynall et al., 2003). A trajectory of developments in the theory of corporate governance reveals the various functions it caters to. These have been given by different authors at different times. In 1976 and later in 1989 Jensen and Meckling and Eisenhardt stated that the fundamental of corporate governance deals with how the principal is able to prevent the agent from maximizing his own self-interest. This is called the agency theory. DiMaggio and Powell (1983), Lichtenstein and Brush (2001) and later Lynall et al. (2003) said that corporate governance ensures the participation of wider constituent groups (i.e. employees, customers, suppliers, shareholders, government, NGOs etc) with economic or social objectives. Gone are the days, when organizations just talk about shareholders' wealth maximization. Stakeholder theory explains a broader view where organizations want to satisfy the owners, employees and their unions, suppliers and customers in order to be successful. Corporate governance also performs the finance function. In 1997, Shleifer and Vishny said that it gives legal protection for investor rights and encourages long-term investment decisions.

Figure 1

Trajectory of theories on Corporate Governance



Hillman and Dalzeil in 2003 postulated that corporate governance also helps firms to acquire critical resources which is a resource dependence function. Also, to protect the rights of the shareholders, it gives shareholders increased rights to participate in important management decisions. Corporate governance focuses on composition of board by including more outside directors, employee representation at some level and reinforcement of government rules and regulations over issues like insider trading, hostile takeovers etc. It aligns the goals of managers and organizations under human resource management function which was given by Buchholtz et al in 2003. Apart from these, corporate governance is based on a trusteeship model and provides strategic leadership. Thus, it can be concluded from Figure 1 that all these functions of corporate governance lead to better performance. It is therefore reasonable to predict that a particular rate of change in the firm's corporate governance practices may help it to improve its performance. Turnbull (1997) identified the influence of corporate governance on companies' operations. The results emphasized the importance of good governance in every field i.e. cultural, political or even for labour welfare. The finance model talked about the construction of rules to align the behavior of managers and the shareholders, second was stewardship model where managers are motivated to work for shareholders' value creation, third was shareholder theory where firm is a system and total wealth maximization is the objective, and the last was political model where government makes the interference and powers, privileges and profits depend upon the government's attitude.

Thus, the objective of this research paper is to review the past studies to identify the impact of various parameters of corporate governance on firm performance. The review has considered board structure, shareholders' activism and overall governance structure and focused on their relation with corporate performance.

REVIEW OF LITERATURE

Various governance variables considered in the recent past pertain to shareholders' dominance, mergers and acquisitions, compensation to executives, board size and their composition, role of non-executive directors, role of various board committees, role of institutional shareholders in improving governance practices and keeping transparency in reporting practices etc. Nesbitt

(1994) reported positive long-term stock price returns for firms targeted by good governance procedures. Millstein and MacAvoy (1998) observed that companies with independent boards appeared to have performed much better in US during 1990s. However, Dalton et al. (1999) showed that board composition has no effect on firm value. Patterson (2000) was also of the same view. But a number of accounting scandals and ethical misconducts brought in an era of regulations which led to improvements in corporate governance practices. McKinsey (2002) found that majority of investors were ready to pay premium price for companies which had good corporate governance.

The various parameters of corporate governance have impact on corporate performance and the present study is based on the objective to prove this through past review. It started with Berle and Means (1932) who discussed the separation of ownership and control in the organizations with their pros and cons. Further, the framework laid out by Jensen and Meckling (1976) defined that agent-managers' interests are not always aligned with the principal-owners' and monitoring devices to align their interests describe firm's corporate governance. Grossman and Hart (1983) described agency problem as a conflict between the interests of managers and shareholders which causes managers to actions that are costly to shareholders. The solution to this is providing ownership to managers that may be used to bring consistency in the interests. Charkham (1994) studied the system of corporate governance practices in USA, UK, Germany, Japan and France, the reason of study being same in all the countries, i.e. protection of shareholders' rights. The importance is being given to role of directors and their accountability to shareholders. The author concluded that the five countries have variations in disclosure and accountability practices. Board of directors are considered to be the most important element of corporate governance and review shows that the accountability of board, proactive shareholders and quality reporting will lead to wealth creation.

BOARD STRUCTURE

The board of a company provides leadership and strategic guidance, objective judgment, independent of management to the company and exercise control over the company, while remaining accountable to the shareholders. Various committees especially the Blue Ribbon

Committee of USA[ii] and Higgs Report[iii] laid considerable stress on the role of non executive directors. In India it is mandatory to have at least fifty percent of directors as non executive. The idea that the board of directors of any corporation should comprise outside directors, with a presumed independence from management is not new. Chandler (1975) said, "It is almost ridiculous to have to justify the importance of a strong majority of outside directors. If it is true that the board must steadfastly represent the stockholders in making a continuous evaluation of the CEO's performance, then a board of predominately outsiders logically follows." Various committees believe that the calibre of the non-executive members of the board is of special importance in setting and maintaining standards of corporate governance. Non-executive directors should bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct. An essential quality which non-executive directors should bring to the board's deliberations is that of independence of judgement. The majority of non-executives on a board should be independent of the company. This means that apart from their directors' fees and shareholdings, they should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. It is for the board to decide in particular cases whether this definition is met or not. Information about the relevant interests of directors should be disclosed in the Directors' Report.

The board structure has been further categorized into the size of the board, proportion of independent directors on the board, composition in terms of female or foreign directors, board duality, board ownership and remuneration of directors.

a. BOARD SIZE

Optimum size of the board finds no mention in the law. In India, the company law has specified a minimum board size of three for a private company and five for a public company. Various codes talked about the presence of directors to regulate the companies but there is no mention about number of directors required in a particular company to play the monitoring role. Neither the CII Code[1] nor the KMB Report makes any reference to this point. International practice also

[1]. The Confederation of Indian Industry (CII) published India's first comprehensive code on corporate governance (Desirable Corporate Governance: A Code) in 1998. This Code was well received by Corporate India and many of its recommendations became part of subsequent regulations.

tends to leave the size issue for determination by the company. Jensen (1993) viewed that larger the board greater is problem for CEO to control them. Rosenstein and Wyatt (1997) assessed the stock market reactions to the appointment of inside directors. Cross sectional regression analysis have shown that general reaction was close to zero but it varied with the level of stock owned by the directors concerned. The results presented fewer fluctuations with the presence of lower stake of inside directors. Bhagat and Black (1999) presented inverse relationship between board size and firm performance. Various studies suggested the optimum board size of ten. Yermack (1996) observed that the increase in size leads to increase in agency problems, slow decision making and board becomes just symbolic in nature. The Institutional Shareholders' Services have stressed on a board size of more than five but less than sixteen. But, the Naresh Chandra Committee (2002) in India recommended a minimum size of seven board of directors. The studies related to board size suggested negative relation with corporate performance. Haniffa and Hudaib (2006) argued that market perceives multiple directorship as unhealthy and do not add value to corporate performance. Limiting board size is believed to improve firm performance because the benefits of larger boards are outweighed by the poorer communication and decision making of larger groups (Lipton and Lorsch, 1992; Jensen, 1993). Anderson et al. (2004) show that the cost of debt is lower for larger boards, presumably because creditors view these firms as having more effective monitors of their financial accounting processes. Brown and Caylor (2004) add to this literature by showing that firms with board sizes of between 6 and 15 have higher returns on equity and higher net profit margins than do firms with other board sizes. Conyon and Peck (1998) also conclude that the effect of board size on corporate performance (return on equity) is generally negative. Garg (2007) concluded that smaller boards are more efficient than larger one and size should be limited to six to achieve better performance. Biswas and Bhuiyan (2008) found that the size of board has no significant impact on corporate governance disclosure.

There is no consistent evidence to suggest that increase in the percentage of outside directors on the board will enhance performance.

b. BOARD INDEPENDENCE

Similarly, studies have been conducted in the recent past giving importance to the board independence and found different results. Beasely (1996) found that no-fraud firms have boards with significantly higher percentages of outside members than fraud firms. Moreover, the likelihood of financial statement frauds decreased when outside director ownership in the firm and outside director tenure on the board increased and the number of outside directorships in other firms by outside directors decreased. Survey of 515 Korean firms by Black et al. (2005) show that firms with 50 per cent outside directors have 0.13 higher Tobin's Q which is consistent with the view that greater board independence causally predict higher share prices in emerging markets. Brickley et al. (1994) found a positive relation between the proportion of outside directors and the stock market reaction to poison pill adoptions; and Clifford and Evans (1997) analysed the presence of independent directors on 100 companies randomly selected from the top 500 Australian companies listed on Australian Stock Exchange as on December 30, 1993. The paper concluded that majority of the boards have been constituted by grey[2] and insider directors and similar pattern prevailed for audit committee members. Bhagat and Black (1999) discussed the trends in proportion of independent directors vis-a-vis the total number of directors of large American public companies since 1960. The study took independence of director, board size, CEO ownership, outside director ownership as independent variables and related it with profitability and growth variables over a period. The results did not depict any evidence that increase in board independence leads to improvement in firm performance but firms with supermajority-independent board performed worse than other firms. Anderson et al. (2004) reported that board independence had an important effect on some corporate outcomes. They found that cost of debt is lower for firms with more board independence and is the same for the boards with fully independent audit committees. Ryan and Wiggins (2004) suggested that the boards with more outside members award the directors with higher levels of equity-based compensation, which in turn reduces the agency costs. Chhaochharia and Grinstein (2007) outlined the changing characteristics of corporate boards from 1997 to 2003. The number of independent directors has increased over a period of time. It was found that large firms tend to have a larger fraction of independent directors than smaller firms. The average board size has significantly decreased over a period of time for large firms. Similarly, Ho (2005) and Brown and Caylor (2004) proved strong and positive correlation between non-executive directors and corporate performance.

[2]. The definition of grey or affiliated directors used here is developed by Equilar (which is a combination of SEC, NYSE and NASD guidelines). Any outside directors who were mentioned in the "certain transactions" section or a former executive were classified as grey directors.

On the other hand, there are empirical studies that found no convincing evidence that more outsiders on the board improve firm performance (Fosberg, 1989; Hermalin and Weisbach, 1991; Lin, 1996), but they were negatively related to performance (Agrawal and Knoeber, 1996), and they directed management effort in maximizing short-term profits (Baysinger and Hoskisson, 1990). Klein (1998) found no relation between overall board independence and operating performance. Weir et al. (2001) concluded that proportion of non-executive directors and presence of independent directors has no significant impact on performance. Garg (2007) also proved inverse relationship between board independence and performance but concluded that decline in performance of the companies lead to appointment of more independent directors.

Thus, it can be observed that board independence leads to better performance and larger size of board not always brings positive results.

c. BOARD DUALITY

The importance has already been given on presence of non-executive chairman of the board and it can be understood that how important it is for the performance evaluation of executive directors. Duality occurs when the same person undertakes both the roles of CEO and chairman. The potential advantage is that they should exhibit a greater understanding and knowledge of the company's operating environment. Fama and Jensen (1983) argued that boards dominated by inside directors are more difficult to control and where the position of chairman is held by inside director, the situation may become worse. The chairman's role should be separate from that of the chief executive. If the two roles are combined in one person, it represents a considerable concentration of power. Cadbury committee had suggested that there should be clearly accepted division of responsibilities at the head of the company, which ensures a balance of power and authority, such that no individual has unfettered powers of decision. Where chairman is chief executive, there should be a strong and independent element on the board. The board members should look to a senior non-executive director, who might be the deputy chairman, as the person to whom they should address any concerns about the combined office of chairman/chief executive and its consequences for the effectiveness of the board.

In India, the Kumar Mangalam Birla Committee report recognized the differing roles of the two positions and expresses itself in favour of separating them but has not mandated this in listing agreement. The Canadian guidelines[3] on corporate governance which while recognizing the need for independence and objectivity in the role of chair considered this separation as very important. Companies must follow Hampel Recommendations[4] which says that listed companies must explain in their annual reports reasons for not separating the two positions.

Daily and Dalton (1994) examined governance structures of 50 bankrupt firms and 50 matching firms of U.S.A. Governance variables were linked with financial variables. The governance variables included were CEO duality, absolute number of independent directors and board composition; while financial variables considered were profitability, liquidity and leverage. The analysis presented that the firms with CEO duality and lower proportion of independent directors were more associated with bankruptcy. But Brickley et al. (1997) found that there is no variation in the financial performance of firms with truly independent chairman and those having old employees or managers as their current chairman. Marston (1997) discussed the nature of investor relations and the asymmetry of information in large UK companies. He concluded that size of the organization is a key factor in determining its effectiveness in governance and a non-executive chairman appeared to contribute to well-organized and controlled investor relations. Sanda et al. (2005) examined governance variables and it was seen that 86 per cent of firms in Nigeria have separate posts for CEO and Chairman, out of which 37 per cent were foreign chief executives. The ownership concentration was high and average board size was 8.45 including 2.41 for outside directors. The regression results presented board size was significantly positively related to Tobin's Q, while ratio of outside directors had the opposite effect. The firms with foreign CEOs achieved high performance but director shareholding was significantly negatively related to firm performance. Dulewicz et al. (2007) conducted a research on various corporate governance aspects including the role of chairman, non-executive directors, and the non-executive director award scheme in UK. The review found few competencies in the chairmen of

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3. Canadian guidelines issued in April 2005 by Toronto stock exchange. (http://www.tsx.com)

4. The Hampel Committee was constituted in UK in 1995. The task of this committee was to consolidate the recommendations of the Cadbury Report in 1992 (focussing on financial reporting) and the Greenbury Report in 1995 (focusing on directors' remuneration), and prepare a 'Combined Code' on corporate governance. The Code, published in 1998, was attached to the listing rules of the stock exchange with the requirement that in order to be listed, companies must either declare their adherence to its provisions or explain any deviation from them.

private companies. Raising finance through relation building was the most important function of chairmen for the success and survival of private companies. On the other hand, chairmen from listed companies led to integrity and high ethical standards and promoted the financial aspects of corporate governance. They also found variations in the responsibilities of non-executive directors in above two categories of companies. Lin and Hu (2007) compared the presence of family member as CEO or professional CEO in the organization taking a sample of 375 firms listed on Taiwan Stock Exchange. The paper suggested that the professional managers cannot operate effectively in family controlled firms. Tam and Tan (2007) observed relationship between ownership type, corporate governance practices and firm performance. The study was conducted on 150 publicly listed firms of Malaysia. The results suggested CEO-duality had an effect on firm performance and further, protection of minority shareholders' rights remained the main issue in Malaysia as firms were dominated by large shareholders. Thus, it can be said that the results for CEO duality are inconclusive but separation of these two roles will definitely avoid concentration of power in one hand and will protect minority from exploitation.

d. BOARD OWNERSHIP

On one side, we are talking about independence of directors and on other there are studies which have related directors' ownership in a firm with its performance. Morck (1988) observed the relationship between board ownership and Tobin's Q of 371 out of Fortune 500 firms in the year 1980. The results showed that Tobin's Q increases with the increase in stake of shareholders but at declining rate. The conclusion remains the same even when top executives acquire more shares. Chae and Lee (2005) observed that more power in the hands of corporate insiders causes mispricing of company's stock which gets corrected slowly. Bolton (2006) related board independence, directors' ownership and CEO chair duality with performance taking return on assets, Tobin's Q, last two years stock returns as performance variables. The results presented ownership of board and CEO-chair duality were positively related with operating performance but board independence was negatively related.

Barnhart and Rosenstein (1998) studied the reverse relationship and argued that strong financial performance leads to retention of large ownership stakes and control by the board of directors. Bhagat et al. (1999) found that if the directors have a large ownership stake they were more likely to replace the CEO when company is underperforming. Hill and Shell (1988), Baysing et al. (1991), Bathel and Liebeskind (1993) and Hoskisson et al. (1994) found that greater board ownership promotes shareholders' interests. Farooque et al. (2007) discussed the governance practices in Bangladesh and related ownership and firm performance of 723 firms for the period 1995 to 2002. The results presented that higher and lower level of board shareholding lead to declining firm performance and vice-versa but impact was positive with moderate level i.e. 22.97 per cent to 60.39 per cent. Chhaochharia and Grinstein (2007) outlined the changing characteristics of corporate boards from 1997 to 2003. The number of independent directors has increased over a period of time. It was found that large firms tend to have a larger fraction of independent directors than smaller firms. The average board size has significantly decreased over a period of time for large firms. There is a little change in separation of CEO's role from that of the chairman. There was decline in the number of interlocked directors and considerable increase in directors from financial sector, retiree directors and directors from law firms. However, directors' holdings have remained stagnant over a period of time. Kapopoulos and Lazaretou (2007) related shareholdings of outside investors and managerial shareholdings with Tobin's Q and accounting profit rate. The paper concluded that higher the controlling interest of shareholders, more effectively management behavior can be monitored and greater the positive impact on performance. The results are very consistent about directors' shareholdings and where significant relation has been found it could be due to other external factors.

e. DIRECTORS REMUNERATION

This is one of the mixed and vexed issues of corporate governance which gained importance during 2000-2002, when CEOs were paying themselves high compensation/pay against the interests of shareholders and led to large corporate failures. According to the Cadbury Report, the shareholders are entitled to a full and clear statement of directors' present and future benefits and how these are determined. Greenbury's Report[5] is specifically on directors' remuneration and covers issues regarding transparency, pay for performance, process for determination, severance payments and about pensions for non-executive directors. Directors are compensated through number of ways i.e. commission, remuneration, sitting fees, stock options etc. the causal direction between director pay and performance is not clear. Agency theory agrees the use of incentives for executives to align their interests but firm's profitability also predicts the directors' compensation. Thus, there is endogenity between the two variables.

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[5]. Greenbury Report gave its recommendations on directors' remuneration, 1995, UK.

Conyon (1997) considered the issue of the directors' compensation and company performance. The effect of remuneration committee on pay has also been seen using a questionnaire survey of thousand largest companies. He found that the director pay tends to be linked to sales growth, which may not be in the interest of shareholders. He concluded that the remuneration committee did not play any role in strengthening the system of governance. Jackson (1997) suggested that companies with chief executives who overpay themselves perform badly in terms of profits and share prices. Such companies signal weak governance and lack of alignment between individuals and shareholders' interests. Mayer (1997) reviewed the relation between corporate governance and corporate performance. He elaborated on the influence of corporate governance system on managerial incentives, commitment and trust, the restructuring of firms as well as finance and investments. The author highlighted the difference between high powered incentive arrangement in UK and USA vis-à-vis those in Germany and Japan. Concentration of ownership encouraged more active corporate governance as well as the establishment of long-term relations. On the other hand, it could be misused to extract private benefit from firms rather than to pursue wider corporate interests. Core et al. (1999) found the relationship between board and ownership structure and CEO compensation of 205 U.S. firms. It was concluded that CEOs of firms with weaker governance earn high compensation but performance firms remained low. The performance has been seen in terms of sales, investment opportunities, return on assets and stock market returns for the prior year. Cordeiro et al. (2007) related stock based compensation for directors with stock returns and Jensen Alpha taking a sample of 450 S & P 500 firms over the period 1995-97. Directors' compensation has been taken in the form of stock option ratio and stock grant ratio. It was concluded that both the ratios were positively related when stock returns were taken as a performance measure while in the case of Jensen Alpha, only stock option ratio had positive relationship.

II PROTECTING SHAREHOLDERS' RIGHTS

Corporate governance moves around principal-agent relationship where protecting the interests of shareholders (principal) is the main objective of directors (agent). The shareholders' rights which have gained importance include secure ownership of their shares, voting rights, the right to full disclosure of information, participation in decisions on sale or any change in corporate assets including mergers and new shares issues etc. The OECD and other organizations have stressed on equal treatment of all shareholders including minority and foreign shareholders. They should have equal opportunity for redressal of their grievances and violation of their rights. Insider trading should be curbed and directors should disclose

Markides and Singh (1997) worked on mergers and restructuring of firms. They discovered that misfits with internal control prompt restructuring activities. Managerial inefficiencies were at the heart of restructuring which ultimately had its effect on the governance. They proved that weak firms had weak governance practices. Shleifer and Vishny (1997) reviewed corporate governance mechanisms, agency problems, management discretion, incentive contracts and agency costs. They dealt with agency problems, i.e. the separation of management and finance. According to them, corporate governance is a mechanism to assure financiers that they get a reasonable return on their financial investments. Carver (2007) concluded that corporate governance is beyond the codes and its objective is to ensure shareholders' value. The investors should become more vigilant and board should bring integrity and transparency through voluntary practices. The shareholders want accountable board and auditors with transparent and fair reporting.

III QUALITY DISCLOSURES

Transparent and qualitative reporting leads to better firm performance. The following studies have related disclosure practices with firm performance. Sengupta (1998) investigated the link between disclosure quality and cost of debt. He suggested that disclosure quality influences cost of debt as lenders and underwriters considered a firm's disclosure policy in their estimate of default risk. Lenders and underwriters relied more on corporate disclosure quality when the market was relatively uncertain about the firm's future and disclosures had been considered as a part of good governance practices. Fox (1999) while relating the disclosure with corporate governance illustrated that disclosures had a positive effect on market control, managerial compensation and cost of capital. All these factors indirectly reduced agency costs. Nwogugu (2003) said that the corporate accountability and quality of corporate disclosure had an impact on many companies and banks, particularly those grown through mergers and acquisitions. The exchange of securities and conflict of interests in such transactions can affect the financial statements. The paper highlighted the importance of legal, performance and credit analysis. Markarian et al. (2007) discussed about the convergence of various governance systems. The study offered insights into recent changes in corporate governance patterns and confirmed that effective, transparent and accountable corporate governance was essential for corporate growth. It also associated increased disclosures with market liquidity, reduced cost of capital and greater overall transparency. Udayasankar and Das (2007) concluded that firms which fail to meet the levels mandated by regulation suffer losses while those which quickly respond earn gains. This proved regulation has a positive effect on corporate governance. The firms with high governance practices had better access to critical resources including human capital and relational resources.

IV CORPORATE GOVERNANCE RATINGS AND PERFORMANCE

The following studies are based on an analysis of overall governance structure of the organizations. These have generated corporate governance indexes and seen the impact on firm performance whether operating, financial or market value.

Klapper and Love (2002) gave evidence that the legal system matters less for well-governed firms since firms with better governance have less need to rely on the legal system to resolve governance conflicts. They regressed governance score on Tobin's Q and return on assets and found them positively correlated. Disclosure and governance index was used by Kamalkant (2002) to examine the relation between disclosure, governance and shareholder value. The profitability measures (return on assets, return on equity, sales growth) were found to have a positive relation with the quality of governance. Bauer et al. (2003) proved that better governed firms have positive impact on firm value (i.e. Tobin's Q) in European Momentary Union but relationship became weak with the adjustment of factors pertaining to country differences. The results of relationship between corporate governance and operating efficiency measured through net profit margin and ROE were significantly negative. It implied that badly governed companies report less conservative earnings estimates. Gompers et al. (2003) formulated governance index based on twenty-four governance rules taking fifteen hundred large firms during 1990s. The scores were given on the basis of the strength of shareholder rights. The results proved that weak shareholder rights cause poor performance, lower profits and sales growth and lead to higher corporate acquisitions. There was no evidence with regard to the fact that better governed firms have higher returns on equity. Bohren and Odegaard (2004) examined the relation between corporate governance and performance. The results indicated that outside ownership concentration destroys market value and firm performance decreases with increasing board size, leverage, dividend payout and the fraction of non-voting shares. Brown and Caylor (2004) applied a broad measure of corporate governance score to operating performance, valuation and shareholder payout. It was found that better governed firms had more profitability in terms of return on equity, profit margin, sales growth, Tobin's Q, dividend yield and share repurchases, shareholder value and pay more cash. Governance scores were ranked in descending order and firms' performance were found to differ in the extreme deciles. Beiner et al. (2005) developed corporate governance index taking 38 parameters based on Swiss (corporate governance) code of best practice and certain specific firm based parameters. They took corporate governance index, voting rights of largest shareholders, board size, leverage as endogenous variables and beta, dividends paid, growth, type of industry, intangible assets, ROA and Tobin's Q as exogenous variables. It was observed that good governance lead to positive firm valuation and firms with dominating shareholders have large sized boards with lesser proportion of outside directors. Brown and Caylor (2006) examined the governance practices and created a corporate governance index taking fifty-one factors. They found positive association between governance score and measures of operating performance, i.e. return on assets (ROA) and return on equity (ROE). Cheng and Wu (2006) studied the impact of governance practices on shareholders return. Governance momentum was constructed based on board monitoring, shareholder rights and corporate transparency momentum and its relation to stock returns. They found positive relation between governance momentum and equity mispricing. Chen et al. (2007) presented the relationship between ownership/ leadership structures and stock returns for firms listed in Taiwan. They formulated a governance index on the basis of four parameters-CEO duality, size of the board of directors, management holdings and block shareholders' holding. They found a strong relationship between governance index and stock performance of firms under both the Market Model and Fama-French Model.

Black et al. (2005) constructed a corporate governance index and found a strong correlation between share prices and board composition (where a firm has fifty per cent or more as outside directors) in Korean companies. But no evidence was found supporting the hypothesis that the better governed firms are more profitable and pay higher dividends. Significant correlation was found between corporate governance index and firm market value.

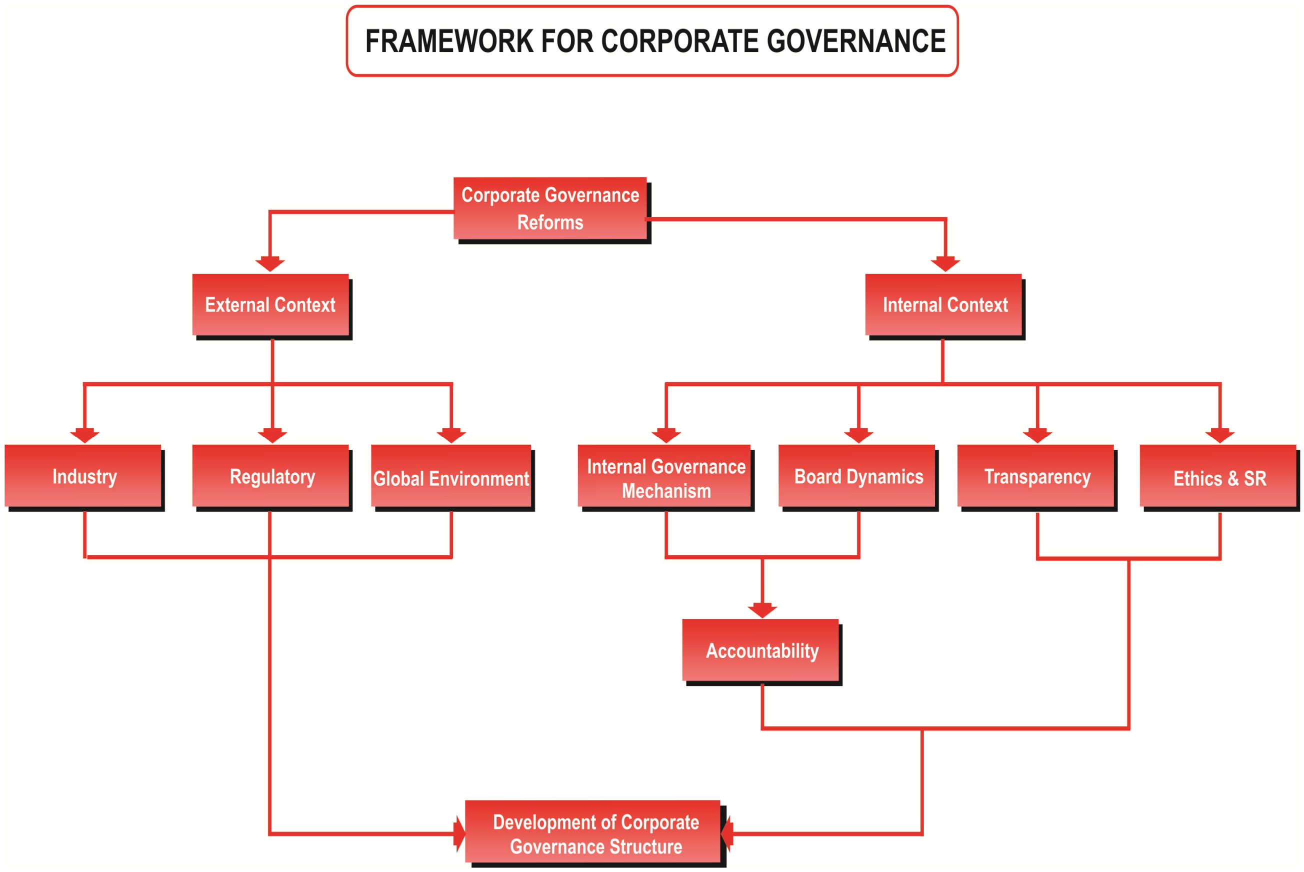
CONCLUSION

The present international and national researches have explored different aspects of the corporate governance. It can be concluded that corporate governance has a role in protecting the interests of stakeholders and maximizing the shareholder's wealth by reducing the cost of capital and agency. There are number of studies relating the governance parameters with the firm valuation. The overall findings of the studies reviewed are:

- Board of directors, their independence, various board committees, transparency, internal audit functions and financial and reporting have a key role to play in present organizational structure.
- The disclosure and governance practices have increased over a period of time and are positively associated with share prices, stock returns, Tobin's Q, return on equity and other performance measures.
- Various codes and legislations have improved governance practices and companies themselves are taking voluntary initiatives.
- The extant research also highlights the fact that much needs to be done in the area of development of corporate governance index which will be helpful to various participants. The impact of the governance score of measured through index can be seen on companies' performance especially in national context.

The review highlighted that research on corporate governance is still disconnected with certain major issues such as role and importance of audit committee, independence of audit committee and its impact on firm performance, financial expertise of audit committee members, personal certification of financial reports by top executives, reporting of financial controls, training of board of directors, adoption of charters, meetings of senior management with independent board and shareholders' and independent board in absence of management. The stock exchanges have mandated certain reforms and only those reforms are under empirical research. The reforms are talking about independence of directors but efforts are not done to revise the definition of independence beyond traditional norms of outsider vs. insider. The investors are still facing corporate frauds (Satyam's Case) are but this time laws more stringent. But still shareholders are required to be more proactive and a high level of responsibility is demanded from institutional shareholders.

Figure 2



On the basis of recommendations of various committees and attitude of the organizations above framework has been developed which will lead to better performance (Figure 2). The corporate governance reforms have an on impact internal as well as external environment of the organization. The companies have adopted these reforms both as compulsory and voluntary measures to compete in their legal, economic and global environment. The board of directors and internal control system have to play a crucial role in the development of good corporate governance structure of the organization. The information asymmetry also creates conflicts between the principals and the agents. Thus, companies should follow fair and transparent reporting practices. They should adopt business ethics and follow stakeholders' approach.

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[i]http:// www.infosys.com

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50. [ii] Blue Ribbon Committee was set up by the Securities and Exchange Commission (SEC), US, in 1998. In February 1999, the Committee published the Report on Improving the Effectiveness of Corporate Audit Committees (the Blue Ribbon Report). The recommendations of the Blue Ribbon Committee were adopted and declared to be mandatory by the NYSE, the American Stock Exchange (Amex), Nasdaq and the American Institute of Certified Public Accountants (AICPA). The recommendations are not mandatory for foreign issuers: these are subject to their own national laws.

51. [iii] The Higgs Report report reviewed the role and effectiveness of non-executive directors in the UK during 2003. The review further developed the UK framework of corporate governance, which commenced with the publication of the Cadbury report in 1992 and was taken forward by the Greenbury, Hampel and Turnbull reports.