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A STUDY OF GLOBAL CG PRACTICES: A CRITICAL REVIEW

Dr. Satvinder Kaur, Associate Professor,
Department of Commerce,
Sri Guru Gobind Singh College of Commerce, University of Delhi.
Email: satvinderkaur@sggscc.ac.in

Abstract

Corporate Governance practices are of paramount importance and this fact has been accepted by all the sectors. Realizing the significance of introducing CG practices world-wide, many researchers are exploring its need and importance.

There exists substantial and continuous emerging literature relating different governance parameters. The studies covers areas explaining importance of respective regulations, some studies highlights comparison of CG practices in different countries, relationship of governance norms and financial performance and other related areas have also been covered by many researchers .The objective of this paper is to see the existing research studies related to CG practices adopted in India and other countries .To meet the objectives of this paper 58 papers have been studied of the duration of late 90's till 2012.Considering the nature of the paper highlighting the existing studies in the respective area, objectives, research methodology, results and conclusions have been summarised.

There have been several studies in developed countries focussing on importance of CG practices, empirical analysis stating relationship of CG practices on organisations performance, relationship of ownership structure with other CG parameters etc. The review of literature also suggests that, despite of so much research in the area; corporate governance is still at its important stage in India which requires deep understanding and focus on related implementation issues and acceptance of these practices by the organisations on a welcome note.. However, India is striding forward with full stern, in its quest to carve a niche in the global arena in the field of corporate governance.

Key Words: Corporate Governance, CG practices in India and abroad, Literature review

Section-1 Introduction

Governance is concerned with nature, purpose, identity and integrity of an organisation with major focus on the entity's reason for existence, it's sustainability and ethical aspects. Good governance has been a motivational factor for smooth running of business.Corporate Governance can be understood as a combination of rules, regulations and policies, which have been designed to run a corporate in an efficient and effective manner. It covers internal policies and external mechanism maintaining balance between corporate objectives and achievable goals of respective stakeholders. The governing mechanism is to be continuously evaluated to assure the concerned parties that the corporate is being run in an ethical way holding balance between social and economic goals.

Section-2 Objective of the study

The purpose of this paper is to study and analyze the several research studies conducted in the respective area in India and abroad. The nature of CG practices in India and scope of further research have been covered in this paper. It is the research paper trying to find areas where studies have conducted and some conclusions had been derived. This paper has highlighted the conflicting viewpoint of different research studies. The specific objectives can be discussed to enhance the understanding of the concept of C.G. practices, their acceptance and implementation in Indian corporates.These objectives are as follows:

* To analyse the background and adaptability of good codes of CG in the Indian context and in other countries.
* To find the gaps in the research areas and to highlight the areas for future research.
* To view implementation of C.G. practices in Indian Corporates and others keeping in mind their importance and impact on other factors.
* To find the important parameters of good CG practices on the basis of already conducted research studies.

Section-3 Research Methodology

With the purpose to meet the objectives of this paper 58 papers have been studied of the duration of late 90's till 2012 within which 5 papers have been included which are prior to this period but carries due importance. 14 papers have been excluded as were not found relevant to the objectives, other 15 were related to Indian studies, out of remaining 28 only 8 articles were referring India in reference section and 20 articles were covering CG studies in other countries. The selected papers have been classified on the following basis;

- CG and ownership structure
- CG and board structure (size and composition)
- CG and financial performance
- Corporate governance ratings
- Role of different committees
- CG practices and investors
- Other research areas

Section-4 Literature Review

A literature review is a glimpse of previous research on the topic. The purpose of literature review is to show the researcher and reader about knowledge and ideas which have already been explored on the topic and allow the reader to understand the depth of up to date research in the relevant area and also to have viewpoints and perspectives on the topic.

The different studies conducted by researchers has been covered and being classified on the basis of several governance parameters. The classification has been designed by taking into account regulatory requirements and different important parameters which are important for understanding of CG concepts and their implementation. Classified literature has been covered in the following section.

Section-4a CG and Ownership Structure

The concept of governance came into view because of different parties' involvement as owners and as managers in case of a corporate entity. The separation of ownership, management and control has been a long-standing concern in corporate sector. The conflict between managers and owners has been studied extensively by researchers to understand the nature of the firm and respective roles towards owners and managers.

The researchers have come to the conclusion that the increased professionalism of management leads to better firm performance rather than working for owners in a situation of conflicting interests between different parties[Berle and Means (1932), Jensen and Meckling (1976)]. Himmelberg, Hubbard, and Palia (1999) have studied the degree of managerial ownership and have argued that it is independently determined by a firm's contracting environment. The viewpoint of other researchers is that concentration of ownership leads to positive firm performance [Ahuja and Majumdar (1998), Chibber and Majumdar (1998: 1999), Khanna and Palepu (1999: 2000), Patibandla (2006), Mork, Shleifer and Vishny (1988)]. Sarkar and Sarkar (2000) conducted the research and found a significant relation between firm value and ownership concentration.

On the basis of studies given above the research results shows the mixed response with respect to relationship of ownership and firm performance with special reference to CG norms, which gives the direction for further research in the respected area.

Section-4b CG and Board Structure (Size and Composition)

Boards have always played an important role in the functioning of the corporates. There have been number of research studies covering size of board, composition of board, different committee requirements etc.

Size of the Board: There have been always conflicting views about the size of the board on the effectiveness of decision making. It has been argued that larger boards tend to provide an increased pool of expertise and environmental links. On this basis the point of view is that a board should have a composition of seven or eight members to function effectively, it has been suggested by Jensen (1983),Goodstein, Gautam, and Boeker (1994) in their respective studies. On the other hand Firstenberg and Malkiel (1994) have stated on the basis of their study that smaller boards are more efficient as they are more likely to reach consensus and allow members to engage in genuine debate and interaction. Forbes and Milliken (1999) also favoured smaller board and stated that larger boards are difficult to coordinate, have difficulty making value maximizing strategic decisions, and as a consequence, fail to implement strategies that maximize firm value, hence favoured the smaller size of board .

Composition of Board: There are on-going arguments about the composition of board members, whether to comprise executive or non-executive or independent and in what composition and how it is going to affect the functioning and performance etc. Kole and Lehn (1999) and other theoretical and empirical studies have suggested board characteristics are endogenously determined and that board size and composition varies with firm characteristics. David A. Carter, Betty J. Simkins, and W. Gary Simpson (2002) have examined the relationship between board diversity and firm value for Fortune 1000 firms. The respective studies suggests the proportion of women and minorities on board increases with firm size and board size. Hossain, Prevost, and Rao (2001) and Reddy et. al.(2008) showed in their studies that New Zealand publicly listed companies do have a majority of independent directors on their boards. Sanjai Bhagat & Brian Bolton (2006) in their study effort has been made to find relationship between Board ownership and corporate governance indices.

It is viewed from above studies and other literature that it is better to have independent directors on the board with the condition of minimum qualification and real independence to perform their duties and obligations and their genuine participation in decision making.

Section-4c Corporate Governance and Financial Performance

It has always been an important point of concern and attention that how the adoption of CG norms going to affect the corporate's performance. Considering the relevance of the area number of researchers has explored this area by using different measures. In this area of study extensive literature is available which has been sub classified on different basis. The following studies have used quantified measures to find the relationship of various CG norms on firm's financial performance. Dalton (1999) has used "Jenson, Treynor and Sharpe market-measures" for performance. Judge (2003) measured performance of the firm with financial profitability, growth in size/assets, product/service quality, capacity utilization, process improvements, customer satisfaction, employment stability and employee training. Drobetz (2004) used average historical returns and found positive relation between corporate governance rating (CGR) and firm value and expected returns to be negatively correlated with CGR, when dividend yields and PE ratios were used as proxies for cost of capital. Bauer et.al., (2004) the objective of his study was to find how CGR impacts firm value and expected returns. They tried to find impact of good CG practices on firm value, for which net profit margin, ROE and Tobin's q has been used. They also tried to analyse whether good corporate governance leads to higher stock returns and enhances firm value in Europe. Beiner et. al.,(2004) have used Tobin's q and ROA for measuring performance of firms quoted at Swiss Stock Exchange. Balasubramanian et. al., (2009), Jackling and Johl (2009) used Tobin's q and ROA as performance indicators for Indian firms. Palanisamy Saravanan have studied the impact of corporate governance in the determination of firm value in the manufacturing firms in India. Bhagat and Bolton (2008) investigated the impact of corporate governance on operating performance of U.S. firms using ROA and Tobin's q as performance measures. Mehran (1995) examines the executive compensation structure of 153 randomly-selected manufacturing firms and reports that firm performance (measured as Tobin's Q and ROA).

Demsetz and Lehn (1985), Adu K. Bonna (2002) , Judge (2003), Brown, Lawrence D., and Caylor, Marcus, (2004), Reddy, Krishna; Locke, Stuart; Scrimgeour, Frank (2008) have studied the relationship between several governance norms and firm performance. The studies found that the best-governed companies had higher returns on investment and equity than those of poorly governed companies. Klein, Shapiro and Young (2005) have studied relationship of governance practices and firm's performance and found that there is no unequivocal evidence to suggest that good corporate governance practices enhances firm performance. Akshita Arora studies the relationship between Corporate Governance and Performance in the context of Indian firms. The results shows board size; institutional ownership and CEO-duality also have a strong influence on firm performance.

Section-4d Corporate Governance Ratings and Good CG Practices

Many researchers have tried to evaluate the working mechanism of regulatory norms and CG practices. Implementation levels of CG practices have been evaluated**.** Jayati Sarkar, Subrata Sarkar (2009) have constructed a Corporate Governance Index for 500 large listed firms in the Indian corporate sector for the period 2003 to 2008. The empirical analysis results in the support of adoption of good governance practices and are rewarded by the market which provides an added incentive to companies to carry out governance reforms. Drobetz (2003) found positive relation between corporate governance rating (CGR) and firm value and expected returns to be negatively correlated with CGR. Gompers et. al. (2003) conducted their study to find relationship of CGR on profitability supported the proposition that companies with a good governance ranking were higher valued and had higher profits than those with a bad ranking. This argument was based on an assessment of the governance of 1,500 US companies using 24 governance 'provisions' analysed by the Institutional Investors Research Center (IRRC) during the 1990s. In the study conducted by Bowen, Rajgopal, and Venkatachalam (2005) dollar ownership of the board members has been proposed as an important governance measure in constructing the governance index. The relationship between credit ratings and corporate governance practices have been investigated by Ashbaugh-Skaife, Collins, and Lafond (2006). They have considered the GIM index and various board characteristics including board independence and SEC ruling NASD and NYSE rule-making relating to Corporate Governance. Black et. al. (2007) has found that firms having high governance score have a high market value. In expectation of the improvement in firm's performance, the stock price might also respond instantaneously to the news indicating better corporate governance. Credit ratings have been given due importance by many researchers. Lafond (2006) have explored the relation between corporate governance and credit ratings. They consider the GIM index and various board characteristics including board independence and compensation as separate governance measures. Adjaoud et.al. (2007) used the 2002 rankings to understand the relationship between firm performance and the governance scores. They found that the relationship between the scores and accounting-based measures of performance (such as ROI, ROE, EPS, and market-to-book) was not significant while the relationship between the scores and measures of value created (such as market value added and economic value added) was generally significant. The efforts have been made to find the relationship between Corporate Governance and Firm Performance by Candy Biancoa, Chinmoy Ghoshb and C. F. Sirmansb (2007). They have tried to find the relationship between the "external" corporate governance index and performance of REITs in 2004 and 2006. It has been suggested that there is a need to pay more attention to the efficacy of internal governance mechanisms. Aggarwal et. al. (2008) found the number of governance attributes in his research and then defines the governance index as the percentage of attributes to check the governance level of selected companies. Mehul Raithatha and Varadraj Bapat (2012) in their study have observed compliance of Corporate Governance requirements by Indian Companies and have observed that financial parameters like Net Profit Margin, Market Capitalization, FII Stake and Leverage Ratio resulted in co-efficient values which were found to be not significantly related to Corporate Governance score.

Section-4e Role of different Committees

Barako et al., (2006) "examined the extent of voluntary disclosure by the Kenyan companies over and above the mandatory requirements." This study covered a period of 10 years from 1992 to 2001. The results of the study showsthat "the audit committee plays a role of a significant factor associated with level of voluntary disclosure, while the proportion of non executive directors on the board doesn't have much impact on the same."

Hoitash and Hoitash (2008) studied the role of audit committees in managing relationship with external auditors after the Sarbanes-Oxley Act of 2002 in the United States using a series of linear and logistic regression models of 2,393 sampling firms. The study resulted in the fact that stronger audit committees contributes more to auditor independence and earnings quality. Existing literature suggests that different committees plays a very important role in CG and in this area further research can be done.

Section-4g CG practices and Investors

Corporate scandals involving leading public firms such as WorldCom, Tyco, Adelphi, Global Crossing, Merrill Lynch, and Enron among others in the United States, as well as Vivendi, Swissair, and Metallgesell shaft in Europe, Satyam in India have adversely affected financial markets and investors' confidence. Due to lack of confidence in financial markets and tension within public corporations there has been severe decline in investment performance which led to insolvency of financial institutions. Millstein and MacAvoy (1998) explored that the firms following good governance practices have an edge over other firms and well governed companies outperformed by 7%. La Porta et. al. (2002) has studied the investors perception w.r.t. well managed firms and argues that an investor's protection tends to be greater when the legal environment is stronger, and therefore his willingness to invest tends to increase. They find strong and positive association between adoption of corporate governance practices and firm's performance.

McKinsey's 'Global Investor Opinion Survey' 2000 is the most widely quoted opinion-based research explaining the link between corporate governance and performance as measured by the valuation of the company. McKinseyreported after conducted surveyover 200 institutional investors and resulted that 80% of the respondents would pay a premium for well governed companies. The size of the premium will differ from marketto market, from 11% for Canadian companies to around 40% for companies operating in countries where the regulatory backdrop was less certain, such as Egypt, Morocco, and Russia. The UK and US have got the preferred premium at 12% and 14% respectively. Bauer et. al. (2004) an analysis of corporate governance data on a sample of European companies included in the FTSE Eurotop 300, provided somewhat mixed support. They found a positive relationship between the corporate governance standards investigated and share price and company value but not operating performance. Fich and Shivdasani (2005) finds that if stock option plans are announced for their directors then the firms higher market to book ratios and higher profitability . Bhattacharyya and Rao (2005) examined the data pertaining to adoption of clause 49 to determine its affect on prediction of volatility and returns for large Indian firms. Data of period prior to June 1, 1998 (before adoption) and after June 1, 2001 (after adoption) have been taken into account for the purpose of this study.

Prof. J.P. Sharma and Dr. Gurcharan sachdeva have taken the perceptual responses of investors to the study the several concepts of corporate governance. The results of the study show that whereas the investors are of the opinion that the regulatory authorities are not able to provide the effective regulatory environment for ensuring corporate governance, however, respondents are satisfied with the behaviour of stock market intermediaries. Kirkpatrick, 2009 suggested that due importance should be given to internal and external factors.

Section-4h Other Research Areas

There have been other studies which could not be grouped in the above categories have been covered under this section. These research areas can be considered for further research. Bhaya (1990) based his findings on the time series data from 1981-82 to 1985- 86 for the public and private sector by the survey of industries, which can be taken up with different time periods. Balmiki Prasad Singh has studied the challenge of good governance in India, need for innovative approaches. The paper lists several areas of concern that need to be addressed energetically and calls for synergy of efforts between government, the market and the civil society. Padmini Srinivasan &Vasanthi Srinivasan have studied several research papers to find the status of Corporate Governance Research on India. Defond, Hann and Hu (2005) studied the appointment of an accounting expert on the board and its corporate governance and found the response of the market to the same. Bowen, Rajgopal, and Venkatachalam (2005) have conducted their research to analyse the relation between corporate governance, accounting discretion and firm performance. Zaleha Othman, Rashidah Abdul Rahman, Shah Alam, have tried to explore role of Ethics as Moral Substance in the Adoption of Corporate Governance practices . Wu (2006) examined ethical structure and its influence on corporate governance practices. A survey was conducted among 500 listed and OTC companies in Taiwan.
Mele et al. (2006) have conducted the research to find the role of the implementation of ethical programmes and corporate governance practices among 500 companies from three countries (Spain, Argentina and Brazil).

Section-5 Research Gaps and Conclusion

In case of studies mentioning ownership structure and corporate governance norms mixed viewpoint is seen where no evidence in favour of concentration of ownership or scattered ownership is seen which requires further research in the given area to have more authenticate conclusions.

Researchers are still trying out the ways to test corporate governance model, which has presented some problems and how it affects financial performance. From the studies in the area of size and composition of board the following research gaps have been observed. Based on these conflicting views, a number of researchers have investigated whether board size has an effect on firm financial performance, role of independent directors, and role of woman directors on the board etc. In view of already conducted studies more research can be in the area of women directors and financial performance.

Extensive literature is available highlighting the relationship between CG norms and firm performance. After the literature survey, it is found that several variables plays very important role such as duality of chairman’s role, board size, and proportion on institutional investors, concentrated ownership, percentage of non-executive and independent directors in the boardand audit committee chairman. Studies also find that the adoption of corporate governance practices results in better operating performance and market valuation.

Firm-level corporate governance is of desired importance in countries where strong legal environment doesn’t exist. This suggests that firms can partially compensate for ineffective laws and enforcement by establishing good corporate governance which will providecredible investor protection. This area requires more research.

Adoption of Corporates governance practices can improve investor protection rights.It can be done by increasing disclosure, selecting well-functioning and independent boards.Imposition of disciplinary mechanisms will lead to prevention of management and controlling shareholders from engaging in expropriation of minority shareholders, etc. Therefore, it will offer varying degrees of protection to their investors within the same country.

The number of study performed in developed countries have been limited mostly due to problems with data gathering and which results in lack of investor awareness of these practices.

India has made considerable effort to tone up the performance and efficiency of the corporates.

Although most of the research studies focus on US and UK data and other countries, Indian corporates are considering the importance of CG practices and implementing the same to fulfil the regulatory requirements.

There has been many studies and research papers which focuses on firm-level corporate governance mechanisms, but most of researches have covered the studies on OECD and US countries (Shleifer and Vishny, 1997, and Maher and Andersson, 2000).

The convergence of the importance of certain topics like Performance and regulatory mechanisms between international and Indian context can be seen. It is an indicator of the presence of thebody of knowledge in the area of corporate governance research. There is however a need for more empirical research in the Indian context and also the development of theories that are embedded in local realities.

According to several studies board independence is positively associated with the corporate entities' financial performance. However, the empirical research evidence w.r.t. the effect of board independence on firm financial performance has been inconclusive.

In the area of CG research, Indian corporates have not been explored to a greater extent.in most research studies India has been taken just as reference. The published papers in Corporate Governance research in India area are just 12-15 % of total research paper published. But as compare to earlier years the research in this area is growing in India as well. It is proposed that the state of CG research in India and emerging markets is likely to be different given its unique institutional contexts.

The analysis of literature review indicates that there has been a steady and growing interest in the field of Corporate Governance in India. The relative inflections of CG reforms in India offer an opportunity to explore a number of themes that have historically been studied in other countries.

Most of the studies have been conducted in the area of CG and firm performance. These studies are either replication or extension of concept with few new variables. The convergences of the importance of certain topics like performance and regulatory mechanisms between Indian and international research studies can be seen as area of importance and of the common body of knowledge in the field of Corporate Governance research.

From the above studies it has been observed that Corporate Governance affects the creation of wealth and its distribution into different pockets. It shapes the efficiency and performance of firms, the stability of employment in the organisations, the long term relationships of suppliers and distributors and stability and the portfolios of investors. Getting Corporate Governance right is important to economic prosperity.

Implementation of CG practices is equally important along with fulfilling just regulatory requirement. It is concerned with wider accountability and responsibility of directors for disclosing all types of quantitative and qualitative information thereby enhancing transparency to all stakeholders of the organisation. The composition of board, structure, appointment, experience, remuneration of board of directors also affects the governance practices in an organisation. It can also be observed that companies should have adequate audit committee, remuneration committee, nomination committee, investor grievance and security transfer and transmission committee for effective governance. Along with above measures some alternate can be seen to increase the participation of stakeholders in corporate decision making.

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