

## CORPORATE GOVERNANCE

Asha Antony.P, MBA, M.Com, M.phil\*

### 1 INTRODUCTION, DESIGN AND ROOT OF THE STUDY

#### 1.01 DEFINITION OF CORPORATE GOVERNANCE

The concept was first used by World Bank in 1989. Corporate governance made a new bridge of interactions relationship between government and public. The roots of definition of corporate governance can be seen in Milton Friedman's definition "corporate governance is to conduct the business in accordance with owner or shareholders desires, which generally will be to make as much money as possible, while conforming to the basic rules of the society embodied in law and local customs"

#### 1.02 HISTORY (CORPORATE GOVERNANCE)

In the 19th century, state corporation law enhanced the rights of corporate boards to govern without unanimous consent of shareholders in exchange for statutory benefits like appraisal rights, to make corporate governance more efficient.

In the 20th century in the immediate aftermath of the Wall Street Crash of 1929 legal scholars such as Adolf Augustus Berle, Edwin Dodd, and Gardiner C. Means pondered on the changing role of the modern corporation in society. Berle and Means' monograph "The Modern Corporation and Private Property" (1932, Macmillan) continues to have a profound influence on the conception of corporate governance in scholarly debates today.

\* Faculty in finance, RL institute of management, TVR nagar aruppukottai road, Madurai 625 022.

Current preoccupation with corporate governance can be pinpointed at two events: The East Asian Financial Crisis of 1997 saw the economies of Thailand, Indonesia, South Korea, Malaysia and The Philippines severely affected by the exit of foreign capital after property assets collapsed. The lack of corporate governance mechanisms in these countries highlighted the weaknesses of the institutions in their economies. The second event was the US corporate crises of which saw the collapse of two big corporations: Enron and WorldCom, and the ensuing scandals and collapses in other organizations such as Arthur Andersen, Global Crossing and Tyco.

#### **Exhibit 1.00 History of Corporate Governance**

19<sup>th</sup> century demand from state laws – corporate governance

20<sup>th</sup> century after Wall Street Crash - legal scholars such as Adolf , Edwin Dodd, and Gardiner C.

Current demand – Asian Financial Crisis of 1997 And US Crises Enron And Worldcom

### 1.03 THREE PILLARS OF GOOD CORPORATE GOVERNANCE

Transparency of operations

Accountability towards stakeholders

Fairness in dealing

### 2.01 THE RESEARCH BACKGROUND AND MOTIVATION

Over the last few years, corporate control and governance have been in focus, both in India and abroad. In India a chamber of commerce has set out guidelines for efficient corporate governance. Stock Market plays a great role in Promoting Good Governance. Recently there has been considerable interest in the corporate governance practices of modern corporations,

particularly since the high-profile collapses of a number of large U.S. firms such as Enron Corporation and Worldcom. Indian stock market is no exception to such crisis with many scams such as Harshad Mehta episode, Ketan Parekh affair, UTI saga, vanishing company scams, IPO scam etc. however the eventual pressure for better corporate governance came from the capital market.

Long before corporate governance became a buzzword in industry circles. Companies learned long back that having the complete cooperation and participation of their employees meant improved efficiencies and, consequently, superior products. Now they have begun understanding that a strong commitment from investors and other stakeholders can lead to similar payoffs for the organization. Corporate governance which demands that broad-based systems of accountability be built into the spinal structures of companies. Government regulations can be a guide, at best, in this process. More important is a culture of self-policing. Efficient stock markets also create incentives to identify poorly managed companies, facilitate the takeover of such companies, replace their management, and make other changes in the companies' corporate governance

In this surging sensex scenario it's apt to know the impact of corporate governance on companies performance in stock market is positively correlated along with some other factors which make the sensex move all the way high. Throw light into the extent of impact of corporate governance on securities performance along with other macro economical factors.

## 2.02 STATEMENT OF PROBLEM – [The Problem Discussion]

There are many regulation, Acts and reforms under SEBI to protect the interest of the investors. Although the presence of these reform & Regulatory authority has set us aside from the real evils of concentrated wealth and from the finance power of huge institutional investors [domestic/foreign], they had the unintended result of ensuring accountability to no one, means they are not accountable for the money/wealth of the investors.

*Among many factors affecting share price what is the stand of corporate governance?*

*Is corporate governance accountable for rising & falling prices?*

*Is corporate governance accountable for investors' wealth?*

*How do investors choose share? Do they consider corporate governance?*

The only factor or constituent which is accountable for the money of investors is the corporate governance of the company or the corporate. Even though the corporate governance is the sole factor accountable to investors, we need to know the degree of accountability by analyzing impact of corporate governance on the performance of companies in the stock market.

*Do stock markets really play a great roll in pressuring corporate to follow good corporate governance?*

*Can the performance of the company in the stock market be an avenue to penalize those corporate not adhering to excellent corporate governance?*

The statement of GN Bajpai, Chairman of Securities and Exchange Board of India [SEBI] that “the adequacy and the quality of corporate governance shape the growth and the future of any capital market and is an important instrument of investor protection. Although the corporate governance had gain some prominence after series of scam - Harshad Mehta episode, Ketan Parekh affair, UTI saga ect. It has been given relatively low profile, the researcher is putting an effort to highlight corporate governance real action, that is positively changing corporate behavior. By studying the impact of corporate governance on share price the researcher is trying to ascertain the accountability of corporate governance in protecting investors' wealth.

*How to bring active corporate governances which is accountable to investors by providing good ROI and safe guard investors from wealth eroding phenomena?*

Without studying the impact of corporate governance research can neither answer the above mentioned questions nor can ascertain harnessing factor for eroding investors' wealth.

### 2.03 THEORETICAL CONTEXT

When scientific research is conducted, empirical evidence and theory must be combined in a manner that best describes reality [Andersen 1998 p.29]. One approach is to start with a theory, create hypotheses and then test empirical findings against that theory. Another approach is to draw general conclusions out of observations which would result in theoretical reflections and analyses [Bryman and bell 2003 p.9]. The researcher has adopted the latter approach which is known as inductive approach.

Since the purpose of this thesis is to examine the impact of corporate governance on the companies' performance in the stock market from customer perspective, the focus of the research is on the empirical information collected through interviews and literature studies. In order to put forward and draw inferences on the matter, we gather information regarding customer perception about corporate governance and expectation about future impact of corporate governance on the companies' performances and other potential pressures from corporate governance which can cease investor's eroding wealth.

### 2.04 OBJECTIVES OF THE STUDY

- To study the impact of corporate governance on companies performance in stock market
- To study factors those are affecting the performance of companies in stock market

### 2.05 SOURCE OF DATA

Primary Data: In the research, survey method has been used to collect the primary data from the respondents [clients and staff of Religare], with the help of questionnaire binary structured and multiple choice questions in closed ended questionnaire. Used few open ended questions also. The fixed alternative questions are used to generalize respondents while the open-ended response questions give a deeper understanding in the subject. The purpose of the field interviews is to survey the some of responses and opinions of employees & clients of Religare securities office on impact of corporate governance on performance of companies in stock exchange.

2.06 SAMPLING METHOD

Simple random sampling is one of the simplest sampling designs and can work well for relatively small populations. A sampling process where each element in the target population has an equal chance or probability of inclusion in the sample. Sample size is 300 units from Religare securities Pvt. Ltd. targeted population size is 500 units from Religare securities Pvt. Ltd [clients and staff]

2.07 LIMITATIONS OR DIFFICULTIES

It was difficult to get suitable respondents. It is a quantitative rather than qualitative and Lack of common measure for corporate governance rating

**3. REVIEW OF THE LITERATURE**

Topic	Theme	Author	Period
corporate governance in latin america- convergence or divergence?	Corporate governance law and practices in latin america's four largest capital markets: brazil, mexico, chile and argentina	jose IC	May-04
Corporate Governance Practices and Firm Performance of Listed Companies in Sri Lanka	Even in adverse economic and political conditions, good corporate governance practices were important to the performance of firms operating in Sri Lanka. for corporate governance practices to have full impact on firm performance in Sri Lanka, boards should consider CSR strategies that are in the interest of all stakeholders and relevant to the business.	Kumudini Heenetigala, Doctor of Business Administration- Victoria University Melbourne	Apr-11
Corporate Governance between Efficiency and Corporate Social Responsibility	Dynamics(Change or Persistence) of Corporate Governance Institutions [CGI] and their Causes. It says about political and Economic Consequences CGI	Jeppe Fisker Jørgensen	nil
CORPORATE GOVERNANCE ACROSS INSTITUTIONAL CONTEXTS	This dissertation consists of three essays that investigate the important issues involved with corporate governance across different institutional contexts	Doctor of Philosophy in the Graduate-School of The Ohio State University- Yi Jiang, M.S.	Jan-06

<p>“The Impact of Managers’ and/or Directors’ Perceptions of Corporate Governance on the Financial Performances of Industrial Firms in Turkey: Comparison of the Stockholder and the Stakeholder Governance Models”</p>	<p>business environment in Turkey shifted from the public-interest dominated culture to the self-interest dominated culture. the firms which give importance to CSR will not carry additional financial burdens when compared to the firms which do not operationalize CSR activities for their stakeholders. [compare firms that implement stakeholder governance model with the firms that implement stockholder governance model in terms of their financial performances in Turkey]</p>	<p>Süleyman Gökhan Günay</p>	<p>nil</p>
<p><b>CORPORATE GOVERNANCE: THE EFFECTS OF BOARD CHARACTERISTICS, INFORMATION TECHNOLOGY MATURITY AND TRANSPARENCY ON COMPANY PERFORMANCE</b></p>	<p>develop a conceptual model to investigate the relationships among the dimensions of board structure, transparency, information technology, and company performance. Also study the corporate governance dimensions of high and low performing companies</p>	<p>Sinan DÜZTAS- doctor of philosopy- university of istanbul</p>	<p>Dec-08</p>

**20. ANALYSIS AND INTERPRETATION- Source: Primary Data**

TABLE – 1: THE AGE OF THE RESPONDENTS

AGE	No. OF RESPONDENTS	%
Below 20 years	38	13
20 to 30	58	19
30 to 40	65	22
40 to 50	74	24
Above 50 Years	65	22
Total	300	100

**INTERPRETATION**

22% of the respondents belong to the age group of above 50 years. 24% of the respondents belong to the age group of 40 to 50 years. 22% of the respondents belong to the group of 30 to 40 years. 19% of the respondents belong to the age group of 20 to 30 years. 13% of the respondents belong to below 20 years

TABLE – 2: THE SEX OF THE RESPONDENTS

SEX	No OF RESPONDENTS	%
Male	270	90
Female	30	10
Total	300	100

#### INTERPRETATION

It is clear from the above table that out of the total respondents taken for the study 90% of the respondents are male and 10% of the respondents are female. Majority of the respondents are male

TABLE –3: EDUCATIONAL QUALIFICATION OF THE RESPONDENTS

QUALIFICATION	No. OF RESPONDENTS	%
School Level	15	5
Degree / Diploma	74	25
Post Graduation	62	21
Professional	141	46
Illiterate	8	3
Total	300	100

#### INTERPRETATION

05% of the respondents belong to school level education. 25% of the respondents belong to degree / diploma. 21% of the respondents belong to post graduation. 46% of the respondents belong to professional group. 03% of the respondents belong to illiterate.

TABLE – 4: OCCUPATIONAL STATUS OF THE RESPONDENTS

OCCUPATIONAL STATUS	NUMBER OF RESPONDENTS	%
Business Man	48	16
Agriculturalist	29	10
Government Employee	121	40
Private	87	29
Others	15	5
Total	300	100

INTERPRETATION

16% of the respondents are business man. 10% of the respondents are agriculturist. 40% of the respondents are government employees. 29% of the respondents are private employees. 05% of the respondents are from other occupational status

TABLE – 5: INCOME LEVEL OF THE RESPONDENTS

<i>INCOME</i>	<i>NUMBER OF RESPONDENTS</i>	<i>%</i>
Below 5000	22	7
5000 - 10000	98	33
10001 - 20000	147	49
20001-25000	33	11
25000 above	0	0
Total	300	100

INTERPRETATION

07% of the respondents fall below 5000 income level. 33% of the respondents fall in 5000 -10000 income level. 49% of the respondents fall in 10001 – 20000 income level. 11% of the respondents fall in 20001-25000 income level. 0% of the respondents fall above 25000 income level

TABLE – 6: TYPE OF THE RESPONDENTS

<b>TYPE OF CLIENTS</b>	<b>No. OF RESPONDENTS</b>	<b>%</b>
INVESTORS	206	69
TRADERS	94	31
Total	300	100

INTERPRETATION

69% of the respondents fall in the category of investors. 31% of the respondents fall in the category of traders. Investors may do either of them [investments / trading ]

TABLE – 7: BASIS FOR STOCK SECTION

<b>STOCK SELECTION</b>	<b>No. OF RESPONDENTS</b>	<b>%</b>
VOLATILITY	110	37
BLUE CHIP CO.	33	11

PROFIT	157	52
TOTAL	300	100

## INTERPRETATION

37% of the respondents select the stock based on volatility. 11% of the respondents select the stock based on Blue Chip Company. 52% of the respondents select the stock based on Profit

TABLE – 8: STOCK SELECTION BASED CORPORATE GOVERNANCE

CORPORATE GOVERNANCE	NUMBER OF RESPONDENTS	%
YES	102	34
NO	198	66
Total	300	100

## INTERPRETATION

34% of the respondents select the stock based on corporate governance. 66% of the respondents do not consider corporate governance while selecting stock. Those who consider corporate governance also consider only few parameters, like profit generation, schools, charitable trust & hospitals run by the company. The knowledge regarding corporate governance is very less and narrow.

Only 34% of the respondents have selected stock based on corporate governance the stock selected by them, mainly were RIL, reliance energy limited, SBI, TATA STEEL, ICICI BANK, M&M. the Reliance, M&M & SBI were rated poor/average in corporate governance by ICSI. The explanation given for selection of ICICI BANK was it's a private bank which is doing very well and there is no chance that it will come to bankruptcy and it's making profit also. From these explanations it's very clear that the 34% respondents were not clear about the corporate governance concept, the main thing is that the rating is not mandatory and it's not given such importance as the Quarter [net profit] result publications, you can see such results showing profit/loss in Visual as well as print medias, so that public are aware of it but such publications are not there in case of corporate governance rating.

TABLE – 9: GRADING FOR CORPORATE GOVERNANCE STOCKS

GRADING	NUMBER OF RESPONDENTS	%
Highly satisfactory	15	15
Satisfactory	29	28
Neutral	45	44
Dissatisfactory	11	11

Highly dissatisfactory	2	2
Total	102	100

## INTERPRETATION

Out of 300 Respondent only 102 have selected stocks based on corporate governance. This grade shows the satisfaction level of respondents when they selected the stocks on corporate governance parameters

15% of the respondents rates corporate governance stocks selection highly satisfactory. 28% of the Respondents rates corporate governance stocks selection satisfactory. 44% of the Respondents rates corporate governance stocks selection neutral. 11% of the Respondents rates corporate governance stocks dissatisfactory. 02% of the Respondents rates corporate governance stocks highly dissatisfactory. **The researcher would like to emphasis that 50% of respondents do not have clarity on the concept**

TABLE – 10: NON-CONSIDERATION OF CORPORATE GOVERNANCE

REASONS	NO. OF RESPONDENTS	%
Prevalence of low profile	81	41
Lack of knowledge	17	9
Consider Tips given	40	20
Consider profit	28	14
Consider Bullish stocks	32	16
Total	198	100

Out of 300 Respondent 198 don't consider corporate governance in selection of stocks. 41% of the respondents don't consider corporate governance in selection of stocks due to its low profile, 9% of the respondents due to lack of knowledge, 20% of the Respondents consider only Tips, 14% of the respondents consider profit & 16% consider bullish stocks.

TABLE – 11: PARAMETERS FOR JUDGMENT OF CORPORATE GOVERNANCE

PARAMETERS	NUMBER OF RESPONDENTS	%
Q Sales	16	5
Q Net Profit	27	9
Blue Chip Co.	10	3
Ratings	54	18
Constant Profit	72	24
Wealth Creation	36	12
All The Above	85	29
Total	300	100

INTERPRETATION

05% of the Respondents judge corporate governance on the basis of Quarterly sales. 9% of the Respondents judge corporate governance on the basis of Quarterly profit. 03% of the Respondents judge corporate governance on the basis of Blue chip co. 18% of the Respondents judge corporate governance on the basis of ratings given by credit rating institutions. 24% of the Respondents judge corporate governance on the basis of Constant profit generation of the company. 12% of the Respondents judge corporate governance on the basis of Wealth creation of the company. 29% of the Respondents judge corporate governance on the basis of all the above parameters. From this research interpret only 18% have clarity of sound corporate governance judgment. 29% have around 80% clarity regarding parameters of corporate governance judgment.

TABLE – 12: CURRENT IMPLICATION OF CORPORATE GOVERNANCE

IMPLICATIONS	NO. OF RESPONDENTS	%
High	61	20
Low	170	57
No idea	69	23
Total	300	100

INTERPRETATION

20% of the Respondents consider current corporate governance implication as high profile. 57% of the Respondents consider current corporate governance implication as low profile. 23% of the Respondents don't have any an idea about current implications

TABLE – 13: Agreeableness -CORPORATE GOVERNANCE MERITS

Stock Selection Rating	CGM						
	LCF	CM	EOF	GW	ESR	MSW	TL
Highly Considerable	15	13	19	12	18	27	104
Considerable	13	27	22	13	17	23	115

Neutral	13	5	5	6	8	8	45
Non Considerable	9	5	5	6	8	3	36
Total	50	50	51	37	51	61	300

**INTERPRETATION**

It's very loud and clear from the above tabular and chart presentation that only 12% of the total respondents do not agree with the corporate governance merits

LCF=LOW COST FUND RAISING, CM=CONTROL MECHANISM, EOF=ELIMINATION OF FRAUD, GW=GOOD WILL, ESR=ETHICAL & SOCIAL RESPONSIBILITY, MSW=MAXIMIZE STAKEHOLDER WEALTH, TL=TOTAL, CGM = CORPORATE GOVERNANCE MERITS

**TABLE – 14: CHI – SQUARE ANALYSIS FOR CORPORATE GOVERNANCE WITH THE PERFORMANCE OF STOCKS IN STOCK MARKET**

CGM \ Stock performance Rating							
	LCF	CM	EOF	GW	ESR	MSW	TL
Highly Considerable	15	13	19	12	18	27	104
Considerable	13	27	22	13	17	23	115
Neutral	13	5	5	6	8	8	45
Non Considerable	9	5	5	6	8	3	36
Total	50	50	51	37	51	61	300

**Null Hypothesis:**  $H_0$ : There is no association between corporate governance and stocks Performance in stock market

**Alternative Hypothesis:**  $H_1$ : There is significant association between corporate governance and stocks performance in stock market

**Calculated value=18.12083**

**At 95% level D.F. (15) = 7.261**

Since the calculated Chi – Square value is greater than that of theoretical value, we reject the null hypothesis. This implies that the stock performance is significantly depended on corporate governance. By imbibing corporate governance code into corporate soul they will be able to gain funds economically and expand the firm creating more wealth to shareholders and satisfy

stakeholders. It's a better control mechanism on all grounds, eliminating corporate frauds, increasing company's goodwill being ethically and socially responsible.

As per the coefficient of contingency [C]measure there is 24% association

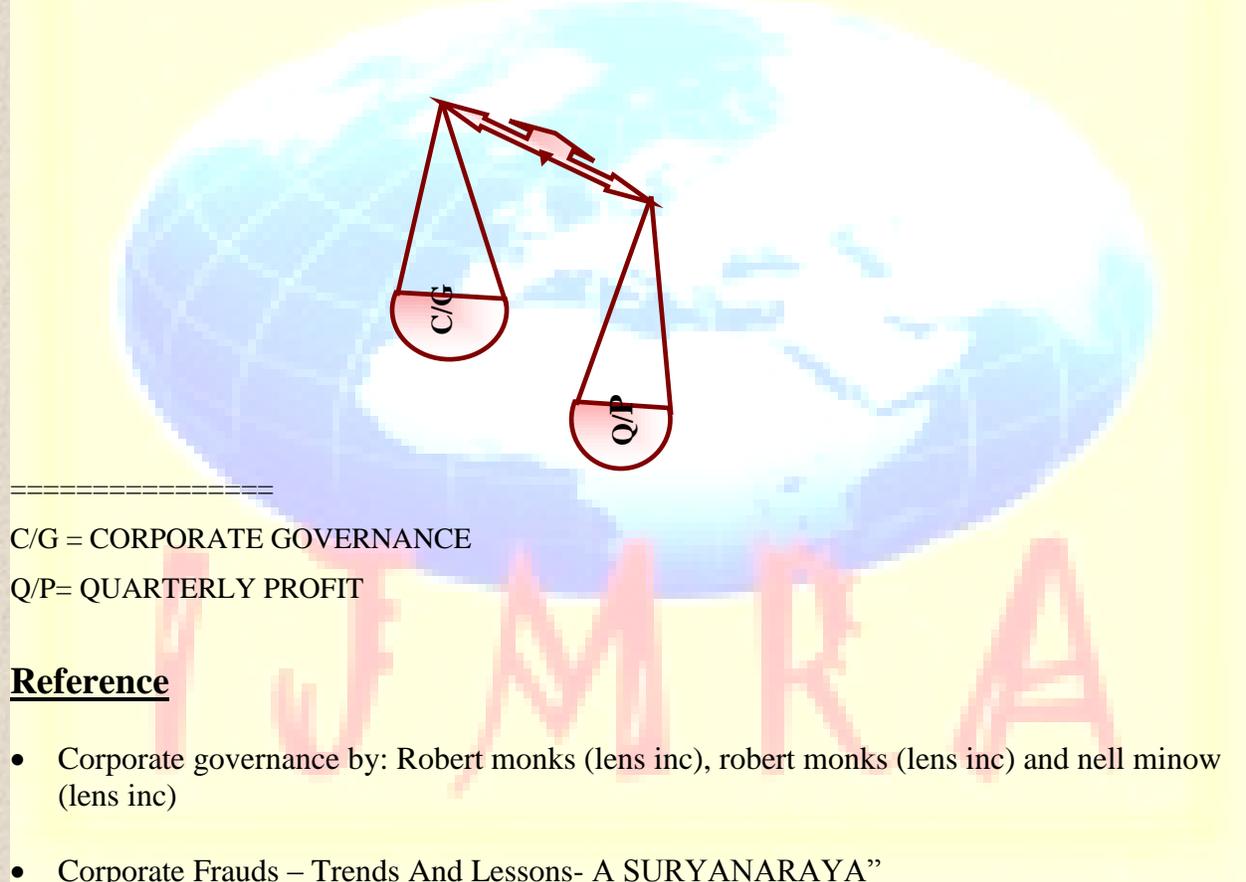
$$C = 0.24$$

### FINDINGS

- Current insisting call for corporate governance is due to complexities in market & eroding investors' wealth
- **Low Profile** of corporate governance is due to lack of Awareness and Compliance among public
- Companies' performance in the stock market has multi-factor effect.
- Mandatory aspect of corporate governance is that listed companies should adhere to Clause 49 in listing
- Issues related to BOD, top management, owners, stakeholders & society are addressed by corporate governance
- Imbibing corporate governance into corporate soul will build ethical society.
- Genuine & voluntary execution / adherence to corporate governance will eliminate occurrence of corporate fraud & scandals
- Companies' performance in the sock market is affected by Multi-Factors such as economic variable, sectoral performance, domestic conditions, economic performance of the company, presence of good reforms, international issues etc
- There is No Identical Corporate Governance Rating System in India different corporate are being rate by different institutions
- **Corporate Governance Rating** currently holds Comparatively Low Profile in stocks selection
- Corporate governance holds average profile in stocks performance in the stocks market
- Profit Generation one of the most vivid aspect of the corporate governance seizes high attraction & hike in stocks price
- Respondents Opine that corporate governance rating should be made mandatory & those violates should be penalized

- Chi square analysis states significant association exist between corporate governance and stocks performance in stock market
- Coefficient of contingency [C]measure the association between corporate governance and stock price as 24%
- Corporate which score poor / average on corporate governance are generating superior profit and their Shares Perform Exceptionally Well in Stock Markets.

**FIGURE 1.23 LOW PROFILE OF CORPORATE GOVERNANCE**



### **Reference**

- Corporate governance by: Robert monks (lens inc), robert monks (lens inc) and nell minow (lens inc)
- Corporate Frauds – Trends And Lessons- A SURYANARAYA”
- Financial services Gordon, M.com, M.phil. and Dr.K.Natarajan, M.com, M.Phil-himalaya publishing house
- The stock exchange - book written by maximilian weber Zahir ma[1992], “factors affecting equity prices in india”
- <http://cgft.sabanciuniv.edu/research/corporate-governance>