DOES GOOD GOVERNANCE PAY?- Evidence from around the Globe.

INTRODUCTION.

The separation of ownership of an organization from its management has attracted a lot of attention on the nature of relationship between managerial ownership and financial performance of the firm. As early as 1776 Adam Smith had argued that the separation of ownership and control in publicly held corporations created poor incentives for professional managers to operate the firm efficiently and the performance of the firm would suffer– the first articulation of the agency problem.

Corporate Governance deals with the agency problem and has been defined by Shleifer and Vishny [1] as "… how to assure financiers that they get a return on their investment". It has also been defined by the UK Committee on the Financial Aspects of Corporate Governance (the Cadbury Committee) as "the system by which companies are directed and controlled"[2] and consist of the set of processes, customs, policies, laws and institutions affecting the way in which a corporation is directed, administered or controlled and includes the relationships among the many players involved (the stakeholders) and the goals for which the corporation is governed.

One of the most comprehensive definitions of Corporate Governance has been provided by the Organization for economic Co-operation and Development -OECD[3], which has since become an international benchmark for policy makers, investors, corporations and other stakeholders worldwide. Recognizing that there is no single model of good corporate governance, OECD has identified the following elements that underlie good Corporate Governance and which should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities;

- The Rights of Shareholders and Key Ownership Functions
- The Equitable Treatment of Shareholders
- The Role of Stakeholders in Corporate Governance.
- Disclosure and Transparency
- The Responsibilities of the Board

Corporate Governance is a multi-faceted subject and an important theme of Corporate Governance deals with issues of accountability and fiduciary duty, essentially advocating the implementation of policies and mechanisms that ensure good behavior and protect the shareholders. A key focus of Corporate Governance

[1] Shleifer, Andrei and Vishny, Robert W., (1997); A Survey of Corporate Governance, The Journal of Finance, Volume 52, Number 2 (June 1997).
[2] Cadbury, Sir Adrian (2000); The Corporate Governance Agenda, Corporate Governance, Volume 8, Number 1, January 2000.
[3] Organization for Economic Co-Operation and Development -OECD, (2004); OECD Principles of Corporate Governance

is the view from the point of "economic efficiency", through which the Corporate Governance system should aim to optimize economic results, with a strong emphasis on shareholders benefit.

The search for determining what constitutes good governance and propagating the same, across organizations, has been prompted by the belief that that good governance would inevitably lead to better performance of the firm besides it being the normatively correct thing to do in the interest of the various stakeholders and has been motivated by the presumed existence of the following intuitive linkages;

- A framework of Good Corporate Governance would lead to protecting the interest of the owners (shareholders) and harmonize the interests of the owners and managers
- Good Governance invariably leads to better organizational performance and makes it easy for companies to access external funds and external investors,

This paper surveys previous research that has attempted to establish a relationship between good governance and better performance, identifies the challenges involved with such studies, examines if it is correct to infer causality based on previous research results and suggests the way ahead for future research in this field which should form the basis of the next generation of corporate governance reforms.

GOOD GOVERNANCE PAYS

Good Governance has been the focus of research by Investors, Fund Managers, Rating Agencies, Donor organizations (like the World Bank) all of whom have attempted to study the relationship between good governance and better performance and identify the desirable characteristics of (good) governance based on the belief that it positively impacts an organization's performance.

Such research falls in one of the following categories;

1. In the first category of research are surveys that link investors' perceptions on good governance with their intention to invest and the premium that they are willing to pay for good governance.
2. A second category of research has been carried out by Rating Agencies in different countries who have attempted to establish causality between good governance practices and better performance.
3. Another category of research has been sponsored by donor agencies like the World Bank who have attempted to study the impact of country specific characteristics on the generally accepted good governance norms.

The broad conclusion of the above three approaches have been near unanimous – Good Governance pays!

Based on investor perceptions, worldwide, investors seem to recognize good Corporate Governance and are likely to not only invest in well governed companies but also pay a premium for good governance. In an empirical study conducted by McKinsey consultants, Coombes and Watson[4] in 2000 major international

[4] Coombes, Paul and Watson, Mark, (2000); Three Surveys on Corporate Governance, The McKinsey Quarterly, 2000, No. 4.

fund managers were asked to estimate the premium they were willing to pay for high quality Corporate Governance.

The McKinsey consultants [5]conducted three separate surveys to discover how shareholders perceived and, more importantly, valued corporate governance in developed and emerging markets. Undertaken in cooperation with the World Bank, Professor Sangyong Park of Yonsei University, and Institutional Investor's regional institutes, the surveys gathered responses from more than 200 institutional investors, who altogether managed about $3.25 trillion in assets. The first survey, which examined attitudes toward investments in Asia, was conducted in September and October 1999 with Institutional Investor's Asia Pacific Institute covering 84 respondents, 82 percent of who had invested in Asia, and held an estimated $1.05 trillion plus in assets under management. The second survey, which looked at Europe and the United States, was conducted in October and November 1999 with Institutional Investor's US and European institutes covering 42 respondents, 95 percent of who have invested in the United States and Europe and held an estimated $550 billion plus in assets under management. The third survey, examining investors' attitudes toward Latin America, was conducted in March and April 2000 with the World Bank covered 90 respondents, 70 percent of who had invested in Latin America and held an estimated $1.65 trillion plus in assets under management.

The Mc Kinsey survey[6] defined a well-governed company as one that has a majority of outside directors with no management ties on its board, undertook formal evaluations of directors, was responsive to requests from investors for information on governance issues and where Directors held significant shareholdings in the company and a large part of their pay came in the form of stock options. Coombes and Watson[7] found that investors said that they while they would pay more for the shares of well-governed companies, the premium the investors would be willing to pay for well-governed companies differed by country. Investors said that they would pay 18 percent more for the shares of a well-governed UK or US company, for example, than for the shares of a company with similar financial performance but poorer governance practices. But they would be willing to pay a 22 percent premium for a well-governed Italian company and a 27 percent premium for a well governed company in Indonesia.

The McKinsey survey[8] suggested that the size of the premium the institutional investors said they are willing to pay for good board governance reflected the extent to which they believed that there is room for improvement in the quality of the financial reporting in a particular country and gave the example of limited and often poor financial reporting in Asia and Latin America, as a result of which investors all over the world believed that their investments in Asia and Latin America were better protected by well-governed companies that respected shareholders' rights. On the other hand, in Europe and the United States, where accounting standards were higher, corporate governance was less important. Lower premiums for well-governed UK and US companies suggested, for example, that the investment community feels that they

[5] Id.
[6] Id.
[7] Id.
[8] Id.

have already addressed many fundamental governance issues. Improvement in these areas can come only by fine-tuning current practices and by identifying innovative ways to raise governance standards further. The premiums in Continental Europe, suggested Coombes and Watson[9], pointed that besides improving corporate governance at the board level, there was a need for more effective disclosure to shareholders of information on governance practices and financial issues. Similarly, the still higher premiums in Asia and Latin America reflected the need for more fundamental disclosure of information and for stronger shareholder rights.

Drawing upon the survey finding that most of the investors said that they already take corporate governance into account when making investment decisions, the Mc Kinsey consultants[10] made a powerful argument for corporate-governance reforms and based on their survey findings advised[11] companies and policy makers that if companies were able to capture a small part of the governance premium that is apparently available, they would create much greater shareholder value. On other hand, companies that failed to reform their governance would find themselves at a competitive disadvantage when they tried to obtain capital to finance growth. High governance standards would prove to be essential to attracting and retaining investors in globalized capital markets and failure to reform would probably hinder companies with global ambitions.

Coombes and Watson[12] also made an important observation that that good corporate governance is rarely simple and required an appropriate combination of an effective board of directors, the right people, the right structure, and the right processes. Furthermore, since policy changes are likely to affect different countries differently, depending on their existing cultural and economic practices, each company and country should consider its own circumstances before choosing the best way to improve corporate governance.

McKinsey followed up on their 2000 global investor survey with another global investor opinion survey that was undertaken between April and May 2002[13], in cooperation with the Global Corporate Governance Forum which reaffirmed their findings from their 2000 survey. As per this survey[14] investors stated that they still put corporate governance on a par with financial indicators when evaluating investment decisions and an overwhelming majority of investors were prepared to pay a premium for companies exhibiting high governance standards which averaged 12-14% in North America and Western Europe; 20-25% in Asia and Latin America; and over 30% in Eastern Europe and Africa.

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9 Id.
10 Id.
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12 Id.
13 McKinsey's Global Investor Opinion Survey was undertaken between April and May 2002, in cooperation with the Global Corporate Governance Forum. The survey was based on responses from over 200 institutional investors; collectively responsible for some USD 2 trillion of assets under management (their organizations manage an estimated USD 9 trillion AuM) - downloaded from http://ww1.mckinsey.com/clientservice/organizationleadership/service/corpgovernance/PDF/GlobalInvestorOpinionSurvey2002.pdf..
14 Id.

The 2002 survey[15] finding that the relative significance of governance appeared to have decreased slightly since 2000, was explained on account of (i) finding that many countries have implemented governance-related reforms that have been welcomed by investors, and (ii) more than 60% of investors stated that governance considerations might lead them to avoid individual companies with poor governance with a third avoiding countries on this account.

Another set of research to examine the relationship between governance and performance has been carried out by bankers, investment advisors and rating agencies. One such landmark report[16] was the one submitted by Deutsche Bank A.G., in 2004, who were invited by the Asset Management Working Group (AMWG) of the United Nations Environment Program Finance Initiative (UNEP FI) to summarize their research on corporate governance.

In conducting this study Deutsche Bank developed a measure to assess a company's corporate governance framework based on four criteria; board independence, shareholder treatment, information disclosure and corporate compensation assessment and through a momentum analysis identified a company as having positive momentum in case the company's current score on governance was more than its previous score and identified companies as having negative momentum in case the current score was less than its previous score.

Based on their analysis of corporate governance in the US, the UK and some other markets they found that standards vary widely among companies of the same country and not only had none of the analyzed companies, including those in the US and UK markets had perfect governance but some companies were far from perfect. However, they found that companies were changing their corporate governance standards and the aggregate momentum was positive suggesting that overall standards of governance were improving;

Thereafter the researchers at Deutsche Bank A.G. crated two portfolios each of S&P 500 and FTSE 350 companies comprising of;

a. Companies with above average corporate governance assessment and positive momentum.
b. Companies with below average corporate governance assessment and negative momentum.

After analyzing the data on share price performance of S&P 500 companies over a two year period (up to June 30, 2003) the researchers at Deutsche Bank A.G. found that companies with above average assessment & positive momentum outperformed those with below average assessment & negative momentum by 18.9%. A similar analysis done by them for the FTSE 350 companies in the UK, over a three year period(up to December 2003) found identical results for the UK companies with companies in the above average assessment and positive momentum group outperforming the companies in the below average assessment and negatives momentum group by as much as 25%.

[15] Id.
[16]Beyond the Numbers-Corporate Governance: Implication for Investors; Deutsche Bank –downloaded from http://www.unepfi.org/fileadmin/documents/materiality1/cg_deutsche_bank_2004.pdf

The Deutsche Bank A.G. research in the US and the UK indicated that there was also a link between corporate governance and share price volatility and company profitability. However, when analyzing the connection between governance and current market valuations, the study did not find a clear relationship, for the S&P 500 or FTSE 350 companies, between corporate governance and valuations, even though a few individual sectors did show some positive relationships and suggested that there could be a time and information gap, causing most investors to react to bad corporate governance news rather than anticipate potential problems.

The study concluded that as investors improved their ability to measure and integrate corporate governance risk into their investment decision making process in a more systematic way, corporate governance standards will increasingly play an important role in a company's valuations.

Based on a survey of 35 leading institutional investors and large brokerage houses in India during the period October-December 2003, ICRA published a Corporate Governance Survey[17] in February 2004. Over 90% of the respondents considered Corporate Governance "very important" in the Indian scenario. A similarly overwhelming majority felt that, contrary to the view sometimes echoed in the corporate sector, the current emphasis on Corporate Governance is desirable and will play a major role in making the capital markets a safer place for investors. Also while close to 85% of the respondents felt Corporate Governance is as important as other quantifiable factors, such as likely growth in earnings, from the point of view of investment decisions. However, a significant 40% also admitted to having invested in companies with questionable Corporate Governance practices in the past, if the 'story' was really appealing.

Broadly mirroring the findings of the global survey by McKinsey, the survey also confirmed that investors were ready to pay a premium for good governance. However, while as many as over 95% of the respondents stated that they would be willing to pay a premium for companies with good corporate governance practices, nearly 60% of the respondents were not in a position to quantify the premium. Lastly many investors believed that there is a linkage between good corporate governance and good long-run corporate performance and close to 40% of the respondents felt that the linkage is strong while nearly 50% felt the linkage is moderate. Only a very small percentage of the respondents felt that there was no linkage between good governance and corporate performance.

CRISIL Ratings conducted a study[18], on a sample of 40 companies, in the Indian context on the effect of governance levels on market valuations based on data available over three fiscal years (2000-01 to 2002-03).This study examined the co-relation between governance premiums, which a company enjoyed, with the governance practices of the firm. The governance practices were measured conventionally (through the use of CLSA Ratings, developed by Credit Lyonnais Securities Asia) as well as by an improved metric that was

[17] ICRA CORPORATE GOVERNANCE SURVEY, February 2004 –downloaded from http://www.icra.in/Files/Articles/CGR%20Survey%20Note.pdf

[18] Mani, G.V. and Sreedhran, Revathy,(2004); Better Corporate Governance Pays , Insight, CRISIL Ratings, Vol II- No. 9, June 2004.

developed by CRISIL - CRISIL GVC ratings – which was an opinion on the capability of firms to create wealth for all their stakeholders (rather than just shareholders) while adopting sound corporate governance practices.

According to CRISIL's analysis,

- Indian companies with higher governance scores consistently enjoyed a superior governance premium over the 3-year period of the study.
- The co-efficient of correlation(r) between governance scores and governance premium averaged about 0.47 over this period and is statistically significant at a confidence level of 99 per cent.
- The level of correlation observed, in India, between governance score and governance premium is much higher than the correlation of 0.07 obtained in a similar study undertaken by Standard & Poor's in about 1500 corporates across US, UK, Europe, Asia Pacific and Latin America.
- Improvements in governance practices of firms resulted in disproportionate increase in the governance premiums of the firms.
- Investors recognized that stakeholder relationships provide more benefits than just shareholder relationships and result in better governance premiums.

The relationship between corporate governance and firm performance has also been of significant interest to funding and donor agencies like the World Bank, ADB, IFC etc who have sponsored considerable research in this area. Such studies have extended the study of the differences in the legal frameworks at the country level, pioneered by La Porta[19] et al in their study ownership structures of large corporations in 27 wealthy economies, to studying the difference at the level of the firm on account of differences in their governance framework.

In one such study reported in 2002, Klapper and Love[20] carried out a study of firm-level corporate governance practices across emerging markets for a better understanding of the environments under which corporate governance matters more. Their empirical tests showed that better corporate governance is highly correlated with better operating performance. More importantly, the authors provided evidence showing that firm-level corporate governance matters more in countries with weak legal environments. Their results suggested that firms can partially compensate for ineffective laws and enforcement by establishing good corporate governance and providing credible investor protection. The authors' tests also showed that firm-level governance and performance is lower in countries with weak legal environments, suggesting that improving the legal system should remain a priority for policymakers.

In another 2004 research sponsored by Asian Development Bank [21], Sang –Woo Nam and Il Chong Nam after surveying 307 sample firms from Indonesia, Korea, and Thailand came to the following conclusions;

[19] La Porta, Rafael, Lopez-de-Silanes, Florencio and Shleifer, Andrei (1988); Corporate Ownership Around the World-downloaded from http://www.nber.org/papers/w6625.pdf.
[20] Klapper, Leora F. and Love, Inessa, (2002); Corporate Governance, Investor Protection and Protection in Emerging Markets, Policy Research Working Paper, Development Research Group, The World Bank, April 2002.
[21] CORPORATE GOVERNANCE IN ASIA, Recent Evidence from Indonesia, Republic of Korea, Malaysia, and Thailand –downloaded from http://www.adbi.org/files/2005.01.book.corporate.governance.asia.pdf

- Gains from better corporate governance in terms of market valuation are substantial. Improving the scores for board effectiveness or overall corporate governance practices from the median to the highest 25% is associated with a 13-15% increase in firms' market value.
- The market seems to discount the quality of corporate governance by about 30% in the case of firms controlled by a single, domestic owner, probably because it suspects expropriation of minority shareholders.
- Corporate governance matters more in countries where the legal and judicial systems to protect investors are weak.
- Finally, among the various components of corporate governance practices, the most significant seems to be information access and other support for (and evaluation of) directors. However, the components of corporate governance practices that a market focuses on appear to differ from one country to another.

Summarizing the research finds in this category, it is clear that there exists a significant body of research, carried out by rating agencies, consultants surveying investor perceptions or sponsored by donor agencies studying the impact of governance, that has shown that not only investors have expressed a preference for investing in companies with good governance practices and even pay a premium for the same, but also, as shown in some of these studies, there exists a positive link between good governance and an organization's performance.

In addition to the this category of research, there is also a considerable body of academic research, based on empirical evidence, that has been carried out to study the relationship between corporate governance and organization performance and the same is reviewed in the next section of this paper.

GOMPERS, ISHII and METRICK (GIM) STUDY.

The first empirical evidence to examine the link between good governance and good performance was the landmark 2003 study entitled 'Corporate Governance and Equity Prices[22],' in which authors Paul Gompers, Joy Ishii, and Andrew Metrick (GIM Study) studied the corporate governance practices of some 1,500 US-based companies in order to determine a correlation between shareholder rights and corporate stock performance during the 1990s.

The authors asked the empirical question[23] "Is there a relationship between shareholder rights and corporate performance?" They noted that starting in the 1980s, hostile takeover attempts led many companies to curtail shareholder rights by such means as staggering the terms of directors, providing severance packages for managers and limiting the ability of shareholders to meet and act. The authors also argued that the event-study methodology adopted by many researchers of the wealth impact of takeover defenses failed to take into account the possibility of contemporaneous conditions at companies, and instead proposed a long-horizon approach for their study.

[22] Gompers, Paul A., Ishii, Joy L. and Metrick, Andrew, (2003); Corporate Governance & Equity Prices (2003); Quarterly Journal of Economics 118(1), February 2003.
[23] Id.

Using data from the Investor Responsibility Research Centre (IRRC) the authors developed a Governance Index (G Index) under which 24 provisions that restricted shareholder rights were tallied for the various organizations[24]. With the exceptions of secret ballots and cumulative voting, each of which would increase the power of shareholders, every other provision included in the Governance Index served to restrict shareholder rights. Based on the Governance Index the authors divided the companies in their study into 'Democratic Portfolios' and 'Dictatorship Portfolios' and found that 'democracies' in the 1990s earned significantly higher returns, were valued more highly and had better operating performance. For responsible investors, who may have shareholder rights as a pillar of their investment strategy, the study offered evidence that integration of such factors led to a portfolio, constructed on that basis, outperforming over the long term.

The GIM Study[25] applied the 24 provisions of the index to the more than 93 per cent of the total capitalization of the combined New York Stock Exchange (NYSE), American Stock Exchange (AMEX), and NASDAQ markets tracked by IRRC to compile lists of the top Democratic and Dictatorial companies. However, according to the authors, "There is no obvious industry concentration among these top firms" and while in 1990, the largest representation among the Democratic companies was the computer industry, with 22.4 per cent; by 1998, that representation had fallen to 12.3 per cent. In a similar vein, the communications industry was not ranked among the top five of dictatorships in 1990.By 1998, however, it was in first place, with 25.3 per cent of the portfolio. In addition, companies identified as dictatorships in the study were more likely to be among the larger S&P 500 companies. Half of the Dictatorship Portfolio was drawn from S&P 500 firms, compared with 15 per cent of the Democracy Portfolio, according to the authors.

The authors found[26] that "an investment of US$ 1 in the (value-weighted) Dictatorship Portfolio on 1 September 1990, when our data began, would have grown to US$ 3.39 by 31 December 1999. In contrast, a US$ 1 investment in the Democracy Portfolio would have grown to US$ 7.07 over the same period. This is equivalent to annualized returns of 14.0 per cent for the Dictatorship Portfolio and 23.3 per cent for the Democracy Portfolio, a difference of more than 9 per cent per year".

The authors tested three primary hypotheses to account for the outperformance of companies in the Democracy Portfolio. The first hypothesis[27] suggests that, "a reduction in shareholder rights causes an unexpectedly large increase in agency costs through some combination of inefficient investment, reduced operational efficiency, or self-dealing". The study found evidence that companies whose corporate governance practices restrict shareholder rights are more likely to engage in such inefficient investments as the adoption of takeover defenses or acquisition activities, both of which could lead to a net negative for firm value.

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[24] Id.
[25] Id.
[26] Id.
[27] Id.

The second hypothesis[28] tested by the authors, that governance provisions were established by managers who forecasted poor performance for their firms in the 1990s, looked for significant relationships between governance and insider-trading by examining data collected from mandatory SEC insider-trading filings. A robust relationship could not be distinguished, so the authors conclude that no support for the second hypothesis could be discerned by data on insider-trading.

The third hypothesis[29] suggested that, "Governance provisions do not cause higher agency costs, but their presence is correlated with other characteristics that earned abnormal returns in the 1990s". As an example of an omitted variable that could contribute to the results of their analysis, the authors offered the concept of corporate culture, by which "management behavior would be constrained by cultural norms within the firm". In such a case, corporate governance would be a symptom, not a cause, and the results of the study could be explained by investors mispricing corporate culture. However, the authors concluded that omitted variables could have contributed only a fraction of benchmark abnormal returns.

The authors concluded their study[30] with the finding "that corporate governance is strongly correlated with stock returns during the 1990s", and an investment strategy of purchasing shares in companies with strong shareholder rights earned abnormal returns of 8.5 per cent per year. Given that shareholder rights are a pillar of the environmental, social and governance (ESG) factors that are a key consideration in the investment strategies of responsible investors, the study provided first empirical support for the assertion that such strategies lead to portfolio outperformance over the long term.

EXTENSIONS OF THE GIM STUDY AND SOME ALTERNATIVE POINTS OF VIEW.

There have been many extensions of the GIM Study of which two are quite notable.

The first study,[31] undertaken by Lucian Bebchuk, Alma Cohen, and Allen Ferrel, of Harvard University (BCF Study), investigated the relative importance of the 24 provisions included in the G Index[32] and postulated that there was no a priori reason to expect that all the 24 provisions contributed to the documented correlation between the G Index and Tobin's Q, as well as stock returns in the 1990s. According to them some provisions might have little relevance and some provisions might be positively correlated with firm value; while among those provisions that are negatively correlated with firm value or stock returns, some might be more so than others.

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[28] Id.
[29] Id.
[30] Id.
[31] Lucian Bebchuk, Alma Cohen, and Allen Ferrel ; What Matters in Corporate Governance? –downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1331874
[32] G Index is a summary measure of corporate governance based on 24 governance factors provided by Investor Responsibility Research Center and developed by Gompers, Ishii and Metrick (GIM Study).refer supra. Note 23.

Bebchuk et al hypothesized[33] that only six provisions among the 24 provisions played a significant role in driving the correlation between G Index and firm valuation; these six provisions were identified based on their interviews with leading M& A practitioners and their own analysis of the various provisions (among the IRRC provisions) that have systematically drawn substantial opposition from institutional investors voting on shareholder resolutions. Of the six provisions, four set constitutional limits on shareholder voting power, which is the primary power that shareholders have. These four arrangements—staggered boards, limits to shareholder amendments of the bylaws, supermajority requirements for mergers, and supermajority requirements for charter amendments—limited the extent to which a majority of shareholders can impose their will on management. Two other provisions are the most well-known and salient measures taken in preparation for a hostile offer: poison pills and golden parachute and put forward an entrenchment index based on these.

Using these six parameters Bebchuk et al constructed an Entrenchment Index (E Index) and studied the relationship between the E Index and the firm value and stock returns. Their detailed study was conducted over a fairly long period (1990-2002) and across companies for which there was information in one of the volumes published by the Investor Responsibility Research Center (IRRC). Given that in any given year of publication, the firms in the IRRC volume accounted for more than 90% of the total U.S. stock market capitalization; their study was quite comprehensive in its coverage.

Bebchuk et al found[34] that increases in the E Index level were monotonically associated with economically significant reductions in firm valuation as well as large negative abnormal returns during the 1990-2003 periods. The other eighteen provisions used in the GIM Study (which were not included in the E Index constructed in the BCM Study) were uncorrelated with either reduced firm valuation or negative abnormal returns.

To the extent that the eighteen provisions in the GIM index that are not in the E index represent "noise," Bebchuk et all suggested[35] that the Entrenchment Index developed by them, based on only six parameters, could be useful in providing a measure of corporate governance quality that is not affected by the "noise" created by the inclusion of extra eighteen parameters used in the creation of the G Index in the GIM study. Cautioning against the tendency of shareholder advisory firms putting forward indexes of good corporate governance based on a large number of provisions, and the pressure on firms to adjust their arrangements in ways that would improve their index scores, Bebchuk et al advised[36] against the "kitchen sink" approach of building ever-larger indexes of governance measures since, in any large set of governance provisions, many provisions are not likely to matter or are likely to be an endogenous product of others. In their view, as compared with a governance rating scheme based on including only the key provisions that matter, a governance rating system based on a much larger set can push firms in directions that are likely to be counter-productive or at the least wasteful, and suggested that such indices would provide a noisier

[33] Supra.Note 31.
[34] Id.
[35] Id.
[36] Id.

measure of governance quality. Stating that," in this area, less can be more", Bebchuk et al advised[37] shareholders and their advisers to focus only on those corporate governance provisions that really matter for firm value.

A very different approach was taken by Lawrence D. Brown, and Marcus L. Caylor[38], who, finding the approach of Gompers et al and Bebchuk et al very limiting, created a broader measure of corporate governance, called Gov-Score, based on 51 factors encompassing eight corporate governance categories: audit, board of directors, charter/bylaws, director education, executive and director compensation, ownership, progressive practices, and state of incorporation. This was based on a new dataset provided by Institutional Shareholder Services (ISS).

Using firm specific data for 2002, Brown and Caylor related Gov Score to operating performance, valuation, and shareholder payout for 2,327 US firms, and found that better-governed firms are relatively more profitable, more valuable, and paid out more cash to their shareholders. On examining which of the eight categories underlying Gov Score are most highly associated with firm performance, they found that good governance, as measured using executive and director compensation, is most highly associated with good performance and, in contrast, they found that that good governance as measured using charter/bylaws is most highly associated with *bad* performance.

Interestingly, Brown and Caylor found that the Gov-Score developed by them was better linked to firm performance than G Index[39]. They attributed this to the fact that the factors constituting the G Index are concentrated mostly in only one ISS category viz. charter/bylaws and since most of the factors in this category represented antitakeover measures, in their view the G-Index was effectively an index of anti-takeover protection rather than a broad index of governance. On the other hand, since Brown and Caylor used all the eight ISS categories to create Gov-Score they claimed to have a broader and more comprehensive measure of governance.

A comprehensive review of the significant relation between market-to-book ratios of the firm and indices purporting to measure the quality of a firm's governance structure that was documented in the GIM study and the BCF study was carried out by Kenneth Lehn, Sukesh Patro and Mengxin Zhao[40].

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[37] Id.

[38] Lawrence D. Brown and Marcus L. Caylor; Corporate Governance and Firm Performance (December 2004) – downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=586423&http://www.google.co.in/url?sa=t&rct=j&q=corporate%20governance%20and%20firm%20performance&source=web&cd=1&sqi=2&ved=0CDYQFjAA&url=http%3A%2F%2Fpapers.ssrn.com%2Fsol3%2FDelivery.cfm%3Fabstractid%3D586423&ei=hSL0TqvmH4qqrAf0rY0C&usg=AFQjCNGXxB

[39] Supra.Note 33.

[40] Kenneth Lehn, Sukesh Patro, and Mengxin Zha; Governance Indexes and Valuation: Which causes Which?(April 2007) –downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=810944&http://www.google.co.in/url?sa=t&rct=j&q=governance%20indexes%20and%20valuation%3A%20which%20causes%20which%3F*&source=web&cd=1&ved=0CCEQFjAA&url=http%3A%2F%2Fpapers.ssrn.com%2Fsol3%2FDelivery.cfm%3Fab

While the results in the GIM study and the BCF study showed that a correlation existed between governance indices and valuation multiples, according to Lehn et al.[41] these studies do not establish whether causation runs from governance to valuation or vice versa. One explanation consistent with the results is that governance provisions, which supposedly entrench managers (e.g., poison pills, staggered boards), adversely affected firm value. However, an alternative explanation that causation ran in the opposite direction from valuation to governance could also be plausible for at least two reasons[42]. First, firms with low valuation multiples may be poorly managed, which makes the probability of an unsolicited bid higher than it is in the case of better performing firms. In response to this higher likelihood of a takeover bid, managers are likely to adopt provisions that comprise the governance indices, such as poison pills. Second, firms with high valuation multiples are likely to be high growth firms and insofar that high growth firms are less likely to become targets of unsolicited bids, these firms are less likely to adopt anti-takeover provisions. This also would result in an inverse relation between valuation multiples and the governance indices.

In their paper Lehn et al.[43] developed a test that attempted to distinguish between the two possible explanations for the observed relation between governance indices and firm value. The test was prompted by the observation that governance provisions, comprising the GIM and BCF indices, were either nonexistent or rarely used before 1986 and this provided an opportunity to test whether causation ran from the governance indices to valuation or vice versa. Using a large sample of firms covered by the IRRC, Lehn et al found a significant relation between market-to-book ratios during 1980-85 and the GIM and BCF indices during the 1990s. Further, after controlling for market-to-book ratios during 1980-1985, no significant relation was found between contemporaneous market-to-book ratios and governance indices during the 1990s. These results are consistent with the hypothesis that valuation multiples affect governance indices, not vice versa. They also examined the relation between the governance indices and the lagged and subsequent values of market-to-book ratios and found that the GIM and BCF indices were inversely related to lagged market-to book ratios but not to subsequent market-to-book ratios. These results were also consistent with the hypothesis that causation runs from valuation to governance. However, as pointed by the Lehn et al[44] their test cannot rule out the possibility that a third variable could affect both valuation multiples and governance indices, thereby creating a spurious relation between the two variables.

Another important empirical study was carried out by David Larcker, Scott Richardson, and Irem Tuna,[45] that examined the relation between a broad set of corporate governance factors and various measures of managerial behavior and organizational performance. Based on a sample of 2,126 US firms and using principal components analysis, Larcker et al distilled 13 governance factors from 38 structural measures of corporate governance (e.g., board characteristics, stock ownership, anti-takeover variables etc.).Thereafter in their empirical study they found that for a wide set of dependent variables (e.g., abnormal accruals,

[41] Id.
[42] Id.
[43] Id.
[44] Id.
[45] David Larcker, Scott Richardson, and Irem Tuna; How Important is Corporate Governance? (May 2005) – downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=595821

excessive CEO compensation, debt ratings, analyst recommendations, Tobin's Q and over-investment) the 13 governance factors, on average, explained only 1% to 5.5% of the cross-sectional variation using standard OLS multiple regression techniques and 1.4% to 9.1% of the variation using exploratory recursive partitioning techniques.

The results of Larcker et al suggested[46] that the typical structural indicators of corporate governance used in academic research and institutional rating services have very limited ability to explain managerial behavior and organizational performance.

However, a very different conclusion was arrived at by Carol Padgett & Amama Shabbir[47] who investigated the relation between a detailed index of non-compliance with the UK corporate governance code (based on an index of what authors considered to be the "spirit" of compliance rather than "formal" compliance as used in other studies) and firm performance for a panel of FTSE 350 companies from 2000 to 2003 and found an inverse relation between the Index and total shareholder returns (TSR) which implied that the more compliant firms enjoy higher TSR in our sample. They also found the Index to be exogenous, implying that causality ran from the Index to performance.

The results from the empirical evidence in studies carried out in the US and Europe have been mixed.

EMPIRICAL STUDIES IN INDIA AND EMERGING MARKETS

The most comprehensive empirical study on establishing the link between corporate governance and corporate performance was carried out by N. Balasubramanian, Bernard Black, and Vikramaditya Khanna[48] who studied the effect of corporate governance on the market value of firms in India. Their study was based on a 2006 survey conducted across 506 Indian public firms and included a mix of large and medium firms in the Bombay Stock Exchange indices and outside of it.

To quantify corporate governance, Balasubramanian et al constructed an "Indian Corporate Governance Index" (ICGI), comprising 49 attributes normally identified with good governance[49]. These attributes were grouped into five categories to provide sub-indices for;

- Board Structure (with sub-indices for board independence and board committees).
- Disclosure (with sub-indices for disclosure substance and for auditor independence).
- Related Party Transactions (with sub-indices for volume of RPTs and approval procedures).
- Shareholder Rights.
- Board Procedure (with sub-indices for overall procedure and for audit committee procedure).

46 Id.
47 Carol Padgett & Amama Shabbi; The UK Code of Corporate Governance: Link between Compliance and Firm Performance ;(2005) downloaded from www.som.cranfield.ac.uk/som/research/researchpapers.asp.
48 Balasubramanian, N., Black, Bernard S., and Khanna, Vikramaidtya,; Firm Level Corporate Governance in Emerging Markets – A case study of India –(March 2008) –downloaded from htpp://ssrn.com/abstract=995650.
49 Id.

Using data from the survey that measured the market value of the firm (based on the firm's Tobin Q value) and its IGCI index, the market value of the firm was regressed against its ICGI and different control variables. Overall, the study found a positive and statistically significant association between their India Corporate Governance Index (IGCI) and corporate performance[50]. This was consistent with findings in prior country-specific and cross-country studies. This association was found to be more significant for more profitable companies and those with greater growth opportunities. While a sub index for shareholder rights was found to be individually marginally significant, sub indices for board structure, disclosure, board procedure, and related party transactions were found to be not significant. According to Balasubramanian et al while the non-significant results for board structure was in contrast to recent studies elsewhere, the results seemed to suggest that India's legal requirements were sufficiently strict so that over compliance did not produce valuation gains.

Furthermore, while shareholder rights were found to have a significant association with firm value, the relationship between the sub-indices for board structure, disclosure, board procedure, and related party transactions and firm value were found to be not statistically significant.

Another major empirical study in India was carried out by Mohanty, Pitbas[51] who, using nineteen measures of corporate governance developed a corporate governance index that he regressed on financial performance measures for a firm like Tobin's Q and industry-adjusted excess stock returns. Based on analysis of data across 113 companies Mohanty found that the corporate governance index was positively associated with these two performance measures

Using only balance sheet information from 4 selected sectors of the Indian industry, Mukherjee & Ghosh [52] analyzed the efficacy of Corporate Governance. Their findings, by and large, painted a disappointing picture with the overall conclusion that Corporate Governance was still in a very nascent stage in the Indian industry. The authors found that decision and policy making was still taken mostly as a routine matter and among the institutional investors also it seemed that the foreign institutional investors are the most consistent in stock picking whereas the performance of the domestic institutional investors was sporadic and volatile, at best. They also found serious shortcoming on the part of the capital market in not being able to enforce better governance on the part of the directors or performance on the part of the managers.

A study carried out by Durga Prasad Samontaray,[53] examined the impact of Corporate Governance on the Stock Prices of the Nifty 50 Broad Index Listed Companies in India by collecting data for the financial year 2007-08 relating to variables like share price, ROCE, EPS, D/E Ratio, P/E Ratio and a Corporate Governance

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[50] Id.
[51] Pitbas Mohanty;Institutional Investors and Corporate Governance in India –downloaded from http://www.nseindia.com/content/research/Paper42.pdf
[52] Mukherjee, Dignata and Ghosh, Tejomay, (2004); An Analysis of Corporate Performance & Governance in India :Study of some Selected Industries, Discussion Paper 04-19, Indian Statistical Institute, New Delhi.
[53] Durga Prasad Samontaray; Impact of Corporate Governance on the Stock Prices of the Nifty 50 Broad Index Listed Companies (2010) –downloaded from http://www.eurojournals.com/IRJFE_41_01.pdf.

Score based upon parameters identified in the Narayana Murthy Committee report on Corporate Governance[54]. A cross-sectional regression analysis of the data demonstrated significant relationship between share price (dependent variable) and corporate governance as well as other independent variables like EPS, Sales and Net Fixed Assets.

A 2009 study carried out by Standard & Poor's[55] examined CG practices and their impact on the firm level performance of Indian companies using the CG score obtained from the S&P ESG India Index as a proxy for firm level governance quality. The results showed a positive and significant relationship between CG score and the firm level performance after controlling for a number of firm specific and time-specific factors and better governed firms not only command a higher market valuation, but they are less leveraged and had higher interest coverage ratios. Furthermore, they provide a higher return on net worth and capital employed, and additionally, their profit margins were relatively more stable. Finally, their Price- Earnings Ratio (P/E) and yield, the return earned by the shareholders by way of dividend, was also higher in comparison to the firms whose CG score is lower.

Empirical studies in other Emerging Markets have also found different "good" governance measures to be positively correlated with firm performance, while assuming governance measures to be exogenous. Such results have been reported from studies carried out in Hongkong[56], Pakistan[57], Taiwan[58], Thailand[59] and Brazil[60]. Based on such results it could be argued that changing a firm's governance characteristics, according to what has been suggested as "better" governance, will cause the firm's performance to improve.

However, when Chidambaran, Palia, and Zheng[61] examined this causality argument by looking at changes in corporate governance and subsequent changes in firm performance, they found no significant performance differences between the firms with "good" changes in governance and the firms with "bad" changes in

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[54] The parameters included financial reporting, risk management, future strategy, recent changes, corporate social responsibility, awards and recognitions.

[55] Corporate Governance and Market Value: *Preliminary Evidence from Indian Companies*; (September 2009) – downloaded from https://docs.google.com/viewer?a=v&q=cache:Oz02qJHCOQ4J:www2.standardandpoors.com/spf/pdf/index/CG_and_Market_Value.pdf+Corporate+Governance+and+Market+Value:+Preliminary+Evidence+from+Indian+Companies&hl=en&gl=in&pid=bl&srcid=ADGEESiGqzp3Tr0k_VMgYM52dVDcH0q6JL1VmHTjL.

[56] Adrian C.H. Lei and Frank M. Song; Corporate Governance and Firm Valuations: Evidence from Hong Kong (December 2004) –downloaded from http://www.ccfr.org.cn/cicf2005/paper/20050131120518.PDF.

[57] Attiya Y. Javid & Robina Iqbal; Does Corporate Governance affect a Firm's Performance? A case study of Pakistan (2008) –downloaded from. http://nbs.nust.edu.pk/Centofexcel/Business%20and%20Economics/Archieves/2008vol1no1/Ch%202.pdf.

[58] Ming-Cheng Wu, Hsin-Chiang Lin, I-Cheng Lin and Chun-Feng Lai;The Effects of Corporate Governance on Firm Performance-downloaded from http://120.107.180.177/1832/9901/099-2-06p.pdf.

[59] Roy Kouwenberg; Better Governance = Better Performance? –downloaded from http://www.set.or.th/en/regulations/cg/files/CG_Excec_Sum_v3_DrRoy.pdf.

[60] Ricardo P. C. Leal and André L. Carvalhal-da-Silva; Corporate Governance and Value in Brazil (and in Chile);(May 2005) – downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=726261.

[61] N. K. Chidambaran, Darius Palia and Yudan Zheng; Does "Better" Corporate Governance Cause Better Firm Performance?(February 2006) – downloaded from http://w4.stern.nyu.edu/emplibrary/ACFzOSME3.pdf

governance. In addition, more than half of the firms with "good" changes in governance had negative subsequent industry-adjusted performance. Their results represent strong evidence against the argument that "better" governance, as defined in the literature, can cause performance to improve and also suggest that firms choose their governance endogenously and are in equilibrium.

THREE KEY ISSUES IN GOVERNANCE RESEARCH

Despite the intuitive appeal of the proposition that 'Good Governance (of the Firm) would lead to Good Performance (by the Firm)' conclusive evidence linking good governance to good performance has been lacking and the results obtained from empirical research, to date, have been mixed. Yet, country after country has gone in for governance reforms including introducing 'model' codes for good governance in the belief that good governance would lead to good performance.

Given the mixed results from the various empirical studies, an obvious question that arises is how sound is the basis of the worldwide movement towards good governance and whether it is based on a thorough and proper understanding of the underlying factors that impact governance and a complete understanding of how governance affects performance? More importantly the question that begs an answer is whether, the changes being made to existing laws/new legislation being introduced in various countries ostensibly to promote good governance, based on a proper understanding of the interplay between the various factors or are the changes only reflective of the subjective views of a powerful minority who are pushing for governance reforms. In case the changes are not based on ground realities-the results from governance changes are likely to fall short of the expectations from the policy changes.

To be able to better understand the issues that underlie the above questions, it is worthwhile to understand the three significant challenges that are faced by researchers in governance research as that would help to better understand the limitations of previous research and also give a better handle on the interpretation of the results that have been obtained through previous research. These are;

- The challenge of defining and measuring governance in a manner that it captures its essence.
- The challenge in establishing a universal standard of good governance. Is it indeed possible to have such a standard; can a policy of 'one size fits all' be applied to corporate governance research?
- The challenge of establishing causality from empirical data; have researchers who have inferred causality between corporate governance and corporate performance drawn conclusions which are beyond the empirical evidence and, conversely, how do we evolve a more comprehensive model to understand the corporate governance process and its interplay with corporate performance.

Many traditional studies on establishing what 'good' Governance are based on assessing compliances with the Corporate Governance Code and equate a high compliance with the Code as 'good' Governance. However, the fact that measuring governance at times requires the use of soft data and there cannot always be an objective measure of 'good' Governance points out to the potential pitfall in using a 'tick-in-the box' approach, that is based on treating the adherence to a written Corporate Governance code as an indicator of 'good' Governance.

For instance, a listed Company in India can comply with all the requirements of Clause 49 (which prescribes the Corporate Governance requirements for Listed Companies) while at the same time it can be very "poorly" governed and blatantly violate the rights of the minority shareholders. Even though the organization may hold the stipulated meetings of the Board, set up all the required Sub Committees of the Board and do all other acts that show a high degree of compliance with the desired Governance Code, what actually defines good governance in organizations are the 'touch and feel' factors such as the quality of the discussions at the Board level, the independence exhibited by the Directors and how the Board handles the difference of views and opinions at Board meetings. Not only are these factors very difficult to observe and measure, they are invariably never captured by an external researcher who usually would depend on the formal record of the filings on corporate governance made by the organization (usually self reported or, at best, certified by the firm's auditor) while making an assessment of the quality of Corporate Governance in the Firm.

As an example, conventional literature and practice has emphasized on the structure and functioning of the Board of Directors as an answer to the issues relating to of 'good' governance. In fact a substantial portion of the Kumar Mangalam Birla Committee Report[62] is devoted to explain the importance of board and the different committees in the Corporate Governance system of a company. While one can look at the composition of the board of a company to see if the board has been constructed as per the guidelines of SEBI committee and thereby comment on the governance structure of the Company, Varma [63] and Dalal[64] have shown that, in many cases, the members of the Board do not play the role that they are supposed to play. Based on anecdotal evidence it is clear that the mere existence of board committees, by themselves, does not guarantee good governance systems in a company.

While some researchers have followed the 'input approach' in defining governance based on board structure, processes, shareholder rights, redressal mechanisms etc another set of researchers have followed and 'output approach'[65] in defining governance which is based on the principle that if a company has got a

[62] The Securities and Exchange Board of India (SEBI) appointed a Committee on Corporate Governance in May 1999 under the Chairmanship of Kumar Mangalam Birla, member SEBI Board and a leading Indian industrialist, to promote and raise the standards of Corporate Governance; the report of the Committee can be downloaded from http://www.nfcgindia.org/pdf/KumarMangalamb_report.pdf

[63] Varma, Jayanth Rama, (1997); Corporate Governance in India: Disciplining the Dominant Shareholder, IIMB Management Review Dec 1997, 9(4), 5-18 available at <http://www.iimahd.ernet.in/~jrvarma/papers/iimbr9-4.pdf.

[64] Among others, business journalist Sucheta Dalal (Dalal) has written extensively on the well known fallout between the Ambani brothers which exposed the weakness of Corporate Governance in one of India's largest companies – Reliance Industries Ltd. Refer to her post on ' Is Reliance rewriting rules of Corporate Governance' available at <http://www.suchetadalal.com/?id=5b03611d-4726-ba29-492e7e5c217f&base=sub_sections_content&f&t=Is+Reliance+rewriting+rules+of+corp+governance> and *"What's Governance to do with it'* available at < http://www.suchetadalal.com/?id=69df756f-5f5c-d212-492e7e1a86f2&base=sub_sections_content&f&t=What's+governance+got+to+do+with+it%3F>.

[65] Bal, Black & Khanna

good governance system then it must get reflected in certain outcome, so a possible way to comment on the governance system of a company is by looking at what should be expected to be the outcome of good governance system. This approach is based on the argument that if the processes are in order, then we must observe certain desirable outcome. If, on the other hand, these outcomes are not present, then the existence of a mere process does not amount to anything. Thus, for example, the mere existence of an audit committee does not imply that all the accounts are in order. However, if it is observed that the accounts are in order (or at least we do not find any evidence to the contrary) then we can be reasonably assured that the company has got good governance practices.

However, irrespective of whether researchers have used the 'input approach' or the 'output approach' in defining and measuring corporate governance the fact is that there is no unanimity between researchers in agreeing to a common set of parameters to define and measure governance. Bebchuk et al[66] reduced the 24 factors, identified by Gompers et al[67] for defining their measure of governance, to only 8 factors which they used in defining their measure of governance as they felt that with a narrower set of parameters the measure would be more precise. On the other hand Brown and Naylor[68] believed that both Gompers et al and Bebchuk et al's construct of the governance index was very restrictive and governance could only be measured only by a broad based index and constructed one which was based on as many as 51 factors. Clearly there is considerable divergence of views between researchers' on how to define and set up a measurable index that would capture the essence of governance.

The lack of a common understanding in defining the parameters that constitute governance becomes even more pronounced when we start looking at some of the more popular governance indices which are used by governance rating agencies.

While the full details of such indices are not available as such details are proprietary information, some details are available in the public domain. Institutional Shareholder Services (ISS) is the leader in providing governance services and its flagship rating product Corporate Governance Quotient (CGQ) covers approximately 7500 companies and is based on approximately 65 criteria for U.S. companies and 55 criteria for non-U.S. companies[69]. The variables that ISS uses to analyze companies fall under four general governance areas: board, compensation, anti-takeover, and audit and ISS has weighted the variables of each category according to their importance to governance so that the variables under the "board" category make up 40% of the CGQ score, and the variables under the "compensation," "anti-takeover," and "audit" categories make up 30%, 20%, and 10% of the CGQ, respectively

[66] Supra. Note 31.
[67] Supra.Note 22.
[68] Supra.Note 40.
[69] Paul Rose."The Corporate Governance Industry";(2006) downloaded from: http://works.bepress.com/paul_rose/2 argues that potential conflicts of interest within some governance firms cast doubt on the reliability of their proxy advice and governance ratings. Additionally, he suggests that governance firms may be overstepping their expertise in proxy voting decisions and in governance rating, in part, because of their reliance on "good governance metrics" for which there is little evidentiary support.

Similarly, Governance Metrics International (GMI) provides corporate governance ratings and reports on nearly 4000 companies in the United States and abroad[70]. GMI uses as many as 500 data points in assessing a company's corporate governance. The result of the GMI analysis is a GMI rating report, which includes a summary of the company's overall governance score, as well as a discussion and individual score for each of six governance broad categories: board accountability, corporate social responsibility, executive compensation, financial disclosure and internal controls, takeover controls and ownership base, and shareholder rights. Like ISS, GMI has produced a set of variables that are structured so that they can only produce "yes," "no," or "not disclosed" answers, which GMI believes eliminates "a large degree of subjectivity."[71]

Another major corporate governance analysis firm, the Corporate Library, founded by former ISS executives, follows a slightly different approach that is less quantitative and more qualitative than ISS' or GMI's analyses[72]. While the Corporate Library does produce some numeric ratings based on the adherence of a company to a set of enumerated "best practices" (which are based primarily on the OECD's model), the company also notes in its analysis that the "one size- fits-all aspects of the best practices compliance approach [is] limited at best." [73]As a result, the Corporate Library does not use the best practices benchmark as a component of its analysis of the board's effectiveness; indeed, the Corporate Library notes that it has "assigned very low Board Effectiveness Ratings to a number of boards that rate quite well on best practices compliance. Such was the case with the disastrous Enron board, for example, the clearest possible confirmation of the notion that best practice compliance alone is simply not enough".[74]

In addition to the first major challenge in governance research viz. a lack of common definition of governance, the second major challenge is the search for a universal standard of governance towards which all firms are expected to strive towards. In recent years, financial economists and commercial providers of governance services have created measures of corporate governance quality that collapse into one number (a governance rating or index) the multiple dimensions of a company's governance, measures which the commercial providers market to institutional investors as aids for portfolio and proxy voting decisions. Given this approach, the question arises whether a uniform standard of governance does exist at all or is the governance framework very contextual to a specific firm and whether governance is best implemented in a flexible framework that allows for differences in firm characteristics and is not based on a rigid 'one size fits all' framework that can be blindly applied across all firms.

Lucian A. Bebchuk & Assaf Hamdani[75] have pointed out that despite researchers and shareholder advisers having devoted much attention to developing metrics for assessing the governance of public companies around the world, such efforts have suffered from a basic shortcoming as these efforts have failed to take

70 Id.
71 Id.
72 Id.
73 Id.
74 Id.
75 Lucian A. Bebchuk & Assaf Hamdani; The Elusive Quest for Global Governance Standards;(2009) - downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1374331

into the differences that exists between companies with controlling shareholders and companies without controlling shareholders. Based on the fact that the impact of many key governance arrangements are considerably dependant on companies' ownership structure, Bebchuk and Hamdani[76] suggest that measures that protect outside investors in a company without a controlling shareholder (NCS) are often irrelevant or even harmful when it comes to investor protection in companies with a controlling shareholder(CS), and vice versa, . Consequently, in their view, governance metrics that purport to apply to companies regardless of ownership structure are bound to miss the mark with respect to one or both types of firms. The quest for developing a global governance standard, they have argued[77], should be replaced by an effort to develop and implement separate methodologies for assessing governance in companies with and without a controlling shareholder(s).

Agreeing with the analysis of Bebchuk and Hamdani, Vikramaditya Khanna[78] has suggested that while delineating governance practices between CS and NCS firms is an important step in making governance rankings more useful, for this approach to be most useful, other factors[79] that impact governance must have a lesser influence on optimal governance when compared to ownership structure. However, in the end, according to Khanna[80] the overall decision about how many governance ranking systems to have is also a matter of judgment and although one could make the case for using other governance metrics when creating governance ranking systems, the additional factors generally do not have as broad of an impact on optimal governance practices as ownership structure and he felt that Bebchuk and Hamdani's recommendations to focus on ownership structure as the critical dividing line seemed judicious and balanced[81].

Sanjai Bhagat, Brian Bolton and Roberta Romano[82] have analyzed the effectiveness of corporate governance indices in predicting corporate performance and have also considered the implications for public policy that follow from such an assessment. Highlighting the various methodological shortcomings of the past research work that claims to have identified a relation between particular governance measures and corporate performance, their core conclusion is that there is no consistent relation between governance indices and measures of corporate performance and there is no one "best" measure of corporate governance.

[76] Id.
[77] Id.
[78] Vikramaditya S. Khanna; Corporate Governance Ratings: One Score, Two Scores or More? (2009)- downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1690573 who suggests ways to implement the analysis of Bebchuk and Hamdani (Supra. Note 75),
[79] Khanna classifies these other factors roughly into those related to the country where the firm is located (e.g., political stability, whether the state has a "grabbing hand," labor-friendly laws, tax laws, and law enforcement) and to firm characteristics (e.g., firm size and industry).
[80] Id.
[81] Id
[82] Refer to Sanjai Bhagat, Brian Bolton, Roberta Romano; The promise and peril of Corporate Governance Indices ; (2007) -downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1019921 for an insightful analysis of the methodological shortcomings of the current papers that claim a relation between particular governance measures and corporate performance..

According to Bhagat et al[83], in practice, the existing indices used to measure governance fail to capture the diverse ways in which governance operates in firms for two reasons. Firstly, no one index can predict a firm's performance on all of the performance measures that are thought to be important to investors. Secondly, indices are constructed so as to treat the various components that constitute the governance mechanisms as complements, whereas the data suggest that several such mechanisms are actually substitutes for, and not complements to each other. Furthermore, the relationship between the various constituents, that define governance, appears to vary across firm characteristics and industry sectors. Taking a view that,' one size does not fit all', Bhagat et all have suggested that good governance is best understood as highly context-specific, something that even the best-constructed index simply cannot capture and convey universally across firms, the most effective governance system depends on context and on firms' specific circumstances and it is very difficult, almost impossible, for an index to capture nuances critical for making informed decisions.

Bhagat et al[84] concluded that governance indices were highly imperfect instruments for determining how to vote corporate proxies, let alone for making portfolio investment decisions, and that investors and policymakers should exercise caution in attempting to draw inferences regarding a firm's quality or future stock market performance from its ranking on any particular corporate governance index measure. Moreover, given the considerable variation in the relationship between indices and measures of corporate performance, they have suggested that corporate governance is an area where a regulatory regime of ample, flexible variation across firms without any governance mandates was particularly desirable.

Recent empirical evidence also suggests that one-size-fits-all governance would generally produce lower returns than a flexible approach that allows corporations to deviate from “best practices.” Sridhar Arcot and Valentina Bruno[85] of the London School of Economics analyzed the effect of corporate governance on performance in the context of the United Kingdom’s disclose-or-explain corporate governance structure[86] . The authors found that “companies departing from best practice for valid reasons perform exceptionally well and out-perform the fully-compliant ones. In contrast, mere compliance with the provisions of the Code does not necessarily result in better performance”[87]. Arcot and Bruno’s research suggests that the mandatory provisions of corporate governance regulations[88] may create inefficiencies by eliminating heterogeneity among firms’ governance structures.

Bhagat et al[89], have pointed to two broad policy implications arising from the limitations in developing an effective index for corporate governance. Firstly, the more widespread forms of current governance

[83] Id.
[84] Id
[85] Sridhar Arcot and Valentina Bruno; One Size Does Not Fit All, After All: Evidence from Corporate Governance; (2007) –downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=887947.
[86] Under the UK approach to corporate governance, compliance with a code of best practices is voluntary, but companies must disclose whether they are complying with the code, and if not, explain why
[87] Supra. Note 85.
[88] Examples of such mandatory provisioning of corporate governance regulations would be the Sarbanes- Oxley and related SEC rulemaking or the imposition of clause 49 by SEBI in India for all listed companies
[89] Supra. Note 82.

regulations need to be rethought because they mimic the approach of the indices as both the current forms of governance viz. the prescriptive mandate (eg the Sarbanes Oxley based US model or the Clause 49 based Indian model) and the 'comply or explain' framework (adopted by most other developed economies', including Canada U.K. and Europe) spell out the governance mechanisms that all firms are expected to adopt. A more appropriate regulatory approach, in their view[90], is a straightforward governance disclosure regime that is based on the premise that there is no one best benchmark or set of best practices that is appropriate for all, or even most, firms. Secondly, under such a governance disclosure regime, investors should treat indices as only one of a multitude of pieces of information of interest about a firms' quality that cannot predict the future stock market performance for the firm.

The uncertain relationship between governance metrics and firm performance may suggest that the project of reducing good governance to metrics is misguided[91] and the attempt to reduce good governance to an index measured through objective (and perhaps even subjective) analysis is bound to result in Type I errors (false positives) like Enron where companies with strong governance practices, according to the wisdom of corporate governance metrics, that still experience major governance breakdowns. On the other hand, such governance analysis is also likely to result in Type II errors (false negatives), as companies with diligent and effective governance practices that do not meet the corporate governance industry's recommendations are penalized for maintaining those practices.

The third major challenge in corporate governance research has been the inference of causality that has been made in several studies based on the evidence of correlation between governance (as defined and measured by the researcher) and performance (usually defined as a financial measure like stock returns or Tobin's Q).

If X (e.g., governance) is found to be positively correlated with Y (e.g., stock returns), as has been established in many governance studies based upon empirical evidence, then the following multiple possibilities of relationship between X and Y exist;

– Higher X causes higher Y (causality).
– X is correlated with a missing variable that causes Y (missing variable).
– Informed agents set X in anticipation of Y (reverse causality).
– X and Y are simultaneously affected by a third variable (common shock).

Given the multiple possibilities (of relationship between X and Y) that exist, implying causality based on observed correlation between governance measures and firm performance is not a robust conclusion. This fact has been recognized in both the GIM study and the BCF study and both have been careful not to infer causality from their research results. The GIM study states[92] that "the data do not allow strong conclusions about causality," adding that "multiple causal explanations have starkly different policy implications and stand as a challenge for future research" whereas the BCF[93] study states that "one important question that

[90] Id.
[91] Supra. Note 69.
[92] Supra. Note 22.
[93] Supra. Note 31.

remains for future work concerns causation. To what extent, if any, does the correlation … result from entrenchment producing lower value? And to what extent, if any, does this correlation simply reflect the tendency of managers of low-value firms to entrench themselves?"

Typically, empirical studies of corporate governance regress some measure of performance, ideally the firm's equity value or a measure of the firm's Tobin's Q, on measures of the stringency of corporate governance, such as ownership structure, capital structure, the structure of the board and the market for corporate control. Such empirical studies on corporate governance have more than the usual share of econometric problems -quite frequently, firm variables are assumed to be exogenous but are actually endogenous; relevant variables are left out; the sample is not selected randomly; and variables are measured with large errors. In all of these cases it becomes difficult to identify the influence of corporate governance factors on firm performance and that makes any inference on causality misleading and erroneous.

Axel Börsch-Supan and Jens Köke[94] have identified four categories of econometric problems that have to be solved in order to infer causal effects of corporate governance on the firm's performance: reverse causality, missing variables, sample selectivity, and measurement error in variables.

According to them[95], the problem of reverse causality (or endogenity) is omnipresent because analyses of the efficacy of corporate control instruments on firm performance require that these instruments are exogenously related to firm performance. In practice, however, it is common that a deterioration of the firm's performance precipitates changes in its governance while, in turn, well performing firms attract investors with equally typical ownership structures and thus corporate governance thereby confirming a two way relationship between governance and performance. Börsch-Supan et al also point out[96] to an interesting consequence that arises from the second category of econometric problems that affect governance studies i.e. the problem of missing variables. Giving the example in the case of interaction of product market competition and corporate control mechanisms, they argue that product market competition and corporate governance are partial substitutes (i.e., bad corporate governance structures can be offset by fierce product market competition) and suggest that an analysis of corporate governance without explicit consideration of product market competition will fail.

Given that most empirical studies analyze only the largest and, among them, only the listed firms, Börsch-Supan et al point out[97] to the problems arising from sample selectivity bias which affects the estimation of corporate governance mechanisms and point out that this third category of econometric problem is as frequent as it is serious since size and being listed are frequently a function of firm's performance and using

[94] Refer to Axel Börsch-Supan and Jens Köke; An Applied Econometricians' View of Empirical Corporate Governance Studies (2002) –downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=320578, for a critical survey of the econometric issues in the empirical research on corporate governance.
[95] Id.
[96] Id.
[97] Id.

those criterion to select the sample for a study on corporate governance would introduce a selectivity bias in the study.

The last in the list of econometric problems, identified by Börsch-Supan et al[98] is the problem of measurement errors and point out that firm performance is hard to measure in practice, particularly during episodes of stress and corporate governance actions. On top of this, corporate governance variables are measured through the construction of proxies and, unless well constructed, would weaken estimation results due to a low signal-to-noise ratio. Both these effects contribute to the problem of deriving incorrect conclusions from empirical studies on corporate governance because of measurement errors.

DIRECTIONS FOR FUTURE RESEARCH AND THE BASIS FOR THE NEXT GENERATION OF CORPORATE GOVERNANCE REFORMS

Following the well publicized corporate scandals like Enron and other well known scams, few areas have attracted as much interest as corporate governance reforms in the hope that implementing good governance in organizations would not only prevent the recurrence of such problems but also lead to good organizational performance[99].

Furthermore, while the last decade has also seen a flurry of regulations introduced across different countries in the world aimed at improving corporate governance practices in organizations, the results from such regulatory changes have been mixed. Indeed some have even argued[100] that introducing corporate governance regulations is no guarantee that we have seen the last time that corporate governance breaks down as new(and different) stress points will develop in corporations and one or another of the persisting fissures will threaten to open and crack, and would need to be fixed..

Effectiveness of corporate governance regulations (in bringing about good performance) depends on the answers to the following two questions;

[98] Id.

[99] The topicality of corporate governance in the media has increased significantly after the various corporate scams surfaced in the beginning of the twenty-first century. As pointed out by Bhagat et al; The Promise and Peril of Corporate Governance (Supra. Note 82) in the nearly five years since Enron's collapse, there have been 1,342 *New York Times* news stories containing the phrase "corporate governance," whereas to reach a comparable count prior to that date, one has to cumulate news stories over ten years to 1986 (totaling 1,388), as searched in Lexis in September 2006.

[100] Mark J. Roe; The Inevitable Instability of American Corporate Governance (2004) downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=615561, points to the inherent brittleness in corporate governance regulation since it is based on negotiations between the regulator who believe that they must lock everything in and the regulated who is able to affect the regulator and weaken the output. Roe suggests that we will continue to face corporate governance crises from time to time as new stress points develop and only if we're lucky, someone will anticipate the problem and fix it up beforehand, if not, we'll muddle through another crisis once again.

- Are the regulatory changes in corporate governance based on sound theory or are they based on popular perceptions and a common position that is arrived at based on the negotiation of the divergent views of various interest groups who are affected by the regulatory changes?
- How robust is the underlying theory of corporate governance, in particular the linkage of good governance to good performance –does it comprehensively model all the factors that impact corporate governance and accounts for differences in contextual and cultural factors that could impact governance. Also, has the corporate governance theory been tested empirically based on actual conditions and have the conclusions been tested for their validity?

Unfortunately the current answer to both the above questions are far from satisfactory- not only have the regulatory changes often been made without being rooted in sound theory but also the current status of corporate governance research, especially the linkage of corporate governance to good performance, has several gaps and conclusions derived from such theory, at times, do not hold up to rigorous testing.

Reviewing the process surrounding the development and passage of the Sarbanes-Oxley Act of 2002 (SOX), in the USA, Roberta Romano[101] has pointed out to the absence of corporate governance research to support the principal requirements of SOX. According to Romano[102], the key provisions of SOX, were largely the result of corporate governance "policy entrepreneurs" taking advantage of public crisis driven by the collapse of two major U.S. corporations, Enron and WorldCom, that occurred during a midterm congressional election cycle and points out that, in the frantic political environment in which the law was enacted, legislators adopted proposals with neither careful consideration nor assimilation of the literature which was at odds with the policy prescriptions.

Based on an extensive review of academic literature, Romano has concluded[103] that there was a lack of empirical evidence to support key provisions mandated by SOX such as the independence of audit committees. She provides a detailed analysis of the legislative process that took place in committee hearings conducted by the U.S. Senate and House of Representatives which indicates that most of the testimony, utilized by experts testifying before the U.S. Congressional Committees, was based on the experts' opinions rather than empirical evidence. Consequently the SOX provisions, in her view[104], were seriously misconceived and were not likely to improve audit quality or otherwise enhance firm performance and benefit investors as the US Congress had intended and has gone so far as to suggest that it is important to work to educate the media, the public, political leaders and others regarding the reality i.e. that the US Congress had committed a public policy blunder in enacting SOX's corporate governance mandates, and that there is a need to rectify that error!

101 Roberta Romano; The Sarbanes-Oxley Act and the Making of Quack Corporate Governance(2005) downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=749524, would have preferred a gradualist approach to the corporate governance crisis in 2001-2002; that would have flowed up from courts and which would have been based on courts' interpretations of dynamic business conditions rather than a top down imposition of policies constructed on an ad-hoc basis by US Congress

102 Id.

103 Id.

104 Id.

Over the last decade, significant steps have been taken by the regulatory authorities in India to enhance corporate governance measures in India; these developments have closely followed efforts in other jurisdictions such as the U.K. (the Cadbury Committee Report) and the U.S. (SOX).As pointed out by Varottil[105] the measures adopted in India do not recognize the differences between the outsider systems of corporate governance (found in the U.S. and U.K.), from which concepts such as independent directors, audit committee and CEO/CFO certification have emerged, and the insider systems of corporate governance (found in India) into which they have been transplanted and suggests that unless these differences are factored in by the regulators, courts, industry and academia, there are likely be difficulties in implementation of the enhanced corporate governance measures (reflected in Clause 49) and their assimilation within the Indian corporate ethos.

A similar view on the corporate governance reforms in India has been expressed by Afsharipour[106] who finds the Indian corporate governance process ineffective despite the 'attentive crafting of detailed governance rules by a group of elites with a deep understanding of corporate governance standards around the world'. According to Afsharipour[107]introducing formal rules into a system where there is an inadequate infrastructure to support the implementation and enforcement of such rules may mean that these rules have little chance of succeeding and points out to the need for further research that can help to develop more appropriate solutions that take into accounts the local conditions and suitably adapting solutions that may have worked elsewhere in the world before introducing them in India.

While the need to have public policy (relating to corporate governance) firmly grounded in sound theory is indisputable, the focus of this paper, however, is on the need to improve the robustness of research on corporate governance itself –an area where several concerns exist at present.

The preceding section of this paper has identified several areas in the existing research where significant gaps exist that could raise doubts on the validity of the conclusions that have been arrived at from such studies inferring causality between good governance and good performance. Therefore it would help to develop an agenda for future research in this field that would go a long way towards developing a holistic theory of corporate governance and help to build a more robust and comprehensive model for corporate governance – undoubtedly, such an effort would ultimately help in developing sound public policy in the area of corporate governance.

Some of the suggested areas for further research in developing a more comprehensive theory for corporate governance (and its linkage to corporate performance) are as follows;

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105 Umakanth Varottil; A Cautionary Tale of the Transplant effect on Indian Corporate Governance (2009) – downloaded from. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1331581.

106 Afra Afsharipour; Corporate Governance Convergence: Lessons from the Indian Experience (2009) –downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1413859.

107 Id.

1. Many studies establishing the linkage between governance and performance are based on measuring the quality of governance based on a measure of good corporate governance. Typically such a measure is based on identifying desirable traits for good governance, based on a normative feel of what is good, and then measuring how individual companies compare against these benchmark measures of good governance. Such an approach is based upon the assumption that the desirable good governance characteristics are universal and can be commonly applied to all companies and companies can achieve good governance standards by following a common set of desirable standards.

   However, there is a need for developing a more complete understanding of the measure for good governance and further research is required in the following areas;

   - A better understanding of the various underlying factors that affect corporate governance in an organization is an essential first step in the study of corporate governance and given the lack of unanimity amongst researchers on what the key underlying factors that affect corporate governance are, this is an area for further research.
   - Taking a 'one size fits all' approach to corporate governance fails to recognize the impact of important contextual factors that make each organization unique and because of which individual solutions may have to be crafted for each organizations and there is a need to better understand the external factors that impact corporate governance.

   It is indeed surprising that despite the enormous amount of work that has been done on corporate governance, very little has actually been learnt about what is actually involved in effective governance and how it contributes to good performance

2. A key criticism of much of current governance research has been its very narrow focus[108].

   Given that an organization's strategy (strategic choice and equally important strategy implementation) has a very significant effect on its performance; researchers into corporate governance must consider systemic factors in their studies.

   Such studies need to go beyond merely studying the impact of simplistic, structural factors like board attributes or shareholder rights on organizational performance and should be able to account for multiple, systemic and multi dimensional influences on corporate performance which are related to the organization's strategy.

[108] Loizos Heracleous; What is the impact of Corporate Governance on Organizational Performance;(2001); downloaded from http://193.146.160.29/gtb/sod/usu/$UBUG/repositorio/10280861_Heracleous.pdf suggests that most studies on corporate governance suffer from the fact that they have a very limited focus, for example they attempt to relate narrow areas like board attributes (as proxies for corporate governance) to organizational performance, and neglect the broader systemic area like organizational strategy that affect organizational performance.

3. The views of Börsch-Supan et al on the need for developing more robust econometric models to study corporate governance have been discussed before in this paper[109] and the pitfalls pointed out by them in developing econometric models need to be avoided by corporate governance researchers.

   Larcker and Rusticus[110] have suggested that, to successfully address the econometric issue relating to endogeneity, it is necessary to concentrate efforts on better development of theory and the emphasis on theory development should guide the development of the empirical model and the choice of exogenous variables.

   There is a need for developing a more comprehensive understanding of the theory before econometric studies on corporate governance are carried out by researchers and studies based on an incomplete or partial understanding of the theory are likely to give misleading results.

4. Most of the models that have examined the causality between corporate governance and corporate performance have been based on developing regressions models to study the relationship between corporate governance and corporate performance where the effects of other parameters like size; assets etc on corporate performance have been controlled.

   Such models have usually not taken into account the basic differences that exist between organizations that are characterized by the 'insider' model of management and the 'outsider' model of management[111].

   Given that governance issues in shareholder controlled companies ('outsider' model) are very different from the governance considerations in non-shareholder controlled companies ('insider' model) any model that is developed to study the relationship between governance and performance must take into account the difference that exists between shareholder controlled companies and non shareholder controlled companies.

5. The quality of Corporate Governance is a soft measure which cannot be measured by a 'tick in the box' approach that many of such studies have adopted. For instance, a study on corporate governance needs to take into account the quality of discussions and debate that takes place in a board room which is the true reflection of the quality of a corporate governance rather than just ascertaining, whether or not, issues have been put up to the board of directors (or a committee of the board members) in compliance with good corporate governance guidelines or regulations.

   Many current corporate governance studies suffer from the limitation that 'form' (compliance- mere adherence to guidelines) takes over 'content' (effectiveness resulting from compliance) and therefore

[109] Supra. Note 94.
[110] David Larcker and Tjomme Rusticus; Endogeneity and Empirical Accounting Research; (2007)-downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=988561.
[111] Supra.Note 75.

the conclusions from such studies on the relationship between corporate governance and corporate performance would be misleading.

In a very incisive article Richard Lebalanc, and James Gilies, [112] have provided several explanations for the lack of an observable relationship between corporate governance and corporate performance and have suggested that a very likely reason for the relationship not being demonstrated is the fact that, in the current corporate governance research, there is no analysis of how boards perform as boards, how they make decisions, and of the impact of the behavioral characteristics of various directors on the decision making process. Pointing out to this lacunae in corporate governance research, Leblanc et al state that t this may well be the most important factor in determining the effectiveness of the governance of an enterprise and suggest the need for greater use of qualitative research methods – including observing boards in real time and interviewing directors – that needs to occur for advancing research in this field. According to them the quantitative researchers are, it would seem, measuring variables in respect of “structural independence,” rather than board and individual director effectiveness, per se and once it is possible to measure variables such as “board effectiveness” and “director effectiveness”, together with their interaction, there is a greater likelihood of distilling a more definitive relationship between corporate governance and corporate financial performance.

Heracleous[113] has also given the example of commonly used proxies for measuring board vigilance (proportion of external directors, shareholding of directors etc.) and pointed to the challenge of trying to measure a behavioral attributes with indicators that may have a tenuous connection to the attribute and has called on scholars to conduct research based on more qualitative research and based on in depth interviewing of the board members on which subsequent quantitative research can build upon..

CONCLUSION

It seems entirely reasonable, and quite plausible, that the fact that even though current empirical studies on corporate governance have not been able to identify a causal relationship between corporate

[112] Richard Leblanc and James Gillies; The Coming Revolution in Corporate Governance – downloaded from http://www.metanoia.net.au/files/services/governance/Governance%20Revolution%20-%20Leblanc%20Oct-031.pdf point out that, firstly, there may be no relationship between governance and performance. Secondly, there may be many internal and external contingencies which, coupled with intervening and moderating factors, may make it impossible to demonstrate a causal link between governance and corporate performance. Thirdly, many of the factors involved in corporate governance are incapable of being expressed in forms that can be measured. Fourthly, there may exist a time lag between board structure and board failure, which makes any relationship between governance and performance difficult to find. And, lastly they have stated that there could be a conspiracy theory at play because academics and regulators "have chosen board independence as a rallying cry or unifying theme of the governance reform movement, and to change the message now would diminish the focus, unity and credibility of the movement".

[113] Supra. Note 108.

governance and corporate financial performance it does not mean that such a relationship does not exist between the two[114].

The serious and large disconnect between popular perception that equates good governance with good performance and research findings probably means that the proper type of research on corporate governance has not been done, or, it has been done badly. Current attempts at improving corporate governance procedures, as new legal and accounting mandates and the use of metrics, have addressed only part of the governance challenge. Equally important are the human dynamics of boards as social systems where leadership character, individual values, decision-making processes, conflict management, and strategic thinking will truly differentiate a firm's governance and which are grossly under researched.

The need for more comprehensive and holistic research into corporate governance is accentuated by the fact that currently regulators, chief executive officers and directors, when they are searching for ways and means of improving corporate governance, are functioning in a knowledge vacuum; that is, they are making regulations and decisions without any real knowledge about what is going on in boards of directors or, at worst, on the basis of an incorrect understanding of the major factors impacting on corporate governance.

[114] According to Richard Le Blanc and James Gillies (Supra.Note 112) the current reality of corporate governance knowledge is that, the "what" and "how" of a board of directors its work and its process is still the "unicorn" of corporate governance, while no one has demonstrated that there is a relationship between Board Tasks, corporate governance and corporate performance; everyone knows that such a relationship exists. Therefore, year after year, in the aftermath of the failures and scandals of major companies, the question is raised "Where was the board?" (at the time when the failure/scandal took place).