The direction for future research in Corporate Governance.

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

[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

mechanisms that ensure good behavior and protection of the shareholders. A key focus 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 corporate 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.

The movement towards good corporate governance has been motivated by the presumed existence of the following intuitive linkages;

- Good corporate governance would protect the interest of the owners (shareholders) and harmonize the interests of the owners and managers
- Good corporate governance would result in better organizational performance and make it easy for firms to access external funds and investors,

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

STATUS OF CURRENT RESEARCH – into the relationship between good governance and firm performance

Good Governance has been the focus of research by Consultants[4], Fund Managers[5], Rating Agencies[6], Donor organizations (like the World Bank)[7] all of whom have attempted to study the relationship between good governance and improved firm performance and identify the desirable characteristics of (good) governance based on the belief that it positively impacts an organization's performance.

Such research can be grouped 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.

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

[5] Beyond the Numbers-Corporate Governance: Implication for Investors; Deutsche Bank –downloaded from http://www.unepfi.org/fileadmin/documents/materiality1/cg_deutsche_bank_2004.pdf.,submitted by Deutsche Bank A.G., in 2004 to the Asset Management Working Group (AMWG) of the United Nations Environment Program Finance Initiative (UNEP FI).

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

[7] 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

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 firm performance.
3. A third 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 McKinsey survey[8] 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 researchers at Deutsche Bank A.G[9]., after analyzing the data on share price performance of S&P 500 companies over a two year period (up to June 30, 2003), found that companies with above average assessment on corporate governance & positive momentum on corporate governance (identified as current score on CG being more than previous year's score) 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%.

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[10] 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, 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.

[8] Supra., Refer Note 4.
[9] Supra., Refer Note 5.
[10] Supra.., Refer Note 6.

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[11] 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 research, in 2004, sponsored by Asian Development Bank [12], Sang –Woo Nam and Il Chong Nam after surveying 307 sample firms from Indonesia, Korea, and Thailand came to the following conclusions;

- 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.

The broad conclusion of the above research efforts have been near unanimous – Good Governance pays!

To put these findings into perspective, clearly reforming the Corporate Governance practices by a Firm can significantly improve its valuation – an exercise that would require considerably lesser effort than the efforts required to boost sales, cost cutting exercise or improving margins to get the same improvement in the Firm's valuation.

But does higher levels of Corporate Governance pay? The empirical evidence and the results of academic research into this question, however, provide mixed results.

A pioneering study by Gompers, Ishii and Metrick (GIM Study), titled ` Corporate Governance and Equity Prices' (2003), concluded that an investor that sold shares in publicly traded US companies with the weakest shareholder rights and bought those with the strongest would have earned "abnormal" returns of 8.5 per cent a year during the sample period. The study analyzed 1,500 companies and ranks them in deciles based on 24 distinct Corporate Governance provisions. The most "dictatorial" firms were less profitable, had lower sales growth and the returns on such firms not surprisingly trailed those of the "democratic" portfolio by an average of 8.5 per cent a year.

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[11] 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.

[12]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

A significant extension to the GIM Study was undertaken by Lucian Bebchuk, Alma Cohen, and Allen Ferrel, of Harvard University (BCF Study)[13], who investigated the relative importance of the 24 provisions included in the Index of Corporate Governance (developed in the GIM Study) and postulated that there was no a priori reason to expect that all the 24 provisions contributed to the documented correlation between the Index and 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.

Bebchuk et al hypothesized[14] that only six provisions among the 24 provisions played a significant role in driving the correlation between C G Index, developed in the GIM Study, and firm valuation and using these six parameters they constructed an Entrenchment Index (E Index) and studied the relationship between the E Index and the firm value and stock 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[15] 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 CG Index in the GIM study.

A very different approach was taken by Lawrence D. Brown, and Marcus L. Caylor[16], 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.

Interestingly, Brown and Caylor found that the Gov-Score developed by them was better linked to firm performance than G Index[17]. They attributed this to the fact that the factors constituting the CG Index (developed in the GIM Study) were concentrated mostly in only one category viz. charter/bylaws and since most of the factors in this category represented antitakeover measures, in their view the CG Index (developed in the GIM Study) was effectively an index of anti-takeover protection rather than a broad index of governance. On the other hand, since they used multiple categories to create the Gov-Score they claimed to have a broader and more comprehensive measure of governance.

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[13] Lucian Bebchuk, Alma Cohen, and Allen Ferrel ; What Matters in Corporate Governance? –downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1331874

[14] Id.

[15] Id.

[16] 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

[17] Supra.Note 33.

A detailed review of the relationship between market-to-book ratios of the firm and indices purporting to measure the quality of a firm's governance structure, which was documented in the GIM study and the BCF study, was carried out by Kenneth Lehn, Sukesh Patro and Mengxin Zhao[18].

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.[19] 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[20]. 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. Their results were consistent with their hypothesis that valuation multiples affect governance indices, not vice versa

Another important empirical study, to examine the causality between governance and performance, was carried out by David Larcker, Scott Richardson, and Irem Tuna,[21] who 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, 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.

The results of Larcker et al suggested[22] 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.

[18] 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

[19] Id.

[20] Id.

[21] 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

[22] Id.

However, a very different conclusion was arrived at by Carol Padgett & Amama Shabbir[23] 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.

For Indian companies, 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[24] 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[25]. 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).

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[26]. 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.

[23] 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.
[24] 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.
[25] Id.
[26] Id.

THREE KEY ISSUES

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 with the results obtained from empirical research, to date, having 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 is how sound is 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. Are 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 that affect governance or are the changes only reflective of the subjective views of a powerful minority who are pushing for governance reforms?

In case the regulatory changes, that are being made to promote good governance, are not based on ground realities then the results from such changes is likely to fall short of the expectations from such policy changes. An effective policy can be built only on a thorough understanding of the underlying parameters and developing a robust model that is tested with empirical data.

To have policy formulation firmly rooted in empirical evidence and sound theory of corporate governance, it is worthwhile to understand the three significant challenges that are faced by researchers in governance research as that would not only help to better understand the limitations of previous research but also give a better handle on the interpretation of the results that have been obtained through previous research.

The three significant challenges in the field of corporate governance research are;

- The challenge of defining and measuring corporate governance in a manner that it captures its essence.
- The challenge in establishing a universal standard of good corporate governance and to examine if it is indeed possible to develop such a standard; can a policy of ‘one size fits all’ 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? Conversely, how do we evolve a more comprehensive model of corporate governance 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[27] 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 such factors very difficult to observe and measure, they are invariably never captured by an external researcher who usually would primarily 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 a solution to the issues relating to of 'good' governance. In fact a substantial portion of the Kumar Mangalam Birla Committee Report[28] 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 [29] and Dalal[30] 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 in an organization.

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 an 'output approach'[31] in defining governance which is based on the principle that if a company has got a 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

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[27] Clause 49 is the list of Corporate Governance compliances for Listed Companies in India which have been prescribed by the Securities and Exchange Board of India (SEBI).

[28] 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

[29] 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.

[30] 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>.

[31] Supra. Note 24.

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 the researcher does not find any evidence to the contrary) then it can be reasonably assumed 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 among researchers in agreeing to a common set of parameters to define and measure governance. Bebchuk et al[32] reduced the 24 factors, identified by Gompers et al[33] 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[34] 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 more 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 defining the underlying parameters 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 –all of which use very different parameters to assess governance.

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[35]. 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. Governance Metrics International (GMI), who provide corporate governance ratings and reports on nearly 4000 companies in the United States and abroad[36], use 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. Another major corporate governance analysis firm, The Corporate

[32] Supra. Note 31.
[33] Supra.Note 22.
[34] Supra.Note 40.
[35] 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.
[36] Id.

Library, founded by former ISS executives, follows a slightly different approach that is less quantitative and more qualitative than ISS' or GMI's analyses[37]. 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." 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".[38]

The first challenge in corporate governance research, therefore, is in evolving a commonly understood (and agreed) definition of governance that captures the essence of governance.

The second major challenge, for research in this field, is the attempt by researcher to search for a universal standard of governance - which all firms are expected to strive for. In recent years, academic researchers and commercial providers of governance services have created measures of corporate governance quality that collapse the multiple dimensions of a company's governance framework into one number (a governance rating or index) that is also marketed to institutional investors as aids for portfolio and proxy voting decisions.

Given that governance framework are quite likely to be very contextual to specific firms and governance is, probably, best implemented in a flexible framework that allows for differences in firm characteristics (and should not be based on a rigid 'one size fits all' framework that can be blindly applied across all firms), serious doubts arise on whether the current efforts of searching for a uniform standard of governance would lead to any meaningful results..

Lucian A. Bebchuk & Assaf Hamdani[39] 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 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[40] 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[41], should be replaced by an effort to develop and

[37] Id.
[38] Id.
[39] 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
[40] Id.
[41] Id.

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[42] 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[43] that impact governance must have a lesser influence on optimal governance when compared to ownership structure. However, in the end, according to Khanna[44] 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[45].

Sanjai Bhagat, Brian Bolton and Roberta Romano[46] 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.

According to Bhagat et al[47], 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.

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[42] 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),

[43] 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).

[44] Id.

[45] Id

[46]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.

[47] Id.

Bhagat et al[48] 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"[49] .

Bhagat et al[50], 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 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[51], 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 attempts of reducing good governance to metrics may be misguided[52] 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, could 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 (but are well suited to the firm's characteristics) are penalized for maintaining those practices.

The third major challenge in current 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

[48] Id

[49] Sridhar Arcot and Valentina Bruno[49] 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[49] . 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". Arcot and Bruno's research suggests that the mandatory provisions of corporate governance regulations may create inefficiencies by eliminating heterogeneity among firms' governance structures.

[50] Supra. Note 46.

[51] Id.

[52] Supra. Note 35.

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[53] 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[54] study states that "one important question that 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 because of which any inference on causality could be misleading and erroneous.

Axel Börsch-Supan and Jens Köke[55] 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[56], 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

[53] Supra. Note 22.
[54] Supra. Note 31.
[55]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.
[56] Id.

between governance and performance. Börsch-Supan et al also point out[57] 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[58] 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 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[59] 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

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[60].

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[61] that introducing corporate governance

[57] Id.
[58] Id.
[59] Id.
[60] Reporting on subject 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.
[61] 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

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;

- 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[62] has pointed out to the absence of corporate governance research to support the principal requirements of SOX. According to Romano[63], 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[64] 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

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.

[62] 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

[63] Id.

[64] Id.

rather than empirical evidence. Consequently the SOX provisions, in her view[65], 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!

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[66] 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[67] 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[68]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 and develop a more robust theory for corporate governance –an area where several concerns exist at present.

The preceding section of this paper has identified 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 previous studies. Therefore it would help to develop an agenda for future research in the field of corporate governance research as sound research would go a long way towards developing a holistic theory of corporate governance and help to build a more robust model for corporate governance; undoubtedly, such an effort would ultimately help in developing effective public policy in the area of corporate governance.

[65] Id.
[66] 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.
[67] Afra Afsharipour; Corporate Governance Convergence: Lessons from the Indian Experience (2009) –downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1413859.
[68] Id.

Some of the suggested areas for further research in the field of corporate governance (and its linkage to corporate performance) are as follows;

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 traits. Such an approach is based upon the assumption that the desirable good governance characteristics are universal and can be commonly applied to all companies who can achieve good governance standards by following a common set of desirable standards.

   However, we need to develop a more complete understanding of the corporate governance model and further research is required in the following areas;

   - To develop a better understanding of the various underlying factors that affect corporate governance in an organization. This 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 is an area for further research.
   - There is a need to better understand the external factors that impact corporate governance -taking a ‘one size fits all’ approach to corporate governance (as is done in most of current research) fails to recognize the impact of important contextual factors that make each organization unique and because of which individual corporate governance solutions may have to be crafted for each organizations.

2. A key criticism of much of current governance research has been its very narrow focus[69].

   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 other key 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.

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[70] and the pitfalls pointed out by them in developing econometric models need to be avoided by corporate governance researchers.

[69] 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.

[70] Supra. Note 94.

Larcker and Rusticus[71] 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.

Hence, 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[72].

   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 to a set of desirable norms - mere adherence to guidelines) takes over 'content' (effectiveness resulting from compliance) and therefore 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, [73] have provided several explanations for the lack of an observable relationship between corporate governance and corporate performance and have

[71] David Larcker and Tjomme Rusticus; Endogeneity and Empirical Accounting Research; (2007)-downloaded from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=988561.
[72] Supra.Note 75.
[73] 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

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, they state that 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[74] 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.

6. A serious lacuna in existing corporate governance research is the absence of an encompassing and unifying theory of corporate governance.

The most popular theoretical framework, Agency Theory, is proving to be a straight jacket: useful in some contexts but quite limiting, particularly when the underlying assumptions do not hold.
The Agency Theory led to the evolution of the Anglo-Saxon model of corporate governance that became the basis for governance codes around the world including in India. Corporate governance theory has tended to look to this model to guide the decisions of the board of directors in curbing excessive executive power in the hands of management. While useful for this purpose, the Agency Theory provides limited guidance on corporate governance in real life situations which are far more complex. With the blurring of the roles of the principal and the agent, the currently prevalent governance framework, based on the Agency Theory has become self limiting and ineffective. Efforts to supplement the Agency Theory with alternative theoretical frameworks such as the Stakeholder Theory and the Stewardship Theory have, at times, tended to place the board of directors in conflict with their legal obligations to work in the interests of the shareholders. A governance model based on the concept of Trusteeship, while providing fresh insights, suffers from problems in implementation and remains a goal to aim for. These alternative

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".

[74] Supra. Note 108.

frameworks have, therefore, not been of much practical use to the board members in helping them to decide what constitutes the "right" decision.

We need new theoretical insights that will take us towards a comprehensive theory of governance. New and different framework models need to develop as the underlying theory for corporate governance. One such model[75] is based on the concept of maximizing the long term strategic value for an organization.

CONCLUSION

It seems entirely reasonable, and quite plausible, that the fact that even though current empirical studies on corporate governance have not been unable to identify a causal relationship between corporate governance and corporate financial performance it does not mean that such a relationship does not exist between the two[76].

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 as most of these attempts have been implemented without adequate research and are not based on sound theory. Also a key focus area for improving corporate governance is centered around the human dynamics of boards as social systems where leadership character, individual values, decision-making processes, conflict management, and strategic thinking truly differentiate a firm's governance framework; these are grossly under researched areas and need much greater focus for future research.

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 incomplete understanding of the major factors impacting on corporate governance.

[75] Pande, Santosh, The Theoretical Framework for Corporate Governance (October 26, 2011). Available at SSRN: http://ssrn.com/abstract=1949615. The framework proposed on this paper is based on holistically viewing the 'organization as an organism' with its primary focus only on the organization's longevity and growth.

[76] 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 processes) 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).