Available online at http://www.journalcra.com

International Journal of Current Research
Vol. 8, Issue, 02, pp.27078-27085, February, 2016

INTERNATIONAL JOURNAL OF CURRENT RESEARCH

ISSN: 0975-833X

RESEARCH ARTICLE

STRATEGIC INNOVATION IN CORPORATE GOVERNANCE RESEARCH- AN EMPIRICAL INTERFACE

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ARTICLE INFO

Article History:
Received 27th November, 2015
Received in revised form
10th December, 2015
Accepted 09th January, 2016
Published online 27th February, 2016

Key words:
Corporate Governance,
Economic Value Added,
Governance Mechanisms.

ABSTRACT

The research methodology adopted to carry out the impact study for a systematic and scientific investigation includes the explanation on every component related to research design and implementation effectively. An extensive literature review carried out to conceptualize the basic research framework and subsequently formulate hypotheses for empirical testing. This paper provides a comprehensive discussion on the research questions, objectives, scope, research framework, hypotheses, sampling plan, questionnaire design, questionnaire administration and quantitative analytical techniques used for the purpose of the impact study. The objective of this paper corroborates the research methodology adopted, wherein a description of the problem statement, objectives, hypothesis, research design and modus operandi of statistical tools and systematic approach followed to study the impact of corporate governance on corporate performance through the economic value added estimation in selected Indian corporates specifying empirical testing. To enable the study's objective in regard to dissect impact of corporate governance on corporate performance by way of economic value added estimation, the strictures of the corporate governance are explored in light of the recent developments and amendments in the Indian legal context. Sample of companies reporting EVA surveyed by the BT-SS (Business Times-Stern Stewart) biggest wealth creators, are retrieved for the last 5 years qualify the study of impact of various facets of corporate governance by constructing a score (Corporate Governance Score) on the shareholder's value creation resulted by way of EVA reporting. Hence it is imperative that developing governance models which get culturally attuned to the nature of economic activity in India shall at least make sense for the region's market participants. This has led to the finding ways to prognostic approach apprehending the benefits of governance to increase the rate of embracing value creation. From the data collected and research methodology applied, empirical relationships between governance performance and corporate performance has been the central implication of the analysis, which shall lead to the level of complacency for Indian companies to find out how the better-governed companies in the region could out-perform their rivals. In the following sections, the various statistical analyses serve as a conduit to the governance regulators and the corporates to envision level of governance progress. This research thus investigates the endogenous relationship between corporate governance (by way of corporate governance score) and economic value added, being the value based corporate performance metric, of the selected listed companies in India.

Citation: **Dr. Twinkle Prusty, 2016.** "Strategic innovation in corporate governance research- an empirical interface", *International Journal of Current Research,* 8, (02), 27078-27085.

INTRODUCTION

The scale of economic development is now so complex, significant and fast, even furious, that the companies need to embrace good governance practices with a heightened sense of urgency and commitment. No shareholder wants to see the reiteration of corporate collapses and value destruction which became the hallmark of the western economies during the financial crisis, and which so severely tarnished the reputations of the central banks and sector regulators.

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As the best practices of corporate governance hails various qualitative aspects of governance like, integrity of management, ability of the board, adequacy of the board systems and processes, commitment level of individual board members, reporting structure, participation of stakeholders in the management and the quality of the corporate reporting, however, expediting the process of legal reforms for effectual governance mechanism to withstand the convulsions unleashed by the growing competitions and increasing incidences of corporate sicknesses and insolvencies has been a matter of apprehension amongst the corporate regulators in India. Moreover, global market pressures are providing the impetus for investors to harmonize corporate governance practices in order to reduce risks to investors and hold up the quality of corporate practices.

Despite the fact that, simply confining to the adherence of rules and regulations without the creation of corporate conscience and consciousness, the culture of transparency, fair disclosure and economic return in the organization and the corporate democracy, shall ultimately, erode the corporate capabilities to sustain and remain vibrant in terms of benchmarking the best quality of governance in the world.

Thus, the metamorphosis in the mindset has begun gradually regarding how high-quality governance could be a source of value creation for the organization by adoption of good corporate practices through education, technical skills, core competency and a scheme of effective communication, both internal and external. The prudent principles of corporate governance, if enabled into constructive performance in terms of shareholders' wealth creation by harnessing the actions and results of future years, then a company's most valuable asset, goodwill would be replicated before its stakeholders that is earned by deeds not demanded.

Review of Literature

Although there is a plethora of research literature on corporate governance, most of the studies have been done on its conceptual framework and very limited research has been done in the areas of linking the practices of the corporate governance and value based corporate performance. Hence, the present literature study makes an attempt to fill these voids and bringing an aid in the research to investigate the implications of corporate governance principles of the Indian corporates, as recommended by SEBI, in its Clause 49 of the listing agreement.

During the last decades, the spirit of corporate governance has become a strategic requisite focusing on the quality of governance. Moreover, in this period, realizing the need for strengthening the corporate governance mechanisms and the various dimensions in its ideology, the literature study has embarked upon the analysis of vital proportions of corporate governance mechanisms in the light of the recommendations made in India and abroad, enabling the fastening the gaps in the field of research on the linkages drawn between corporate governance and corporate performance.

Research objectives

The focus of this research study is to explore the implications of practices of corporate governance on the economic value added, a value based performance measure for the Indian corporates. It further appraises the association of the parameters of corporate governance with the economic value added of the sample companies based on the BT-SS Survey of the India's biggest wealth creators and assesses whether conformance of the various aspects of corporate governance could bring about direct impact on the corporate performance by way of EVA reporting.

The study further requires highly structured analysis to examine any indirect impact of the corporate governance components on the economic value added due to the presence of some controlled intermediary variables.

Thus, the objectives of the study is summarised below as:

- To examine the relationship of corporate governance and corporate performance and finding out the existence of any endogeneity between governance mechanisms and economic value added, a value based performance measure.
- To evaluate whether the governance characteristics are important in explaining the linkages between corporate governance and economic value added and contribute significantly in establishing any causal association.
- To analyse whether the evaluation of corporate governance practices are consistent in the economic framework for shareholder's wealth creation for establishing internal governance system of selected Indian companies by adopting corporate governance scoring methodology.

Hypotheses Development

The analysis of the past literature has led to the construction of seven null and alternative hypotheses with various sub-hypotheses. These hypotheses have been formulated to give a direction to the flow of the research.

- **H1o:** There is no significant and positive relationship between corporate governance and the Economic Value added, a value based performance measure.
- **H2o:** There is no significant and positive relationship between corporate governance mechanisms and the Economic Value Added, a value based performance measure.
- **H3o:** Corporate Governance does not influence Economic Value Added through the controlled variables.

Research Design

The arrangement of conditions for collection and analysis of data, aimed at combining relevance to the research purpose and the information obtained through extensive literature review falls in as both exploratory and descriptive approaches of research design in identifying the proper relationships of the intended variables. The research approach has adopted the quantitative methods determining specific predictors of the financial performance variables.

Sampling method, Data and Sample Selection

In this study, non-probability judgemental or purposive sampling procedure employed so as to select the top wealth creators of India listed on the National Stock Exchange of India (NSE). NSE is a leading stock exchange in India which provides modern, fully automated screen-based trading system with national reach. For the purpose of the present study, companies constituting the S&P CNX Nifty (Nifty) and CNX Nifty Junior (Nifty Junior), of 100 stocks, have been considered. Nifty is a well-diversified stock index, while Nifty Junior represents the next level of liquid securities after Nifty. Nifty and Nifty Junior combined together constitutes CNX 100, which represents about 78% of the free float market capitalisation as on March 31, 2013 according to the BT Stern

The review of studies have been summarised in the table given below.

Table 1. Review of Studies: Summary Table

Sl.	Authors(year)	Main Results
1.	Cadbury, (1992)	Ideal proportion of executive and non-executive directors impacts corporate performance
2.	Lee, Rosenstein, Rangan, and Davidson(1992)	*Positive & significant between Board independence and EVA-124 companies*
3.	Yermack (1996)	Significant negative relationship between board size, firm value, profitability & assets utilization. Positive firm value due to separation of CEO & chairperson
4.	Shleifer and Vishny (1997); Jensen and Meckling, (1976); Fama and Jensen, (1983)	Corporate governance reduces control rights of stockholders and creditors confer on managers, increasing the probability that managers invest in positive net present value projects
5.	Shleifer and Vishny (1997)	Better-governed firms have better operating firm performance
6.	Dalton, Daily, Ellstrand, & Johnson (1998)	Significant relationship between board size, composition and corporate performance
7.	Eisenberg, Sundgren, and Wells (1998), Hermalin and Weisbach (2003), Mak and Kusnadi (2003), Alshimmiri (2004), Andres, Azofra and Lopez (2005)	Negative relationship between board size and firm performance
8.	Bhagat& Black (2002) and Hermalin and Weisbach(1991)	Firms with independent boards have higher returns on equity, higher profit margins, larger dividend yields, and larger stock repurchases, suggesting that board independence is associated with other important measures of firm performance aside from Tobin's Q.
9.	Coomber and Watson (2000)	High premium paid in the highly governed companies
10.	Karamanou and Vafeas(2005)	*Positive & significant between Board meeting and EVA-89 companies*
11.	Jensen(2001)	*Not significant between Board meeting and EVA-107 companies*
12.	Salmi And Virtanen (2001)	Company profitability(earning growth) has a positive and significant relationship with EVA
13.	Djawahir(2003)	Age of the firm has better EVA
14.	LeBlanc and Gillies (2003)	Measures of good corporate governance are associated with good firm performance
15.	Gompers, Ishii and Metrick (2003)	Used GIM i.e Investor Responsibility Research Center (IRRC) data-concluded- firms with fewer shareholder rights have lower firm valuations and lower stock returns.
16.	Arnott and Asness (2003)	Larger free cash flow payouts reduce managers' abilities to invest in value-destroying projects, give out net present values, suggesting for better-governed firms able to pay out more cash to shareholders.
17.	Metrick(2003)	Gov-Score is more closely linked to firm performance.
18.	Hermalin and Weisbach(2003)	Not significant between outside directors & EVA-Gov. Index -500 companies
19.	Gompers (2003), Bebchuk and Cohen (2004) and Bebchuk, Cohen and Ferrell (2004)	Firms with stronger stockholder control rights are the amount of discretion or control managers have over allocating investors' funds
20.	Anderson(2004)	Cost of Debt is lower for larger boards & independent audit committee ensuring effective monitoring of financial process.
21.	Cremers& Nair(2003)	Shareholder activism significant for internal corporate governance
22.	Bebchuk& Cohen(2005); Cremers and Nair(2005)	Governance score is positively related to firm valuation identifying both internal & external governance factors.
23.	*Utama and Afriani (2005)*	*Positive and significant CGPI (2001) and spread EVA*
24.	Brown &Caylor(2006)	Identified five governance provisions that matter for firm valuation
25.	Garg (2007)	*Negatively significant between Board size and EVA-98 companies*
26.	Reddy,Locke,Scrimgeour(2008)	*Not significant between Board independence and EVA- 437 companies*
27.	Rosentein, Wyatt(2008)	*Positive & significant between Board size and EVA-CGPI-2001*
28.	Reddy,Locke, &Scrimgeour (2010)	*Not significant between Board size and EVA-67 firms*
29.	Ammann, Oesch&Schmid(2010)	Positive association between corporate governance attributes and firm value
30.	Vasal, Varshney, Kaul(2012)	Positive and significant relation between board size and EVA; negative relation between proportion of outside directors, meetings and CEO duality and EVA of western companies
31.	Sarkar, Subroto, Sen(2012)	Strong association between Corporate Governance Index and market performance of the Indian companies
32.	Haldar, Rao(2012)	Positive association between corporate governance and financial performance measured by Tobin Q of Indian industries and negatively impacts leverage.
33.	Kowalewski(2012)	Positive correlation between CG index and firm performance and cash dividends for Poland industries measured by Tobin Q
34.	PankajVarshney, Vijay Kumar Kaul and V.K. Vasal(2012)	Positive & significant between Index of CG of 105 companies.*Board size, board meeting and independent directors with EVA*
35.	Haldar&Rao(2013)	CG Index and firm performance has strong and positive association

Stewart survey, the most accurate report card of India Inc's ability to create (or destroy) wealth, of the top 100 wealth creators of Indian companies having more than Rs. 10000 crores market capitalisation, comprising from 20 important industries of the economy, as at the end of March 2013.

However, 50 companies could be finally obtained for analysis, after eliminating those companies,i.e16 Banking Companies and Financial institutions; 3 Companies merged or delisted during the period 2013-14 ; 12 companies for whom EVA data was not available;19 (9 –BT & 10 NIFTY & NIFTY

JUNIOR)companies -Lost their position in top 100 wealth creators as on 31st March 2014, which did not match the study criteria for effective analysis following the Indian legal standards of practices of corporate governance.

Period of study and Data Source

The time period for which data, relating to EVA and corporate governance attributes, of the sample has been collected is five years: 2008-09 to 2012-13.

Research Technique

The research techniques adopted in the study used various advanced statistical methods like, Panel regression, Ridge panel regression (econometrics) and Structural Equation Modelling-SEM (Amos 21) that analysed the quantitative data measured in the ratio scale by applying the parametric tests. Sampling adequacy tests as well as the reliability and validity of the data were tested with the model parameters to confirm before running the models for the best outcome.

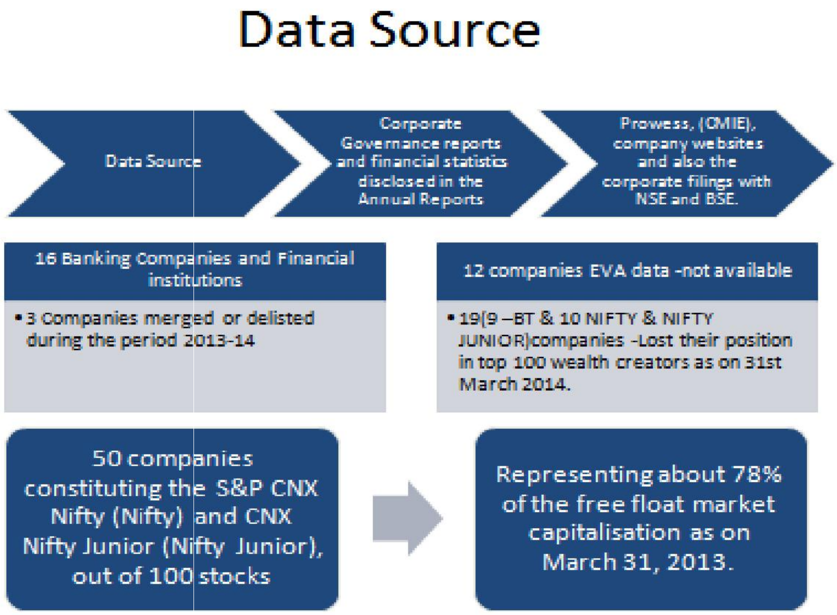

Figure 1. Data sample and Source Information

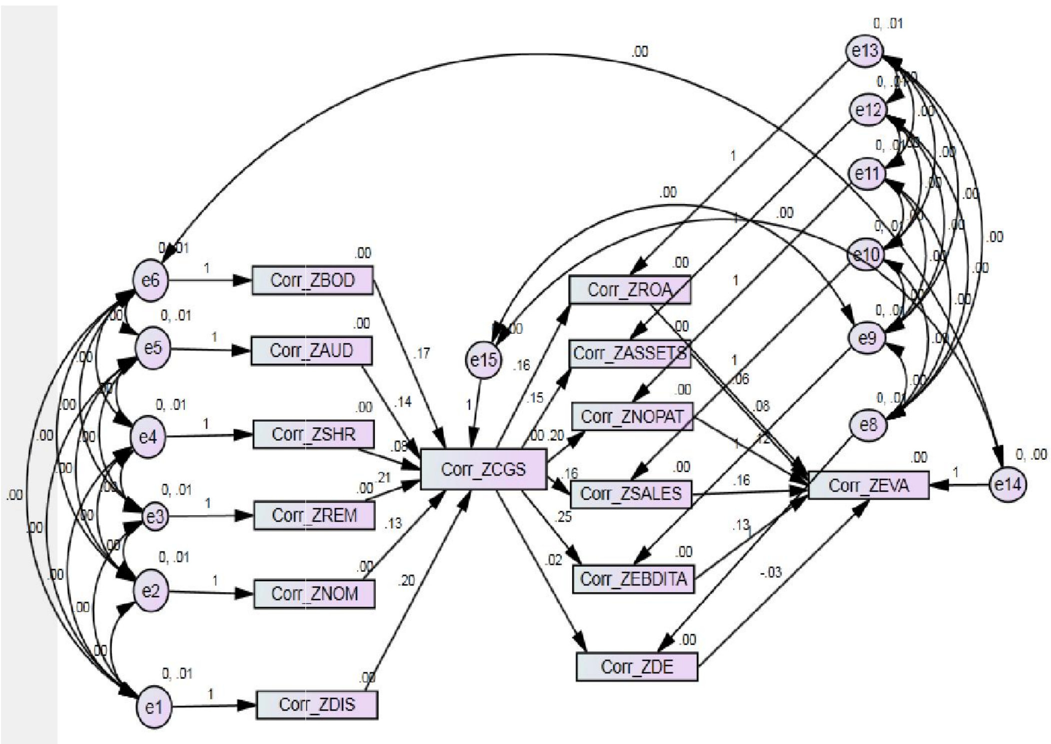

Figure 3 SEM-MODEL

•Governance mechanisms vs CGS
•CGS vs Controlled variables
•Controlled Variables on EVA

To facilitate the objectives of the study, the corporate governance scoring system (CGS) has been used for evaluating and rating the companies in terms of their adoption of the standards, codes and principles of good practices of corporate governance, which was done on the basis of the various source documents, mentioned previously. A binary coding system has been adopted to obtain the CGS for each of the sample companies by way of a questionnaire developed considering the various aspects of corporate governance as given precedence by CRISIL and GMI for the effectiveness of the standard system followed in the Indian context as per clause 49, SEBI. The process of the construction of corporate governance score has been detailed out in the next section.

Reliability and Validity Test

For assessing the degree of measurement error present in any measure, the research addresses two important characteristics of measure i.e, validity and reliability.

Testing of Validity and Reliability of the Instrument

In the study to reduce measurement error, Exploratory Factor Analysis (CFA) for Convergent validity and Discriminate validity of items (six components of CGS and six controlled variables) based on normalized data was conducted. It has been observed that the items have both construct validity and discriminant validity.

The content validity was tested during unidimensionality tests through internal reliability testing (e.g., Cronbach's Alpha =.942 for 6 items of CGS components and Cronbach's Alpha =.652 for 6 items of controlled variables, and Cronbach's Alpha =.574 for 12 composite items). KMO (Kaiser-Meyer-Olkin) has a value of .804 and shows a good measure of sampling adequacy.

RESULTS

- The results of panel regression(random effects model) shows that there is a positive significant relation observed between corporate governance and economic value added entailing a strong impact to the extent of 46.07% which is more as compared to other corporate performance measures like return on assets and return on capital employed.
- From the random effects model, R-square (within) indicates that there is 27.76 percent variation in the total variation of EVA as is explained by CGS between any two companies. It signifies that the effect of CGS on EVA is positive and relatively stronger when performance of a company on EVA through CGS increases. Moreover, the better the company performs among themselves with high and significant CGS, the better the EVA is among the companies.
- The overall R-square suggests that there is 25.44 percent variation in the total variation of EVA which is explained in overall by CGS without regarding the companies. It indicates that the effect of CGS on EVA is positive and relatively stronger in general. Moreover, it depicts that there is positive impact of CGS on EVA and when there is good in improvement of CGS, there is a good improvement in EVA too.
- The SEM results also validate a strong positive and significant influence of corporate governance on economic value added as has been observed in different models.
- The results from panel regression models, ridge panel regression and SEM validates that the impact of the corporate governance mechanisms on economic value added is positive and significant with different proportions of regression weights being observed in different models. The influence of the controlled variables on EVA is positive and significant excepting Debt equity ratio which has a negative but significant relationship with EVA.

Models' Outcome (SEM) Summary

To bring up homogeny with the research objectives and resolution to its hypotheses, the path design to build models under SEM method has been framed in the following manner:
The model is based on six controlled variable constructs to establish the endogeneous relationship between corporate governance mechanisms and CGS, CGS on the six controlled variables' and their influence upon EVA at 5% level of significance with the normalised data. The generated model shows the causal impact of corporate governance upon the controlled variables i.e Sales, Assets, EBDITA, NOPAT, ROA and Debt Equity ratio and their impact upon EVA.

It is observed that impact of the governance mechanisms is the highly significant with positive values upon CGS, the highest being shown by REM, followed DIS, BOD, AUDI, SHR & NOM in the sequence. At the same time this model predicts that the impact of CGS is highly significant on NOPAT, EBDITA, ROA, Sales and Assets while having negative and low significance on D_E. On the other hand, amongst the controlled variables, Sales & EBDITA have shown strong influence upon EVA in comparison to others i.e NOPAT, Assets & ROA in the progression, while showing negative but significant relation with D_E. The outcome suggests that this is a good model fit as given by the model fit measures.

MODEL Depiction

To study the impact of corporate governance on controlled variables; impact of controlled variables on EVA; impact of governance mechanisms on corporate governance Summary Analysis

The model is recursive and contains the following variables:
Chi-square/df has a value of 1.53 with probability value of 0.027. Since this probability value is more than 1% level of significance, SEM has a better fit of the model with above variables. It is also supported by NFI, IFI, TLI and CFI which have a value more than .90. It also supported by RMSEA with value of 0.045 less than .05.

Interpretation

Corr_ZDIS, Corr_ZNOM, Corr_ZSHR, Corr_ZAUD, Corr_ZBOD and Corr_ZREM all have postive significant impact on Corr_ZCGS at 5 percent level of significance. Corr_ZREM has the greatest effect on Corr_ZCGS . It is followed by Corr_ZDIS, Corr_ZBOD, Corr_ZAUD, Corr_ZNOM and Corr_ZSHR. Corr_ZSALES, Corr_ZROA, Corr_ZASSETS, Corr_ZNOPAT and Corr_ZEBDITA have a positive significant effect of Corr_ZCGS at 5 percent level of significance.

Table 2. Results of Baseline comparisons for SEM fit Indices: Model better fit

RMSEA	0.045
CMIN/DF	1.533
NFI	0.945
RFI	0.974
IFI	0.980
TLI	0.952
CFI	0.979

However, Corr_ZDE has negative significant effect of Corr_ZCGS at 5 percent level of significance. All the controlled variables except Corr_ZDE have positive impact of Corr_ZCGS. Corr_ZSALES, Corr_ZROA, Corr_ZASSETS, Corr_ZNOPAT and Corr_ZEBDITA have a significant positive impact on Corr_ZEVA at 5 percent level of significance except Corr_ZDE, which has a negative significant impact of Corr_ZEVA. Moreover, Corr_ZSALES has the highest positive impact of Corr_ZEVA. It is followed by Corr_ZEBDITA, Corr_ZNOPAT, Corr_ZASSETS, Corr_ZROA and Corr_ZDE with negative sign.

Conclusion

The research has introduced an authentic and holistic model to reduce the consummate corporate failures while it emerged out drawing the impact upon the main underlying proposition of linking corporate governance with value based performance measure, economic value added in the Indian corporate sector. It also provided an adequate solution for the ongoing debate in corporate governance about the coalesced roles of various governance mechanisms to achieve value creation for the Indian corporates. To reach a sustainable and innovative solution to this global problem the study endeavours to embed and reflect value creation in the veins of the corporate management routing through the economic framework with the execution of governance mechanisms and addressing the various shortcomings in the Indian corporate sector. This generic approach articulated inflection as one of the first corporeal and measurable means to create a valuable way of life within organizations, characterized by trust, credibility, transparency, accountability, integrity, heading to a high performance motivational culture which will have a positive impact throughout society. The analysis of the listed Indian companies provided evidence that corporate governance is influential and is a long-lasting concept for the firms in the economic point of view to enhance their performance.

Implications and Suggestions of the Study

The study has objectively made contributions to the literature by developing novel ideas in the existing field of corporate governance putting across therein the grounds for high relative linkages between corporate governance score and corporate performance valued in the economic significance. The findings are causative to the regulators, investors, academics and others who contend that good corporate governance does impact the most in regard to the value based corporate performance measure, EVA than other corporate performance measures and add credence to the conception that good corporate governance as measured by its score is ostensibly better linked and represented in the value creating companies reporting positive EVA.

The empirical models developed has enabled identifying the factors controlling or replicating the economic value added performance measure, which on the other hand are found to be influenced by high corporate governance score, thus bringing up the relevancy of corporate governance impact both directly and indirectly through various factors representing good governance and controlling variables. The results of the study provided important implications necessitating establishing the fact that the various corporate governance mechanisms viz., board structure and activity, audit committee, shareholders' rights, remuneration committee, nomination committee and disclosure practices influences the economic value added for consistent internal governance and value creation for the Indian companies. The impact study of corporate governance has been able to commend relevance to monitor, supervise and control the management's ability to grow earnings, and minimise cost for, shareholder value which is the sum of all strategic decisions that affect the firm's ability to efficiently increase the amount of free cash flow over time. Making wise investments and generating a healthy return on invested capital are two main drivers of shareholder value. The study identifies a fine line between responsibly growing shareholder value and doing whatever is needed to generate a profit.

In contrast, taking a process view of corporate governance, this study has dissected the efficacy of the internal system of corporate governance with the value-based performance metric that is consequential for the creation of shareholder value maximization, set as the objective of the research. The adoption of the outcome from the assessment of the main contribution of this study shall form the goal of the Indian corporates endorsing valuable corporate governance in three ways. First, it provides the necessary pre-commitment between shareholders and managers for the creation of value congruence as the goal of the company. Second, it necessitates a greater flow of disclosure of relevant information and the disaggregation of financial cost information. The reflections from the study give a clear identification of the goal of the corporates for value creating activities which are important to eliminate destructive utilisation of assets and resourceful execution of contracts between shareholders and managers. Substantive flows of transparency in the information are needed to bridge the gaps in the incomplete transactions.

Future research directions

The reported findings indicate need for further research that aspire relevance for boards and policy-makers. All other value based management should be linked up with the measures of corporate governance mechanism to draw the implications of the compliance and impact drawl. Governance mechanisms individually are to be studied on all the components of EVA to assess the exact impact i.e the risk eccentricity on the various projects controlling the equity market and long term sustainability with market value need be considered for future study. Impact study of the governance mechanisms, on the technology- driven international business needed to be focussed. The study of the association of the corporate governance system on the corporate computing system introducing the extended business language reporting system in the accounting practices, forensic audit and audit trail system in India, need to be conducted. Managers are the main corporate scientists and their perception and incentivising schemes need proper focus in regard to the practice of corporate governance on the human resource development.

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