

# THE IGNORED TOOL OF CORPORATE GOVERNANCE RATING: AN OVERVIEW OF THE CORPORATE WORLD IN THE EMERGING MARKET

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## Abstract

**How to cite this paper:** Rao, A. L., Kulshrestha, N., Ramakrishnan, G., & Bahuguna, P. C. (2022). The ignored tool of corporate governance rating: An overview of the corporate world in the emerging market. *Journal of Governance & Regulation*, 11(1), 38–44.  
<https://doi.org/10.22495/jgrv11i1art4>

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**ISSN Print:** 2220-9352  
**ISSN Online:** 2306-6784

**Received:** 27.07.2021  
**Accepted:** 06.01.2022

**JEL Classification:** G38, M42, M48  
**DOI:** 10.22495/jgrv11i1art4

Generally, the interest of stakeholders is to see the growth of their entities, also they benchmark their entities through business performance metrics or tools like return on equity, return on assets (Mishra & Kapil, 2018), earnings per share, gross profit margin, employee productivity, sales turnover, ratings given by prominent credit rating agencies, such as Investment Information and Credit Rating Agency (ICRA), Credit Rating Information Services of India Limited (CRISIL), Standard and Poor, etc. In addition to this, internal governance mechanisms, board of directors' characteristics, their independence, transparency, concentration, and presence of employees in the ownership structure also influence financial and stock market performance (Braendle, Stiglbauer, Ababneh, & Dedousis, 2020). However, assessing the performance of entities through some of these limited angles is not always possible. One more criterion for assessing the performance of entities is *corporate governance rating* (CGR). However, it is not widely used as a tool to assess a firm's performance in emerging markets. The present research paper is intended to address the scenario of corporate governance rating in Indian corporate world to assess a firm's performance. With the help of majorly secondary sources of data, this study was conducted from 2003 to 2021 based on the CRISIL's rating pattern. The results revealed that only 20 companies adopted the process of corporate governance rating. The findings showed the significance of corporate governance rating, its adoption and future research in the development of the rating mechanisms in India as well as in other emerging markets.

**Keywords:** Corporate Governance, Stakeholders, Benchmarking, Metrics, Rating

**Authors' individual contribution:** Conceptualization — A.L.R.; Methodology — G.R.; Validation — G.R.; Formal Analysis — A.L.R.; Investigation — A.L.R.; Resources — N.K.; Data Curation — G.R.; Writing — Original Draft — A.L.R.; Visualization — A.L.R.; Supervision — A.L.R.; Project Administration — P.C.B.

**Declaration of conflicting interests:** The Authors declare that there is no conflict of interest.

**Acknowledgements:** The authors extend their gratitude to all the experts and officials of various companies for extending their support in the completion of this work.

## 1. INTRODUCTION

Corporate governance in simple terminology refers to how a corporation is governed (Kibirige & Kiryabwire, 2019). The governance of a corporation majorly rests on its board of directors (BOD). Boards of directors are central in the theme of corporate governance. Their relationship with shareholders and other stakeholders is very crucial to the concept of corporate governance. Unfortunately, the BOD in most cases has no clear-cut idea of managing the affairs of a company.

Corporate governance in one way or another equips corporate entities with certain guidelines, principles, and best practices. The framework of corporate governance also depends on the legal, regulatory, institutional, and ethical environment. To cut short it revolves around three vital limbs. They are law, ethics and wealth maximization.

The concept of corporate governance is crossing its boundaries. The importance of good governance is recognized by investors and regulators. Governance has a great impact on global financial markets. The significance of corporate governance is well recognized by all business leaders, directors, and other stakeholders.

The theme of corporate governance rating (CGR), though not outdated, yet gained its popularity because of the initial steps taken by Governance Metrics Inc. (GMI), which is a New York-based rating agency and which conducted rating on the basis of 600 data points on a rating scale of 1-10 in Japan in May 2003.

Later, in addition to GMI, the Organization for Economic Co-operation and Development (OECD) also proposed the corporate governance rating based on four principles of fairness, transparency, accountability and responsibility.

As corporate governance rating is not mandatory, the Securities and Exchange Board of India (SEBI) did not enforce the rating of Indian companies. It has left the adoption of corporate governance rating to individual companies' discretion. The corporate bodies in India have the liberty to rate themselves with the help of agencies like Credit Rating Information Services of India Limited (CRISIL), Investment Information and Credit Rating Agency (ICRA), CARE, etc. At this juncture, one of the statutory bodies, Institute of Company Secretaries of India (ICSI), developed a rating mechanism to rank and rate the corporate bodies based on the following model:

1. Hard-core parameters:
  - board accountability;
  - financial disclosure;
  - internal controls;
  - executive compensation;
  - ownership base;
  - potential for dilution and shareholder rights.
2. Core parameters, i.e., wealth maximization.
3. Desirable parameters, i.e., ethics and societal welfare.

In India, CRISIL in 2003 started rating corporate bodies voluntarily if they apply for rating. Later, ICRA and CARE also started rating companies. They initially started with rating 50 companies, out of which only 19 companies disclosed their ratings.

This situation was not much improved even after nearly 18 years, i.e., 2003-2021. Accordingly, the present study takes into consideration the scenario of corporate governance rating from 2003 to 2021 and substantiates a lot of previous research works with respect to corporate performance and frameworks used to measure the performance of corporate bodies (Neely, 2005). Another research work by Bansal (2005) incorporated the base for evaluation of corporate governance by adopting a scoring pattern and this pattern was initially adopted by ICSI. Bhasin (2008) in his study on corporate governance rating observed that there were no global benchmarks to measure with respect to corporate governance standards. A research work by Holm, Balling, Poulsen, and Cook (2014) addressed a prominent question, whether the corporate governance rating reduces the problems of asymmetric information between companies and investors. Isiaka (2014) viewed that corporate governance rating is a useful tool for providing the investor with the necessary information and aimed at solving the primary theoretical problem of principal and agent relationship.

After going through the literature since 2003, it has been discovered that corporate governance rating is an important and significant area but is still found as a gray area in research barring a few recent surveys by SAHA, an independent rating agency that revised the World Corporate Governance Index (WCGI) in 2018 and in March 2021 in 150 countries by classifying all these countries into 5 groups. Apart from these major research works not much progress has been found in adopting corporate governance rating in the emerging world by any regulatory body or at a policy level by any government, therefore the present study will definitely provide a supplement in the field of corporate governance rating. The study is significant for regulators, policymakers and researchers to get an insight into the rating.

The current research work majorly studies the scenario of corporate governance rating starting from 2003 to 2021, especially by focusing on Indian corporate world. The manuscript is structured into 6 sections. Section 2 presents the literature, Section 3 focuses on research methodology, Section 4 analyses the state of corporate governance rating, Section 5 discusses the findings, Section 6 concludes the study.

## 2. REVIEW OF LITERATURE

Donaldson and Davis (1991) advocated various theories of corporate governance. According to them, some of the theories may be appropriate to some regions or countries, some theories may be appropriate for a certain time period depending on the stage at which an individual country or group of countries is at or may have. They felt the subject of corporate governance emerged due to an increasingly globalized and regulatory environment.

According to Coles, McWilliams, and Senc (2001), corporate governance is viewed as a remedy in resolving conflicting interests; further they also

defined corporate governance as a set of customs, processes, policies, laws and institutions which affects the way a corporate body is directed, controlled and administered.

As per ASX Corporate Governance Council (2003), "Corporate governance is the system by which companies are directed and managed. It influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimized. Good corporate governance structures encourage companies to create value (through entrepreneurship, innovation, development and exploration) and provide accountability and control systems commensurate with the risks involved" (p. 6).

A Corporate Governance Report, which is popularly known as Cadbury Committee's report, was submitted by Sir Adrian Cadbury in 1992. The committee noted the major deviations in countries with respect to corporate governance, in particular in board structures (The Committee on the Financial Aspects of Corporate Governance and Gee and Co. Ltd., 1992).

The Study Group of Directors' Remuneration (1995) discussed mainly the disclosure of director's remuneration. It elaborately discussed the level of disclosure that should be with respect to directors' remuneration and how useful these detailed disclosures may be. The Greenbury Report, which was issued in the UK in 1995, was established on the initiative of the Confederation of British Industry (CBI) because of public concern about directors' remuneration.

Kumar Mangalam Birla Committee of India, which was established in May 1999 to study corporate governance in India, published its report on corporate governance in 2000 (SEBI, 2000).

A detailed description of corporate governance principles was provided by Fernando (2006). The study dealt with the policies and practices in firms in theoretical settings and with case study orientation.

Newquist and Russel (2007) described what a good governance practice is and what is not by quoting the relevant examples.

After a thorough review of various research articles, reports, reference books, and other published and unpublished works, it was found that a vital phenomenon of corporate governance rating is not much tapped. The scenario with respect to India is still not much progressive, there could be many reasons for this aspect. However, one of the major setbacks for governance rating, as per the author's interactions with some business leaders, is the phenomenon of cost. As per them, there are already a great number of tools, which are available for measurement of a firm's performance, why there should be another tool in the form of corporate governance rating? Further, Roy (2009) in his study made an observation that only 19 companies out of 4700 listed companies resorted to corporate governance rating.

In a study made by Erkens, Hung, and Matos (2012) it was found that out of 296 firms from 30 countries, firms with more independent boards

and higher institutional ownership witnessed poor stock returns during the global meltdown period.

Anton (2016) conducted a study on listed Romanian firms from 2001 to 2011, and it was found a causality between economic growth and economic uncertainty. Also it was observed in the same study that profitability influences firm growth.

Cheung, Naidu, Navissi, and Ranjeeni (2017) conducted a study to investigate the association between good capable managers and firm performance, which is affected by the joint effect of managerial discretion and monitoring quality.

A study was conducted by Antoniadis, Gkasis, and Koutsas (2019) to examine the influence of 636 insider trading announcements on 14 listed firms in Athens Stock Exchange from 2007 to 2013; a surge of abnormal stock returns was found.

AlHares, Dominic, and Abu-Asi (2020) studied the data from 2010 to 2019 on 200 companies from Forbes 2000 list and showed that institutional ownership is positively correlated to cost of capital.

A research work carried by Foss and Jensen (2018) discussed the lack of proper literature in the field of management and governance on "managerial meta-knowledge". Basically it refers to whether managers know their capabilities with respect to the firms they govern and manage.

The above indicates a good reason for the research gap in the existing body of literature as well as a research problem and the same is justified with other supplements in the foregoing sections.

### 3. RESEARCH METHODOLOGY

Corporate governance rating is a known phenomenon since 2003, yet it has not gained its popularity due to various issues. The present research paper is intended to see the overall corporate governance rating process in selected corporate entities. The study is intended to see, why corporate governance rating is untapped in Indian corporate sector. Although corporate governance rating acts as a benchmark for assessing corporate performance by differentiating well-managed companies from companies, which are not following good governance practices, yet the scenario is not in a welcoming shape.

The study is performed majorly on the basis of secondary sources of data, such as corporate governance reports, research papers, journal articles, magazines, other published and unpublished works. Further, the researchers used observation and some unstructured interviews (see Appendix) with top-level management groups of nearly 10 companies to assess the phenomenon of corporate governance rating. Due to the confidential nature of discussions, the names of the companies and the names of the respondents are not provided. The interview groups majorly consist of auditors, finance managers, asset managers and compliance officers.

The research methodology used for the objective is as follows (see Table 1):

**Table 1.** Research methodology

<b>Objective</b>	To find out why corporate governance rating is untapped in Indian corporate sector.
<b>Research design</b>	Descriptive research study.
<b>Sources of data</b>	Secondary data, such as corporate governance reports, research papers, journal articles, magazines, other published and unpublished works. Primary data using unstructured interviews with top-level management persons (10 companies).
<b>Questionnaire design</b>	1. Variable identification through literature review (various facets of corporate governance rating). 2. Questionnaire preparation. 3. Pilot testing of questionnaire. 4. Administering the questionnaire to the selected sample.
<b>Sampling design</b>	Convenience sampling: the sample was conveniently selected as some of the parameters used to elicit data are complex.
<b>Data analysis</b>	Descriptive statistics.

#### 4. STATE OF CORPORATE GOVERNANCE RATING

As there is no universally accepted tool available for measuring corporate governance, measuring corporate governance is not an easy task, whereas measurement of the financial position of a firm can be done without much difficulty.

But nowadays there is one tool available to measure corporate governance as there is a growing awareness of the concept. The tool is *corporate governance scoring or rating* which addresses many problems and best practices.

The Securities and Exchange Board of India considering the importance of corporate governance rating recommended the companies to adopt corporate governance rating as an advisable good governance practice and referred to CRISIL and ICRA for a further study rating of corporate bodies for a suggestive rating model. Some of the important parameters as prescribed by the SEBI and ICSI to obtain the corporate governance score are as follows:

- structure of the board;
- company's philosophy on code of corporate governance;
- various other sub-committees and their practices, such as audit, compensation, remuneration, grievance redressal, nomination, code on ethics, share transfer;
- position of the chairman and chief managing director;
- annual general body meetings, other disclosure practices;
- practices on corporate social responsibility.

The authors made a study in Indian corporate bodies to see the significance of corporate governance rating as per the standard methodology. It was found that out of 647 public limited companies in 25 sectors only 20 companies were in the process of following or adopting rating their corporate governance practices, amongst this list (see Table 2) the following prominent business entities were found following CGR:

- Infosys;
- mHLL;
- Aditya Birla Group;
- Dabur;
- ONGC;
- Tata;
- Toyota;
- Wipro;
- Mahindra & Mahindra;
- ITC.

**Table 2.** State of CGR in Indian corporate bodies

No.	Sector	No of companies (approx.)	No of companies follow CGR
1	Tobacco	6	1
2	Automobiles	10	2
3	Petrochemicals	15	2
4	Cables	12	0
5	Beverages (alcoholic)	18	0
6	Beverages (non-alcoholic)	30	4
7	Fertilizers	23	0
8	Petroleum	16	2
9	Metal	16	1
10	Consumer durables	15	3
11	Pharmaceuticals and health care	100	2
12	Banks	27	1
13	Infrastructure	22	1
14	Leather	13	0
15	Mining	13	0
16	Electronics	8	0
17	Paints	6	0
18	Electric equipment	10	1
19	Food processing	55	0
20	Cement	89	0
21	Insurance	29	0
22	Paper	45	0
23	Hotels	44	0
24	Telecommunications	12	0
25	Shipping	13	0
	<b>Total</b>	<b>647</b>	<b>20</b>

Source: Authors' compilation.

The observations of the authors were that in India the level of awareness on corporate governance scoring or rating as a tool for measuring the effectiveness of corporate governance practices is low when compared with other Western markets. The valuation techniques followed by many of the corporate bodies are similar with some differences with respect to the scope of coverage, compilation, and evaluation of information. In addition to this, the corporate governance rating process is voluntary. Either, neither SEBI or nor other regulatory body so far has made corporate governance rating compulsory. One more observation through some discussions with top-level executives is that corporate governance rating is the sheer wastage of time and resources because there are already many other regulatory clutches, which corporate bodies are following, and adding the rating process will increase the compliance costs and accordingly they are not in favour of the rating process.

#### 5. FINDINGS AND DISCUSSIONS

The revised clause No. 49 issued by SEBI in consonance with Companies Act 2013 was silent on corporate governance rating. However, it reiterated the objective of maintaining best practices in line with the provision of Indian Companies Act 2013. The authors after a thorough review of the rating process found that the whole structure of corporate governance rating was questioned starting from the board of directors of a company and its compliance officers, who generally have some resentment towards this practice and accordingly it can be said that corporate governance rating systems are another tool to exploit the innocent investors because acceptance or concurrence of the rating process always rests on top-level management and various compliance officers. There could not be any evidence if there exist any *quid pro quo* dealings between the agents and the raters, and the major theme of corporate governance, i.e., transparency becomes a question mark.

However, the major purpose of the rating is to provide the investors with recommendation with respect to corporate performance. One of the key observations of the researchers is that corporate governance cannot be seen through papers, and even through metrics, it should be exhibited in reality, especially the employees and other stakeholders, whose confidence and reliability on the part of the corporation to which they belong is always an index of good governance.

### 5.1. Rating by ICRA and CRISIL

The corporate governance rating is assigned on a six-point scale of CGR1 to CGR6 by ICRA. The rating provided by ICRA shows the ICRA's opinion on the company is based on the company's practices, conventions and codes. However, ICRA's opinion is not a certificate of statutory compliance or a comment on the rated company's future financial performance, credit rating or stock price.

It is observed that ICRA's coverage of analysis of corporate governance practices being followed by a corporate entity appears to be much wider than that of CRISIL. CGR rating of CRISIL includes a scale of eight levels, whereas the CGR rating of ICRA includes a scale of six levels, which means that CRISIL allows more flexibility in its rating process than ICRA. The general rating methodology of CRISIL is presented in Table 3 and the ranking of the entities is presented in Table 4.

**Table 3.** Rating of corporate governance

No.	Governance parameters	Points assigned
1	Statement of code of governance	2
2	Structure and strength of the board	2
3	Chairman and CEO duality	5
4	Disclosure of directors' particulars	2
5	Disclosure of age & tenure	2
6	Post-board meeting follow-up	2
7	Appointment of lead director	2
8	Disclosure of other provisions relating to BOD and committees	1
9	Disclosure of remuneration policy and remuneration of directors	2
10	Board committees	25
11	Disclosure and transparency	19
12	General body meetings	3
13	Means of communication and general shareholder information	2
14	Compliance of corporate governance auditors' certificate	10
15	Disclosure of stakeholder interests	10
16	Various committees and reports	6
17	Shareholders/investor grievance redressal committee	5
	<b>Total</b>	<b>100</b>

Source: Adapted and refined from CRISIL score pattern.

**Table 4.** Ranking of companies based on corporate governance scores as per CRISIL

Score range	Rank
76-90	Excellent
61-75	Very good
46-60	Good
31-45	Average
Below 31	Poor

### 5.2. Findings

Corporate bodies in India are not in a mood to accept another performance indicator. Some of the reasons for disinterest are as follows:

- adoption of proper metrics measurement;
- identification of key parameters;
- need for proper and approved rating agencies/individuals/firms/consultants with sound knowledge on the subject for undertaking measurement;
- approval of and willingness of the corporate bodies for rating;
- active involvement of all the parties for undertaking measurement.

The current corporate regulations in India are not enforcing the rating of corporate bodies as a compliance practice. Some of the corporate legislations like the Indian Companies Act 2013 and Securities and Exchange Board of India Act 1992, if adopted, contain the rating mechanism, and the rating process may become another tool for measuring good performance.

The above issues must be addressed in true letter and spirit, then some of form of progress in this area can be found. Visualization of everything from an investment perspective may not yield return in the short run, but in the long run, the performance assessments in various forms strengthen corporate bodies in implementing the best practices. The key essence of corporate governance is that the stakeholders should be informed in a real sense.

### 6. CONCLUSION

Securities and Exchange Board of India believes that corporate governance rating would help prevent companies as well as management from committing fraud if CGR is based on a model fortified by checks and balances.

In fact, SEBI advocated an ethical approach to corporate rating. Mr. G. N. Bajpai, a former chairman of SEBI stated that "we need to develop an appropriate instrument that can assess the standards of corporate governance not only on the basis of compliance with rules and regulations but also with the principles behind them" (Singh, 2005, p. 260). He further added that "rating should ensure that the implementation of the codes of corporate governance should be true in both letter and spirit" (Singh, 2005, p. 260), merely getting the auditors to follow the accounting norms will not solve the problem. "Remember, this is also an issue of ethics", he said in April 2004 (Singh, 2005, p. 260). This concern over corporate governance is mainly because of the scandals that have rocked corporate America, and also by the general impression that the compliance levels of corporate governance in India are far below the desired levels.

Further, in the rating process hard-core parameters, core parameters and desirable parameters were majorly mentioned and nothing specific was given to the values, the rating process without a value criterion is not much significant, therefore, it is recommended to follow a rating pattern like A\*, A\*\* and A\*\*\* with some exact scale values to get a full understanding of the assessment.

Although the rating process adopted by CRISIL to some extent looks fine, it could be better to define companies coming with the *Excellent* category as A\*\*\*. This could give some meaning to the process.

The adoption of corporate governance rating in other countries is also still at inception, the reason for non-adoptability is more or less common in other countries as well. However, the strong compliance laws added advantage in some countries like Sweden, Denmark, France, Norway, Germany and Australia.

The major limitation of the current research work is “evidenced data” as not many sources are available to hunch and dig further, the authors extracted the relevant data as far as possible through various means. A study period of 18 years is fairly too long to depict the phenomenon, yet it could substantiate the ignorance of the measurement tool for firms’ performance. Another phenomenon noticed is data confidentiality and fear of sharing and expression consequently, the authors conducted the study with the available sources.

From the viewpoint of future research, the current research work gives enough cushion to concentrate and carry on cross-country, cross-company, and industry studies to have a better picture leading to the advantage to all the stakeholders. The various rating bodies can focus exclusively on the rating aspect to serve as a bridge between the investors and entities. Another important research projection is conducting of cost-benefit analysis for the adoption of rating. The role of regulatory bodies, policymakers and legislative enactment bodies can be verified in protecting the interest of stakeholders. Future research can focus on what makes firms reluctant in implementing the rating philosophy and practice. Finally, the current research could be of great help to see the level of corporate governance rating in various countries and could be used extensively by academicians and researchers.

After a thorough study, the authors have concluded that corporate governance rating is an ignored tool by corporate bodies or managers to indicate and assess the firm’s performance in the emerging markets.

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## APPENDIX

**Table A.1.** Model questionnaire on corporate governance rating used for interviews in the selected companies

No.	Question	Reply
1	Do you know about corporate governance rating?	Yes/No
2	Is corporate governance rating process adopted in your opinion?	Yes/No
3	What is your view on adopting corporate governance rating in your opinion?	Willing/Unwilling
4	Is there any problem with implementation of rating methodology?	Yes/No
5	What is the major problem that is impacting non-implementation of corporate governance rating?	Tick on the following: Cost/Process/ Not compulsory/Others
6	In your opinion, is the rating process a good indicator of your organization's financial performance?	Yes/No
7	Are you willing to consult rating bodies for providing rating?	Yes/No
8	Do you submit regularly corporate governance reports to your stakeholders?	Yes/No
9	Are you satisfied with the existing reporting practices?	Yes/No
10	If corporate governance rating is made compulsory for all, will you follow in true spirit?	Yes/No