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GRT CLAUSE 49 AND ITS IMPACT ON PERFORMANCE MEASURES

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Abstract:-This study attempts to understand the effect of India's adoption of major governance reforms (with reference to Clause 49) which is based on a voluntary 1998 Code of Corporate Governance, developed by the Confederation of Indian Industry (CII, an organization of large Indian public firms). If investors consider the reforms to be valuable (or more valuable for larger firms), firm return in the form of share prices, accounting profit and earning per share should react positively to the key adoption announcement. Over a span period of 10 years before and after the announcement by the Securities Exchange Board of India (SEBI, India's principal securities regulator) for adoption of Clause 49, the profit after tax and EPS of the listed companies specifically the group of companies selected for this study has shown the positive effect on the above specified components. Average returns had increased considerably and even EPS also present the same picture, but these changes may have been due to factors other than the reforms. These results also supported by statistical testing. Overall, we report evidence consistent with investors expecting the Clause 49 reforms to increase the efficiency of corporates.

Keywords: Profit, Corporate governance, listed companies.

OBJECTIVE OF THE STUDY

The primary objective of the project is to assess the effectiveness of clause 49 of listing agreement, SEBI on the performance of the companies. The aim is to compare the differences in the average returns of the selected companies before and after implementation of the clause on the basis of various parameters like profit after tax and earning per share.

The work was undertaken in order to study or assess the effectiveness of corporate governance measure in the real life and how they are actually affecting the performance of the companies in actual terms with the help of accounting and statistical measures.

The study seeks to achieve the above mentioned objectives by testing the following hypotheses:

H_0 : Null Hypothesis

H_A : Alternate Hypothesis

H_{01} : Implementation of Clause 49 of listing agreement has a positive impact on EPS* of companies

H_{A1} : Implementation of Clause 49 does not have a positive impact on adjusted EPS of companies

H_{02} : Implementation of Clause 49 has a positive effect on average Profit After Tax of Companies

H_{A2} : Implementation of Clause 49 does not have a positive effect on average Profit after Tax of Companies

To support the findings of the project, hypotheses testing have been used at two significance levels 5% and 10%.

METHODOLOGY

The research methodology includes empirical analysis of the financial performance of selected companies by taking data from their past annual and financial statement. Secondary sources (specifically proweess) of data collection have been used

to compare average annual returns of 5 years before and 5 year after implementation of the clause to assess the performances of companies.

1.6.1. Statistical Analysis

Basic statistical tool have been used to analyses the data like Averages, Standard deviation, coefficient of variation to ascertain the variation in the returns as well as hypotheses testing and t- testing is used to test the results found. For statistically testing the performance of companies here we are using t-distribution, as the sample size is 30 and the population standard deviation is not known. Furthermore, here we are assuming that the population is normal or approximately normal as the clause is applicable on all the listed companies in India.

Test: Paired Two Sample for Means

A paired test can be used when there is a natural pairing of observations in the samples, such as when a sample group is tested twice — before and after an experiment. This analysis tool and its formula perform a paired two-sample Student's t-Test to determine whether observations that are taken before a treatment and observations taken after a treatment are likely to have come from distributions with equal population means. This t-Test form does not assume that the variances of both populations are equal.

Raw data as per annexure-I is used to evaluate the performances of companies.

LIMITATIONS OF THE STUDY

The study was limited to 30 listed companies (in BSE) only.

Most of the information collected is through secondary data.

The data is compared and analyzed on the basis of performance of the companies over the past ten years.

While comparing the results only some accounting measures have been considered like profit after tax and Earning per share due to limitation of time and resources.

The study only evaluates the differences in the profits or EPS i.e. market valuation of the companies have not been considered

Data Selection and Analyses

Data Selection

The present study analyses 30 companies listed in Bombay Stock Exchange which also represent BSE SENSEX to assess the impact of clause 49 of listing agreement on corporate governance issued by Security Exchange Board of India for the period 2000-2010.

About BSE SENSEX

The BSE SENSEX (Bombay Stock Exchange Sensitive Index), also called the BSE 30 (BOMBAY STOCK EXCHANGE) or simply the SENSEX, is a free-float market capitalization-weighted stock market index of 30 well-established and financially sound companies listed on Bombay Stock Exchange (BSE). The 30 component companies which are some of the largest and most actively traded stocks are representative of various industrial sectors of the Indian economy. Published since January 1, 1986, the SENSEX is regarded as the pulse of the domestic stock markets in India. The base value of the SENSEX is taken as 100 on April 1, 1979, and its base year as 1978-79. During the introduction of the SENSEX in 1986, some of the companies included in the base calculation in 1979 were removed and new companies were added.

List of Selected Companies (BSE SENSEX companies)

Clause 49 And Its Impact On Performance Measures

	Company	Industry
1	Housing Development Finance Corporation	Consumer finance
2	Cipla	Pharmaceuticals
3	Bharat Heavy Electricals	Electrical equipment
4	State Bank Of India	Banking
5	HDFC Bank	Banking
6	Hero Motocorp	Automotive
7	Infosys	Information Technology
8	Oil and Natural Gas Corporation	Oil and gas
9	Reliance Industries	Oil and gas
10	Tata Power	Power
11	Hindalco Industries	Metals and Mining
12	Tata Steel	Steel
13	Larsen & Toubro	Conglomerate
14	Mahindra & Mahindra	Automotive
15	Tata Motors	Automotive
16	Hindustan Unilever	Consumer goods
17	ITC	Conglomerate
18	Sterlite Industries	Metals and Mining
19	Wipro	Information Technology
20	Sun Pharmaceutical	Pharmaceuticals
21	GAIL	Oil and gas
22	ICICI Bank	Banking
23	Jindal Steel & Power	Steel and power
24	Bharti Airtel	Telecommunication
25	Maruti Suzuki	Automotive
26	Tata Consultancy Services	Information Technology
27	NTPC	Power
28	DLF	Real estate
29	Bajaj Auto	Automotive
30	Coal India	Metals and Mining

Data Analysis

Data have been done through statistical analyses

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Measures used for assessing the performance of companies

Profit after tax, Earning Per Share , Profitability Ratios like PAT as % of capital employed, PAT as % of net worth, PAT as % of total assets, PAT as % of total income and PBDITA as % of total income have been used for measuring the performance of the corporates in this study

Following is the analysis of (5 year) average EPS* of selected companies before and after implementation of clause 49 of listing agreement

Analysis of EPS*							
All figures in Rs.							
Company Name	From Year 2000 to 2005			From Year 2006 to 2010			%Increase in Average EPS
	Average EPS	Standard Deviation of Average EPS	CV of Average EPS	Average EPS	Standard Deviation of Average EPS	CV of Average EPS	
Bajaj Auto Ltd.#	NA	NA		72	40	56	
Bharat Heavy Electricals Ltd.	27	9	32	75	20	26	175
Bharti Airtel Ltd.	1	3	237	31	12	39	2672
Cipla Ltd.	42	16	39	60	8	14	42
Coal India Ltd.	112	78	70	459	96	21	310
Dr. Reddy'S Laboratories Ltd.	35	24	69	44	20	46	24
G A I L (India) Ltd.	17	5	31	27	5	20	56
H D F C Bank Ltd.	13	6	47	45	12	27	251
Hero Motocorp Ltd.	25	13	50	63	31	49	151
Hindalco Industries Ltd.	97	23	24	155	59	38	59
Hindustan Unilever Ltd.	6	1	20	8	1	16	21
Housing Development Finance Corpn. Ltd.	38	7	18	71	17	24	89
I C I C I Bank Ltd.	14	10	72	34	2	5	143
I T C Ltd.	50	12	24	71	15	21	40
Infosys Ltd.	111	52	47	86	19	22	-23
Jindal Steel & Power Ltd.	150	103	69	557	370	66	272
Larsen & Toubro Ltd.	26	25	96	62	14	23	141
Mahindra & Mahindra Ltd.	21	14	67	41	17	43	97
Maruti Suzuki India Ltd.	12	72	623	57	19	33	391
N T P C Ltd.	5	3	51	8	1	16	66
Oil & Natural Gas Corpn. Ltd.	55	24	44	79	3	4	43

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Reliance Industries Ltd.	32	12	38	80	24	30	150
State Bank Of India	54	19	36	113	29	25	108
Sterlite Industries (India) Ltd.	42	29	67	79	9	11	86
Sun Pharmaceutical Inds. Ltd.	19	7	39	45	14	32	135
Tata Consultancy Services Ltd.	11	22	200	42	7	16	277
Tata Motors Ltd.	8	20	252	45	17	37	481
Tata Power Co. Ltd.	24	4	17	36	5	15	48
Tata Steel Ltd.	28	23	82	66	7	11	136
Wipro Ltd.	29	10	35	22	7	30	-26

as Bajaj Auto limited has been incorporated in 2007 so it is not been included so it is not been included.

* EPS have been adjusted for the face value differences found during different time period for respective companies .It has been adjusted by making the EPS calculated for a specific face value for example if the face value per share of a company has been changed from Rs.10 to Rs.5 than the EPS of that current/previous period is multiplied/divided by 2, through this return on a comparable amount of investment has been calculated. Similar exercise is done for each company and each change in EPS of respective companies.

Hypotheses Testing

For statistically testing the performance of companies using t distribution, as the sample size is 30 and the population standard deviation is not known. Furthermore, here we are assuming that the population is normal or approximately normal as the clause is applicable on all the listed companies. To support the findings of the project, hypotheses testing have been used at two significance levels 5% and 10%

H_0 : Null Hypothesis

H_A : Alternate Hypothesis

Testing at 5% and 10% significance level

H_{01} : Implementation of Clause 49 of listing agreement has a positive impact on EPS* of companies

H_{A1} : Implementation of Clause 49 does not have a positive impact on adjusted EPS of companies

Degree of Freedom : 28 i.e. (n-1)

*as Bajaj Auto limited has been incorporated in 2007 so it is not considered in calculations. So n equals to 29 and DOF (29-1) 28.

At Significance level : 5%

Degree of Freedom : 28 i.e. (n-1)

Clause 49 And Its Impact On Performance Measures

t-Test: Paired Two Sample for Means		
At Significance level : 5%		
	After	Before
Mean	88.22048	38.12646
Variance	14592.79	1302.955
Observations	29	29
Pearson Correlation	0.834312	
Hypothesized Mean Difference	0	
DF*	28	
t Stat	2.905612	
P(T<=t) one-tail	0.003543	
t Critical one-tail	1.701131	
P(T<=t) two-tail	0.007085	
t Critical two-tail	2.048407	

As per the above results it is clearly evident that the t-value (2.905612) comes in the rejection zone (i.e. Beyond critical value 1.701131) which results in rejecting the null hypothesis and accepting the alternate one, which states that there is a difference in the before and after average EPS of companies, however, it is also clear from the above results that after the implementation of the clause companies shows the positive results (i.e. increase in average EPS of companies).

At Significance level : 10%

t-Test: Paired Two Sample for Means		
At Significance level : 10%		
	After	Before
Mean	88.22048276	38.126456
Variance	14592.78834	1302.9554
Observations	29	29
Pearson Correlation	0.834312	
Hypothesized Mean Difference	0	
Df	28	
t Stat	2.905612124	
P(T<=t) one-tail	0.003542575	
t Critical one-tail	1.312526782	
P(T<=t) two-tail	0.007085149	
t Critical two-tail	1.701130934	

Clause 49 And Its Impact On Performance Measures

Even when the significance level has been increased from 5% to 10% the same results are revealed by the analysis. The t-value (2.905612) comes in the rejection zone (i.e. Beyond critical value 1.312526782) which results in rejecting the null hypothesis and accepting the alternate one, which states that there is a difference in the before and after average EPS of companies.

Following is the analysis of (5 year) average PAT of selected companies before and after implementation of clause 49 of listing agreement

Analysis of Profit after Tax (PAT)							
all figures in Rs. Million							
Company Name	From Year 2000 to 2005			From Year 2006 to 2010			%Increase in Average Profits
	Average Profit after tax	Standard Deviation of average Profit after tax	CV of average Profit after tax	Average Profit after tax	Standard Deviation of average Profit after tax	CV of average Profit after tax	
Bajaj Auto Ltd.*	NA	NA		10368	5767	56	
Bharat Heavy Electricals Ltd.	5727	2227	39	28804	9711	34	403
Bharti Airtel Ltd.	2021	4941	244	58919	29391	50	2815
Cipla Ltd.	2455	979	40	7671	1861	24	213
Coal India Ltd.	7157	4971	69	28437	8286	29	297
Dr. Reddy'S Laboratories Ltd.	2342	1702	73	6541	3698	57	179
G A I L (India) Ltd.	14393	4441	31	26483	3357	13	84
H D F C Bank Ltd.	3649	2001	55	17592	8441	48	382
Hero Motocorp Ltd.	5036	2511	50	12621	5646	45	151
Hindalco Industries Ltd.	7878	2798	36	22453	4841	22	185
Hindustan Unilever Ltd.	14727	3157	21	19775	4067	21	34
Housing Development Finance Corpn. Ltd.	6724	2393	36	20804	6501	31	209
I C I C I Bank Ltd.	8955	8304	93	35182	6794	19	293

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I T C Ltd.	13573	4943	36	30769	6816	22	127
Infosys Ltd.	9726	5563	57	44590	14377	32	358
Jindal Steel & Power Ltd.	2069	1730	84	11058	4440	40	435
Larsen & Toubro Ltd.	4922	2538	52	24888	14148	57	406
Mahindra & Mahindra Ltd.	2466	1603	65	11915	5150	43	383
Maruti Suzuki India Ltd.	2846	3875	136	16396	5317	32	476
N T P C Ltd.	42289	10304	24	74058	11389	15	75
Oil & Natural Gas Corpn. Ltd.	78722	35100	45	159338	9573	6	102
Reliance Industries Ltd.	41841	19398	46	144129	40224	28	244
State Bank Of India	28630	10232	36	67929	23356	34	137
Sterlite Industries (India) Ltd.	1524	526	35	8623	2627	30	466
Sun Pharmaceutical Inds. Ltd.	1943	806	41	8536	3169	37	339
Tata Consultancy Services Ltd.	4623	9128	197	42595	10876	26	821
Tata Motors Ltd.	3108	6254	201	17456	4826	28	462
Tata Power Co. Ltd.	4601	1213	26	8077	1460	18	76
Tata Steel Ltd.	12356	12256	99	45328	6866	15	267
Wipro Ltd.	8316	4062	49	31595	10564	33	280

* As Bajaj Auto limited has been incorporated in 2007 so it is not been included.

H₀₂: Implementation of Clause 49 has a positive effect on average Profit After Tax of Companies

H_{A2}: Implementation of Clause 49 does not have a positive effect on average Profit after Tax of Companies

At Significance level : 5%

Degree of Freedom* : 28 i.e. (n-1)

as Bajaj Auto limited has been incorporated in 2007 so it is not considered in calculations. So n equals to 29 and DOF (29-1)

28.

Clause 49 And Its Impact On Performance Measures

t-Test: Paired Two Sample for Means		
At Significance level: 5%		
	After	Before
Mean	35605.69793	11883.3
Variance	1354109739	280000000
Observations	29	29
Pearson Correlation	0.9033859	
Hypothesized Mean Difference	0	
Df*	28	
t Stat	5.5883392	
P(T<=t) one-tail	0.0000028	
t Critical one-tail	1.7011309	
P(T<=t) two-tail	0.0000056	
t Critical two-tail	2.0484071	

As per the above results it is clearly evident that the t-value (5.5883392) comes in the rejection zone (i.e. Beyond critical value 1.7011309) which results in rejecting the null hypothesis and accepting the alternate one, which states that there is a difference in the before and after average PAT of companies, however, it is also clear from the above results that after the implementation of the clause companies shows positive results (i.e. increase in average PAT of companies).

At Significance level : 10%
 Degree of Freedom* : 28 i.e. (n-1)

t-Test: Paired Two Sample for Means		
At Significance level : 10%		
	After	Before
Mean	35605.69793	11883.34
Variance	1354109739	280000000
Observations	29	29
Pearson Correlation	0.90338593	
Hypothesized Mean Difference	0	
Df*	28	
t Stat	5.588339237	
P(T<=t) one-tail	2.79E-06	
t Critical one-tail	1.312526782	
P(T<=t) two-tail	5.57E-06	
t Critical two-tail	1.701130934	

Even when the significance level has been increased from 5% to 10% the same results are revealed by the analysis. The t-value (5.588339237) comes in the rejection zone (i.e. Beyond critical value 1.312526782) which results in rejecting the null hypothesis and accepting the alternate one, which states that there is a difference in the before and after average PAT of companies.

5.1. Findings of the Study and Recommendations

The design of the corporate governance framework in India is considered matching that of the advanced countries, on aspects of enforcement and quality of supervision, even though scope exists for significant improvement. The planned implementation of clause 49 laid a benchmark for listed companies and affects their performance in real terms which can be identified in the above study. Some of the major highlights of the study are:

EPS Analyses

Through a comparative analysis of 2000-2005 period & 2005-2010 periods, it is apparent that EPS have been showing an upward trend & this holds true for all most all the companies under consideration. This can be attributed to the implementation of clause 49 by SEBI. Another point of consideration can be that the behavior reflected by all firms is not identical in all terms. They are showing a rising trend but the rate of increase is showing varied behavior. Even exceptionally some companies showing a steep decline in EPS during 2005 like sun Pharmaceuticals ltd, Infosys Ltd, Dr. Reddy's laboratories and Larsen and Tubro Ltd which can be linked with the sectorial or industrial differences. We can attribute this to the presence of factors other than the event under study which can be firm specific factors or macro-economic level factors like most of the companies are effected by the recession occurred in 2008 after subprime crises of US as showing a slow growth or decline in their EPS after that. Most of the companies recovered after that in 2009-10.

PAT Analysis

Profit after tax figures of companies also presenting the same picture as of EPS except they are consistently increasing. All companies having upward sloping PAT curves with diverse magnitudes, this variance could be assigned to the differences of industries or to internal factors of the company. The statistical analyses found huge differences in the average profits before and after implementation of clause which is also supported by the graphical presentations.

Profitability Ratios

These ratios are giving pretty much different results as compare to previous analyses as most of the companies showing independent results over the clause implementation. Except some of them most of the company ratios are on a declining or static move some specific reasons for each ratio can be identified as below

PBDITA as % of total income

Profit before depreciation interest tax and amortization (PBDITA) or operating cash flow ratio in the above study showcase the different results for each company. the very basic reasons which could be assigned for these differences are the differences in the asset base or debt financing of companies as this ratio represent the PBDITA over total income. Some companies have an increasing trend while others are indifferent or declining.

PAT as % of total income

Profit after tax (PAT) as a % of total income provide the information about how much money will be available for owners of the company out of the total funds generated during the year. Most of the companies differing in their results like BHEL and Bharti Airtel ltd. Showing an upward swing in 2005 after implementation of clause, some like HUL or Dr. Reddy's Laboratories Ltd showing a steep decline or some of them like SBI, NTPC and HDFC Ltd. Etc. are indifferent.

PAT as % of total assets

Profit after tax as a % of total assets also doesn't deviate much with the above results, however the differences between the companies in this regard can be due to differences in the assets base of the companies i.e. companies belonging to industries with huge investment in assets like manufacturing or infrastructure having low ratio as compare to companies with comparatively low investment industry like IT. This ratio helpful in ascertain the returns of the companies on investment in the form of assets.

PAT as % of net worth

This ratio can be defined as PAT as a % of owners' equity also which reflect return on owner's fund. In the above study for all the companies, these ratios also follow the above trend i.e. doesn't provide a clear cut effect of the clause on company's profitability. Every company affected by its internal as well as external factors.

PAT as % of capital employed

Capital employed can be defined as, Fixed assets plus working capital or Total assets less current liabilities. Earning over capital employed provide a good measure of analysis of performance evaluation of a company. In the present study all companies following their other ratio trend in this frame also. Most of the companies found at least a ripple effect on their profits and ratios, however the extent of effect depend on their on factors. Even though the curves are not showing thrilling results but somewhere the clause left its effect by increasing or stabilizing the returns of the companies in general for all companies with very few exceptions.

In general all the companies showing positivity towards the corporate governance reforms, however the effectiveness of the clause can be increased by revising it after considering the specific industrial needs as all industries providing different results with the same clause. Another area which needs improvement is stricter penalties for non-compliance.

CONCLUSION

In the last few years, the thinking on the corporate governance in India has gradually crystallized into the development of norms for listed companies. However the bigger challenge in India lies in the proper implementation of those rules at the ground level. Even the most prudent norms can be hoodwinked in a system plagued with widespread corruption.

The present project studies India's adoption of major governance reforms (with reference to Clause 49) Over a span period of 10 years before and after implementation of clause 49. The study clearly reveals the effectiveness of the clause in different large cap companies. The selected group of companies statistically tested for their positive results on specified component i.e. accounting profits ,earning per share and on profitability ratios out of them EPS and Average profits had increased considerably during the study period however the profitability ratios doesn't provide a concluding result as they are effected by the industrial as well as company specific factor a lot. This study provide evidences that how much effect the clause 49 have on corporate efficiency it also provide bases for further improvement in this area and highlights the new areas which could affect the reform process in present and in future as well. Corporate governance in India if practiced in the right spirit, it can lead to unlocking the new horizons for the companies by improving their efficiency. This is supported by the results of this study also.

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