

# Corporate Governance: Shareholder Rights And Firm Performance

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## ABSTRACT

*In the 21<sup>st</sup> century, greater attention is being paid to the issue of shareholder rights and corporate governance in U.S. corporations by regulators, shareholders and the general public. A previous paper by the authors finds that the level of shareholder rights generally has not increased and may have declined amongst the S&P 500 companies, despite the recent legislative and regulatory reforms. Evidence suggests that instead firms are searching for an optimum level of shareholder rights that balances the risks and rewards of greater shareholder rights. This study investigates the financial performance of firms with greater shareholder rights (GSR) and contrasts it with that of firms with lower shareholder rights (LSR). This paper finds that GSR firms may perform better on some financial criteria, in absolute terms, but when adjusted for volatility, LSR firms may perform better, contrary to the conventional wisdom.*

**Keywords:** corporate governance, shareholder rights and financial performance

## INTRODUCTION

The importance of good corporate governance is well recognized amongst various constituents, including, investors, money managers, and regulatory and professional bodies. As a result, greater attention is being paid to developing processes for measuring, monitoring, and quantitatively assessing the corporate governance of U.S. publicly traded firms. This paper first discusses the standards for an ideal model of corporate governance, as described in the literature. Secondly, it reviews the academic research in this area and develops a theory of *optimum* shareholder rights. Thirdly, the study evaluates the financial and accounting performance of firms with varying degrees of shareholder rights. The methodology section describes the sample selection and data sources underlying the study. The results section describes the research findings, and the paper concludes with the summary and conclusion.

## CORPORATE GOVERNANCE IN THE U.S. PUBLIC CORPORATION – AN IDEAL

The corporate governance ideal in the U.S. embodies the concept that the stockholders own the corporation (Bebchuk, 2006). As a result, they are entitled to share in the profits and future direction of the company through their voting rights. Shareholders elect the board of directors which is responsible for appointing senior management. Management becomes the agent of the stockholders and is charged with maximizing shareholder wealth. It is generally believed that greater shareholder rights are associated with better corporate governance and consequently greater efforts by management to enhance shareholder wealth. Thus, agency costs are reduced.

Shareholder-oriented corporate governance is generally assessed by four standards. The first standard describes the degree of board independence and performance. This standard embodies the notions that a substantial number of board members should be independent of the management, and the audit and compensation committees should be comprised of independent members, with financial expertise on the audit committee. Moreover, according to this standard, management decision processes should be transparent to the board for evaluation.

The second standard prescribes equal voting rights for all shareholders without dual/multi- classes. Shareholder rights should not be abridged by takeover defenses, unequal voting rights, and restrictions on changing corporations' by-laws or limiting shareholder proposals. The shareholders should have the right to elect the full board each year, without the limitation of staggered terms. The shareholders should have the right to an independent nominating committee. Essentially, this second standard implies that the firm's management is not entrenched and can be replaced. Moreover, shareholders are free to sell the firm to outside parties.

The third standard of shareholder-oriented corporate governance emphasizes the importance of transparency of financial information and effectiveness of internal controls. Shareholders should have the right to select and change auditors periodically. This fourth and final standard ensures that there is an independent committee for determining management compensation, and that compensation is based on performance.

Recent legislation, such as the Sarbanes-Oxley Act of 2002 (SARBOX), and certain SEC and NYSE regulations, have addressed these four standards, mandating new practices such as required certification of financial statements by the CEO and CFO, disclosure of off balance sheet transactions, board review of financial controls, regular board meetings without the presence of management, required shareholder approval of all equity-based compensation, and other similar measures. Supposedly these changes should improve the quality of corporate governance, as described earlier.

However, this study finds support for the notion that there is an *optimum* level which balances the risks and rewards of greater shareholder rights. The following section describes the risks and reward of increasing the level of shareholder rights and summarizes the empirical literature.

## A THEORY OF OPTIMUM SHAREHOLDER RIGHTS

It is generally asserted in the literature that greater shareholder rights ensure a higher value of the firm. There are several reasons for this hypothesis: in the first place, litigation costs may be reduced, since greater transparency of governance processes and financial information, and protection of minority shareholder rights, may result in fewer conflicts. Secondly, agency costs may be minimized, as independent boards can effectively monitor and supervise management. In addition, appropriate incentives may be put in place to enhance managerial performance. Thirdly, greater shareholder-oriented corporate governance may be regarded as a positive signal by investors and analysts. Fourthly, greater transparency may elevate credit ratings, resulting in a lower cost of debt (Ashbaugh-Staife, Collins and LaFonde, 2006). The empirical literature demonstrates that greater shareholder rights generally are associated with higher share prices, higher growth rates, higher profitability and lower volatility in share prices (Bebchuk, Cohen, and Ferrell, 2004; Gompers, Ishii and Metrick, 2003; Deutsche Bank, 2004). Cost of equity capital may also be lower for firms with greater shareholder rights (Gompers, Ishii and Metrick, 2003 and Ashbaugh-Staiffe, Collins and LaFonde, 2004).

On the other hand, it should be emphasized, but it is not so well recognized, that greater shareholder rights in the context of the "Ideal" corporate governance, entail several important costs. These costs include such factors as (1) disclosure to competitors of strategic and tactical information, (2) slower and less efficient decision-making in a competitive environment, (3) a short-run focus on profitability, resulting in reduced capital investment and R&D expenditures (Lehmann, Warning, and Weigand, 2002), (4) higher career risk requiring higher CEO compensation (Heffes, 2007 and Hermalin and Weisbach, 2007), and (5) higher agency costs for creditors in view of frequent management turnover resulting in lower credit ratings and higher debt costs (Ashbaugh-Staife, Collins and LaFonde, 2006; Weber, 2006), and, finally, (6) higher costs of efforts by the CEO to distort/disguise proprietary and strategic information from the board and the shareholders in order to protect the competitive position of the firm.

A second theory of the firm, in contrast to the "Ideal" of corporate governance implying shareholder ownership and requiring share price maximization, recognizes that the firm is a legal entity and management is expected to be the agent of the firm, not exclusively the agent of the shareholders. Consequently, management has responsibilities to several stakeholders—employees, vendors/customers, and society, in addition to the shareholders. According to this theory, management strives for long-run value creation of the firm, taking into account the interests of all stakeholders (Stout, 2007 and The Economist, 2007).

A third theory of the firm is based on the failure of the “Ideal” model of corporate governance. In order to reduce the agency costs, incentive compensation schemes have been devised to align the interests of shareholders and the management. Management, whose compensation derives principally from stock option and other bonus plans, may increase the turnover and the volatility of the stock price through share repurchase and other tools of finance, and through excessive risk taking. These strategies may work to the detriment of shareholders and the long-run franchise value of the firm. Speculative efforts by management may dominate over enterprise and innovation (Mitchell 2009 and 2007).

In summary, there are costs and failures associated with greater shareholder rights in the “Ideal” model of corporate governance. In addition, alternative theories of the firm encompass responsibilities for all stakeholders and emphasize the long-run franchise value of the firm. Therefore, this paper asserts that there is an *optimum* level of shareholder rights which maximizes the value of the firm. The “Ideal” of greater shareholder rights monotonically increasing the value of the firm without limits, is not valid. The concept of an *optimum* level of shareholder rights are depicted in Figure 1. As shareholder rights increase from some minimum level, involving greater transparency and board independence, the shareholder wealth is initially enhanced. But, beyond some efficient level of shareholder rights, decision processes and judgment may become constrained, inflexible, and costly. Additional liberalization of shareholder rights beyond the *optimum* may cause the firm to become less competitive and adversely affects the firm’s franchise value, as other stakeholders’ interests are sacrificed. This study examines the “optimality” of shareholder rights in corporate governance by analyzing the financial performance of firms with varying degrees of shareholder rights.

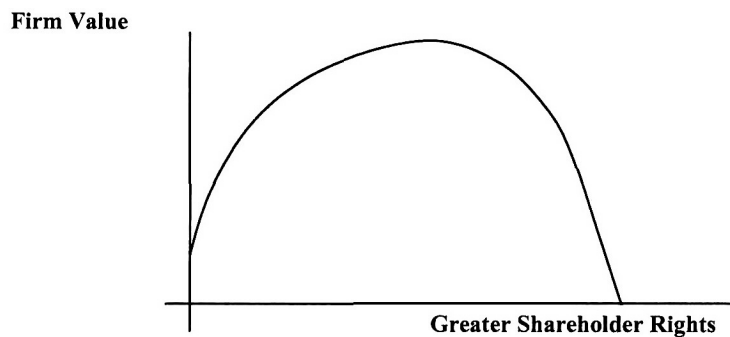


Figure 1: Optimum Shareholder Rights and Firm Value

## METHODOLOGY, SAMPLE AND DATA

This paper measures the level of shareholder rights using the G-Index developed by the Investor Responsibility and Research Center (IRRC) and available at the Wharton Research Data Services (WRDS). The G-Index incorporates all four standards of shareholder rights described above. It consolidates twenty-four provisions which *limit* shareholder rights, as described in Appendix A, on about 1,800 reporting firms. The G-Index varies from 0 to 24, as each parameter of shareholder rights is given a zero/one score. Zero indicates an absence of that particular limitation on shareholder rights, whereas a “one” indicates the presence of that *limiting* provision. Therefore, the lower number indicates greater emphasis on shareholder rights, a relative absence of management entrenchment provisions, and greater transparency of information and processes. A higher number indicates greater management entrenchment, less transparency and the existence of more provisions limiting shareholder rights. The G-index is available for the 17-year period 1990 to 2006, with eight census years (1990, 1993, 1995, 1998, 2000, 2002, 2004, and 2006).

Tables 1 and 2 describe the statistical distribution of the population index for various years. It is worth noting in Table 1 that the mean and mode are in the range of 8-10 for all 17 years and the median is 9 for all the sample years. Table 2 highlights the phenomenon that the percentage of firms with G-scores between 8 and 10 is the highest of any category in all the years. Furthermore, an increasing number of firms is clustering around a

median-level of shareholder rights. Firms are seeking to reduce the risks and costs of both very high and very low levels of shareholder rights.

**Table 1: Statistics on G-Index by Year -- IRRC Population (1,800 companies)**

	1990	1993	1995	1998	2000	2002	2004	2006
<b>Mean</b>	8.89	9.19	9.29	8.77	8.98	9.03	9.03	9.02
<b>Median</b>	9	9	9	9	9	9	9	9
<b>Mode</b>	10	9	9	10	9	8	8	9
<b>Min</b>	1	2	2	2	2	1	1	2
<b>Max</b>	17	17	17	18	19	18	18	18
<b>Std. Dev.</b>	2.89	2.88	2.81	2.85	2.69	2.64	2.56	2.52

**Table 2: Distribution of G-Index Frequencies (percentages) - IRRC Population (1,800 companies)**

Categories*	1990	1993	1995	1998	2000	2002	2004	2006
GSR: Class 1-7	33.95	29.67	27.81	35.48	31.69	29.14	27.13	27.53
MSR: Class 8-10	36.06	35.95	36.83	35.68	38.95	42.29	44.38	44.57
LSR: Class 11-	29.99	34.38	35.36	28.84	29.36	28.56	28.49	27.90

\*GSR denotes Greater Shareholder Rights--it includes companies whose G-Index is less than 8; MSR is the mid-range shareholder rights category and includes companies whose G-Index is 8 through 10; LSR consists of companies with the least shareholder rights and is made up of companies whose G-Index is 11 and above.

The study develops the following categories based on the data in Tables 1 and 2:

- Firms with a G-index score between 1-7 are defined as having the highest level of shareholder rights, denoted as **GSR**.
- Firms with a G-index score of 11 and above are defined as having the lowest level of shareholder rights, denoted as **LSR**.

All 1800 IRRC companies were examined since 2000 (4 census years for each of the 1,800 companies) and only 8 companies consistently had a G-index score of 7 or below. These are denoted the GSRs. Similarly, only 11 companies consistently had a G-index of 11 and above, and so are designated the LSRs. Table 3 shows the list of companies in each category.

**Table 3: List of Firms in the GSR and LSR Categories**

GSR Firms	LSR Firms
Amazon.Com	Avery Dennison
Broadcom	Centex
Cisco Sys	Centurytel
Loews Corp	Cigna
Pepsi Bottling	Exelon
Pepsico Inc	Limited Brands
Public Storage	Paccar
SLM Corp	PPG
	Precision Cast
	Sovereign
	VF Corp

## PERFORMANCE CRITERIA

Financial performance of the 19 firms is evaluated on the basis of the variables generally accepted in the evaluation of corporate governance. In particular, they are: (1) sales growth, (2) return on assets (ROA), (3) return on equity (ROE), (4) growth in earnings per share (G-EPS), and (5) price-to-book value (PBV). Data were obtained

on these variables from the Compustat database for the seven years 2000-06. In order to evaluate the long-term financial performance, the study computed the mean, growth rate, variance and CV for each variable for each company. It also computed the performance of the portfolios of the 8 GSRs and eleven LSRs. Growth coefficients were computed using OLS regression.

## RESULTS AND INTERPRETATIONS

The following section describes the empirical results of the performance variables for GSRs and LSRs. It also sets out the interpretation of the findings in the context of previous empirical studies.

### Sales growth

Table 4 reports the sales growth among the firms according to varying degrees of shareholder rights. Among the GSR companies, 7 of the 8 had statistically significant positive growth rates, and only one had a negative growth rate. Whereas, among the LSR companies, 7 of 11 had significant positive growth rates; one had significant negative growth rate. Three did not show any trend. Thus, a clear majority in both groups demonstrated significant positive growth rates.

It is worth noting that the mean growth rate for both GSR and LSR categories is the same (3%). This is in complete contrast with the conclusion of Babcheck, et. al. (2004), which predicted higher growth rates for GSR companies.

Table 4 demonstrates that within the GSR group the growth rate varied between positive 11% and negative 17%, whereas in the LSR category the growth coefficients varied between positive 7% to negative 2%. The firms in the LSR group attain the same growth rate, on average, as the GSR firms, but exhibited less variance. In summary, GSR is not necessarily correlated with significantly higher sales growth rates and GSRs display more volatility.

Table 4: Sales Growth by Degree of Shareholder Rights: 2000 – 2006\*

Firms	Growth Rate Coeff	T-Stat	R-Sq	Firms	Growth Rate Coeff	T-Stat	R-Sq
<b>Greater Shareholder Rights</b>				<b>Lower Shareholder Rights</b>			
Amazon.Com	0.11	26.70	0.99	Avery Dennison	0.03	7.91	0.93
Broadcom	0.10	7.15	0.91	Centex	0.07	30.20	0.99
Cisco System	0.03	2.77	0.61	Century Tel	0.02	4.35	0.79
Loews	-0.17	-2.35	0.53	Cigna	-0.02	-6.00	0.88
Pepsi Bottling	0.04	33.21	0.99	Exelon	0.03	1.82	0.40
Pepsico, Inc.	0.03	6.02	0.88	Limited Brands	0.01	0.80	0.11
Public Storage	0.04	5.96	0.88	Paccar, Inc.	0.07	4.75	0.82
SLM Corp.	0.05	3.08	0.65	PPG Industries	0.02	4.29	0.79
<b>Mean growth rate coefficient</b>	0.03			Precision Cast	0.05	3.66	0.73
<b>SD of coefficient</b>	1.69			Sovereign	0.04	3.49	0.71
<b>CV</b>	56.33			VF Corp.	0.01	1.77	0.38
				<b>Mean growth rate coefficient</b>	0.03		
				<b>SD of coefficient</b>	0.02		
				<b>CV</b>	0.67		

\*Growth rate coefficient has been calculated by regressing the log of sales against time. The mean, standard deviation and CV have been calculated using only the statistically significant growth coefficients

Table 5: Return on Assets (ROA) of Firms by Degree of Shareholder Rights

Greater Shareholder Rights	2000	2001	2002	2003	2004	2005	2006	Mean	SD	CV
Amazon.Com	-66.1	-34	-7.53	1.63	18.11	9.01	4.36	-10.65	29.49	-2.77
Broadcom	-14.7	-75.68	-100.92	-47.57	7.58	9.78	7.77	-30.53	44.87	-1.47
Cisco Sys	8.12	-2.88	5.01	9.64	13.96	16.94	12.88	9.10	6.59	0.72
Loews Corp	2.65	-0.71	1.39	-0.86	1.68	1.69	3.27	1.30	1.57	1.20
Pepsi Bottling	2.96	3.88	4.27	3.66	4.23	4.04	4.38	3.92	0.49	0.12
Pepsico Inc	11.9	12.25	14.1	14.08	14.9	12.85	18.84	14.13	2.34	0.17
Public Storage	4.12	4.04	3.3	3.22	3.45	4.47	0.4	3.29	1.36	0.41
SLM Corp	0.93	0.7	1.47	2.16	2.26	1.37	0.97	1.41	0.61	0.43
<b>Mean</b>	-6.27	-11.55	-9.86	-1.76	8.27	7.52	6.61	<b>Mean: 56 obs.</b>		<b>-1.01</b>
<b>SD</b>	25.39	29.29	37.26	19.13	6.47	5.58	6.34	<b>SD: 56 obs.</b>		<b>22.19</b>
<b>CV</b>	-4.05	-2.54	-3.78	-10.90	0.78	0.74	0.96	<b>CV: 56 obs.</b>		<b>-22.07</b>
<b>Lower Shareholder Rights</b>										
Avery Dennison	10.5	8.63	7.04	5.91	6.36	6.94	8.21	7.66	1.58	0.21
Centex	6.45	4.24	4.25	4.79	4.84	5.05	5.72	5.05	0.80	0.16
Centurytel	3.61	5.42	2.44	4.36	4.32	4.3	4.97	4.20	0.96	0.23
Cigna Corp	1.04	1.08	-0.45	0.66	1.95	2.84	2.73	1.41	1.18	0.84
Exelon	1.64	4.07	4.46	1.89	4.3	2.24	3.59	3.17	1.21	0.38
Limited Brands	10.47	11	6.85	9.11	11.58	10.5	9.52	9.86	1.57	0.16
Paccar	5.34	2.19	4.28	5.3	7.42	8.26	9.29	6.01	2.46	0.41
PPG Industries	6.8	4.58	-0.76	5.94	7.65	6.87	7.1	5.45	2.91	0.53
Precision Cast	3.53	4.85	1.65	6.46	3.61	6.61	9.31	5.15	2.53	0.49
Sovereign	-0.12	0.35	0.87	0.92	0.83	1.06	0.14	0.58	0.45	0.78
VF Corp	6.03	3.22	10.16	9.32	9.45	10	9.78	8.28	2.64	0.32
<b>Mean</b>	4.34	3.92	3.38	4.95	5.85	6.05	6.43	<b>Mean: 77 obs.</b>		<b>5.17</b>
<b>SD</b>	3.51	3.29	3.80	3.46	3.77	3.61	3.76	<b>SD: 77 obs.</b>		<b>3.20</b>
<b>CV</b>	0.81	0.84	1.12	0.70	0.64	0.60	0.60	<b>CV: 77 obs.</b>		<b>0.62</b>

### Return on Assets (ROA)

Table 5 reports ROA results for each firm and for each year in the sample period. Out of the 8 GSR firms, six exhibited positive average ROAs over the sample period, whereas two exhibited very large, negative ROAs. On the other hand, all 11 LSRs reported positive ROAs. Furthermore, the LSRs, with 77 observations, exhibited only three negative returns. Out of 56 observations for GSRs there were nine cells with negative returns. Thus, GSRs displayed greater variability in their performance over the sample period.

The mean return for the portfolio of the GSR firms was negative for 4 out of 7 years, whereas the portfolio of LSR firms reported positive returns for all 7 years. A portfolio of GSRs held over 2000-2006 generated a mean return of negative 1.01 percent with standard deviation of 22.19. Whereas, a LSR portfolio generated a mean return of positive 5.17 percent with volatility of only 3.2.

In summary, the LSR's portfolio outperformed the GSR's portfolio with less risk. These findings are contrary to the results described by Bebchuk, et. al. (2004), and Gompers, et. al. (2003), which assert that greater shareholders rights generate higher profitability and lower volatility.

### Return on Equity (ROE)

Table 6 reports the ROE performance of the firms. Seven out of eight GSRs exhibited positive mean ROEs, whereas all LSR firms achieved positive mean ROEs. For 56 observations amongst GSRs, 7 cells had negative ROEs; whereas, among LSRs, only 3 out of 77 cells are negative.

The portfolio of GSRs generated a mean ROE of 13.69% with standard deviation of 35.04; whereas, an LSR portfolio generated a mean ROE of 16.1% with volatility of 8.10. The portfolio of LSRs demonstrated positive returns for each of the 7 years, whereas the GSR's portfolio demonstrated positive returns for 5 out of 7 years. These results are similar to those for the ROAs reported earlier.

In summary, LSRs have higher ROEs with lower business and financial risks, compared to the GSRs. This stands in contrast to the previous literature.

Table 6: Return on Equity (ROE) of Firms by Degree of Shareholder Rights

Greater Shareholder Rights	2000	2001	2002	2003	2004	2005	2006	Mean	SD	CV
Amazon.Com	0.00	0.00	0.00	0.00	0.00	135.37	44.08	25.64	51.10	1.99
Broadcom	-15.37	-85.49	-136.00	-64.43	9.25	11.69	9.04	-38.76	57.71	-1.49
Cisco Sys	10.07	-3.74	6.61	12.77	19.24	24.77	23.34	13.29	10.11	0.76
Loews Corp	16.77	-5.55	8.75	-6.03	10.16	9.11	15.25	6.92	9.20	1.33
Pepsi Bottling	13.91	19.05	23.47	22.44	23.45	22.81	25.05	21.45	3.80	0.18
Pepsico Inc	30.11	30.72	35.59	29.97	30.73	28.46	36.51	31.73	3.06	0.10
Public Storage	7.24	7.88	6.82	6.80	7.70	10.70	0.84	6.85	2.97	0.43
SLM Corp	36.27	24.71	42.58	56.47	64.75	42.16	29.55	42.36	14.22	0.34
<b>Mean</b>	12.38	-1.55	-1.52	7.25	20.66	35.63	22.96	<b>Mean: 56 obs.</b>		<b>13.69</b>
<b>SD</b>	16.31	36.48	56.41	34.98	20.32	41.79	14.24	<b>SD: 56 obs.</b>		<b>35.04</b>
<b>CV</b>	1.32	-23.49	-37.05	4.83	0.98	1.17	0.62	<b>CV: 56 obs.</b>		<b>2.56</b>
<b>Lower Shareholder Rights</b>										
Avery Dennison	34.24	26.19	24.35	18.41	18.06	19.30	20.98	23.08	5.80	0.25
Centex	18.12	16.45	18.06	20.92	25.48	23.63	24.36	21.00	3.56	0.17
Centurytel	11.42	14.71	6.15	9.92	9.90	9.26	11.61	10.42	2.61	0.25
Cigna	18.23	19.57	-10.27	13.21	30.31	23.81	26.77	17.38	13.44	0.77
Exelon	7.85	17.48	21.57	9.33	19.54	10.42	15.94	14.59	5.38	0.37
Limited Brands	18.47	18.91	10.21	13.62	30.19	26.95	22.84	20.17	7.07	0.35
Inc	19.64	7.71	14.30	16.22	24.10	29.05	33.57	20.66	8.92	0.43
PPG	20.02	12.57	-2.79	17.18	19.12	19.52	21.99	15.37	8.54	0.56
Precision Cast	11.02	13.85	4.46	15.01	7.90	13.45	16.31	11.71	4.23	0.36
Sovereign	-2.11	5.60	12.37	12.33	9.09	11.64	1.53	7.21	5.74	0.80
VF Corp	12.00	6.26	21.47	20.28	18.82	18.41	16.37	16.23	5.36	0.33
<b>Mean</b>	13.14	12.74	8.92	14.65	19.88	19.16	19.42	<b>Mean: 77 obs.</b>		<b>16.17</b>
<b>SD</b>	7.66	5.69	11.25	3.33	8.41	7.03	9.44	<b>SD: 77 obs.</b>		<b>8.10</b>
<b>CV</b>	0.58	0.45	1.26	0.23	0.42	0.37	0.49	<b>CV: 77 obs.</b>		<b>0.50</b>

Table 7: Growth of Earnings per Share (G-EPS) by Degree of Shareholder Rights

Greater Shareholder Rights	Growth Coeff	T-Stat	R-Sqd	Lower Shareholder Rights	Growth Coeff	T-Stat	R-Sqd
Amazon.Com	0.713	3.45	0.7	Avery Dennison	0.11	1.78	0.39
Broadcom	1.078	2.43	0.54	Centex	0.32	0.47	0.04
Cisco Sys	0.145	3.42	0.7	Centurytel	0.21	2.54	0.56
Loews Corp	0.27	0.71	0.09	Cigna	0.40	1.41	0.28
Pepsi Bottling	0.224	11.16	0.96	Exelon	0.05	0.41	0.03
Pepsico Inc	0.29	6.21	0.89	Limited Brands	0.127	5.22	0.85
Public Storage	-0.08	-0.9	0.14	Paccar	0.53	4.98	0.83
SLM Corp	0.463	2.62	0.56	PPG	0.32	1.07	0.19
<b>Mean</b>	<b>0.49*</b>			Precision Cast	0.52	3.49	0.71
<b>SD</b>	<b>0.35*</b>			Sovereign	0.14	1.11	0.2
<b>CV</b>	<b>0.73*</b>			VF Corp	0.554	4.69	0.81
				<b>Mean</b>	<b>0.39*</b>		
				<b>SD</b>	<b>0.20*</b>		
				<b>CV</b>	<b>0.52*</b>		

\*Mean, standard deviation and CV have been calculated for the statistically significant coefficients.

## Growth Rates in Earnings per Share (G-EPS)

EPS growth rates are reported in Table 7. Amongst the GSRs, 6 out of 8 (75 percent) showed statistically significant positive growth rates. Amongst the LSR firms only 5 of the 11 (45 percent) showed statistically significant positive growth rates. The mean growth rate amongst the GSRs was 49 percent; whereas, for the LSRs it was 39 percent. The GSR's portfolio exhibited more volatile growth rates with CV of 73%; whereas, for the LSR's firms CV was 52%. To summarize, the GSRs exhibited higher EPS growth rates on average, but with higher volatility.

Table 8: Price to Book Value Ratio (PBV) by Degree of Shareholder Rights

Greater Shareholder Rights	2000	2001	2002	2003	2004	2005	2006	Mean	SD	CV
Amazon.Com*										
Broadcom	5.56	2.33	0.96	5.98	3.93	4.83	3.75	3.90	1.78	0.46
Cisco Sys	22.95	5.39	3.40	4.95	5.44	5.15	4.43	7.39	6.90	0.93
Loews Corp	0.97	1.09	0.74	0.88	1.14	1.37	1.42	1.09	0.25	0.23
Pepsi Bottling	3.55	3.85	3.69	3.45	3.63	3.30	3.16	3.52	0.24	0.07
Pepsico Inc	10.38	8.75	7.66	7.33	6.86	6.93	6.39	7.76	1.38	0.18
Public Storage	1.21	1.72	1.69	2.44	3.20	3.90	3.07	2.46	0.98	0.40
SLM Corp	9.53	9.68	9.61	6.85	8.39	7.06	5.06	8.03	1.77	0.22
<b>Mean</b>	7.74	4.69	3.96	4.55	4.66	4.65	3.90	<b>Mean: 49obs.</b>		<b>4.88</b>
<b>SD</b>	7.66	3.41	3.43	2.39	2.43	2.02	1.59	<b>SD: 49obs.</b>		<b>3.75</b>
<b>CV</b>	0.99	0.73	0.87	0.53	0.52	0.43	0.41	<b>CV: 49obs.</b>		<b>0.77</b>
Lower Shareholder Rights										
Avery Dennison	7.71	6.68	6.57	4.91	4.67	3.81	4.27	5.52	1.46	0.27
Centex	1.54	1.60	1.37	2.14	1.89	1.60	1.02	1.59	0.36	0.23
Centurytel	2.54	2.03	1.37	1.40	1.40	1.22	1.52	1.64	0.47	0.29
Cigna	3.78	2.52	1.29	1.91	2.35	2.48	3.17	2.50	0.81	0.32
Exelon	12.95	1.98	2.00	2.61	3.06	3.49	4.28	4.34	3.88	0.90
Limited Brands	4.21	3.28	1.46	1.92	2.16	4.50	4.38	3.13	1.28	0.41
Paccar	1.67	2.24	2.10	3.21	3.76	2.91	3.42	2.76	0.77	0.28
PPG	2.49	2.81	3.06	4.31	3.60	2.92	3.05	3.18	0.60	0.19
Precision Cast	1.95	2.06	1.16	1.71	2.97	3.95	5.33	2.73	1.47	0.54
Sovereign	0.97	1.41	1.35	2.19	1.62	1.36	1.41	1.47	0.37	0.25
VF Corp	1.83	1.90	2.30	2.52	2.60	2.25	2.94	2.34	0.39	0.17
<b>Mean</b>	3.73	2.27	1.84	2.55	2.76	2.98	3.50	<b>Mean: 77obs.</b>		<b>2.84</b>
<b>SD</b>	3.88	0.58	0.65	0.86	0.73	0.99	1.18	<b>SD: 77obs.</b>		<b>1.79</b>
<b>CV</b>	1.04	0.26	0.35	0.34	0.26	0.33	0.34	<b>CV: 77obs.</b>		<b>0.63</b>

\*Amazon.com is not being used in this calculation as it had negative equity for several of the years.

## Price to Book Value (PBV)

Table 8 reports the results for PBV. GSRs demonstrated a mean PBV of 4.88x, higher than the PBV for LSR firms of 2.84x. The volatility for GSRs is higher, with CV of 0.77, compared to the CV of 0.63 for LSRs.

In about 8 percent of the observations, the share price of the GSRs is less than the book value. In contrast, only one LSR observation (1.3%) is less than 1. The number of observations with PBV between 1 and 2 is 14.3 percent for GSRs; whereas, for LSRs it is 35 percent. The portfolio of GSRs is more volatile with CV higher in 6 of the 7 years.

In summary, the PBV is higher but more volatile for GSRs. This is in contrast to the previous literature: Ashbaugh-Staiffe, et. al. (2004).



## SUMMARY AND CONCLUSION

The previous corporate governance literature states that greater shareholder rights will ensure higher stock prices, higher sales growth rates, higher profitability and lower cost of equity capital. This assertion is based upon the “ideal” concept of firm ownership by the shareholders in which the management is the exclusive agent of the shareholders. This “ideal” ignores alternative views which emphasize the firm’s responsibility to all stakeholders. In addition, this view does not consider the potential for failure of incentive compensation schemes for management. The present study argues that there is an *optimum* level of shareholder rights, based upon considerations of various costs and risks of increasing shareholder rights. With increasing shareholder rights beyond some optimum level, decision processes and judgment may become cumbersome and inflexible. Furthermore, liberalization of shareholder rights beyond the *optimum* may distort managerial enterprise and innovation. It may also adversely affect the franchise value as other stakeholder interests get sacrificed.

This paper finds that the median level of shareholder rights has not changed in the last 17 years, and furthermore, firms have a tendency to converge toward the median level. The study evaluates the financial performance of firms with varying degrees of shareholder rights. It finds that firms with greater shareholder rights show higher growth rates in earnings per share, higher price to book value ratio, and equal sales growth rates, compared to firms with lower shareholder rights. However, these results for the GSRs are associated with higher volatility in these variables. It should be emphasized that firms with lower shareholder rights achieved higher profitability (ROA and ROE) with lower volatility. In summary, firms with lower shareholder rights demonstrated greater stability without any diminution in financial performance. These results contrast with the findings of the previous literature.

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## APPENDIX A: 24 COMPONENTS OF THE G-INDEX

1. Antigreenmail	Prohibits Large shareholder from not seeking control of a company in exchange for right to sell stock back at a premium, unless all shareholders offered same opportunity.
2. Directors Indemnification Contract	Firm is contractually obligated to pay legal expenses and judgments for suits alleging misconduct.
3. No-Secret Ballot	Allows management to examine individual proxy cards.
4. Blank Check	Allows Board broad latitude in determining shareholder rights.
5. Fair Price	Limits the rights of shareholders to tender shares.
6. Pension Parachutes	Acquirer cannot use surplus pension funds to finance acquisition.
7. Business Combination Law	Imposes moratorium on M&A by a large shareholder
8. Golden Parachutes	Lavish severance agreements for senior executives following change in control
9. Poison Pill	Target firm shareholders have right to buy additional shares at a steep discount.
10. Cash-Out Law	Forces acquirer to pay highest recent price to all shareholders.
11. Limit to amend by-Laws	Eliminates or limits the right of shareholders or the Board to amend the by-laws.
12. Severance Agreements	Assures officers of their positions/compensation without reference to changes in control.
13. Compensation Plans	Allows cash out of options or accelerated bonuses in the event of changes in control.
14. Limit to Amend Charter	Eliminates or limits the right of shareholders or the Board to amend the charter.
15. Silver Parachutes	Similar to golden parachutes, but in this case a large number of employees is eligible in the event of change in control.
16. Director Indemnification contracts	Charter and by-laws obligate firm to pay legal expenses and judgments for suits alleging misconduct against officers and directors.
17. Limits to Special Meeting	Eliminates or limits ability of shareholders to call a special meeting of the corporate shareholders.
18. Director Liability	Eliminates or limits Directors personal liability for certain acts.
19. Limits Written Consent	Limit ability of management and Board to negotiate M&A to regularly scheduled meeting.
20. Staggered Board	Only part of the Board is elected each year.
21. Unequal Voting	Long-term shareholders are given more vote than recent buyers.
22. Supermajority	Supermajority of voting shareholders required for M&A.
23. Directors Duties	Allows Board to consider other constituencies to reject takeover.
24. No-Cumulative Voting	Limits rights of dissident shareholders. Reduces number of independent/dissident directors.