CG practices and its impact on the financial performance of selected Indian Companies

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Abstract: Corporate governance is set of rules and regulations through companies are directed and controlled towards predetermined objectives of organization. It defined the rights and responsibilities of all the stakeholders. It is based on the principles such as integrity, transparency, accountability and independency to ensure the sustainable growth and development of organization along with protection of interest of all stakeholders. This study conducted to examine the impact of CG practices and its impact on financial performance of selected Indian companies. Five years are selected from the financial years 2015-16 to 2019-20 for the study period. For the purpose of study, 10 companies are selected from the BSE S&P 200 listed entities on the basis of systematic random sampling method. Independent variable such as corporate governance practices, dependent variables such as ROE and control variables such as firm age and leverage are used in the study. Corporate governance index was formed with the help of formation of checklist by including different vital components of corporate governance standards on the basis of mandatory and non-mandatory norms inserted in SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. The CG index includes the 143 facts or pieces of information which is based on the equal and unequal weight method. These all the financial variables are accounting base measurements. Descriptive statistics such as mean, standard deviation, minimum, maximum, skewness, kurtosis etc. are used and for the purpose of analysis linear multiple regression analysis is applied. It has been found that CG practice has negative and significant impact on financial performance (ROE). However the Leverage and firm age have insignificantly negative impact on ROE.

Key words: CG, SEBI, LODR, ROE, Woman director

Introduction:

Corporate governance is certain structure which contains the set of rules and regulations required for desire direction and controlling of organization in proper way. It defines the rights and responsibilities of all parties of organization for better coordination amongst them. CG structure is established with objective of transparency, accountability and fairness in organization to ensure protection of interest of minor shareholders along with interest of other stakeholders through the sustainable growth and development of organization.

In the present time, it is more emphasizing on the corporate governance due to modern technology and globalization. Because in the many countries such USA, UK, South Africa, Russia, Japan, China, South Korea etc. India has commercial relation and most of these countries follows the best corporate governance practices. Thus, if the Indian companies have to compete with these countries' companies, it has to also follow the good corporate governance practices. It is also focus on the privatization in the country which required the strict rules and regulations that come under the corporate governance. In India, to make more effectiveness of corporate governance, number of independent directors increased in the board rooms and various committees such as audit committee, nomination and remuneration committee and to maintain gender diversity in board room it has been mandatory to include one woman director in board of directors through the revised clause 49 and at least one independent woman director in board of directors through the SEBI (LODR) regulations, 2015. The main aim of corporate governance is to sustainable development of organization and protection of interest of small investors and other stakeholders through the transparency, fairness and accountability. It leads the growth as well as development of organization and people working in, which also leads the healthy and sound economy of country as well. Thus, corporate governance code is very important in present time for organization and country sustainable long term development and existence of sound and healthy economy.

Review of Literatures and development of hypothesizes:

Corporate governance and Firm performance:

(Yasser, 2011) It has found that corporate governance have significant impact on the both the performance of family and non-family firm. (Javid & Iqbal, 2008) In this study, it was seemed to positive influence of ownership concentration on the performance measures and profitability but inverse to that there is positive association between the corporate governance and disclosure and transparency with the concentration of ownership. Thus it has been concluded that inverse relation between the corporate governance and performance measures. (Love , 2011) It was stated that as generalization there is positive relation between the corporate governance and firm performance but it was suffered from the endogeneity problems. Finally it was concluded in the study that corporate governance was likely to develop endogenously and depend on the specific features and its environment. (Lee, 2015) The paper shows the positive association between the corporate governance and firm performance. In this study, institutional investors monitor the firm performance by the active voting and it found that investors' voting is significantly related to long term firm performance. (Domadenik, Prašnikar, & Svejnar, 2016) This paper reveals that negative relationship fully or partially between the corporate governance and firm performance if the firm is connected to politicians especially in the case of corrupted politicians. (Wen) Under this study, comparative examination was performed at change in the performance of firm with different types of restructured reforms regarding the internal structure of firm as ownership (Privatization). And this structured affect the labour productivity and productivity of firm. (Stanwick & Stanwick, 2002) This paper support that corporate governance has positive impact on the firm short term as well long term performance. In the study as component corporate governance includes the board independency, board quality and shareholders accountabilities. (Akbar, Poletti-Hughes, El-Faitouri, & Shah, 2016) This study shows the result that corporate governance not determinant of financial performance of the organization in the UK. It was conducted with sample size of 435 over the period of 1999 to 2009. (Core , Holthausen, & Larcker, 1999) It has been found that greater compensation paid to CEO in case of less effective of corporate governance and in addition to ownership structure significantly negative impact on corporate performance which indicates that due to weaker corporate governance triggered the agency problems as well as greater compensation and worse firm performance. (Shu & Chiang, 2020) Under the study, it has been observed that Board independence is positively associated with firm performance. The hypothesis to be tested is as follows:

H_0 1: There is no significant impact of corporate governance on accounting based financial performance of selected companies

Leverage and firm performance:

Leverage refers to the use of borrowed fund to magnify returns from an investment or project. In short, it is ratio of debt to total asset (Arora & Sharma, 2016) (Hayes, James , & Schmitt, 2022). There are many finding in this area, some result show the (Ehikioya, 2009), (Adewuyi & Olowookere, 2013) positive impact on the firm performance and Existence of leverage indicates the highest good changes while other represents the (Reddy, Locke, & Scrimgeour, 2010) (Liu & Qu, 2018) Inversely relation to firm performance (Lemmon & Lins, August, 2003) Negative relation between the leverage and stock return. The following hypothesis to be tested is as given below:

H_0 2: There is no significant impact of leverage on accounting based financial performance of selected companies.

Firm age and firm performance:

Firm age refers to difference between present year and incorporate year (Arora & Sharma, 2016) (Bansal & Sharma, 2016). (Mishra & Kapil , 2017), (Ofoeda, 2017)Firm age has negative relation with firm performance, which indicates that more age of firm shows poor performance. (Afrifa & Tauringana, 2015), (Madanoglu & Karadag, 2016) , (Coleman & Wu, 2021) while in other case reveals positive relation with firm performance which indicates increase firm performance with increase in age of firm. The hypothesis which is to be tested as follows:

H_0 3: There is no significant impact of firm age on accounting based financial performance of selected companies.

Control variables:

There are many control variables such as Firm age, leverage, firm size, sale growth, assets tangibility which are helpful to control the industry and firm effect. But in the present study only leverage and firm age are applied.

Research Methodology:

Data Collection and Sample Size:

As the population, BSE S&P index selected which consists the 200 companies. It represents the 76 industries collectively which have effective dominance and influence on movement of Indian stock market. All the companies are reputed and financial healthy companies along with having well traded stock. Out of population 10 listed Indian companies selected on the basis of systematic random sampling. For the purpose of this study, data have been collected through the annual reports of selected companies.

Study period: Data have been collected only five years due to unavailability of data for other years, which are from the financial year 2015-16 to financial year 2019-20.

Construction of Corporate Governance Disclosure Index:

Table-1: Corporate Governance Disclosure Index:

Sr. No.	Corporate Governance Parameters	Items
1	Corporate Philosophy on code of governance	1
2	Board of Directors	22
3	Category of Chairman	5
4	Audit Committee	11
5	Nomination and Remuneration Committee	9
6	Remuneration of Directors	8
7	Stakeholder's Grievance and SRC	9
8	Risk Management Committee	4
9	Discloser Practices	23
10	Significant Web-links for Shareholder Reference	8
11	CG requirement with respect to Subsidiary Companies	4
12	Obligations with respect to Independent Directors	6
13	Obligations with respect to employees	4
14	General Body Meetings	6
15	Means of Communication	5
16	General Shareholder Information	16
17	Declaration signed by CEO	1

18	Compliance Certificate from either Auditor or CS	1
	Total	**143**

All the parameters which are given in above table and criteria for examination of corporate governance standards have been selected on the 100 point scale. For calculation of corporate governance disclosure score, different key parameters are used to prepare the checklist on the basis of mandatory and non-mandatory norms inserted in SEBI (LODR) Regulations, 2015 and. Checklist consists 143 items which are classified into 18 parameters. As per compliance of corporate governance practices, selected companies have been provided specific point on key parameters along with adequate weightage are provided according to importance of parameters. In checklist 138 items are based on equal weight method while 5 items are related to unequal weight method. In case of equal weight method, score value is provided to selected companies on the basis of information disclosed by them in their annual report for shareholders. If companies follows particular items specified in corporate governance index then value one is given to that company otherwise zero. And in case of unequal weight method, the score is given as per their weight. The score of each company are aggregated and tabulated as per need, for the purpose of proper analysis. Corporate governance disclosure score has been calculated with the help of following formula:

$$Extent\ of\ corporate\ governance\ score = \frac{total\ score\ gained\ by\ company}{no\ of\ items\ in\ checklist} \times 100$$

Results and Analysis:

The results of regression models have been conducted to examine the impact of corporate governance practices on financial performance of selected companies. The following regression model was applied to meet the objectives:

$Y = a + b_1 X_1 + b_2 X_2 + b_3 X_3 + \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ b_n X_n + e$

The above equation contains Y which refers to dependent variables, whereas $X_1, X_2, X_3, \ldots\ldots\ldots\ldots\ X_n$ refers to independent variables or explanatory variables. And $b_1 X_1$ refers to regression coefficient of first independent variables, $b_2 X_2$ refers to regression coefficient of second independent variable etc. and e refers to model error.

Table-2: Frequency distribution of variables

Variables	N	Minimum	Maximum	Mean	S. D.	Skewness	Kurtosis
CG Score	50	93.00	127.00	111.32	8.58	-0.27	-0.51
ROE	50	6.00	37.48	17.10	6.63	0.62	0.65
Leverage	50	0.07	0.61	0.36	0.16	-0.06	-0.96
Firm age	50	18	98	46.00	20.394	1.262	1.456

Table-2 shows that mean value of Corporate Governance Score (CGS) is 111.32±8.58 and the mean score of dependent variables i.e. return on equity (ROE), 17.10±6.63 over the period of five years for total numbers of 50 observations. Similarly Mean values of control variables i.e. Leverage and Firm age are .36±0.16 and 46.00±20.394 respectively. It has been observed that two times of value of standard deviation of CG score, ROE, Leverage and Firm age are 17.16, 13.26, 0.32 and 40.788 respectively that are less than respect mean value (CGS-111.32, ROE-17.10, Leverage-.36 and Firm age-46) which indicates that data are normally distributed.

Table-3: Correlation Matrix of Variables

		CG Score	ROE	Leverage	Firm age
CG Score	Pearson Correlation	1			
	Sig. (2-tailed)				
ROE	Pearson Correlation	-.561**	1		
	Sig. (2-tailed)	.000			
Leverage	Pearson Correlation	.333*	-.225	1	
	Sig. (2-tailed)	.018	.116		
Firm age	Pearson Correlation	.179	-.188	.085	1
	Sig. (2-tailed)	.214	.190	.557	
**. Correlation is significant at the 0.01 level (2-tailed).					
*. Correlation is significant at the 0.05 level (2-tailed).					

Table-3 shows that CG score has negative and significant correlation with ROE at level of 0.01 while it has positive as well as significant correlation with leverage at the level of 0.05 but has positive and insignificant correlation with firm age at the both level of significance. Similarly ROE has negative and insignificant correlation with leverage and firm age as shown in table-3 -.225 and -.188 respectively.

Testing of Hypothesis:

Before the test of hypotheses, data are evaluated for existence of multicollinearity and Autocollinearity. VIF values concerned to all variables like as firm age, leverage and corporate governance score are 1.034, 1.125 and 1.154 respectively. All the VIF values of variables are less than 10; so it shows the sound evidence that multicollinearity is not a problem for regression model-I (ROE). Rule of thumb explain that values of Darbin Watson test statistics in the range of 1.5 to 2.5 are relatively normal and when the value is less than 1 or more than 3 are definitely indicates the cause for concern (Glen, 2016). Value of Darbin Watson Models (Model-ROE), is 2.357 which is between the 1.5 to 2.5 which implies the acceptable range of this model.

Table-4: Result of Regression Analysis: Model Summary (Return on Equity)

Model	R	R Square	Adjusted R Square	F	P-value (Sig)	Durbin-Watson
Model I-ROE	.570	.325	.281	7.368	.000	2.357

Table-4 represents shows the summary of result of multiple regression models which is performed by SPSS. Table-4 indicates that the value of R is .570 which implies the moderate correlation between the independent and dependent correlation whereas the value of R square and the adjusted value of R square are .325 and .281 respectively which implies that 28.1 percent of variation in Return on Equity is explained by independent and control variables are applied in the study while the 71.9 percent of variation in Return on Equity is due to other elements which are not subsumed in this model. The value of this model is .001 that is less than .05 which indicates that the regression model is statistically significant and a fit model.

Table-5: Regression Coefficients of sampled Companies

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity
		B	Std. Error	Beta			VIF
1	(Constant)	64.829	10.599		6.117	.000	
	Firm age	-.029	.040	-.090	-.730	.469	1.034
	Leverage	-1.700	5.388	-.041	-.316	.754	1.125
	CG Score	-.411	.101	-.532	-4.085	.000	1.154

Table-5 shows the results of coefficient of sampled companies and test was performed with the help of multiple regressions. In Regression Model (Return on Equity), the beta value of Corporate Governance Score (CGS) and Leverage are negative as shown in the table-5, -.532 and -0.041 respectively which implies that there is negative impact of Corporate Governance Score and Leverage on Return on Equity (ROE). It has been also observed that CGS has statistically significant impact on ROE because p-value (001) is less than .05 (at 95 percent level of significance). Therefore, the null hypothesis “There is no significant impact of corporate governance on ROE of selected companies” is rejected. On the contrary, Leverage has statistically insignificant impact on Return on Equity because p-value of Leverage (0.754) is greater than .05 (at 95 percent of significance levels). Therefore, the null hypothesis “There is no significant impact of leverage on ROE of selected companies” is accepted. The beta value of Firm age is also negative as shown in the table-5 -.090 which implies that there is negative impact on Return on Equity. However, p-value of firm age as shown in the table-5 0.469 is greater than .05 (at 95 percent of significance level) which implies that it has statistically insignificant impact on Return on Equity. Thus the null hypothesis “There is no significant impact of firm age on ROE of selected companies” is also accepted.

Conclusion:

Present study is conducted to find the relationship between the corporate governance practices and financial performance of selected companies in India. For the analysis of this, multiple regression technique has been applied. Result shows that corporate governance practices of selected companies has negative and significant impact on return on equity whereas leverage and firm age have also negative impact on firm performance but statistically insignificant. However there are different committee and norms inserted by SEBI as well as other regulatory and government bodies which advocated that there will be positive impact of complying with the norms. It has been also found in the many research work (Lee, 2015), (Stanwick & Stanwick, 2002), (Javid & Iqbal, 2008) the positive relation between the firm performances while in other (Domadenik, Prašnikar, & Svejnar, 2016), (Akbar, Poletti-Hughes, El-Faitouri, & Shah, 2016) found negative relation. Thus, this study at present supports the negative relation between these variables. Reason behind this result, it may be that each selected companies did not fully comply with the norms inserted by SEBI (LODR) regulations, 2015.

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