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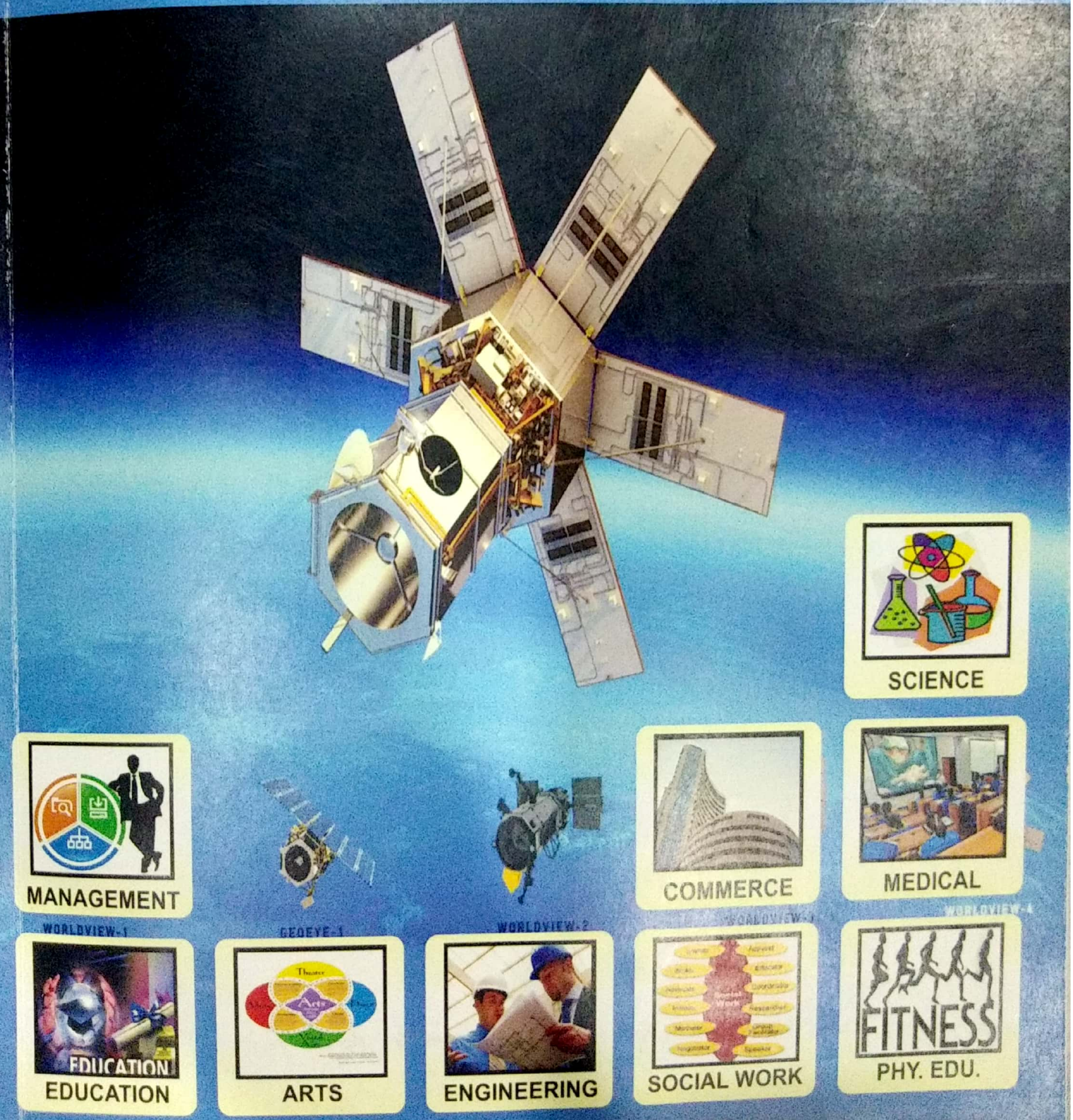

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CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE: AN EMPIRICAL STUDY OF SELECTED INDIAN COMPANIES

Corporate Governance is related with financial performance. Corporate Governance is playing an important role in organization in an effective manner. Corporate Governance is a process or a set of systems and processes to ensure that company is managed to suit the best interest of all stakeholder. The purpose of corporate governance is to facilitate effective management that can deliver the long term success of the company. Financial performance is often described as the outstanding practices in managing the organization and achieving results, all based on a set of financial values. The further details of this topic are outlined and examined in this research paper.

Key words: **CORPORATE GOVERANCE, FINANCIAL PERFORMANCE**

Corporate Governance is a system by which firms are managed. The stages of development of Corporate Governance and its systems synchronize with the evolution of the economy, corporate structure, ownership groups, political and legal developments of a country. Academicians, practitioners and researchers have evolved different theories and models describing different facets of governance and its practices across different countries of the world. In this process, metrics are also being developed to measure Corporate Governance and its processes.

With rapid growth and internationalization of businesses, there is an urgent need to examine the vocabulary of business organizations to include deliberately sustainability, ethics, governance and corporate responsibility. There have been several calls from thought leaders in business and academia to incorporate a deeper understanding of the principles pertaining to responsibility of business in the business organization working. Corporate Governance is about the nitty-gritty of how a company fulfills its obligations to investors and other stakeholders. It is about commitment to values and ethical business conduct and a high degree of transparency. Corporate Governance is the system by which companies are directed and controlled. Corporate governance provides a structure through which the objectives of the company are set and achieved.

❖ CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE:

A number of studies to explore the relationship between Corporate Governance, as measured by index and firm performance have been conducted both in developed countries and in emerging
markets. However, in India on this aspect, only two studies-1.Balasubramanian et al., (2010) covering the year 2005-06 and 2.Mohanty (2003) covering the year 2002, have been carried out. Therefore, there is a dearth of index-based studies on Corporate Governance in India. Mohanty's (2003) study is on general Corporate Governance attributes with a focus on stakeholders (Customers, society, employees and others). It does not cover any of the regulations of clause 49(Recent SEBI LODR, 2015) which came into force in the year 2000. The study of Balasubramanian et al., (2010) is a survey based one. This kind of study has its limitations. Moreover, this was conducted prior to the amendment to clause 49(Recent SEBI LODR, 2015) of the listing agreements which came into force from 1st January, 2006.

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❖ TITLE OF THE STUDY:

Researcher has selected topic as under:

"CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE: AN EMPIRICAL STUDY OF SELECTED INDIAN COMPANIES"

❖ REVIEW OF LITERATURE:

Reviews of literature of the study are stated below:

Klapper and Love (2004) used firm-level data (based on CLSA governance index) of 14 emerging stock markets to examine the Corporate Governance practices and firm valuations of those countries. Their findings suggest a positive relationship between Corporate Governance and firm performance proxied by Tobin's Q and ROA.Their other findings are that there is wide variation in firm-level governance scores across countries and stock prices of better governed firms in countries with weaker legal systems, are relatively higher than the stock prices of firms in countries with stronger legal systems. Firm level cross country studies by Aggarwal et al., (2006); Bruno and Claessens (2007); show a positive relationship between Corporate Governance indices and firm market values measured by Tobin's Q. Based on the study of 7380 firm years spanning across 22 Common Law countries, Gupta et al., (2010) find that positive firm level governance attributes are associated with reduced cost of equity and correspondingly better firm values. Based on Deminor Corporate Governance Ratings of companies included in the FTSE Eurotop 300, a study by Bauer, Gunster and Otten (2004) found positive relationship between governance indices and firm performance among European companies. Similar firm level cross country studies by Doidge et al., (2007); Durnev and Fauver (2010) find positive relationship between governance and firm values. Besides, they find that there are country specific influences on Corporate Governance practices of firms and accordingly the Corporate Governance measures differ.

Post Asian financial crisis of 1998, Mitton (2001) studied 399 Asian firms comprising of Thailand, Korea, Indonesia, Malaysia and Philipines. His study focused on differences in the Corporate Governance variables at the firm-level, particularly disclosures. His observations are that higher firm valuations, measured by Tobin's Q, are associated with better disclosure quality of the financial statements, certified by big accounting firms. Research study by Claessens et al., (2000), covering 1,000 firms of East Asia and Chile, show evidence of a positive relationship between Corporate Governance and firm performance.Their other important observation is that business groups adopt their own methods of managing business risks and do not depend much on the capital markets of the country.

Khanna and Rivkin's (2001) study covers firm level studies of five Latin American countries of Argentina, Brazil, Chile, Mexico and Peru and their findings affirm the positive relationship between Corporate Governance and firm performance. In addition to the studies made by individual researchers, commercial agencies (Mckinsey, Deuche Bank and CLSA) made cross country assessment on the positive impact of good governance practices on firm performances. Their findings affirm the findings of the researchers.

❖ GAP ANALYSIS:

On the basis of evaluation of literature, researcher is found following gap:

1. The roles of corporate governance and financial performance have been significantly changed and yet it was not studied.
2. Financial performance have been drastically changed in corporate sector after provision of corporate governance and yet it need to study.

❖ OBJECTIVES OF THE STUDY:

The main objectives of the study are stated below:

1. To indicate the role of corporate governance and financial performance in an effective way.

2. To examine the relationship between Corporate Governance index and firm values/ performance of companies as measured by Tobin's Q, MVBV and ROA.

3. To explore the relation between corporate governance and financial performance.

❖ **RESEARCH METHODOLOGY:**

The data were obtained from the annual reports of the companies. Research literature provides evidence that annual report disclosures reveal credible, relevant information that is priced by investors, reduces estimation risk and information asymmetry (Lang & Lundholm 1996; Botosan & Plumlee 2002;Lundholm & Myers 2002).The following are the sources of Annual reports:

1. Company web sites
2. SEBI EDIFAR site
3. NSE/BSE web site
4. Commercial agencies like Report junction, Cygnus etc.There are many statistical tools & techniques are used for the study like average, percentage, correlation & regression analysis, Cross sectional regression etc..

❖ **SAMPLE:**

The data over a period of one year from FY 2016-17 has been used for analysis. The sample comprises of 10 Indian companies; listed on the BSE; which have continuously been included in SENSEX 30 Index during 1st April, 2016 to March, 2017. The lists of the companies given below:

1. RELIANCE INDUSTRIES LTD.
2.. HDFC BANK LTD
3. INFOSYS LTD
4. VEDANTA LIMITED
5. TATA MOTORS LTD
6. TATA CONSULTANCY SERVICES LTD
7. ITC LTD.
8. ONGC LTD.
9. HCL TECHNOLOGIES LTD.
10. HINDUSTAN UNILEVER LTD.

❖ **HYPOTHESIS:**

H0: There is no relationship between Corpo Governance index and financial Performance as measured by Tobin's Q, M and ROA.

H1: There is relationship between Corpor Governance index and financial Performance as measured by Tobin's Q, M and ROA

❖ **COMPUTATION OF FINANCIAL DATA**

Financial data, collected from the Prowess C data base for the companies belonging to BSE group was analyzed.

Dependent variables	Proxy for	Description
Tobin's Q	Financial performance /Firm value	(Mkt Cap + Total debt)/TA
MVBV	Financial performance /Firm value	Market Value of the share/book value of the share
ROA	Financial performance	EBIT/Assets

Independent Variables	Description
CGI	Corporate Governance index
Log assets	Natural logarithm of book value of assets
Margin	EBIT/Sales or income
Asset dumı	Asset dummy is set to one if the firm belongs to the above median asset group and '0' otherwise
Pro hol	Percentage share ownership by promoters ie Promoters' holding

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❖ ANALYSIS OF RESULTS OF CORPORATE GOVERNANCE AND FIRM PERFORMANCE:

Descriptive Statistics of different variables for the year 2016-17

Variables	Mean	Std. Dev.	Min	Max
Tobin's Q	2.524	2.281	0.837	14.774
MVBV	5.642	8.031	0.642	56.271
ROA	0.166	0.126	0.003	0.738
CGI	14.705	1.737	12.000	19.000
Log assets	8.838	1.546	5.030	13.039
Margin	0.305	0.233	0.020	0.936
Asset dum	0.500	0.503	0.000	1.000
Pro hol	47.226	21.291	0.000	89.500

The above table provides the descriptive statistics for the year 2016-17 for the main variables used.

Correlation Matrix of Tobin's Q and other independent variables used in the multiple regression for the year 2016-17

Variables	Tobin's Q	CGI	Log assets	Margin	Asset dum.	Pro hol.
CGI	0.32	1				
Log assets	-0.35	0.17	1			
Margin	-0.11	0.02	0.38	1		
Asset dum	-0.04	0.17	0.71	0.07	1	
Pro hol	0.15	0.21	0.12	0.02	0.12	1

The above table shows the results of Correlation coefficients of different variables.

Cross sectional regression 2016-17: Tobin's Q

The table reports the regression results of Tobin's Q on CGI index, Log assets, margin and promoter's holding. The regression also includes asset, margin, and dummy variables. Asset dummy is set to one if the firm falls in the above median asset group and '0' otherwise. Margin is set to one if the firm falls in the above median margin group and '0' otherwise. *T* values are based on White's heteroskedasticity- consistent standard errors. *, indicate significance at 1% level.

Variables	Coff.	Std. Err	t	P>t
CGI	0.413*	0.099	4.170	0.000
Log assets	1.689*	0.498	3.390	0.001
Margin	0.625	1.781	0.350	0.727
Asset dum	0.306	0.551	0.560	0.581
Pro hol	0.018	0.013	1.400	0.166
R Sq	0.521			
Adj R Sq	0.450			

The coefficient of CGI is positive and significant at 1% level (p-value 0.000). This indicates that firms having higher valuations measured by Tobin's Q. The coefficient of Log assets is negative and significant at 1% level and that of asset dummy is positive but not significant which implies that firm valuations measured by Tobin's Q is lower among firms with higher physical assets. The coefficient of Margin is negative but not significant and that of Margin dummy is positive but not significant and this indicates that the impact of margin on Tobin's Q is not significant. The coefficient of promoters' holding is positive but not significant. Adjusted R square value is 0.450.

❖ FINDINGS & CONCLUSION OF THE STUDY:

The following findings are:

⇒ The study reveals that there is a positive and statistically significant relationship between Corporate Governance Index and financial performance of Indian firms over a period of five years in both cross sectional regressions and panel data regressions. The results are also robust to different estimation methods. The Corporate Governance Index is found to be positively related to Tobin's Q.

⇒ The results show that the relationship between Margin/Margin dummy and Tobin's Q is positive but not significant. In the case of MVBV also the relationship is not significant. The relationship with financial measure of ROA is positive and significant implying that higher margins of firms results in increase in returns on assets.

⇒ The relationship between promoters' holding and financial performance proxied by Tobin's Q was found to be positive and significant at the overall level. However the segmented analyses shows that the relationship is negative when the holdings are between 0-40 percent and then turns positive and significant between 40-60 percent level and then positive but not significant at higher level.

⇒ **Relationship between CGI and Tobin's Q:** The relationship is found to be positive and significant in four out of five years of cross sectional regressions. In the random effects regression, it is found to be positive and significant. Based on this, it can be inferred that the relationship is positive.

⇒ **Relationship between CGI and ROA:** The relationship is found to be positive and significant in four out of five years of cross sectional regressions. It is found to be positive and significant in the fixed effects regressions. It implies that the relationship is positive.

⇒ As there is a significant positive relationship between Tobin's Q/ROA and Corporate Governance, the null hypothesis (H0) that there is no relationship between Corporate Governance and Financial performance/firm values measured by Tobin's Q/ROA is rejected.

❖ LIMITATIONS OF THE STUDY:

The following limitations are:

1) Limitation of secondary data will remain with the study of the role of corporate governance and financial performance.

2) CGI is a single measure of Corporate Governance and there is no unanimity in the construction of the Corporate Governance index. Hence the CG index suffers from some limitations.

3) Survey methods can capture some good governance practices which are not available in the public domain and these have been not considered in this study.

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