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Corporate Governance Policy Implications & Theories Effecting Financial Performance of Listed Companies in India

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Abstract

The purpose of this study is to investigate the impact of corporate governance variables on the company performance of Indian leading companies. The data were gathered from the financial reports of India leading companies for the period of five years (2019 - 2023). The effect of corporate governance variables (Chief Executive Off icer(CEO) duality, the board size, and the board independence) on company performance were plumbed by Return on Asset (ROA). The panel data of the study were analyzed by descriptive statistics(mean, standard deviation, maximum and minimum values), correlation, and regression analyses. The coefficients of correlation indicated that there is no multicollinearity problem of independent variables. The regression analysis is statistically not significant. The findings showed that there is no epochal impact of corporate governance variables on the company performance of India leading companies in the sample. The paper's main objective is to determine the relationship between CG performance scores and firm financial performance. Moreover, the methods used to check for possible errors in the regression model are also detailed. These tests are intended to increase the reliability of the research results. Finally, an explanation of the research results is offered.

Keywords: Corporate governance, company performance, ROA, CSR.

Introduction

Corporate governance, company performance, ROA, CSR Corporate governance is a multifunctional approach of governance. It mainly focuses on the improving corporate performance through responsibility of people participating in the administration. According to Berle and Means(1932), corporate governance is the technique in which board of directors are very important in controlling mechanism to minimize the conflict of interest between management of companies and owners. Further, Jensen and Meckling (1976) explained that corporate governance is required to protect shareholder interests. The need for accountability, transparency of resources utilization, and motivation to attract new investment by shareholders, enhances the demand of corporate governance. Hence, nowadays, corporate governance became a vital tool for every organization. Good corporate governance is

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undertaking by public and private organizations to carry out their long term and strategic objectives accomplishment (Economic Cooperation and Development Organization, 2004; Crowther D and Seifi S, 2011) Tricker (2019) explained the difference between corporate management and governance. Corporate management is responsible for managing the corporation and corporate governance ascertain that whether the corporation is managed properly or not. Further, Nguyen and Nguyen (2023) stated that the directors are accountable for the financial performance and related decisions. Association of financial performance and corporate governance has became almost attention-getting and arguable issues of nations in the world. Said, Jaafar & Atan(2019) showed that different people combined their resources to operate an entity, but unable to manage and control it in group. To manage this knotty, the corporate governance, which addresses the benefit of owners, is found to be vital. The ambivalence of benef it developed from the distance of ownership and management can be overwhelm through good corporate governance which guarantees the welfare of the parties (Maria Maher and Thomas Andersson, 2000). A number of investigations were implemented to identify the impact of corporate governance variables like CEO(Chief Executive Officer) duality, CEO payment, board number etc on the performance of the firm with return on asset (ROA) (Fauzi Locke, 2019; Zeitun and Tian, 2007; and Zeitun, 2009). The result of these empirical findings were mixed and controversial (Minichillin, Zattono & Zona, 2009). For example, Javid and Iqbal (2008) found the direct and signif icant relationship between board composition and company performance. In contrast, Ibrahim, Rehman & Raoof (2010) explained that ROA has negative correlation with board size. Agin, Yasser, Entebang &Mansor (2011) found that ROA has no significant correlation with CEO of the company. Kesner, 1987 reported thedirect and fundamental correlation between board of directors & result of execution. Similarly, Danoshana.S & Ravivathani.T (2014) identified that corporate governance techniques have strong positive impact on firm performance. ROA and return on equity (ROE) are used to evaluate organization value. Further, the findings of a investigation conducted on corporate governance, by Velnampy.T and Pratheepkanth.P (2013), corporate reporting and board composition have significant effect on ROE & ROA value of firm performance. Ahmadu Sandu, et al, (2005), identif ied that the companies which have large number of external boards managed to advance their performance higher than other firms. Likewise, the companies managed by foreigner CEO performed better than those operated by local CEOs. Black and Jang, (2006), in their research, found thata great concern on board of directors structureof the firm they studiedin selecting outsider directors to boost share value of the firm and superior of governance. Lal C.Chugh, et al, (2011), found that firms with more number of board of directors created and utilized more opportunities and wealth, hence, improving their financial performance. Besides, the authors noticed that the duality of CEO has no effect on synergy. Akshita Arora (2010), reported that the firms with big number of boards and regular board meetings have improved firm performance. Generally, the studies conducted on the f irm performance and corporate governance variables came up with inconsistent results. Hence, it is of paramount importance to regularly investigate the effectiveness and impact of corporate governance on productivity of business f irms. Therefore, the purpose of this study was to examine whether or not these approach to governance is effective in the leading companies of Indian. The study provides empirical evidences from Indian leading companies in the year of 2019 and 2021. Based on their five years 2019-2023) financial reports.

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Objective of The Study

1. To identify corporate governance factors that affect the performance ofleading companies in India.
2. To examine the relationship between Corporate Governance variables and company performance.
3. To analyse the impact of corporate governance variables on company performance ofleading companies in India.

Hypothesis

H1: There is a significant relationship between CEO Duality and firm performance
H2: There is a significant relationship between board size and firm performance
H3: There is a significant relationship between board independence and firm performance.
H1: Good corporate transparency and disclosure practices play a significant role in firm performance.

Research Methods

Sample Description and Data Sources The primary target of this study was to analyze the impact of corporate governance on the performances of leading organizations. The study examines the CEO duality, board size and board independence, & their effects on company performance. The targets of this study were Indian leading companies. As observation of the impact of corporate governance on company performance requires two years, leading companies in the year 2019 and 2021 were considered. Top ten companies of the two years (2019 and 2021) are identified. Some of the companies are leading in the two years (2019 and 2021) and others are not. Therefore, to investigate the effect of corporate governance, those companies were grouped in two strata. One stratum includes leading companies in both years and the second stratum includes the companies leading only in the year 2019. Finally, four companies are selected randomly from each strata. This study covers the financial information of the year 2019 to 2023. This period is taken with the purpose of investigating the impact of corporate governance implementation including the year before leading and after that.

Implications for Policymakers

By grading CG for companies listed in India, the findings show that the compliance level of listed companies with mandatory information disclosure under Circular 121 of the Ministry of Finance is quite good during the evaluation phase of the project. However, because the project uses a set of standards in line with international practices for grading, it must be remembered that international practices apply stricter regulations than Circular 121 in India. For example, the percentage of independent members must be at least 50%, while India's regulation is 1/3. Therefore, policymakers need to research and contribute to the following:

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- It is necessary to quickly develop a set of criteria for assessing CG practices for India to meet international practices and these should be in line with the environment of India.
- Promulgate specific regulations and stricter requirements concerning international practices on mandatory information to be disclosed, as well as voluntary disclosure of information should be encouraged, especially information pertaining to related parties.
- Periodic disclosure of CG practice scores should be required of listed companies.
- Designate a competent authority to certify the transparency of nonfinancial information disclosed by companies, and this agency should maintain data to help investors and stakeholders and should make such data easily accessible to all researchers for evaluation.
- Provide sanctions for violations of the issuance of late, incomplete or no transparent disclosure.
- It is necessary to promulgate regulations to protect whistle-blowers from company violations (this is also a cultural issue in India).

Evaluations Compared With the Theories

Agency theory.

Shareholders expect managers to make decisions that benefit shareholders. However, managers' priorities are sometimes not the same as shareholders' priorities; their own goals may differ in increasing the company's value. In other words, they want to maximize personal benefits. Because managers' goals are not always about maximizing corporate value, owners may try to monitor and control managers' behaviors and thus, supervisory and control actions incur agency costs of equity. Therefore, the divergence of interests between shareholders and managers can generate agency costs, and if this conflict persists, this can also affect firm performance in the long run.
The last common point of agency theory is that it proposes that if a governance structure is weak, the firm will have significant agency problems, and managers will be able to derive great personal benefits, which can affect the company's financial performance. Therefore, the role of CG is mainly for protecting and enhancing the interests of shareholders and stakeholders. Through the regression results, the agency theory used in the study has shown the strengthening of the following: the relationship between owners and managers and the relationship between large and small shareholders through the power index of shareholder's rights, the index of equal treatment of shareholders and the responsibilities of the board of directors of listed companies. This situation thereby verifies this relationship with firm performance.

Principle theory.

Theoretical and empirical studies show that conflicts occur in those emerging markets and developing countries where regulatory enforcement is weak and investor protection is poor. In this situation, even if the role of significant shareholders helps to reduce conflicts between owners and managers because they have many assets contributed to the company, shareholders must supervise managers closely and request explanations, which causes

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conflicts between significant shareholders and minority shareholders (owners – owners). Therefore, the research results acknowledge that the division of ownership among major shareholders can reduce the appropriation of interests of minority shareholders, and the majority, therefore, must approve any decision. Therefore, the theory calls for better protection of minority shareholder rights and urges increased transparency.

Stakeholder theory.

CG debates the company's responsibility to the community at a more extensive scope. This study shows that stakeholder theory has gained some influence when it comes to assuming that stakeholder management positively contributes to firm performance. In addition, the researchers have found a strong relationship and solidity between CG and financial performance as a result of implementing stakeholder theory. Stakeholders have a significant influence on a company's financial performance. The authors have found evidence that good stakeholder governance leads to enhanced shareholder value. Considering that the relationship between stakeholders present on the board and stakeholders' performance may directly correlate with the company's financial performance, the study's results support the above hypothesis.

Stakeholder theory governance practices will lead to higher profitability, stability and growth and will thus affect company performance. Therefore, good CG must focus on creating a sense of security, ensuring that the company observes the interests of its stakeholders, such as those of the board of directors responsible for the company and other stakeholders. According to Jensen (2002), stakeholder theory deals with problems caused by multiple goals, as this theory seeks to maximize value in the long run. Furthermore, if management decisions do not consider the interests of all stakeholders, the company cannot maximize its value.

Asymmetric information theory.

Because there is information asymmetry between the executives (managers) of the company and shareholders (or investors) or more specifically, it might be the case that corporate managers have informational advantage of the company they operate over shareholders, outside investors and stakeholders, executives tend to take advantage of their position for self-interest. Costs associated with the above self-interest reduce the income of shareholders. Therefore, the authors have found empirical evidence to prove that information asymmetry is one of the essential theoretical bases to explain the complex relationship between directors and shareholders, particularly between directors and general corporate stakeholders.

Therefore, to reduce asymmetric information, many researchers and international organizations, such as the OECD, encourage the establishment of a CG system to create a multidimensional open and transparent information flow (financial, financial materials) between the company and related parties, which thereby helps to reduce conflicts of interest.

The study acknowledges that the CG quality index is essential in attracting external capital for maintaining a high growth rate and for reducing asymmetric information between insiders (shareholders and managers) and outsiders (investors and stakeholders).

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Limitations and recommendations for future study

Concerning this research, several limitations will be discussed.
Firstly because the CG index is established based on an un weighted approach, this may not accurately reflect the importance of each CG principle for different countries because it is a set of general principles.
Second, the transparency of the reports of non financial information provided by listed companies cannot be checked.
Third, there may be an overlap in information. For example, the shareholder rights index has two questions with the same information as the answer:

1. The latest annual general meeting (AGM) minutes record that shareholders have the opportunity to ask questions or raise problems and
2. Do the minutes of the latest AGM indeed record questions and answers?

In principle, the minutes of the meeting must record all critical issues that occur during the meeting, so when collecting secondary data, respondents can only base their answers on the same content in the minutes to answer both of the above questions. Therefore, the score will be duplicated or more precisely, the information will be duplicated. Alternatively, the equity treatment and transparency indexes have similar questions regarding dividend policy.
Fourth is the time limit of the research sample: the study could not test the endpoint of the spillover effect of good CG practice on financial performance.
Finally, because the goal of the study only considers a one-way relationship of the impact of the CG index on financial performance, the study – due to data limitations – does not thoroughly address the two-way relationship as do previous overseas studies. In addition, further research needs to review the two-way relationship between the CG index and the CG, as well as the change in the CG practice quality index and CG performance change. Finally, there is also space for a study to compare analysis results from two different research data sources, including manually collected secondary data and data collected from direct surveys.

Summary

This study explained, the result of corporate governance variables and company outcome of India leading companies. The study was based on the companies in the list of leading companies in two years(2019 and 2021) and in 2019 only. The financial data of the five years between 2019 to 2023 were taken to investigate the relationship between corporate governance variables such as CEO duality, the board size and the board independence with company performance. Performance is calculated by ROA or in the ratio of net income and total assets. Regression of panel data were run to analyze the impact of independent variables on dependent variable. The outcomes of regression showed that there is no fundamental effect of CEO duality, board size and board independence on company value. From this, it is possible to conclude that corporate governance techniques(CEO duality, board size and board independence) have no impact on the performance of Indian leading companies.

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Conclusions

The score of transparency disclosure and information index in 2019 decreased compared to 2019 and 2020, mainly due to the impact of the COVID-19 epidemic, which prompted many businesses to apply for an extension to hold the General Meeting of Shareholders. Specifically, 54% of enterprises had to apply for an extension of the date of holding the General Meeting of Shareholders in 2020 due to social distancing reasons, compared with 13% in 2019. According to the LOE, the General Meeting of Shareholders must be assembled annually within four months, which can be extended up to six months following the end of the fiscal year. However, due to the impact of the COVID-19 epidemic, many businesses could not hold meetings within the specified time. The evaluation results show that 149 companies did not hold the General Meeting of Shareholders on time out of the total number of enterprises assessed but disclosed information about the approval to extend the meeting. Among the remaining enterprises, more than 54 licensed enterprises, i.e. the equivalent of 42%, successfully held a General Meeting of Shareholders within four months. This result shows that the COVID-19 epidemic greatly affected the organization of enterprises' General Meetings of Shareholders as compared to the 2019 rate when the ratio of those organizations that held meetings on time reached 83%.
However, these studies did not find evidence of a relationship between the board of directors' responsibilities and financial performance. Therefore, there is a need for a future study that compares the results of analysis from two different research data sources, including secondary data collected manually and data collected from a direct survey or a qualitative case study or studies. Also, research concerning which aspects of management should be examined would likewise be welcome.

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