CORPORATE GOVERNANCE AND FIRMS PERFORMANCE
A CASE OF INDIA

Ata Ul Haq*
School of Business Administration, Liaoning Technical University, China
ata.chuhan@gmail.com

Baofu Zhao
School of Business Administration, Liaoning Technical University, China

and

Ramiz Ur Rehman
Lahore Business School, University of Lahore, Pakistan
ramiz.rehman@hotmail.com

Abstract

This study examined the impact of the corporate governance on firm’s performance, in the case of India. Different measures of corporate governance like the Board size, Board independence and Board directors, were studied in the Indian firms. The financial performance was measured through the Return on Assets and Return on Equity. After applying the regression analysis, it was found that there was positive relationship between Board size, Board independence and performance of Indian firms.

Keywords: Board Size, Board independence and Firm Performance

JEL Code : G34 and L25

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1. Introduction

Stewardship model is about executive as “steward”, as opposed to fully rational economic man, agency theory (Muth and Donaldson, 1998). Agency theory accepts some type of homo-economicus, which delineate subordinates as self-serving, individualistic, artful, and opportunistic. On the other hand, sociological and psychological ways to deal with governance, e.g., stewardship theory, delineate assistants as collectivists, pro-organizational, and dependable.
Board of directors was taken as the ground of corporate governance. Any board's role (Providing strategic directions, monitoring and administration of obligation to shareholders) is vital to any organization (Carey, 2006). Monitoring by the directors is one of a few foundations, that has emerged in organizations, to solve the agency issue among higher management and investors (Hermalin and Weisbach, 1991). (Yermack, 1996) Companies, with fewer board members, came up with healthy financial ratios. Rosenstein and Wyatt, 1990 found evidence that outside executives of a specific occupation were either more or less important than others. Absence of independent leadership in firms makes it different for the board, to expel inadequately performing directors (Goyal and Park, 2002).

2. Review of Literature

Another impactful variable, for firm performance, can be the size of board. A larger board size is beneficial for firm’s performance because of diversity, expertise, knowledge and skills of directors. It shows up the expanded capacities and assets a large group of directors could convey to the strategic decision making process (Haleblian and Finkelstein, 1993); (Sanda, et al., 2005). On the other hand, some studies showed a different perspective and the negative aspects were observed with larger board size. Jensen(1993) argued that a CEO can control small boards effectively and small boards can have positive impact on organization’s performance. Less than eight board members will work viably and there would be less chances of conflict between them. Lipton and Lorsch (1992) supported this argument by stating that excess of ten individuals in board, can prevent them from expressing their thoughts and suggestions in the limited time available. At the point when boards get to be
too huge, agency issues crop up and the board turns out to be more representative and less a part of the organization procedure (Weisbach and Hermelin, 2000). Yermack (1996) recommended that there is a critical negative connection between board size and performance. Some studies argued that large board size can cause coordination issues. A large board cannot achieve consensus and hence bigger boards are less proficient and slower in settling on their choices (Kholief, 2008). Some support the positive relation between large size of boards and firm’s performance.

Garg (2007) maintained that the board size ought to be sufficiently large enough to have required skills and knowledge, to operate the firm efficiently and effectively but small enough for significant talk to occur. Examining 93 Nigerian exchange listed firms, during the period 1996 to 1999, positive relationship was found between the size of board and the benefit, as estimated by ROE. Halebian and Finkelstein (1993) found that corporations, with larger team size, were more beneficial. Jensen and Meckling, 1976 investigated how board meeting attendance can impact the performance of Indian firms. High percentage of meeting attendance, by executives themselves, can upgrade an organization’s performance but high participation by directors’ representatives recorded an unfavorable impact on performance (Chou, et al., 2013). Lin, et al., 2014 found negative relation between board meetings and company’s performance. Johl, et al., 2015 found adverse impact of board meetings on organization’s financial performance. Chou, et al., 2013 empirically found that participation in board meeting by directors themselves was beneficial for the firm but sending their representatives instead, can cause firms contra effect on performance. Lin, et al., (2014) examined listed organizations in Taiwan, from 2006 to 2008, and found that directors, held directorships of various organizations reported less presence in meetings and attendance was also affected by board size, and the busy routine of directors. Johl, et al., 2015 found negative impact on company’s performance on the basis of annual reports of the 700 listed organizations in Malaysia, for the year 2010.

3. Statement of the Problem

The study proposes to analyse the corporate governance and its impact on firm performance.

4. Need of the Study

The current debate among scholars highlights the need of this study, to examine the relationship between corporate governance and firms’ performance, especially in developing countries like India. This study may fill this need by exploring the relationship between corporate governance and firm performance.

5. Objectives of the Study

This study proposes to study the impact of directors’ numeration and board meeting attendance, in addition to other variables, on the financial performance of a firm and to examine the impact of Board Size, non-independent directors, independent directors on company’s performance, expressed in ROA and ROE (Table-1).

6. Hypotheses of the Study

NH-1: There is no relationship between board size and firm’s performance.

NH-2: The board attendance does not influence the firm’s performance

7. Methodology of the Study

7.1 Sample Selection

To examine the relationship between corporate governance and firm’s performance, a sample of 458 listed companies on Bombay stock exchange was identified.
7.2 Source of Data

Data were collected from the published report, issued by the companies, as per the requirement of Securities and Exchange Commission of India.

7.3 Period of the Study

This study used cross-sectional data for the period of 2019.

7.4 Tools Used in the Study

The study used the cross-sectional data and descriptive statistics and regression analysis were employed.

\[ \text{ROA} = \alpha + \beta_1 \text{BS} + \beta_2 \text{MA} + \beta_3 \text{BI} + \beta_4 \text{BNI} + \epsilon \quad \ldots \ (1) \]
\[ \text{ROE} = \alpha + \beta_1 \text{BS} + \beta_2 \text{MA} + \beta_3 \text{BI} + \beta_4 \text{BNI} + \epsilon \quad \ldots \ (2) \]

8. Data Analysis

8.1 Descriptive Analysis of Corporate Governance

Table-2 reveals skewness, for majority of variables to be less than 1, which was acceptable because of large sample size. Standard deviation for all variables, other than attendance and foreign directors, was low, which indicated that numbers were very close to average or mean value.

8.2 Descriptive Analysis of Financial Variables

According to Table-3, average for the overall sample was 5.33% and -6.75%, for ROA and ROE respectively and it differed from members of data, at 11.86 and 312.29. Skewness for ROA was -1.75 and it skewed on left and ROE at -20.94 value, showed that it was not acceptable.

8.3 Regression Analysis of Corporate Governance with ROA

Table-4 reveals in independent director variable, to report co-efficient of 0.35, which indicated that ID recorded weak but positive and significant impact on company’s performance. Change in one unit of ID will change 0.35 units or 35% of ROA. Probability value, for ID was 0.03**, which indicated the significance among two variables. Probability value, for NID (0.00***) showed that the variable was statistically significant. Hence, NH-2: The Board attendance does not influence the firm’s performance, was rejected. NID, with co-efficient of 0.03 (which is weak but positive), indicated that change in one unit of NID will change 0.03 units of ROA or will change 3% of it in the positive direction. Not just external director but also internal directors did play important role in the financial capability of firm and autocorrelation for them was positive at 1.53. Board meeting attendance and ROA also reported positive coefficient of 0.026 but in weaker zones. It indicated that one unit change in attendance will change 0.026 units or 2.6% of ROA, in direct dimension. Probability of 0.00*** made it highly significant, with positive autocorrelation of 1.78. Table-5 shows that BS recorded positive regression coefficient of 1.98. Change in 1 unit of board size will change 1.98 units of ROE or will change ROE by 1.98%, in the positive direction. Board size variable was significant with 0.00*** probability. On the other hand, autocorrelation, defined by Durbin Watson Test was 2.03, which revealed negative autocorrelation, as it was slightly above two. Independent director variable reported co-efficient of 3.46, which indicated that ID exercised strong, positive and significant impact on company’s performance. Change in one unit of ID will change 3.46 units or 3.46% of ROE. Probability value for ID was 0.02** and it described the significance among two variables. Probability value for NID (0.00***) showed that the variable was statistically significant. Results of ROE were different and it went against the hypothesis about relation of NID with firm performance. NID, with co-efficient of 7.31, (which is strong and positive) indicated that
change in one unit of NID will change 0.03 units of ROE or will change it by 3% in positive direction. Not just external director but also internal directors did play important role in the financial capability of firm. Autocorrelation for them was positive at 2.35. Board meeting attendance and ROE also produced positive coefficient of 0.89. Hence, **NH-1: There is no relationship between board size and firm’s Performance**, was rejected. In other words, one unit change in attendance will change 0.89 units or 89% of ROE, in direct dimension. Probability of 0.00*** made it highly significant and Durbin Watson Test for attendance, was slightly negative because it was a bit above two.

9. **Findings of the Study**

It was found that both concepts of independent directors bringing skills and external knowledge to organization and internal directors, using internal knowledge, which were strongly linked (positive) to return on equity, implied that increase in boards size will have increase in return on equity. This research found that executive directors also did play a significant positive role, for the financial performance of organizations. This may be because of some new legal development and provisions in the laws of corporate governance. For example, on the basis of Kotak Committee’s suggestions, SEBI, had started applying new rules since the beginning of 2019.

10. **Suggestions**

This study has real applications Managers, by utilizing these results could evolve strategies, not only for getting the financial outcomes but also for attracting new investors. This study will also academically contribute to the existing literature, by discussing the emerging economies, as it may be different from developed countries.

11. **Conclusion**

Study showed significant impact of corporate governance (characteristics of boards), on the profitability (ROA and ROE) of organizations in India, by using agency theory concept. This study examined wide range of corporate governance characteristics on firm performance, as compared to previous studies in India. Previous studies indicate that executive directors exercised negative impact on firm performance. This research has provided empirical evidence about the impact of board characteristics on CG. By using simple linear regression model (regression co-efficient), Standard error, T-statistics, probability, correlation analysis, R square and Durbin Watson Analysis (for autocorrelation), the study tried to find the significance of independent variables, for ROA and ROE, by having total assets and net sales as control variables and Group A, Group T and Group Z as dummy variables.

12. **Limitation of the Study**

This study suffered from some limitations as it used cross-sectional data. The study considered only one country, that is, India. The study was not able to generalize.

13. **Scope for Further Research**

The phenomena can be used for multiple countries and more corporate governance variables can be employed, to get better results.

14. **References**


Table-1: Defining Variables

<table>
<thead>
<tr>
<th>Variables</th>
<th>Definitions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Independent Variable</strong></td>
<td></td>
</tr>
<tr>
<td>Board Size</td>
<td>Total number of current directors</td>
</tr>
<tr>
<td>Independent Directors</td>
<td>Number of independent directors</td>
</tr>
<tr>
<td>Non-independent Directors</td>
<td>Number of non-independent directors</td>
</tr>
<tr>
<td>Attendance</td>
<td>Percentage of attendance of board members</td>
</tr>
<tr>
<td><strong>Dependent Variables</strong></td>
<td></td>
</tr>
<tr>
<td>ROA</td>
<td>Division of net income by total assets</td>
</tr>
<tr>
<td>ROE</td>
<td>Division of net income by shareholder's equity</td>
</tr>
</tbody>
</table>

Source: Compiled by Authors

Table-2: Descriptive Analysis for Corporate Governance

<table>
<thead>
<tr>
<th></th>
<th>ABAGE</th>
<th>BS</th>
<th>ID</th>
<th>NID</th>
<th>ATTN</th>
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<tbody>
<tr>
<td>Mean</td>
<td>61.35</td>
<td>9.31</td>
<td>4.79</td>
<td>4.52</td>
<td>82.68</td>
</tr>
<tr>
<td>SD</td>
<td>5.03</td>
<td>2.89</td>
<td>1.76</td>
<td>1.79</td>
<td>14.08</td>
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<tr>
<td>Skewness</td>
<td>0.03</td>
<td>0.41</td>
<td>-0.01</td>
<td>0.69</td>
<td>-1.92</td>
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</table>

Source: Authors own analysis

Table-3: Descriptive Analysis for Financial Variables

<table>
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<tr>
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<th>ROE</th>
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<tr>
<td>Mean</td>
<td>5.33</td>
<td>-6.75</td>
</tr>
<tr>
<td>Std Dev</td>
<td>11.86</td>
<td>312.29</td>
</tr>
<tr>
<td>Skewness</td>
<td>-1.75</td>
<td>-20.94</td>
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</table>

Source: Authors own analysis

Table-4: Regression Analysis of corporate governance with ROA

<table>
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<tr>
<th></th>
<th>Co-efficient</th>
<th>p</th>
<th>DW Stat</th>
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<tr>
<td>BS</td>
<td>1.84</td>
<td>0.00***</td>
<td>1.59</td>
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<tr>
<td>ID</td>
<td>0.35</td>
<td>0.03**</td>
<td>1.53</td>
</tr>
<tr>
<td>NID</td>
<td>0.03</td>
<td>0.00***</td>
<td>1.53</td>
</tr>
<tr>
<td>ANB</td>
<td>0.01</td>
<td>0.00***</td>
<td>1.69</td>
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* *, **, *** indicates significance at the 10%, 5%, 1%, levels
Source: Authors own analysis

Table-5: Regression Analysis of corporate governance with ROE

<table>
<thead>
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<th>Co-efficient</th>
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<th>DW Stat</th>
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</thead>
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<tr>
<td>BS</td>
<td>1.98</td>
<td>0.00***</td>
<td>2.03</td>
</tr>
<tr>
<td>ID</td>
<td>3.46</td>
<td>0.02**</td>
<td>2.35</td>
</tr>
<tr>
<td>NID</td>
<td>7.31</td>
<td>0.00***</td>
<td>2.35</td>
</tr>
<tr>
<td>ATTN</td>
<td>0.89</td>
<td>0.00***</td>
<td>2.05</td>
</tr>
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</table>

* *, **, *** indicates significance at the 10%, 5%, 1%, levels
Source: Authors own analysis