Impact of Corporate Governance on Firm Performance: Evidence from Indian Leading Companies

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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 (2012 - 2016). The effect of corporate governance variables (Chief Executive Officer(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 coefficientsof correlationindicated 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.

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

Introduction

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 undertaking by public and private organizations to carry out their long term and strategic objectives accomplishment (Economic Co-operation and Development Organization, 2004; Crowther D and Seifi S, 2011)

Tricker (2015) 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 (2016) 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(2015) 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 benefit 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, 2012; 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 significant 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), identified 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 firm 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 firms. 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 2015 and 2017. Based on their five years 2012-2016) financial reports.

Objectives 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.

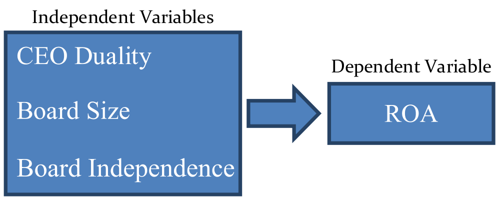
Hypothesis

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.

Conceptual Framework



Dependent Variable

ROA=Net Income/ Total Asset

Independent Variables:

Board Size= total no of board of directors.

Board Independence = Independent/ outsider directors/ total board of directors

CEO duality is dummy variable

CEO duality=1

CEO non duality =0

Literature Review

Corporate Governance: An overview of its origin and definitions

Corporate governance was originated before eighteen century. Smith (1776) as cited in Tricker (2009), define corporate governance as: "The directors of organizations, being managers of other people's resource than their own, it cannot well be awaited that they should watch over it with the same eager attention with which partners in a private company often watch over their own". A group of people invest their resources together to run a business. But these multiple owners are unable to manage and control their business. To address this difficulty suitable body that serve the most benefit of owners are required. This shows the demand of corporate governance (Bainbridge, 2008; Tricker, 2009; Said, Jaafar & Atan, 2015)

Further, corporate governance is defined as "the system by which companies are directed and controlled" by an independent and responsible body like Governance Code (2014:1) of The United Kingdom (UK).

Australian Corporate governance Council (2014:2) explains corporate governance as, "The framework of rules, relationships, systems and processes within and by which authority is exercised and controlled within corporations. It encompasses the mechanisms by which companies, and those in control, are held to account". Besides, the Organization for Economic and Development (2004:11) elaborates corporate governance as essential way of keeping jointly the interests and relations of several stakeholders. According to this organization corporate governance a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance provides the structure through which the objectives of the company are set. It is also a means of monitoring performance of companies and attaining those objectives.

Corporate Governance: Techniques

There are a number of corporate governance techniques used to protect and decrease inefficiency and wrongdoings in companies (Afolabi & Dare, 2015). Basic corporate governance techniques include board structure, inside controls (directions, procedures and policies), leveling authority, market power, and compensation (Dalwai, Basiruddin and Rasod, 2015). Boards are organs selected by share owners with responsibility to secure resource utilization and other benefits of the shareholders (Grove & Clouse, 2015). Board of directors have relation with the managers and owners of the organization. They are accountable to the company on behave of the shareholders (Said et al., 2015). Furthermore, the load of power has given to boards of directors where ownership and management are detached. Board of directors bridges the gap between the management and shareholders. They are a dynamic governing unit of a corporation (Tricker, 2009; Garg, 2007).

The functions of boards are primarily connected with various theories namely: stakeholders, agency, resource based, stewardship and social capital theories, which are briefly elaborated below. These theories highly influence the type and advancement of corporate governance (Tricker, 2009; Mallin, 2010).

Corporate Governance: Theories

Agency Theory

This is the theory based on how to deal with the ambivalence of benefit between management and owners. In other words, agency theory is implemented when the two are separated. Zahra and Pearce (1989) elaborated the main features of directors, such as, structure, composition, characteristics & decision process. Tricker (2009), stated that "The agency theory looks at corporate governance practices and behavior through the lenses of the agency dilemma", it occurs when director get into agreement with owner to administer the organization resource.

Mallin (2010) argues that agency theory views corporate governance techniques, especially the board of directors, as being an essential monitoring device in the context of corporations and issues of corporate control. According him, board of directors ensures that any problems that may be brought about by the principal agent relationship are minimized. That is, agency theory identified board of directors are essential governing and managing body of the organization.

Stewardship Theory

This theory is founded on the integration of authority at the topmost of an organization. In other words, the combination of Chief Executive Officer (CEO) & chairperson's function can be beneficial for the owners. It provides high integrity of guidance and powerful control & authority. It opposes the importance of effective board of directors. According to stewardship theory, managers used their power in the most benefit of owners(Donaldson & Davis, 1991 cited in Muth and Donaldson, 1998). However, it emphasizes on the essential of board composition (Zahra and Peace, 1989). This study based on the agency and stewardship theories.

Corporate Governance: Empirical Findings

CEO duality and firm performance

The findings of previous studies have been inconsistent or mixed. Some researchers explained that CEO duality has positive relationship with company performance. The argument in support of CEO duality explained as, CEO duality decrease the ambivalence of benefit between boards and management, avoid the expected rivalry among the CEO and the chairperson, remove the combination of the two authorities, and enhance invention and Entrepreneurship of the CEO. Further, the advocators of the duality of CEO argue that combination of these duties cater a distinct direction for operating the organization but segregation of the roles of the two charge more the company than gain (Fama and Jensen, 1983 cited in Nguyen et al, 2014; Brickley et al., 1997 cited in Abdullah 2004;).

On the contrary, those who are opposing CEO duality argue that duality could, encumber board freedom & lessen the activities of the directors. CEO can decently plan to perform and manage segregation of decision making and controlling the firm creates rivalry for existence. Consequently, unsecured directors may not genuine when they give evaluation on financial performance. Foundation of agency theory states that, CEO duality would constraint the directors role of playing the monitoring activity due to compromising impaired board. Moreover, it is largely conceived that the authority of controlling role could be misused for CEO's self-benefit. To overcome this difficulty, separation of CEO role/CEO non-duality would track to better monitoring consequences. Separation of CEO role would decrease agency's difficulty through dispersing the controlling & managing activities. When one individual is CEO and chairman, the controlling power and freedom of board of directors in controlling and monitoring would be impaired due to absence of independence and conflict of interest (Abdullah, 2004; Yermack , 1996)

According to the study conducted by Boyd, 1995 cited in Vo and Nguyen, 2014, agency & stewardship theories propose "the effect of chair directors on firm performance is different across various environments". Other findings showed that there is no considerable differences on performance due to change in CEO duality(duality to non-duality) and it needs observation of two years to evaluate its effect on company performance (Berge and Smith (1918 cited in Abdullah 2004)

Board size and firm performance

The outcomes of previous studies regarding the relationship between board size and company result are controversial. Some researchers determined the positive relationship between board number and company value; others identified indirect relationship between them. When the board number is large in the organization, it creates the problem of coordination, communication and lessen the capacity of the board controlling the organization. Companies with small board size achieve more returns than that of large board size(Jensen, 1993; Lipton and Lorsch, 1992; Mak and Kusnadi, 2005; Yermack, 1996). "when boards get beyond seven or eight people they are less likely to function effectively and are easier for the CEO to control" (Jensen, 1993, p. 865).

On the other hand, a small board number maybe have difficulty to influence and control the CEO because of potential social unity. When the board size is more the board independence is enhanced. Larger boards control and influence the CEO which leads to higher firm performance (Muth and Donaldson, 1998).

Board independence and firm performance

The previous studies also reported controversial results on board independence and firm performance. Out side boards reduce agency cost, improved decision and increase effective monitoring of the company which leads to higher value(Fama and Jensen, 1983; Brickely et al., 1994 cited in Saibaba 2013; Dahya et al., 2008 cited in Saibaba 2013).

Out side boards provide important resources for the firm, bring critical knowledge and skill that support the management for strategic decision making; which increase the performance of the company(Daily et al., 2003 cited in Nguyen et al., 2014; Singhchawla et al., 2011; Fama and Jensen, 1983 cited in Abdullah 2004; Wu and Li, 2015; Jackling and Johl, 2009 cited in Saibaba 2013; Baysinger and Butler, 1985 cited in Vo and Nguyen, 2014).

In contrary, there are ample findings identified inverse relationship among board independence and company performance. Outsider boards have no full information about the internal activities of the firm which important to monitor the business. Ineffective monitoring of the firm reduce the value of the firm(Defond et al., 2005; Agrawal and Knoeber, 1996; Fich, 2005; Yermack; 2006; Klein, 1998; and Caselli and Gatti 2007 cited in Saibaba 2013)

On the other side, several studies indicates no fundamental relationship between board structure and company value Yermack, 1996 cited in Bhagat and Black, 1999). Hermalin and Weibach, 1991 cited in Vo and Nguyen, 2014 reported the absence of relationship between director independence and company performance. The impact of inside & outside boards are not different. The empirical findings of (Mehran, 1995; Klein, 1998; Dalton et al..,1998) are not showed the fundamental connection among external boards and organization value (Singhchawla et al., 2011).

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 2015 and 2017 were considered.

Top ten companies of the two years (2015 and 2017) are identified. Some of the companies are leading in the two years (2015 and 2017) 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 2015. Finally, four companies are selected randomly from each strata. This study covers the financial information of the year 2012 to 2016. This period is taken with the purpose of investigating the impact of corporate governance implementation including the year before leading and after that.

Top 10 Indian Companies in 2015

1. Tata Consultancy Services (TCS)
2. Reliance Industries Limited (RIL)
3. Oil and Natural Gas Corporation (ONGC)
4. HDFC Bank

5. ITC (India Tobacco Company Ltd)
6. Coal India
7. Infosys
8. Sun Pharmaceuticals Industries Limited
9. SBI (State Bank of India)
10. Hindustan Unilever

Top 10 Indian Companies in 2017

1. Reliance Industries Limited
2. State Bank of India
3. HDFC Bank
4. Indian Oil Corporation
5. Tata Motors
6. ICICI Bank Ltd.
7. TATA Consultancy Services
8. N.T.P.C.(National Thermal Power Corporation Ltd.)
9. Axis Bank
10. Larsen And Toubro Company

Strata and selected companies

List of companies in Stratum 1	Randomly Selected companies	List of companies in Stratum 2	Randomly Selected companies
Reliance Industries Limited (RIL)	Reliance Industries Limited (RIL)	Tata Consultancy Services (TCS)	Tata Consultancy Services (TCS)
SBI (State Bank of India)	HDFC Bank	Sun Pharmaceuticals Industries Limited	ITC (India Tobacco Company Ltd)
HDFC Bank		Oil and Natural Gas Corporation (ONGC)	
		Hindustan Unilever	
		ITC (India Tobacco Company Ltd)	
		Coal India	
		Infosys	

Accordingly, Reliance Industries Limited (RIL) and HDFC Bank were selected randomly from companies leading in the year 2015 and 2017.

Tata Consultancy Services (TCS) and ITC (India Tobacco Company Ltd) were selected randomly from leading companies only in 2015.

Data Analysis

Panel data analysis was used to analyze the relationship between corporate governance variables and company performance. Panel data combines cross-section and time-series data. Panel data used to control heterogeneity of variables which help to reduce the risk of getting biased outcome. With panel data it is possible to examine more variables and correlations between them, which are changing over time. It is used to structure the model in proper way and thus to remove the effect of some types of omitted variables bias in regression outputs (Baltagi, B., 2008). Majority of previous researchers who conducted studies related to corporate governance employed this method of data analysis. In this study, the nature of the panel data was examined by using mean, standard deviation and maximum-minimum values of the considered variables. To examine the extent of the relationships among the variables, correlation method was employed. To determine the extent of the variations in the performance of the companies accounted for by the corporate governance variables, panel regression analysis was employed.

Data Interpretation

Descriptive Statistics

Descriptive statistics is used to analyze the preliminary distribution of the data. The following table explains the summary of 20 observations, mean, standard deviation, minimum and maximum for all dependent(ROA) and independent variables(board size, CEO duality, board independence) for five years from 2012 to 2016.

Table 1 : The results of descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
boardsize	20	13.55	2.645254	11	18
ceoduality	20	.25	.4442617	0	1
oardindep~e	20	4.05	4.310025	0	11
roa	20	.1865	.1040888	.02	.32

As indicated in table 1 above, the mean of CEO is 0.25. This indicates that the majority of leading companies separate the duty of CEO and Chairperson.

Regarding the board independence, the average percentage of independent boards to total board of directors is 4%. The maximum independence ratio is 11% and the minimum is zero. From the board of directors size point of view, the average number of directors is 14. As stated in Jensen (1983) and Lipton and Lorsh (1992), the maximum amount of board size should be 7 to 8 and not more than ten board of directors. The large size choice could be arise due to several particular characteristic of the company like company size, company age or organization penchant or the position of acquiring many heterogeneous ability and skillfulness of directors.

The mean ratios of the companies show wide range value of ROA,i.e maximum and minimum of 32% and 2% respectively. Over all, the distribution of the data is normal and useful for statistical analysis.

Correlation Analysis

Correlation analysis is used to see multicollinearity problems which results between independent variables. The difficulty arises when independent variables are extremely related. It falsifies the outcome of regression (Hair et al.., 2010).

Table 2 : Correlation coefficients among the considered variables

	boards~e	ceodua~y	boardi~e	roa
boardsize	1.0000			
ceoduality	-0.1232	1.0000		
boardindep~e	0.7776	0.4329	1.0000	
roa	0.0494	-0.5150	-0.2201	1.0000

As pointed in the above table 2, all statistical values used in evaluating multiple correlation problem is below 0.8 (Hair et al., 2010). Thus, in this investigation, there is no multicollinearity problem. The largest correlation is between board independence and board size ratio which also show direct relationship. The relationship could be explained that companies with large size of board of directors has the room to include independent boards. In addition, CEO duality and board independence are correlated at about 0.43 ratio, which indicates companies assign two positions for single individual need to have independent boards. The negative value between duality and board size indicates that the company adopt CEO duality has small board size.

Regression Analysis

Table 3 : The Results of Regression Analysis

roa	Coef.	Std. Err.	z	P>|z|	95% Conf.	Interval
boardsize	-.0049211	.0229076	-0.21	0.830	-.0498192	.0399769
ceoduality	-.1375989	.0951345	-1.45	0.148	-.324059	.0488612
boardindep~e	.0031722	.015478	0.20	0.838	-.0271641	.0335086
cons	.2747332	.273163	1.01	0.315	-.2606564	.8101229
sigma_u	0					
sigma_e	.06567791					
rho	0	(fraction of variance due to u_i)				

As shown in the above table, the p value of CEO duality, board independence, and board size are statistically not significant. The results of previous empirical studies on CEO duality and company performance were mixed. The results of this study align with the studies by: Baliga et al. , 1996; Berge and Smith (1918), cited in Abdullah (2004); Nhung H.& Thuy N., 2017). In addition, according to the studies by Linck, Netter and Yang, 2008 cited in Duru et al., 2016 company performance is not determined by CEO duality. According to the findings of Nguyen and Nguyen, 2016; Mak and Kusnadi, 2005, board size is inversely significant to company value. However, the results of the study showed that, there is no fundamental effect of board size on company value. This could be due to the differences in companies position under investigation.

However, regarding the relationship between the board independence and firm performance, the p value shows that independence has no significant impact on company performance. This finding is agreeable with the outcome of Kaur and Gill, 2008 and Lange and Sahu, 2008.

Summary and Concluding Remarks

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(2015 and 2017) and in 2015 only. The financial data of the five years between 2012 to 2016 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.

The study is limited to only few areas of corporate governance techniques such as CEO duality, board size and board independence while not considering other important variables like committees, ownership structure,board diversity, etc. The study considered only five years data for four companies which have no sense in panel data model. Hence, the future researchers should focus on these uncovered areas in the study.

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