



## Contours of Corporate Governance and Firm Performance in India : An Empirical Study

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**Abstract:** *The relationship between corporate governance and firm performance has been a topic of much interest among researchers in recent years. The study at hand was undertaken to examine the effect of a good corporate governance mechanism on institutional performance of firms of certain selected industries. Using judgment sampling, the performance of the firms under study on the basis of eight corporate governance variables have been explored. The results are indicative of the fact that strong governance metrics, namely the board size and remuneration committee had significant influence on the firm performance, whereas, variables such as audit committee, debt-equity ratio and whistle blower policy did not affect their institutional performance.*

**Key Words:** *Corporate Governance, Firm Performance, Firm size, Firm value, Leverage.*

### 1. INTRODUCTION:

In today's globalised environment, India is witnessing a rising class of responsible and aware investors. Empowered by changing rules, regulations and complex business environment, present and prospective investors are asking the right questions of managements and vocalizing their opinions by casting their votes. To augment and boost stakeholder confidence, companies need to upgrade their corporate governance framework to ensure it is in line with international, regional and local level best practices of governance. Denis and McConnell, (2003) define corporate governance as, "The set of mechanisms both institutional and market based- that induce the self-interested controllers of a company (those that make decisions regarding how the company will be operated) to make decisions that maximize the value of the company to its owners (the suppliers of capital)." Broadly, there are two views of Corporate Governance; a narrow view, commonly referred to as Anglo-Saxon, which sees corporate governance as dealing with the relationship between corporate managers and shareholders and a broad view, i.e., the Franco-German paradigm which takes a holistic approach to the concept. It considers the interest of stakeholders such as shareholders, creditors, managers, directors, customers, society, government and legal regulatory authorities/agencies. A third view advocates for a mega policy to bind economic theory with public morality. It goes without saying that the heart of corporate governance is transparency, disclosure, accountability, responsibility, independence, fairness, equality and integrity.

The economic success of an organization is not only dependent on effectiveness, efficiency and innovation but also on compliance and implementations of corporate governance principles. According to Gabrielle O'Donovan, "Sound corporate governance is reliant on external market place commitment and legislation, plus a healthy board culture which safeguards policies and processes."

The need of corporate governance enforcements, requirements and practices are influenced by a large collection of impressive legal framework and domains which are company law, securities law, SEBI law, accounting standards, auditing standards, insolvency law, labour law, contract law and tax law, to name a few.

### 2. REVIEW OF LITERATURE:

A brief and comprehensive review of literature conducted by going through academic journals, articles and other proceedings of repute are presented as under.

Grossman & Hart (1982) opined that commitment to fulfil the principle of debt and reduce free cash flow for activities that are not optimal and the use of debt financing can increase the likelihood of costly bankruptcy and job loss, consequently encouraging managers to perform optimally and make better investment decisions. Fama and French (1988) disagreed with the previous notion, arguing that more profitable firms tend to have lower levels of debt. In this



case, increasing debt would signal poor future prospects for the firm, since future earnings will be impacted negatively due to cash flow being used to service debt, reducing the amount of money available to fund future development.

Milton Harris & Raviv (1991) observed that corporate debt policy is generally justified as a significant Corporate Governance tool in reducing agency conflicts between shareholders and managers. Debt financing can solve agency problems by reducing free cash flow and increasing the likelihood of bankruptcy risk. Jensen and Meckling (1994) agency theory postulates that both the agent and the principal act in their self-interest and these interests may not necessarily converge. Agency problem arises as a result of conflict of interest by the agent who may take advantage of the agency relationship to direct corporate resources for their own benefit to the detriment of outsiders (owners). The principal, as a rational investor is also a utility maximiser and could thus, take steps that may be detrimental to the agent.

Raju and Roy (2000) establish that the value of available information contributing to firm profitability is higher for larger companies and is higher for industry sectors where there is intense competition. Therefore, the release of credible information by managers affects the performance of a firm and has an impact on the perceptions held by the external market about a firm.

Liu (2006) asserts that there is an increase in monitoring of a firm as the size of external financing increases. This serves as a mitigating factor against the challenges of information asymmetry and agency costs as mentioned earlier.

Arora and Bodhanwala, (2018) opined that corporate governance aims at facilitating effective monitoring and efficient control of business. Its essence lies in fairness and transparency in operations and enhanced disclosures for protecting interest of different stakeholders.

### 3. OBJECTIVE OF THE STUDY:

The main objective of the study is to examine the impact of corporate governance on firm performance. Keeping the primary objective in view, the study also aims to offer concluding observations and suggestions for improving the prevailing situation

#### 3.1 HYPOTHESIS FORMULATION

The first hypothesis of the study is:

H<sub>1</sub>: There is no significant impact of audit committee on firm performance

The second hypothesis of the study is:

H<sub>2</sub>: There is no significant impact of board size on firm performance

The third hypothesis of the study is:

H<sub>3</sub>: There is no significant impact of employee benefits on firm performance

The fourth hypothesis of the study is:

H<sub>4</sub>: There is no significant impact of other committees on firm performance

The fifth hypothesis of the study is:

H<sub>5</sub>: There is no significant impact of Debt-equity ratio on firm performance

The sixth hypothesis of the study is:

H<sub>6</sub>: There is no significant impact of remuneration committees on firm performance

The seventh hypothesis of the study is:

H<sub>7</sub>: There is no significant impact of Investors Grievance on firm performance

The eighth hypothesis of the study is:

H<sub>8</sub>: There is no significant impact of whistle blower policy on firm performance

#### 4. RESEARCH METHODOLOGY

The study is both exploratory and empirical in nature. Sampling technique used in this study is judgment sampling. Accordingly, the sample under study has been selected to be four companies each from manufacturing, service, automobiles and consumer goods industry. Data has been collated from annual reports of the firms under study and other relevant secondary data sources. For evaluating the impact of governance factors on firm performance different accounting and statistical tools like Descriptive Statistics, Regression Analysis, etc. have been used. Content analysis has been done through SPSS software.

The present study covers five years of each of four companies, 2017-2021.

Variables	Notations	Proxies (Self-assessment, document, paper and observation)
Firm performance	EVA	NOPAT-K <sub>o</sub>



Audit Committee	AC	Experiences and functions
Board Size	BS	Number of directors
Employee Benefit	EB	Welfare elements
Remuneration committee	RC	Members and functions
Investor's Grievance	IG	Implementation process
Other Committee	OC	Nine principles
Leverage position	DER	Proportion of external and internal capital
Whistle Blower companies	WBP	Code of Business Principles

Table-1: Variables, notations and proxies of the research

**REGRESSION MODEL**

Y (Dependent Variable= Economic Value Added) =  $\alpha + \beta_1$  (Audit Committee) +  $\beta_2$  (Board Size) +  $\beta_3$  (Employee Benefits) +  $\beta_4$  (Other committees) +  $\beta_5$  (Investors Grievance) +  $\beta_6$  (Remuneration Committees) +  $\beta_7$  (Debt-equity ratio) +  $\beta_8$  (Whistle Blower Policy) +  $\epsilon$  (Epsilon=Externalities)

**4.1 RESEARCH FINDINGS AND INTERPRETATIONS**

Research Variables	Industry	Average	Std. Errors	S.D	COV %	Skewness	Kurtosis
EVA	A	232.20	2.417	5.404	2.327304	-0.896	0.427
	S	343.60	3.750	8.385	2.440338	-1.307	0.1836
	M	348.00	3.847	8.602	2.471839	-1.382	1.825
	C	277.40	9.968	22.289	8.034968	-0.765	-0.593
AC	A	6.20	0.374	0.837	13.50	-0.512	-0.612
	S	5.20	0.374	0.837	16.09615	-0.512	-0.612
	M	4.60	0.510	1.140	24.78261	-0.405	-0.178
	C	6.40	0.640	1.140	17.8125	-0.405	-0.178
BS	A	4.60	0.401	0.894	19.43478	1.258	0.313
	S	3.80	0.374	0.837	22.02632	0.512	-0.612
	M	5.01	0.447	1.001	19.98004	0.000	-3.001
	C	8.21	0.374	0.837	10.19488	-0.512	-0.612
EB	A	7.21	0.374	0.837	11.60888	-0.512	-0.612
	C	5.81	0.374	0.837	14.4062	0.512	-0.612
RC	C	6.01	0.707	1.581	26.30616	0.000	-1.201
IG	S	3.81	0.374	0.837	21.9685	0.512	-0.612
	M	4.01	0.316	0.707	17.63092	0.000	2.001
	C	5.61	0.509	1.139	20.30303	-0.405	-0.178
OC	C	7.01	0.316	0.707	10.08559	0.000	2.001
DE	A	2.4881	0.16678	0.37292	14.98814	0.501	-3.107
	S	2.0541	0.4202	0.9397	45.74753	0.559	-2.881
	M	2.5381	0.1183	0.26452	10.42197	0.653	-2.923
	C	3.1341	0.6447	0.14415	4.599407	0.695	-2.752
WBP	C	6.21	0.374	0.837	13.47826	-0.512	-0.612

Source: Output from SPSS-20 with compiled data from annual reports

Table 2: Descriptive Statistics

	Co-efficient of variation
A (EVA)	2.327304 %
S (EVA)	2.440338 %
M (EVA)	2.471839 %
C (EVA)	8.034968 %
A (AC)	13.50 %



S (AC)	16.09615 %
M (AC)	24.78261 %
C (AC)	17.8125 %
A (BS)	19.43478 %
S (BS)	22.02632 %
M (BS)	19.98004 %
C (BS)	10.19488 %
A (EB)	11.60888 %
C (EB)	14.4062 %
C (RC)	26.30616 %
S (IG)	21.9685 %
M (IG)	17.63092 %
C (IG)	20.30303 %
C (OC)	10.08559 %
A (DE)	14.98814 %
S (DE)	45.74753 %
M (DE)	10.42197 %
C (DE)	4.599407 %
C (WBP)	13.47826 %

Table 3: Co-efficient of variation

▪ **First Hypothesis (FH)**

**Null Hypothesis (H<sub>0</sub>):** Firm performance is independent of audit committee (AC)

**Alternative Hypothesis (H<sub>1</sub>):** Firm performance is dependent of audit committee (AC)

The observed value of alpha first hypothesis (FH), audit committee (AC) is 27.90 per cent which is more than 5% and the finding supports the firm performance and firm value. Hence, we accept the null hypothesis and reject the alternative hypothesis of influence ability of the perception of existence and functioning of audit committee (AC) on firm performance and institutional value.

▪ **Second Hypothesis (SH)**

**Null Hypothesis (H<sub>0</sub>):** Firm performance is independent of Board Size (BS)

**Alternative Hypothesis (H<sub>1</sub>):** Firm performance is dependent of Board Size (BS)

The observed value of alpha of second hypothesis (SH), board size (BS) is 2.60 per cent which is less than 5% and the finding supports the firm performance and resource value. Hence, we reject the null hypothesis which states that the position of board size (BS) has an influence on firm value (FV). This means that the higher the proportion of board size within the company, better will be the firm performance.

▪ **Third Hypothesis (TH)**

**Null Hypothesis (H<sub>0</sub>):** Firm performance is independent of Employee Benefit (EB)

**Alternative Hypothesis (H<sub>1</sub>):** Firm performance is dependent of Employee Benefit (EB)

The observed value of alpha of third research variable, employee benefit (EB) is 97.50 per cent which is more than 5% and hence we accept the null hypothesis. This implies that firm performance is not influenced by the existence of Employee Benefits.

▪ **Fourth Hypothesis (FH)**

**Null Hypothesis (H<sub>0</sub>):** Firm performance is independent of Other Committee (OC)

**Alternative Hypothesis (H<sub>1</sub>):** Firm performance is dependent of Other Committee (OC)

The observed value of alpha of fourth research variable, other committee (OC) is 29.80 per cent { with absolute t value 1.092 } which is more than 5% and hence, we accept the null hypothesis. The result showcases that the presence of other committees is unable to significantly bear an influence on firm performance.

▪ **Fifth Hypothesis (5H):**

**Null Hypothesis (H<sub>0</sub>):** Firm performance is independent of Debt-equity ratio (DER)

**Alternative Hypothesis (H<sub>1</sub>):** Firm performance is dependent on Debt-equity ratio (DER)

The observed value of alpha of fifth research variable, debt-equity ratio (DER) is 68.90 per cent { with absolute t value 0.411 } which is more than 5% and hence we accept the null hypothesis, i.e., firm performance is independent of Debt-equity ratio (DER).



- **Sixth Hypothesis (6H)**

**Null Hypothesis (H<sub>0</sub>):** Firm performance is independent of Remuneration Committee (RC)

**Alternative Hypothesis (H<sub>1</sub>):** Firm performance is dependent on Remuneration Committee (RC)

The observed value of alpha of sixth research variable, remuneration committee (RC) is 4.30 per cent {with absolute t value 2.291} which is less than 5% and hence we reject the null hypothesis. Thus, remuneration committee influences performances of the firms under study.

- **Seventh Hypothesis (7H)**

**Null Hypothesis (H<sub>0</sub>):** Firm performance is independent of Investors Grievance {IG}

**Alternative Hypothesis (H<sub>1</sub>):** Firm performance is dependent Investors Grievance {IG}

The observed value of alpha of seventh research variable, Investors Grievance {IG} is 37 per cent {with an absolute t value 0.935} which is more than 5% and hence we accept the null hypothesis. Investors Grievance does not affect firm performance as per the statistical finding of the study.

- **Eighth Hypothesis (8H):**

**Null Hypothesis (H<sub>0</sub>):** Firm performance is independent of whistle blower policy {WBP}

**Alternative Hypothesis (H<sub>1</sub>):** Firm performance is dependent on whistle blower policy {WBP}

The observed value of alpha of seventh research variable, whistle blower policy {WBP} is 28.30 per cent {with an absolute t value is 1.129} which is more than 5% and hence we accept the null hypothesis. The whistle blower policy is seen not to influence firm performance.

## 5. CONCLUSION:

The research study undertaken serves as a pointer to corporate governance and firm performance in India. The findings are helpful in documenting the fact that certain aspects of corporate governance environment affect the performance of firms, while certain factors do not. Presence of audit committees, other committees, Employee benefits, Debt-equity ratio, Investors Grievance and presence of Whistle Blower policies do not create an impact on firm performance. But certain metrics such as Board size and remuneration committees have been able to influence the financial performance of the firms under study. Policy makers of the firm should definitely take into account such parameters when developing structural policies for improving the performance and efficiency of firms. The findings in this study have important implications for putting into practice steady corporate governance across developing countries in general and emerging countries in particular. Areas of further research could include studies expanding the current time frame as enumerated in the particular research and covering firms belonging to other industries. With more focus and relevance being given to the strengthening of corporate governance mechanisms and its subsequent impact on firm performance, not just restricted to financial but social as well, an environment of enhanced transparency can be rightly expected by investors and business houses alike.

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## APPENDIX

### Coefficients<sup>a</sup>

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
	<b>701.979</b>	<b>63.349</b>		<b>11.081</b>	<b>0.000</b>
	<b>-11.315</b>	<b>9.945</b>	<b>-0.264</b>	<b>-1.138</b>	<b>0.279</b>
	<b>18.415</b>	<b>7.164</b>	<b>0.688</b>	<b>2.570</b>	<b>0.026</b>
	<b>0.466</b>	<b>14.464</b>	<b>0.009</b>	<b>0.032</b>	<b>0.975</b>
1	<b>-24.486</b>	<b>10.689</b>	<b>-0.538</b>	<b>-2.291</b>	<b>0.043</b>
	<b>-10.398</b>	<b>11.120</b>	<b>-0.214</b>	<b>-0.935</b>	<b>0.370</b>
	<b>-24.875</b>	<b>22.772</b>	<b>-0.445</b>	<b>-1.092</b>	<b>0.298</b>
	-11.222	27.303	-0.100	-0.411	0.689
	<b>-15.104</b>	<b>13.380</b>	<b>-0.290</b>	<b>-1.129</b>	<b>0.283</b>

a. Dependent Variable: (NOPAT-K0)RsCr.



**Model Summary<sup>b</sup>**

R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
				R Square Change	F Change	df1	df2	Sig. F Change	
.922 <sup>a</sup>	.850	.741	25.898	.850	7.803	8	11	.001	1.698

- a. Predictors: (Constant), Wistle Blower Policy, Audit Committee, Employee Benefit, Investor's Grievance, Remuneration committee, DEBT EQUITY RATIO, Board Size, Other Committee  
 b. Dependent Variable: (NOPAT-K0)RsCr.

**ANOVA<sup>a</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	41864.633	8	5233.079	7.803	.001 <sup>b</sup>
	Residual	7377.567	11	670.688		
	Total	49242.200	19			

- a. Dependent Variable: (NOPAT-K0)RsCr.  
 b. Predictors: (Constant), Wistle Blower Policy, Audit Committee, Employee Benefit, Investor's Grievance, Remuneration committee, DEBT EQUITY RATIO, Board Size, Other Committee

**REGRESSION RESULTS**

**Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Information
		B	Std. Error	Beta			
1	(Constant)	701.979	63.349		11.081	0.000	Accepted
	Audit Committee	-11.315	9.945	-0.264	-1.138	0.279	Rejected
	Board Size	18.415	7.164	0.688	2.570	0.026	Accepted
	Employee Benefit	0.466	14.464	0.009	0.032	0.975	Rejected
	Remuneration committee	-24.486	10.689	-0.538	-2.291	0.043	Accepted
	Investor's Grievance	-10.398	11.120	-0.214	-0.935	0.370	Rejected
	Other Committee	-24.875	22.772	-0.445	-1.092	0.298	Rejected
	Debt-equity ratio	-11.222	27.303	-0.100	-0.411	0.689	Rejected
	Wistle Blower Policy	-15.104	13.380	-0.290	-1.129	0.283	Rejected

- a. Dependent Variable: (NOPAT-K0)RsCr.