SMART

Journal of Business Management Studies

(An International Serial of Scientific Management and Advanced Research Trust)

Vol - 7	Number - 1	January - June 2011	Rs. 200

ISSN 0973-1598

Dr. M. SELVAM, M.Com, PhD,

Founder-Publisher and Chief Editor

SMART Journal is indexed and abstracted by Ulrich's Periodicals Directory, Intute Catalogue (University of Manchester) and CABELL'S Directory,USA

SCIENTIFIC MANAGEMENT AND ADVANCED RESEARCH TRUST (SMART)

TIRUCHIRAPPALLI (INDIA)

www.smartjournalbms.org

IMPACT OF CORPORATE GOVERNANCE PRACTICES ON ENTERPRISE PERFORMANCE (A STUDY WITH SPECIAL REFERENCE TO FAST MOVING CONSUMER GOODS SECTOR)

C. Samuel Joseph
Director ,School of Management,Karunya University,Coimbatore,Tamil Nadu, India
E-mail: sam_608@yahoo.co.in
&
K.Sampath Kumar
Assistant Professor, Department of Management Sciences,
DJ Academy for Managerial Excellence, Coimbatore, Tamil Nadu, India
E-mail : busisampath@gmail.com

Abstract

There is growing concern world over for the Governments, Regulators of Stock Exchanges, Banks and other financial institutions to continuously review the system and procedures in order to enhance Corporate Governance. In developing countries, governance issues of small and mid-sized companies, often family controlled also, is an issue. In the Indian Context of Corporate Governance, Cadbury Model is followed. There is urgency to ensure that companies work with dedication and commitment to all the stake holders. Not only companies but the total governance structures have to be made effective so that beneficiaries (both the investors/ stakeholders for a company and general public) get a complete solution from the governance structures. In the present study, the Authors attempted to measure the firms' commitment to the Disclosure Norms set by Regulatory Bodies, through the TDI developed by Oswar Kowalaski and analyze the relationship between the Corporate Governance Practices and the Dividend Performance of the firms.

Key Words: *Corporate Governance, Governance Structures, Disclosure Norms, Transparency Disclosure Index (TDI), Dividend Performance.*

Introduction

There is growing concern world over for the Governments, Regulators of Stock Exchanges, Banks and other financial institutions to continuously review the system and procedures in order to enhance Corporate Governance. In developing countries, governance issues of small and mid-sized companies, often family controlled also, is an issue. In the Indian Context of Corporate Governance, we have followed the Cadbury Model. It is true that Audit Committees, Managing Committees and Remuneration Committees have all come into existence. The CII studies of 1999, chaired by Mr. Kumara Mangalam Birla, was a landmark document with 25 recommendations 19 of whom are 'mandatory'. Publication of quarterly or half yearly results of the companies, being vetted by the Audit Committee, is now a well established practice. What perhaps is missing in the Indian situation at the present moment is the equivalent legislation, in line with the Sarbanes-Oxley Act. The Institute of Chartered Accountants of India have set up quite rigid Accounting Standards to be followed and they have progressively tightened compliances. There is urgency to ensure that companies work with dedication and commitment to all the stakeholders. Not only companies but the total governance structures have to be made effective so that beneficiaries (both the investors/ stakeholders for a company and general public) get a complete solution from the governance structures.

Review of Literature

The impact of Corporate Governance can be measured at the country and firm level. Both approaches were used in papers presented, often with new data covering new countries, and using new methodological approaches. Here are some of the reviews which are relevant.

Country-level Evidence on the Relationship between Corporate Governance Quality and performance

Nicola, Laeven and Ueda (2007), in their paper, studied the relationship between Corporate Governance and the decline in firm value during the Financial Crisis. The authors analyzed both the effect of country-level institutions on stock market and firm-level disclosure practices on the decline in the value of particular stocks.

Bekaert, Harvey, Lundblad and Siegel, 2008 showed that measures of financial openness, political risk, local banking sector and stock market development, and "push" factors, together with equity market openness, explain almost half of the variation in the degree of segmentation of equity markets. This finding suggests that Corporate Governance Reforms can help emerging markets integrate with global financial markets and thereby lower their risk-adjusted cost of capital.

Yavuz (2007) explains why the effects of investor protection on the cost of equity cannot be fully diversified even in integrated markets and why investor protection is different from other country-specific factors that affect the cost of equity. This paper not only justifies many previous empirical findings but also provides a new prediction. The effect of minority investor protection on the cost of equity is stronger in countries with larger GDP and higher GDP growth volatility.

Firm-level Evidence on the Relationship between Corporate Governance Quality and Performance.

While country level evidence is useful to document broad patterns, such studies do not always identify the channels. Firm level studies can more directly find effects of Corporate Governance Reform and enhanced Corporate Governance practices on valuation and operational performance, sources and ease of financing, and reduced level of expropriation. Such studies have shown that the channels through which Corporate Governance adds value include: (i) improved operating performance (productivity, return on assets, etc.), (ii) lower cost of capital and higher valuations, and (iii) better access to external finance. Many such studies exist for developed countries, but only recently has similar evidence been documented for emerging markets, transition economies, and other developing countries.

Kowalewski et al (2007) constructed a ***Transparency and Disclosure Index (TDI)*** to measure the quality of the Corporate Governance for Listed Polish Firms and shows that a higher TDI is associated with a higher level of dividend payouts. The authors also document that concentrated share ownership and deviations from the one-share-one-vote principle lead to lower dividend payout ratios. Since dividends affect firm value, this evidence supports better Corporate Governance Practices to be associated with higher valuations.

Bernard S. Black & Khanna provide an overview of Indian Corporate Governance Practices, based primarily on a 2006 survey of 370 Indian Public Companies. Compliance with legal norms is reasonably high in most areas, but not complete and identify areas where Indian Corporate Governance is relatively strong and weak, and areas where regulation might usefully be either relaxed or strengthened. On the whole, Indian Corporate Governance Rules appear appropriate for larger companies, but could use some strengthening in the area of related party transactions, and some relaxation for smaller companies.

Kyereboah-Coleman (2007) used data on companies in many African countries, including Ghana, South Africa, Nigeria and Kenya and showed that better governance practices are associated with higher valuations and better operating performance.

Baker et al (2007) used a unique dataset from Alliance Bernstein, an international asset management company, with monthly firm-level and country-level governance ratings for 22 emerging markets countries over a five year period and reported a significantly positive relation between firm-level (and country-level) corporate governance ratings and market valuation, suggesting lower cost of equity for better governed firms.

Choi et al (2007) established that changes in corporate governance framework and other reforms affect firms' performance and valuation. The authors toook advantage of a unique experiment arising from the first target announcement of the so-called Korean Corporate Governance Fund which has the explicitly stated goal of investing in companies whose stocks are undervalued due to governance problems and generating profits by actively addressing those problems. The Authors discovered that companies, whose governance structure empowers corporate insiders at the expense of outside shareholders, experience a more positive stock price reaction to the Fund's first target announcement.

Objectives of the Study

The following are the objectives of the study.

1. To measure the firms' commitment to the Disclosure Norms set by Regulatory Bodies through the TDI.
2. To analyze the relationship between of the Corporate Governance Practices and the Dividend Performance of the firms.

Hypothesis of the Study

There has been considerable research that seeks to identify the determinants of enterprise performance. One line of this research is based on dividends. Dividends expose firms to more frequent inspections by the capital markets as dividend payout increases the likelihood of fresh issues of shares (EasterBrook, 1984). In addition, shareholders may prefer dividends, particularly when they fear expropriation by insiders. As a consequence, Authors hypothesize that dividend payouts are determined by the strength of corporate governance. Hence this study to analyse the corporate practices in depth and to find out their association with the enterprise performance.

Scope of the Study

The Study confines itself to issues relating to the Corporate Governance Practices and their impact on Enterprise Performance in the Fast Moving Consumer Goods Industry in India. It is mainly concerned with the understanding of the association of Corporate Governance Practices with Dividend Payouts.

Methodology of the Study

In order to measure the Corporate Governance Standards, the Authors have used the Transparency Disclosure Index (TDI) as constructed by Oskar Kowalewski et.al. for top five FMCG Companies listed on Bombay Stock Exchange. The Authors constructed various sub-indices to study Corporate Governance Practices in depth. The financial data were obtained from the CMIE Prowess Data Base. The statistics for the Corporate Governance Index were also obtained from the company's websites and annual reports.

Results & Discussions

To test the reliability of the data, the Authors identified appropriate indicators for dividend measure and finally settled with the popular measure viz., Cash Dividends to Cash Flows. As cash flow is the relevant measure of company's disposable income, this ratio captures the choice to distribute the money generated each year to shareholders or not.

The Return on Assets (ROA) is included as an accounting measure that is beyond management manipulation and it is calculated as the Earnings Before Interest and Taxes Over Total Assets. The ratio reflects the availability of resources to distribute, once investment funding is secured, which increases dividend payments.

The TDI measures a broad set of corporate governance features for five listed FMCG Companies in India using public information as on March 2009. Public sources include information published by companies through websites, annual reports, internet sources and business publications. The TDI comprises of 26 binary items as presented in **Exhibit-1**, which cover a broad range of corporate governance topics. For each feature, the company is given a value of 1 if there is full or partial public information and 0, if otherwise. The TDI consists of four sub indices, viz, Accounting Policies, Board, Shareholders, and Others. The sub-index, Accounting Policies, measures the significant accounting policies, FOREX Disclosures, GAAP Financial Indicators etc. The sub-index, Board, measures the structure, procedures and compensation of board and top management members. The sub index, shareholders, measures qualitative information regarding the compensation to shareholders. Finally, the sub index, Others, measures the legal suits, R&D, CSR etc. Thus the sub index disclosure measures the degree to which the company informs relevant corporate facts to outside stakeholders.

Corporate Governance Index, Performance and Control Variables

The Descriptive Statistics for our Corporate Governance Measures are presented in Panel A of **Exhibit 2**. The mean of TDI illustrates that the Corporate Governance Standards are, on an average, relatively high among the listed companies under observation. The sub index, Board, is quite low at 0.493.

Cash Dividends to Cash Flow and TDI

The estimated coefficient (and robust t statistic) on alternative TDI measures, namely, the four sub indices defined in the text (accounting policies, board, shareholders and others), each measured as the TDI on a 0 -100 scale.

It is observed from **Exhibit 3** that in the regression, the TDI and each sub index are statistically significant. The strongest results are for the TDI sub indices such as Accounting Policies, Board, Shareholders and Others in that order. The coefficient of 0.864 on the sub index TDI Board and the coefficient of 0.658 on the sub index, TDI Share holders, concerning Accounting Policies and the Board increases the dividends to cash flow ratio.

Conclusion

Our empirical results demonstrate that Corporate Governance is an important determinant in explaining the Dividend Policy. To measure the quality of Corporate Governance, the Authors had used the TDI Framework suggested by Oskar Kowaleswki and incorporated suitable sub indices pertaining to FMCG Companies. As a result of the analysis, the Authors discovered a strong positive correlation between the TDI and Dividend Payout. Therefore it is concluded that Corporate Governance is a significant determinant of dividend policy in the FMCG Segment. The Authors firmly believe that this Study will become a stepping stone for future researchers in the area of Corporate Governance and Enterprise Governance with more sub indices. In addition, studies can be undertaken on Corporate Governance under Clause 49 of SEBI Guidelines.

References

Journals

1. Steve C C Fong and Winney W Y Shek (2009) "Corporate Governance Disclosure and Company Performance of Hong Kong based and China based Family Controlled Property Development Companies", ICFAI University Journal of Corporate Governance, July and October 2009, Vol VIII, No 3 & 4, Page 7 - 50
2. Easterbrook, F.H., 1984. Two agency-cost explanations of dividends. American economic review, 74, 650–659.
3. Bebczuk, R., 2005. Corporate governance and ownership: measurement and impact on corporate performance and dividend policies in Argentina. Center for Financial Stability working paper.

Websites

1. Nicola, Laeven and Ueda (2007) http://fir.nes.ru/en/programs/econ/Documents/WorkingPaper/Akhunianov_e.pdf
2. Yavuz (2007) http://cgft.sabanciuniv.edu/tr/AnaSayfa/documents/Yavuz-WhydoesInvestorProtection.pdf
3. Sarkar (2007) http://www.researchgate.net/publication/4999293_Shareholder_Protection_and_Stock_ Market_Development_A n_Empirical_Test_of_ the_Legal_Origins_Hypothesis
4. Kyereboah-Coleman (2007) http://cgft.sabanciuniv.edu/tr/AnaSayfa/documents/Kyereboah-Coleman-CorporateGovernance.pdf
5. Baker, Godridge, Gottesman and Morey (2007) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1527123&http://www.google.co.in/search?hl=en&num=10&lr=&ft=i&cr=&safe=active&safe=on&q=Baker%20Godridge%20Gottesman20and%20Morey%202007%20%22alliancebernstein%22%20filetype:pdf&spell=1&sa=X
6. Kowalewski, Stetsyuk and Talavera (2007) http://www.diw.de/documents/publikationen/73/diw_01.c.60098.de/dp702.pdf
7. Centre for Monitoring Indian Economy – Prowess Data Source
8. www.myiris.com
9. www.indiainfoline.com
10. www.sebi.gov.in

EXHIBIT NO - 1

Percentage of Firms with Public Information on Each Item

Item	% of firms with Public Information on each Item
TDI – ACCOUNTING POLICIES	
Certificate of Compliance from Auditors	100
FOREX Disclosures	40
Accountant Fees and Services	60
GAAP/Accounting Policies	100
Disclosure of Financial Indicators	100
TDI – BOARD	
Related Party Disclosure	100
Executive and Board Member Compensation	100
Rationale for Executive and Board Member Compensation	100
Director Appointment and Retirement	80
Particulars of Directors	80
Composition of Directors	100
Future Plan of Action	100
TDI – SHAREHOLDERS	
Ownership of certain Beneficial Owners	100
Qualitative&Quantitative Factors of Market Risk	60
Financial Disclosure	100
Dividend Policies	100
Rationale for Dividend Policies	100
Percentage of Outstanding Equity Shares	100
Business Performance Opportunities	100
Shareholders Grievance and Ethics	80
TDI – OTHERS	
Strategic Plan Disclosure	0
Auditors Fees	80
Legal Proceedings	100
R&D	60
Corporate Social Responsibility	60
Employees	100

Source: Computed by Authors

EXHIBIT NO - 2

Mean, Standard Deviation, Minimum And Maximum Values Of Corporate Governance Index, Performance And Control Variables.

Variable	Definitions	Mean	Std. Dev
PANEL A: CORPORATE GOVERNANCE INDEX			
TDI – Accounting Policies	Transparency and Disclosure Index	0.800	0.283
TDI – Board	Board Structures and Procedures	0.493	0.098
TDI – Shareholders	Shareholders	0.925	0.149
TDI – Others	Other General Information's.	0.667	0.372
PANEL B: PERFORMANCE AND CONTROL VARIABLES			
ROA	Earnings Before Interest and Taxes to Total Assets	55.80	44.21
RONW	Net Income to Share holders Equity	58.64	50.81
ROCE	EBIT/ Total Assets- Current Liabilities	71.05	56.89
Gross Profit Margin	Revenue – Cost of Goods Sold/Revenue	38.41	6.35
Operating Margin	Operating Income/Net Sales	15.11	7.55
Net Profit Margin	Net Profit/Revenue	13.97	5.38
Book Value Per Share	Value of Common Equity/No.of Shares outstanding	101.04	115.662
Earnings Per Share	Net Income-Dividend on Preferred Stock/Average Outstanding Shares	27.992	24.21
Dividends Per Share	Sum of Dividends – Interim Dividends/Outstanding Shares	12.14	8.98

Source: Computed by Authors

EXHIBIT NO - 3

Cash Dividends to Cash Flow and TDI

TDI Sub Index (Independent Variable)	Cash Dividend to Cash Flow Coefficient value
Accounting policies	0.658
Board	0.864
Share Holders	0.060
Others	0.187

Source: Computed by Authors