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Impact of Corporate Governance Mechanism and Firm Performance with Special Reference to BSE Listed Companies in India

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Abstract—The Corporate Governance (CG) investigates how to secure, motivate efficient management of corporation by the use of mechanism, such as organizational designs, directors and boards. The adequacy and quality of corporate governance shapes the growth and future of emerging economy. Without good corporate governance, it is exceedingly difficult to increase the shareholder's value and protect the interests of other stakeholders of a company. The objective of this study is to explore the corporate governance mechanism that influences the firm performance. The paper analysed board independence and financial performance of listed companies in Bombay Stock Exchange (BSE 100) during the study period. The study found that corporate governance mechanism which incorporated Promoters' Ownership and Profitability creates more opportunity and resources for better performance.

Keywords: Corporate Governance Mechanism, Financial Performance, Leverage, Board Size and Board Directors.

INTRODUCATION

The Corporate Governance (CG) is the system by which companies are directed and controlled. It involves regulatory and market mechanisms, and the goals for which the corporation is governed. The Corporate Governance specifies the relationship among various primary participants (shareholders, directors, and managers) in determining the directions and performance of corporations. In a broader sense, it delineates the rights and responsibilities of each primary stakeholder and the design of institutions and mechanisms that induce or control board directors and management to best serve the economic interests of shareholders (and other stakeholders) of a company **(Palanisamy Saravanan 2012)**.

The stakeholders also play roles in monitoring the behaviour of the board/management. The part of any organization that has the most control over governance is the board of directors. The Board is the 'soul' of a company i.e, the foundation of all business decisions and the origin of corporate culture of the whole entity. The essence or attributes of good corporate governance include ethics, managerial discipline, and independence, protection of shareholders' rights, fairness, transparency, board responsibilities, accountability, and social awareness **(Parmjit Kaur 2001)**.

The Board comprises of outside directors to monitor corporate management on the behalf of shareholders **(Fama and Jensen, 1983)**. In the agency settings of emerging economies, where ownership concentration is the general norm along with weak protection of shareholder rights, the composition of board with outside directors (particularly independent directors) pose a significant challenge. As such, the supervision of the management by outside directors cannot be overemphasized. Further, the board performs multifaceted tasks and has direct or indirect effect on firm performance **(Ruigrok *et al.*, 2006)**. The aims of this study to enhance the understanding about the important corporate governance mechanism and their effect on firms' performance.

REVIEW OF LITERATURE

A number of researches have conducted research on the corporate governance mechanism. Some of them have worked on ownership structure, firm's performance on corporate governance. An attempt is made here to review in previous studies. The summarized results of reviews made in this study are given in **Table 1**. The above literature provides an overview of different models used to study the Ownership Structure and Corporate Performance from various parts of the world. Thus an attempt has been made in this study to evaluate Firm Performance and Corporate Governance Mechanism in the Indian context, taking the models used in the above studies.

Table 1: Summary of Literature Review

Author(s) and Year(s)	Methodology	Sample	Findings	Results
Jayesh Kumar (2004)	Descriptive Statistics and Regression	Unbalanced panel of 2478 Indian Corporate firms for 1994 to 2000	The study explained that the unobserved firm heterogeneity explains a large fraction of cross-sectional variation in firm performance that exists among Indian corporate firms.	The study suggests that the document effect of managerial shareholding and firm performance does not differ significantly across group and stand-alone firms.
Ahmadu Sanda, Aminu S. Mikailu and Tukur Garba (2005)	Descriptive Statistics and Regression	Nigerian Stock Exchange (NSE) for 1996–1999	The study investigated that no evidence to support the idea that boards with a higher proportion of outside directors perform better than other firms, there is evidence that firms run by expatriate CEOs tend to achieve higher levels of performance than those run by indigenous CEOs.	The results have the implication that regulatory agencies should encourage firms. There is also need to encourage firms to achieve a reasonable board size since overly large boards may be detrimental to the firm.
Ajay Kumar Garg (2007)	Descriptive Statistics, ANVOA and Regression	BSE 100, NSE 50 companies for 2001–2003	The study found mixed evidence that independent directors add value and improve the performance of the firm. It is pertinent to mention that there was no conflicting evidence that they destroy value.	Board size and performance as also board independence and performance were found to be inversely related. This means that a bad performance leads to an increase in both board size as well as board independence.
Deeksha A. Singh and Ajai S. Gaur (2009)	Descriptive Statistics, Correlation and Regression	Top 500 Indian and Chinese companies for 2007	Found that group affiliated firms performed worse than unaffiliated firms, and the negative relationship was stronger in the case of Indian firms than Chinese firms.	The result suggests that it may not be beneficial for firms to blindly include many independent directors as a supervisory role is more important in the emerging economies.
Akshita Arora (2010)	Descriptive Statistics, Correlation and Regression	BSE Companies for 2001–2010	The relationship between corporate governance and performance indicators for Indian firms.	The study suggests that when the boards of firms are dominated by executive directors and frequency of board meetings is high, it enhanced firms' performance.
Naveen Kumar and J.P. Singh (2012)	Descriptive Statistics, Correlation and OLS Regression.	BSE 200 Companies for 2008	In his study, he found that the negative effect of outside directors on the firm value of Indian companies is mainly due to the grey directors.	The result indicates that the policy makers to find a suitable board model for companies and define the role of independent directors.
Palanisamy Saravanan (2012)	Descriptive Statistics, Means Test, Correlation and Regression	BSE Companies for 2001–2010	The study attempts the impact of corporate governance in the determination on firm value.	The results suggest that the significant differences in the corporate governance characteristics between the manufacturing firms and non-manufacturing firms.
Pankaj Varshney Vijay Kumar Kaul and V.K. Vasal (2012)	Descriptive Statistics, Correlation, ANOVA and OLS Regression.	S & P CNX Nifty and CNX Nifty Junior for 2003–2009	The coefficient on the Corporate Governance Index was either positive or negative depending upon the performance measure used, but they were not statistically significant in any of the models considered.	The study concludes that there is a positive relationship exists between governance index and firm performance.

STATEMENT OF THE PROBLEM

Corporate Governance (CG) investigates how to secure, motivate efficient management of corporations by the use of mechanism, such as organizational designs, directors and boards. The adequacy and quality of corporate governance shapes the growth and future of emerging markets and economy. The success of any business firm mainly depends upon the good and effective corporate governance. Many companies are affiliated with a family managed business group, and show high ownership concentration with the dominant (promoter) shareholders having control of most of these firms. The problem is that there is dominance by majority shareholders on the minority shareholder. The good proportion of outside director on the board is essential for good corporate governance. The Outside directors (non-executive directors), particularly independent directors are mandated by law, in order to protect interest of the minority shareholders, and to increase firm profitability and its value. Hence, the corporate governance is essential to protect the interest of all type of stake holders. Against this background the present study entitled Impact of Corporate Governance Mechanism and Firm Performance with Special Reference to BSE Listed Companies in India is made.

OBJECTIVES ON THE STUDY

The main aim of this study is to explore whether the corporate governance mechanism influence the firms' performance in India.

HYPOTHESIS OF THE STUDY

NH 1: There is no significant relationship between corporate governance mechanism and the firms' performance in India.

METHODOLOGYOF THE STUDY

SAMPLE SELECTION

BSE is the oldest stock exchange in Asia. BSE Sensex is considered to be the best indicator that reflects the whole economy of India. The BSE 100 companies are one of the best indicators introduced by BSE. Out of 100 companies, only 50 companies are selected based on the value of Market Capitalization (refer Annexure-1). The companies that earn high market capitalization are selected for the analysis of this study.

SOURCE AND COLLECTION OF DATA

The study mainly depends on secondary data. The required data regarding financial statements of sample companies were collected from the CMIE Prowess Corporate Database and www.bseindia.com. The other relevant details of this study were collected from various books, journals and magazines.

PERIOD OF THE STUDY

The study analyzed the financial statement of sample companies from 1st April 2005 to 31st March 2012.

TOOLS USED IN THE STUDY

The present study used the following tools:

a. Descriptive Statistics like Mean, Standard Deviation, Minimum and Maximum.

b. The Financial Ratios like Earnings per Share and Tobins.

c. Cross Correlation.

The following equation is used to calculate Cross Correlation.

$$r = \frac{n(\sum xy) - (\sum x)(\sum y)}{\sqrt{n(\sum x^2 - (\sum x)^2)(n\sum y - (\sum y)^2)}}$$

Where

N = Number of observations

Σx = Dependent variables, and

Σy = Independent variables

d. OLS Regression

The residual, ê, is the difference between the actual Y and the predicted Y and has a zero mean. In other words, OLS calculates the slope coefficients so that the difference between the predicted Y and the actual Y is minimized. (The residuals are squared in order to compare negative errors to positive errors more easily)

The estimated regression equation is:

$$Y = ß_0 + ß_1X_1 + ß_2X_2 + ß_3D + \hat{e}$$

A set of variables is perfectly multicollinear if there exist one or more exact linear relationships among some of the variables.

$$\lambda_0 + \lambda_1 X_{1i} + \lambda_2 X_{2i} + \dots + \lambda_k X_{ki} = 0$$

The holding for all observations i, where λ_j are constants and X_{ji} is the i^{th} observation on the j^{th} explanatory variable. We can explore one issue caused by multicollinearity by examining the process of attempting to obtain estimates for the parameters of the multiple regression equation.

$$Y_i = \beta_0 + \beta_1 X_{1i} + \dots + \beta_k X_{ki} + \varepsilon_i$$

The Variables Used in the Study

Table 1

Name of the Variables	Abbreviation	Measure of Variables
Earnings per share	EPS	Earnings per Share (Net Earnings/Outstanding Shares)
Tobins Q	TOBINS Q	Year-end market capitalization divided by the book value of total assets and the sum of the market value of equity and the book value of debt divided by the book value of total assets.
Board Size	SIZE	Total Asset Logarithm
Firm Leverage	LEV	Ratio of long term debt to the total assets
Profitability Margin	PM	Profit Margin (Profit after Tax/Turnover)
Board Independence	BOARD	Independent directors/Number of directors
Insider ownership	INOWN	Percentage of promoters or promoter group ownership in firm
Grey directors	PERGR	Number of non-executive non-independent directors divided by the total number of directors on the board

LIMITATIONS OF THE STUDY

- This study focused only on BSE 100 Companies.
- This study was based mainly on secondary data, and hence it is riddled with certain limitations, which are bound to be connected with secondary data.
- The study period is restricted to the period of eight years from 2005 to 2012.
- This study used the statistical tools which have certain inherent limitations.

...ALYSIS OF CORPORATE GOVERNANCE MECHANISM AND FIRMS PERFORMANCE

For the purpose of this study, the analysis was made as follows:

a. Analysis of Descriptive Statistics for Corporate Governance Mechanism of Sample Companies.
b. Analysis of Cross Correlation for Corporate Governance Mechanism and Firm Performance of Sample Companies.
c. Analysis of OLS Regression for EPS of Sample Companies.
d. Analysis of OLS Regression for Tobins Q of Sample Companies.

ANALYSIS OF DESCRIPTIVE STATISTICS FOR CORPORATE GOVERNANCE MECHANISM OF SAMPLE COMPANIES

Table 2 reveals the results of Descriptive Statistics for 50 companies during the study period from 1st April 2005 to 31st March 2012. It is to be noted from the above Table that the variables like EPS Tobins Q, Board Size, Leverage, Profitability Margin, Board Independence, Insider Ownership and Grey Directors were used to test Corporate Governance Mechanism. For the purpose of analysis (variables) of Indian firms, the Mean, Standard Deviation, Minimum, Maximum, Kurtosis and Skewness have been used. The analysis of mean return value was 56.2438 while standard deviation of INOWN was at 0.9663. The EPS assumed lowest risk (1.7071) with the highest return (41.0236). The standard deviation of Leverage was low (0.9094) with the high mean return (6.8737) and the value of other indicators namely SIZE was 1.7500 and Tobins Q (0.0222) recorded low risk and low return. It is to be noted that the Profitability Margin (PM) earned for highest risk (16.1753) with the highest mean return (29.7770). According to the results of this study, the earning per share (EPS) and Insider Ownership (INOWN) was important factor than the other parameters during the study period. The results of kurtosis shows that there was Platykurtic in all parameters, however it was high in the case of profitability Margin (2.8464) and BOARD (2.4777). Besides, the analysis of kurtosis indicates that all the variables were perfectively distributed in normal bell curve. The value of skewness reveals that the sample companies were positively skewed in Earnings per Share (0.1901), Tobins Q (0.6311), Profitability Margin (1.1597), Grey Directors (0.1710) and negatively skewed in SIZE (-0.3774), Leverage (-0.8097), BOARD (-1.0512) and Insider Ownership (-0.3593).

Table 2: Analysis of Descriptive Statistics for Corporate Governance Mechanism of Sample Companies from 1st April 2005 to 31st March 2012

Variables \ Descriptive Statistics	Mean	Standard Deviation	Minimum	Maximum	Kurtosis	Skewness
EPS	41.0236	1.7071	38.9281	43.3305	1.7307	0.1901
TOBINS Q	0.0222	0.0038	0.0184	0.0284	1.9114	0.6311
SIZE	1.7500	0.0074	1.7377	1.7596	1.8904	-0.3774
LEV	6.8737	0.9094	5.2083	7.7916	2.2800	-0.8097
PM	29.7770	16.1753	16.8462	61.7024	2.8464	1.1597
BOARD	5.8151	0.5012	4.9001	6.3001	2.4777	-1.0512
INOWN	56.2438	0.9663	54.6759	57.4983	1.8782	-0.3593
PERGR	0.0145	0.0019	0.0124	0.0173	1.3982	0.1710

Source: Computed from PROWESS corporate database using E-Views (5.0)

Note: EPS-Earnings per Share, SIZE-Board Size, LEV-Leverage, PM-Profit Margin, BOADR-Board Independence, INOWN-Insider Ownership and PERGR-Grey Directors

ANALYSIS OF CROSS CORRELATION FOR CORPORATE GOVERNANCE MECHANISM AND FIRM PERFORMANCE OF SAMPLE COMPANIES

Table 3 shows the results of cross correlation test for sample firms during from 1st April 2005 to 31st March 2012. The analysis of the above Table reveals the fact that there was significant and positive relationship between INOWN and SIZE at 0.9991, the p-value for two-tailed test of significant was 0.0091 at 5% significant value. Besides there was also significant relationship between PERGR and TOBINS Q (0.8742); and its p-value was 0.0045 at 5% significant level. It is observed that there was negative correlation coefficient between INOWN and TOBINS Q (-0.1714) and its p-value was 0.0047. The other variables as given in the above Table namely EPS, SIZE, LEV were not significantly correlated and sum of the variables (BOARD) were also negatively insignificant. From this, it is inferred that there was no significant relationship between the corporate governance mechanism and firm performance. Hence the null hypothesis (NH1) namely **'There is no significant relationship between the corporate governance mechanism and firm performance'**, is partially accepted. In the light of findings, it is suggested that the stake holders and the policy makers may carefully make the decision benefiting the stakeholders.

Table 3: Analysis of Cross Correlation for Corporate Governance Mechanism and Firm Performance of Sample Companies from 1st April 2005 to 31st March 2012

Variables	Pearson Correlation	EPS	TOBIN	SIZE	LEV	PM	BOARD	INOWN	PERGR
EPS	Pearson Correlation	1							
	Sig. (2-tailed)	.							
TOBIN	Pearson Correlation	0.0864	1						
	Sig. (2-tailed)	0.8386	.						
SIZE	Pearson Correlation	0.1640	-0.1700	1					
	Sig. (2-tailed)	0.6978	0.6372	.					
LEV	Pearson Correlation	0.3304	-0.2507	-0.5508	1				
	Sig. (2-tailed)	0.4240	0.5491	0.1570	.				
PM	Pearson Correlation	-0.0071	-0.2689	0.2501	-0.507	1			
	Sig. (2-tailed)	0.9866	0.5195	0.5501	0.1997	.			
BOARD	Pearson Correlation	-0.0337	0.5278	0.3655	-0.5571	0.3526	1		
	Sig. (2-tailed)	0.9368	0.1787	0.3732	0.1513	0.3916	.		
INOWN	Pearson Correlation	0.1650	-0.1714**	0.9991**	-0.5486	0.2473	0.3646	1	
	Sig. (2-tailed)	0.6961	0.0047	0.0091	0.1590	0.5547	0.3744	.	
PERGR	Pearson Correlation	-0.1778	0.8742**	-0.4599	-0.0299	-0.5418	0.2640	-0.4595	1
	Sig. (2-tailed)	0.6734	0.0045	0.2515	0.9438	0.1654	0.5274	0.2519	.

**Correlation is significant at the 0.01 level (2-tailed).

Source: Computed from PROWESS corporate database SPSS (11.5)

Analysis of OLS Regression for EPS of Sample Companies

The results of the Ordinary Linear Regression (OLS) Analysis for 50 sample companies for the period from 1st April 2005 to 31st March 2012 are shown in **Table-4**. It is understood that there was negatively significant coefficient value recorded for INOWN (-0.0155) and for firms with PERGR (-0.0058). The value for sample firms with BOARD was-4.6269 which was negatively insignificant. The coefficient of EPS was not significant at 5 per cent level, which indicates that there was no impact between corporate governance mechanism and firm performance. According to the above Table, the R^2 was 0.8041 for ROA with 80% of variation. With reference to the analysis of F value, it is clear that there was insignificant value (1.6424). Based on the F-statistics, it is observed that there was no significant difference between the governance mechanism and firm performance of sample companies during the study period. It is inferred that the variance inflation factors (VIF) of multicollinearity with SIZE (6.6431), LEV (9.0071), BOARD (6.6801) and the value of Profitability Margin (15.2201), INOWN (13.0001), Grey Directors (20.1201) were not correlated. Further, Durbin-Watson statistic of 3.0961 clearly indicates autocorrelation in the residuals. Hence, the null hypothesis (NH1) namely, **'There is no relationship between corporate governance mechanism and firm performance in Indian companies'**, is accepted. In other words, the result at 5% level of significance reveals that the corporate governance mechanism followed by sample companies did not have any relationship with firm performance measures during the period taken in the study.

Table 4: Analysis of OLS Regression for EPS of Sample Companies from 1st April 2005 to 31st March 2012

Variables	Coefficient	Std. Error	t-Statistic	Prob.	VIF
SIZE	3.2201	1.4328	-0.2431	0.8481	6.6431
LEV	4.8604	1.7628	2.7571	0.1102	9.0071
PM	0.2915	0.1288	2.2626	0.152	15.2201
BOARD	-4.6269	2.7542	-1.7351	0.2248	6.6801
INOWN	-0.0155	2.0101	2.4918	0.1303	13.0001
PERGR	-0.0058	1.0911	2.1808	0.1609	20.1201
C	-93.663	31.1284	-2.2395	0.1544	
R-squared	0.8041	F-statistic		1.6424	
Durbin-Watson stat	3.0961	Prob(F-statistic)		0.4201	

Source: Computed from PROWESS corporate database using E-Views (5.0)

*Significant at 0.05 level.

ANALYSIS OF OLS REGRESSION FOR TOBINS Q OF SAMPLE COMPANIES

Table 5 reveals the results of OLS Regression for 50 companies for the period from 1st April 2005 to 31st March 2012. The above Table clearly shows that there was significant Positive Coefficient value for SIZE (0.0324), Leverage (0.0032), Profitability Margin (0.0002), INOWN (0.0043) and negative for BOARD (-0.0031) during the study period. Besides, there was a significant value for TOBINS Q at 5% level. The coefficient value of PERGR was (4.2981) positively insignificant during the study period. The value of the R^2 was 0.9576 for TOBINS Q which was at 95% variation level. From the analysis of F-statistics, it is inferred that there was significant value of TOBINS Q (9.0421). Based on the F-statistics, it is clear that there was significant difference between the corporate governance mechanism and firm performance of sample companies. The value of VIF was correlated with SIZE (5.2301), LEV (9.0073), BOARD (6.6801) and sum of the variables were not correlated (PM, INOWN and PERGR) in multicollinearity. The Durbin-Watson Statistic of 2.6201 indicates autocorrelation in the residuals. Based on this, the null hypothesis (NH1), **'There is no significant difference between the corporate governance mechanism and firm performance'**, is rejected. The results OLS Regression for 50 sample companies at 5% level of significance reveals that the corporate governance mechanism followed by the sample companies have relationship with financial indicators measures during the period taken for the study.

Table 5: Analysis of OLS Regression for TOBINS Q of Sample Companies from 1st April 2005 to 31st March 2012

Variables	Coefficient	Std. Error	t-Statistic	Prob.	VIF
SIZE	0.0324	0.0181	1.7801	0.3261	5.2301
LEV	0.0032	0.0018	1.7655	0.2195	9.0073
PM	0.0002	0.0001	2.0352	0.1787	15.2217
BOARD	-0.0031	0.0028	-1.1066	0.3837	6.6801
INOWN	0.0043	0.0021	2.0894	0.1718	13.1001
PERGR	4.2981	1.3128	3.2739	0.0819	20.1566
C	-0.2975	0.1367	-2.1755	0.1615	
R-squared	0.9576	F-statistic		9.0421	
Durbin-Watson stat	2.6201	Prob(F-statistic)		0.1025	

Source: Computed from PROWESS corporate database using E-Views (5.0)
**Significant at 0.05 level.*

DISCUSSION AND CONCLUSION

Board of Directors has to play important role in Corporate Governance mechanism add values and improve the performance. According to earlier research studies, there was mixed evidence that independent directors add value and improve the performance of the firm. The results of these study suggested that independent directors have so far failed to perform their monitoring role effectively. It is to be noted that 'board independence' is something that has just started getting importance and is catching on in India.

Board size and performance and board independence and performance were found to be inversely related. This means that a bad performance leads to an increase in both board size as well as board independence. Independent directors added vales under pressure from the stakeholders. It is important for the investors to take appropriate decision on the portfolio, after taking into account these pieces of information. A major issue, however, is the limited availability of trained independent directors who are well versed with the procedures, tasks and responsibilities to be discharged in firm as expected by Stakeholders. Further, the independent directors remain independent of the promoters and able to safeguard the minority shareholder rights.

According to the results of earlier research studies undertaken by Ahmadu Sandu *et al.*, (2005), Jayesh Kumar (2004), Ajay Kumar Garg (2007), Deeksha A. Singh *et al.*, (2009) and Naveen Kumar *et al.*, (2012), there was no significant relationship between Corporate Governance Mechanism and Firm Performance. In the same way, the present study also confirmed the findings of these studies. However, there are few other studies undertaken earlier by Akshita Arora (2010), Palanisamy Saravanan (2012) and Pankaj Varshney *et al.*, (2012) which found that there was significant relationship between Corporate Governance Mechanism and Firm Performance. The present study did not confirm with the findings of these studies.

SCOPE FOR FURTHER RESEARCH

The present study is an attempt to mainly study the corporate governance mechanism and firm performance in Indian companies. The scope for further research is summarized below:

- The companies from BSE Mid-cap, Sensex, BSE Small-cap, BSE 500 are could be taken up for further research.
- The study with similar objectives could be made from time to time.
- The sample companies from various indices of NSE could be taken up for studies of this nature.

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