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“An Empirical Study On Corporate Governance And Its Impact On Financial Firm's Performance”

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Abstract

Corporate governance is well known as one of the key implications to attract investors and build confidence in the market about the organization and overall economy of the country. It is very important to promote solid “corporate governance (CG) standards to attract investors, improve company’s performance, and reduce operation risks. Speaking of which, this study is aimed to determine the impact of corporate governance on performance of financial firms in Indian context.

This study also explores the link between CG practices as well as firm performance in context of some of the key corporate governance reforms introduced since the beginning of 21st century. In order to fulfil these objectives, this study is based on primary data conducted on employees of financial firms in India using Google Forms and survey data will be analysed using SPSS software 22.

The finding of this study will be significant, given the enaction of important corporate governance provisions to ensure corporate social responsibility (CSR)” to be applied to companies to meet the given profitability and turnover limits as per corporate governance regulations in the country. It will also open further research path on desirable and mandatory CG norms in India. It is recommended for Indian firms to focus on corporate governance practice when investing in CSR practices with purpose-led interventions as well as long-term benefits, instead of considering it as just another provision with short-term expenses.

Keywords: “corporate governance, corporate social responsibility, CSR, CG norms, CG practices, financial firms, Indian firms”

1. Introduction

Corporate governance (CG) has adopted central position in management and business. What happened in corporate world recently has reflected the far-reaching consequences of corporate governance on social functioning. Ethical and social values of corporate governance have been cleared but research studies still need to discuss its role in improving “business value of financial firms. This study is an attempt to know the most underrated yet important linkages between corporate governance and firm performance.

Good corporate governance is defined as the “application of best management practices, compliance of law in true manner, and adherence to ethical standards for effective distribution and management of wealth and discharge of social responsibility for sustainable development of stakeholders (ICSI, 2014)." There are three key criteria for ideal corporate governance, i.e., board accountability, independence, and quality (Byrne, 2000). The roles of CEO and Chairman are categorized by the features of good CG to manage the composition of board in terms of core competencies and skills, along with proportions of outsiders and insiders with defined criteria for independence of director and for creating transparent and robust processes for appointing directors (Garratt, 2010).

1.1 Background

The market reforms were started by the government of India in 1991 which marked the opening of economy to foreign investments and multinational companies. Foreign investment was increased drastically in India which doubled the interest in application of western governance and good corporate governance in Indian companies (Jackling &Johl, 2009). India had to expand to marketplaces. For doing this, capital was needed to exploit outsourcing and liberalization opportunities. Several CG reforms were passed with major initiatives in this way for meeting the capital needs. Introduction of "clause 49" in the "Securities and Exchange Board of India (SEBI)" listing agreement was the first step in this path. It consists of prominence of individual directors in various provisions. A leap was taken by the government by mandating "corporate governance" provisions for companies in India with the enactment of "Companies Act, 2013" w.e.f. April 1, 2014 (Kapil & Mishra, 2019).

Corporate governance has been correlated with performance of firms in several empirical and theoretical researches in context of developing countries (Khanna & Palepu, 2000a;200b; Gibson, 2003; Klapper& Love, 2004; Young et al., 2008; Ehikioya, 2009; Claessens&Yurtoglu, 2013)."Proper functioning of CG mechanisms is very important in developing countries for both foreign investors and local firms which are aimed to pursue various growth and investment opportunities provided by those developing countries (Rajagopalan & Zhang, 2008). Companies in developing countries are reduced in financial markets due to poor governance, as compared to the same in developed markets in local firms' perspective (Jackling &Johl, 2009). It is important to improve corporate governance to boost investors' confidence for financial firms in developing countries and improve their access to working capital (Rajagopalan & Zhang, 2008).

2. Literature Reviews

India faced the economic crisis in the year 1991. Due to this reason, the government of India had decided to establish a market controller "Securities and Exchange Board of India" in 1992 in order to build corporate governance reforms and regulate the securities market in the beginning (Kumar, 2020). In 1999, the first initiative for corporate governance was started in India when the "Code of Corporate Governance" was introduced by the "Confederation of Indian Industry (CII)". The expected norms of firms were specified by this code in terms of disclosure and accounting transparency while abiding the globally acceptable norms and it was focused on the role of audit committees to retain corporate governance (Rajiah-Benett, 2020).

Today, the "Ministry of Corporate Affairs and SEBI closely regulate the implementation of corporate governance in the country and the "Companies Act, 2013" is an important law to outline more strict norms of corporate governance in terms of transparency, disclosures, and norms after amendment

(Arora &Bodhanwala, 2018). Though large businesses were initially family-based, it is important to determine the arrangement of the management board as well as its structure strictly. Effectiveness of monitoring CG and extra powers of leading shareholders in corporate governance in India are the major concerns which question the effectiveness of corporate governance (Almaqtari et al., 2020).

Insufficient corporate governance, especially in developing countries, are a serious threat to its adherence and practice (Al-ahdal et al., 2020). According to Ararat et al. (2020), CG scenario has been evolved like other markets and businesses globally with the growth of experience and knowledge over the decades, which caused heightened attention on the structure and role of the board. All corporate governance reforms may not be able to provide the best results. Arora & Sharma (2016) studied 29 types of firms in manufacturing sector in India for around a decade and observed the rising and favourable contribution of knowledge by individual and external directors. Hence, CG creates different opportunities and challenges in Indian context.

Arora &Bodhanwala (2018) paid emphasis on variables like board proportion of individual directors, board size, board meetings, and shareholding and equity patterns to create a "Corporate Governance Index (CGI) in India". They noticed significant impact of board size and structure on the performance of the firm through monitoring. Ali et al. (2020) conducted a meta-analysis and found contrasting impact of independence of board, board structure, and board meetings on firm performance in India. It is the sign of the importance of function and structure of the board along with directors' independence and their role in performance of the firm.

2.1 Research Gap

India is the fastest growing and most attractive market for foreign investments and has significant opportunities for companies to grow. Hence, this empirical study provides evidence on the impact of corporate governance on typical performance measures of financial firms". This study contributes to existing knowledge by doing so. It will also propose the right organizational structure to help stakeholders, so they can differentiate between ineffective and effective corporate governance in firms.

2.2 Research Question

- Is there an "impact of corporate governance on performance of financial firms"?
- What are the policy recommendations for effective corporate governance?

2.3 Research Objectives

- To analyse the impact of corporate governance on performance of financial firms
- To propose right policy recommendations for decision-makers to ensure effective corporate governance

2.4. Hypothesis

H1 – There is a "significant impact of corporate governance on performance of financial firms"
H0 – There is no "impact of corporate governance on performance of financial firms"

3. Research Methodology

To fulfil above objectives, this study gathers empirical evidence from select financial firms in India. An online survey was conducted by distributing Google Forms to employees in financial firms and Excel spreadsheet is used to gather the data. The survey data was then interpreted using SPSS 22 software. The data was collected from the sample of 118 participants.

4. Analysis of Study

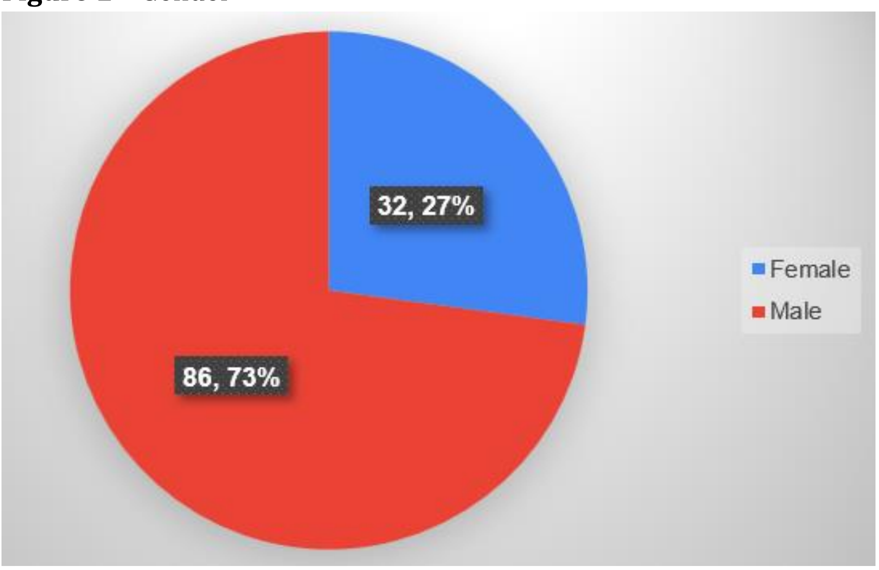
4.1. General Information

Out of 118 participants in this study, "86 (73%) were male and 32 (27%) were female (Table 1) (Figure 1).

Table 1 - Gender

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Female	32	27.1	27.1	27.1
	Male	86	72.9	72.9	100.0
	Total	118	100.0	100.0	

Figure 1 – Gender



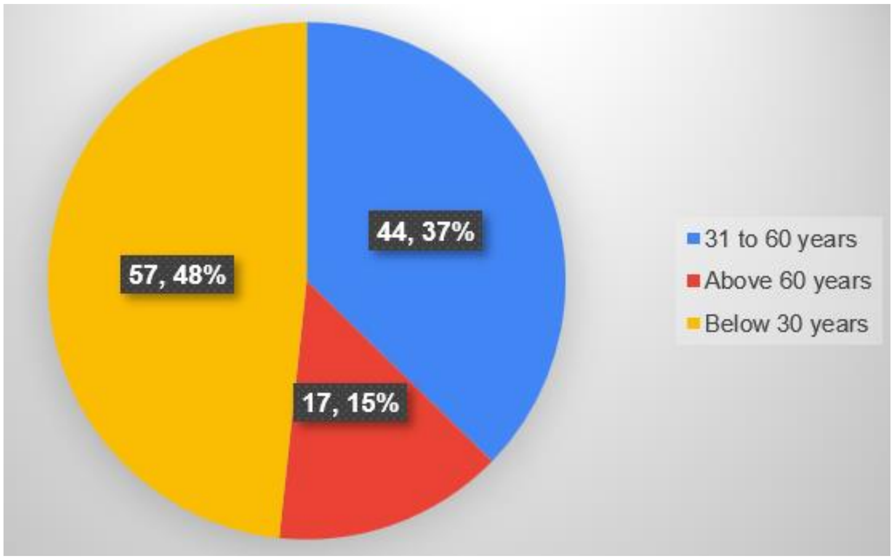
Most of the sample population in this study are young. There are 57 (48%) participants who are aged below 30 years, 44 participants (37%) were aged 31 to 60 years, and 17 (14%) participants were over 60 years old (Table 2) (Figure 2).

Table 2 - Age

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	31 to 60 years	44	37.3	37.3	37.3

	Above 60 years	17	14.4	14.4	51.7
	Below 30 years	57	48.3	48.3	100.0
	Total	118	100.0	100.0	

Figure 2 – Age of the participants

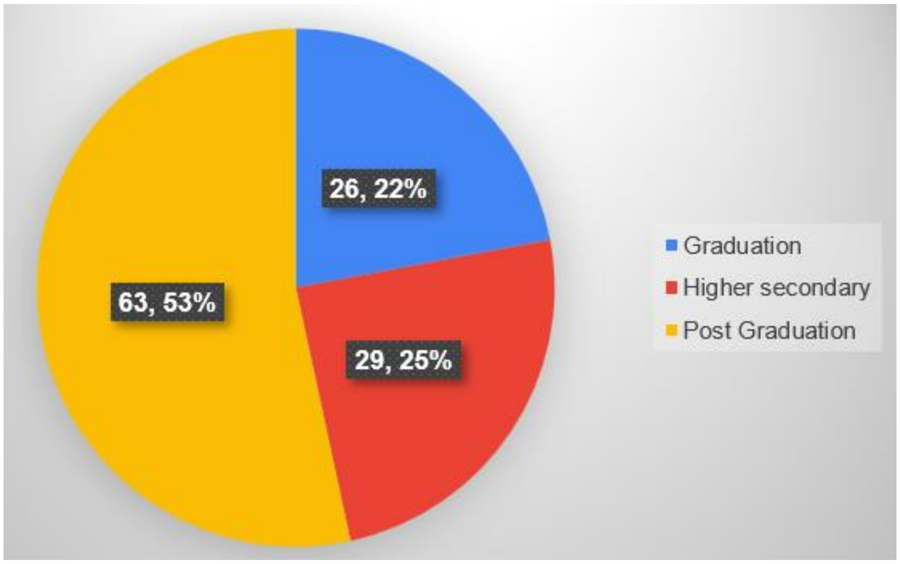


When it comes to academic qualification, 63 (53%) participants have completed post-graduation, 29 (25%) participants have completed higher secondary education, and 26 (22%) participants have been graduated (Table 3) (Figure 3).

Table 3 - Academic qualification

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Graduation	26	22.0	22.0	22.0
	Higher secondary	29	24.6	24.6	46.6
	Post Graduation	63	53.4	53.4	100.0
	Total	118	100.0	100.0	

Figure 3 - Academic qualification

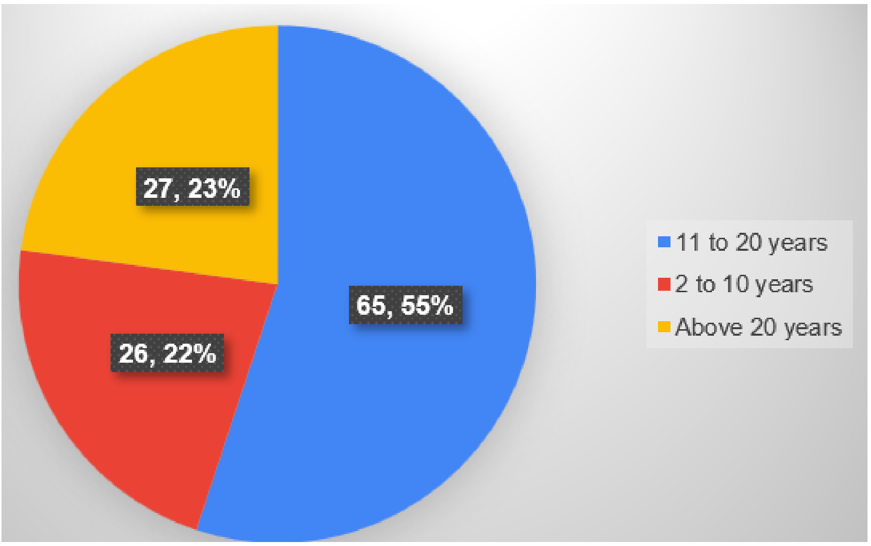


There are 65 (55%) participants who claimed that their company has been operating for 11 to 20 years, 27 (23%) participants claimed that their company has been running for over 20 years, and only 26 (22%) participants who said that their company is running from 2 to 10 years (Table 4) (Figure 4).

Table 4 - Years of operation

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	11 to 20 years	65	55.1	55.1	55.1
	2 to 10 years	26	22.0	22.0	77.1
	Above 20 years	27	22.9	22.9	100.0
	Total	118	100.0	100.0	

Figure 4 – Years of operation

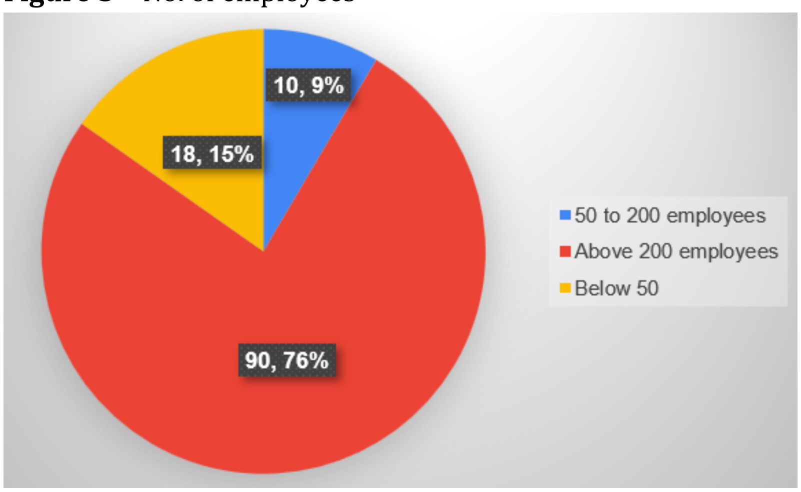


There are 90 (76%) participants who said that their financial firms have over 200 employees, 18 (15%) participants claimed that their companies have less than 50 employees, and 10 (9%) employees who claimed that their companies have 50 to 200 employees (Table 5) (Figure 5).

Table 5 - No. of employees

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	50 to 200 employees	10	8.5	8.5	8.5
	Above 200 employees	90	76.3	76.3	84.7
	Below 50	18	15.3	15.3	100.0
	Total	118	100.0	100.0	

Figure 5 – No. of employees

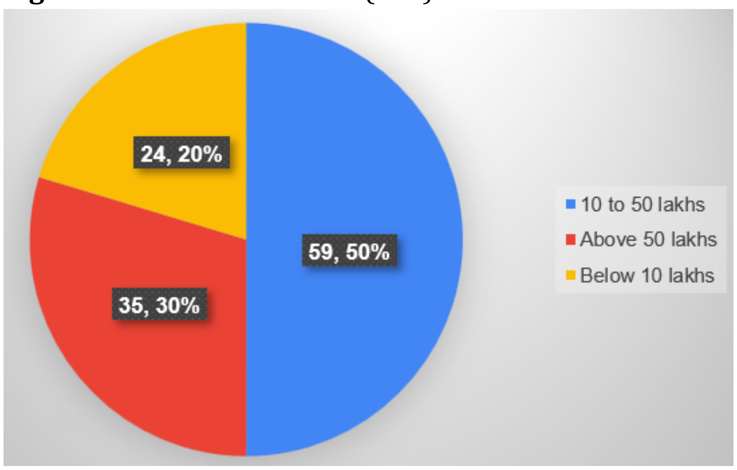


There are 59 (50%) participants who said that the annual turnover of their financial firms is Rs. 10 to 50 lakhs, 35(30%) participants claimed that the annual turnover of their firms is over Rs. 50 lakhs, and 24 (20%) participants have said that the turnover of their companies is under Rs. 10 lakhs (Table 6) (Figure 6).

Table 6 - Annual Turnover (INR)

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	10 to 50 lakhs	59	50.0	50.0	50.0
	Above 50 lakhs	35	29.7	29.7	79.7
	Below 10 lakhs	24	20.3	20.3	100.0
	Total	118	100.0	100.0	

Figure 6 – Annual Turnover (INR)



4.2. Corporate Governance Compliance

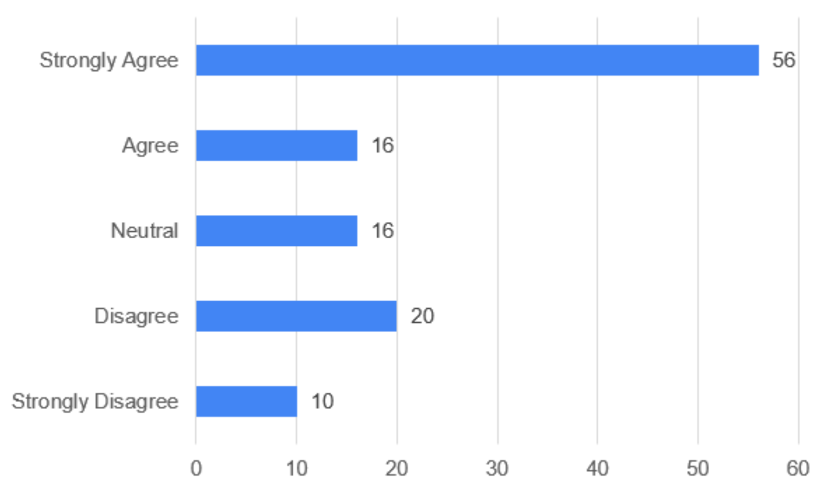
There are 56 (48%) participants who strongly agree and 16 (14%) participants who agree that their financial firms have a board of directors to comply with corporate governance, while 16 (14%) participants were neutral, 20 (17%) participants disagree, and 10 (8%) participants strongly disagree (Table 7) (Figure 7).

Table 7 - Your firm complies with corporate governance by having a board of directors

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	10	8.5	8.5	8.5
	Disagree	20	16.9	16.9	25.4
	Neutral	16	13.6	13.6	39.0
	Agree	16	13.6	13.6	52.5

	Strongly Agree	56	47.5	47.5	100.0
	Total	118	100.0	100.0	

Figure 7 – Compliance by having a board of directors

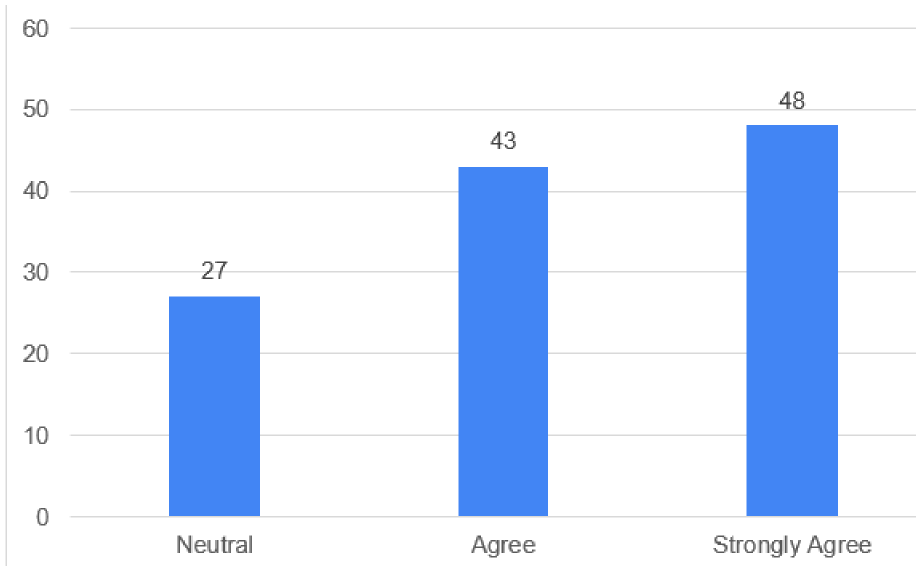


There are 48 (41%) participants who strongly agree that their firm complies with corporate citizenship and ethical leadership, while 43 (36%) participants agree, and 27 (23%) participants were neutral (Table 8) (Figure 8).

Table 8 - Your firm complies with corporate citizenship and ethical leadership

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Neutral	27	22.9	22.9	22.9
	Agree	43	36.4	36.4	59.3
	Strongly Agree	48	40.7	40.7	100.0
	Total	118	100.0	100.0	

Figure 8 - Your firm complies with corporate citizenship and ethical leadership

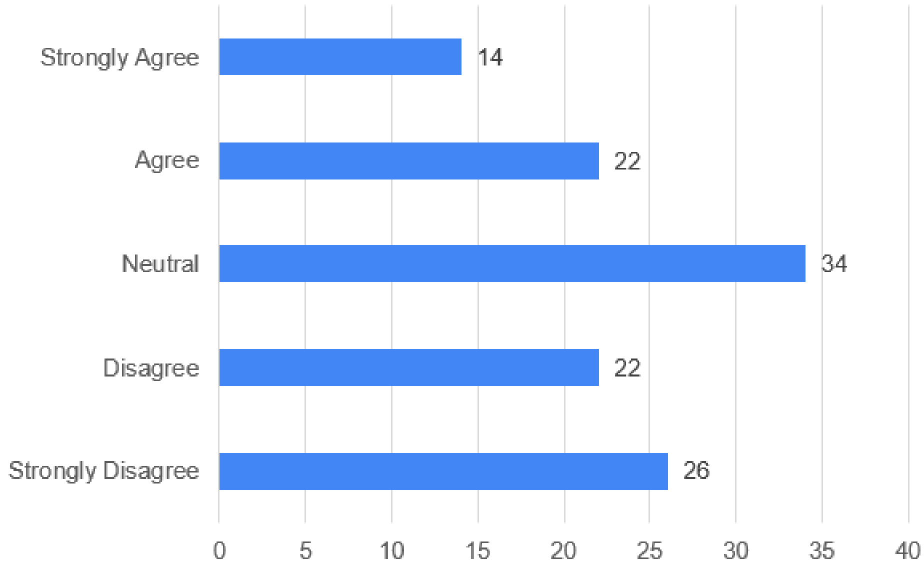


There are 22 (19%) participants who agree and 14 (12%) participants strongly agree that their firm have a risk governance structure with external auditing, while 34 (29%) participants neither agree nor disagree, 22 (19%) participants disagree, and 26 (22%) participants strongly disagree (Table 9) (Figure 9).

Table 9 - Your firm have a risk governance structure with external auditing

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	26	22.0	22.0	22.0
	Disagree	22	18.6	18.6	40.7
	Neutral	34	28.8	28.8	69.5
	Agree	22	18.6	18.6	88.1
	Strongly Agree	14	11.9	11.9	100.0
	Total	118	100.0	100.0	

Figure 9 – Your firm have a risk governance structure with external auditing

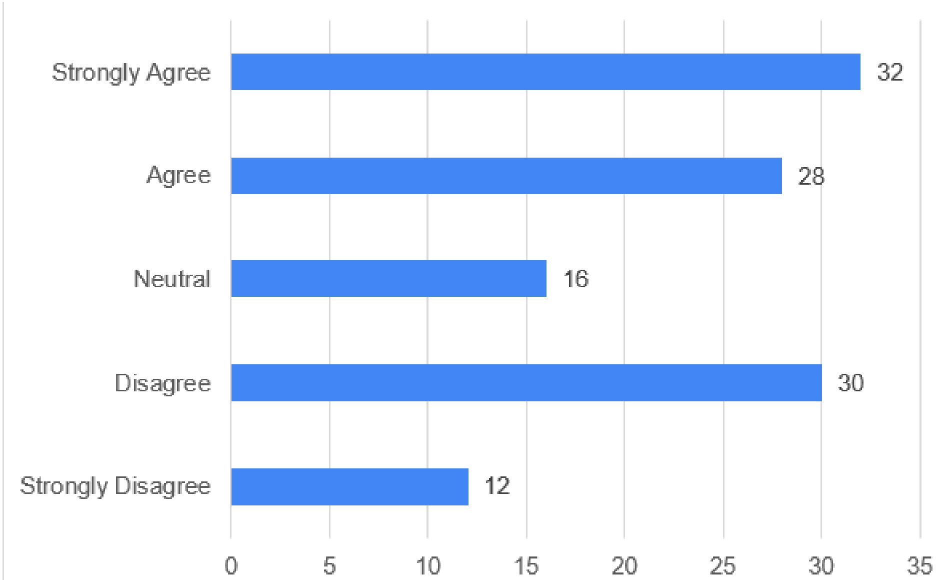


There are 28 (24%) participants who agree and 32 (27%) participants who strongly agree that their firm have an IT governance structure, while 16 (14%) participants didn't say anything, 30 (25%) participants disagree and 12 (10%) participants strongly disagree (Table 10) (Figure 10).

Table 10 - Your firm have an IT governance structure

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	12	10.2	10.2	10.2
	Disagree	30	25.4	25.4	35.6
	Neutral	16	13.6	13.6	49.2
	Agree	28	23.7	23.7	72.9
	Strongly Agree	32	27.1	27.1	100.0
	Total	118	100.0	100.0	

Figure 10 – Your firm have an IT governance structure

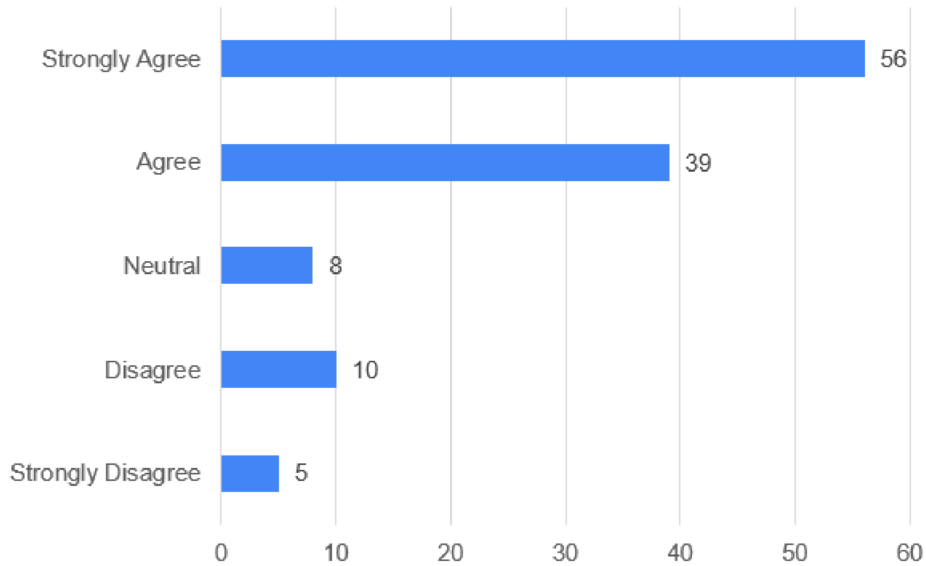


There are 39 (33%) participants who agree and 56 (47%) participants who strongly agree that their firm conducts internal auditing for proper shareholder management, while 8 (7%) participants neither agree nor disagree, 10 (9%) participants disagree, and 5 (4%) participants strongly disagree (Table 11) (Figure 11).

Table 11 - Your firm ensures shareholder management with internal auditing

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	5	4.2	4.2	4.2
	Disagree	10	8.5	8.5	12.7
	Neutral	8	6.8	6.8	19.5
	Agree	39	33.1	33.1	52.5
	Strongly Agree	56	47.5	47.5	100.0
	Total	118	100.0	100.0	

Figure 11 – Your firm ensures shareholder management with internal auditing



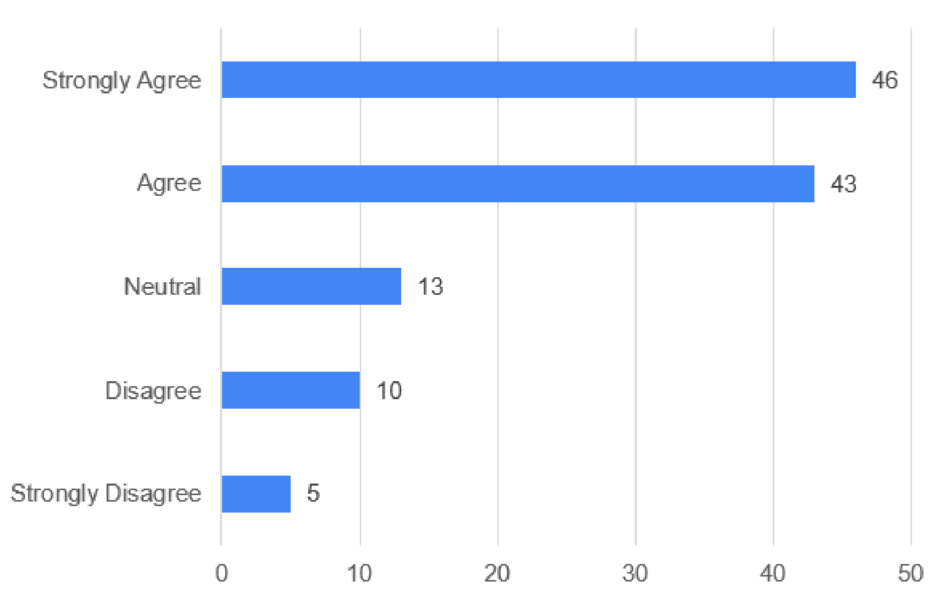
4.3. Impact on Firm Performance

There are 43 (36%) participants who agree and 46 (39%) participants who strongly agree that audit committee in their financial firm review financial statements frequently, while 13 (11%) participants were neutral, 10 (9%) participants disagree and 5 (4%) participants strongly disagree (Table 12) (Figure 12).

Table 12 - Audit Committee in your financial firm review financial statements frequently

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	5	4.2	4.3	4.3
	Disagree	10	8.5	8.5	12.8
	Neutral	13	11.0	11.1	23.9
	Agree	43	36.4	36.8	60.7
	Strongly Agree	46	39.0	39.3	100.0
Total		118	100.0	100.0	

Figure 12 –Audit Committee in your financial firm review financial statements frequently

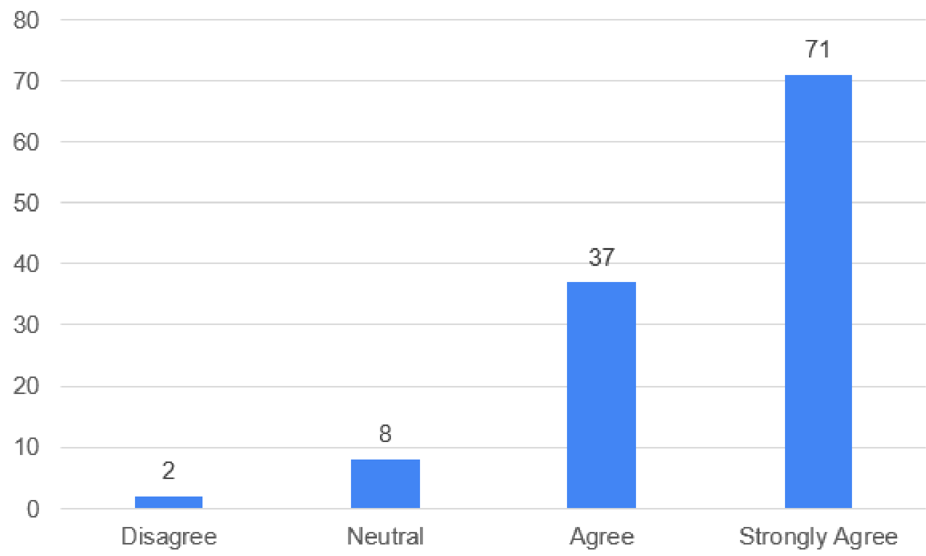


There are 71 (60%) participants who strongly agree and 37 (31%) participants who agree that their firm has a "written information disclosure" policy to provide all the material information to the stakeholders on timely basis, while only 2 (2%) participants disagree and 8 (7%) participants were neutral (Table 13) (Figure 13).

Table 13 - Your firm has a "written information disclosure" policy to provide all material information to the stakeholders on timely basis

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Disagree	2	1.7	1.7	1.7
	Neutral	8	6.8	6.8	8.5
	Agree	37	31.4	31.4	39.8
	Strongly Agree	71	60.2	60.2	100.0
	Total	118	100.0	100.0	

Figure 13 - Your firm has a "written information disclosure" policy to provide all material information to the stakeholders on timely basis

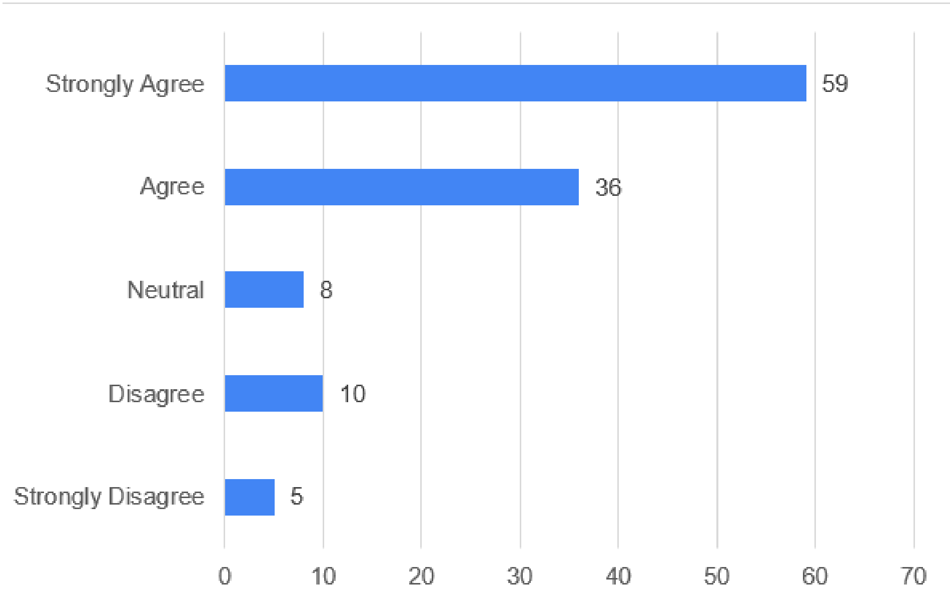


There are 59 (50%) participants who strongly agree and 36 (31%) participants who agree that their firm efficiently holds periodic meetings with securities experts, while only 10 (8%) participants disagree, 5 (4%) participants strongly disagree, and 8 (7%) participants were neutral (Table 14) (Figure 14).

Table 14 - Your firm efficiently holds periodic meetings with securities analysts

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	5	4.2	4.2	4.2
	Disagree	10	8.5	8.5	12.7
	Neutral	8	6.8	6.8	19.5
	Agree	36	30.5	30.5	50.0
	Strongly Agree	59	50.0	50.0	100.0
	Total	118	100.0	100.0	

Figure 14 - Your firm efficiently holds periodic meetings with securities analysts

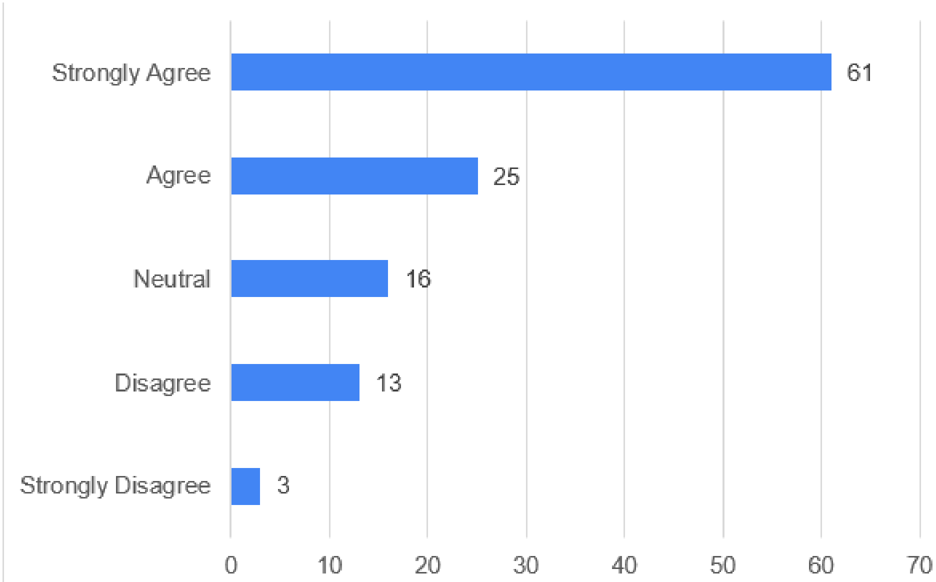


There are 61 (52%) participants who strongly agree and 25 (21%) participants agree that their firm has protection measures for minority shareholders, while 16 (14%) participants were neutral, 13 (11%) participants disagree, and 3 (2%) participants strongly disagree (Table 15) (Figure 15).

Table 15 - Your firm has protection measures for minority shareholders in place

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	3	2.5	2.5	2.5
	Disagree	13	11.0	11.0	13.6
	Neutral	16	13.6	13.6	27.1
	Agree	25	21.2	21.2	48.3
	Strongly Agree	61	51.7	51.7	100.0
	Total	118	100.0	100.0	

Figure 15 –Your firm has protection measures for minority shareholders in place



4.4. Impact of Corporate Governance on Firm Performance

To find out the impact of corporate governance on firm performance, we have performed one sample t-test. It is observed that the value of Sig. (2-tailed) is 0.000 ($p<0.005$)," which means H1 is accepted, i.e., "There is a significant impact of corporate governance on firm performance" (Table 16)

Table 16 - One-Sample Test

	Test Value = 0					
	t	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference Lower	Upper
Your firm complies with corporate governance by having a board of directors	28.749	117	.000	3.746	3.49	4.00
Your firm complies with corporate citizenship and ethical leadership	58.152	117	.000	4.178	4.04	4.32
Your firm have a risk governance structure with external auditing	23.287	117	.000	2.797	2.56	3.03
Your firm have an IT governance structure	26.212	117	.000	3.322	3.07	3.57
Your firm ensures shareholder management with internal auditing	39.756	117	.000	4.110	3.91	4.31
Audit Committee in your financial firm review financial statements frequently	37.620	117	.000	3.958	3.75	4.17

Your firm has a "written information disclosure" policy to provide all material information to the stakeholders on timely basis	69.729	117	.000	4.500	4.37	4.63
Your firm efficiently holds periodic meetings with securities analysts	39.698	117	.000	4.136	3.93	4.34
Your firm has protection measures for minority shareholders in place	38.532	117	.000	4.085	3.87	4.29

5. Results

The evidence from the survey supports the hypothesis that "There is a significant impact of corporate governance on financial firm's performance," which suggests researchers to recommend financial firms to keep complying with their corporate governance norms and standards to improve performance and get the benefits of more investors' attention. This practice can improve the growth and survival of financial firms in India (Kapil & Mishra, 2019). In addition, managers or owners of financial firms should adopt corporate governance ethics in their core values, mission and vision to remind every employee about those principles when engaging with their roles and building a different corporate culture. In other words, financial firms should comply with the principles and implement the same for sound corporate governance to improve their performance.

5.1. Policy Recommendations for Decision-Makers

On the basis of above findings, it is inferred that Indian government as well as other developmental organizations for financial firms should formulate strategies and standards for corporate governance exclusively for financial firms to improve their compliance. It will help those firms to have competitive position in the market and enhance their sustainability and growth in the long term. Additionally, managers and owners of those firms should be aware and trained about the value of complying with corporate governance principles. It can be made possible by holding conferences and workshops on corporate governance for providing proper training. Corporate governance fund can also be provided by the government for those firms which find it hard to practice CG in their premises. They can use funds for subsidizing the training and workshop expenses to all the small firms.

6. Conclusion

This study adds to the existing body of knowledge about corporate governance practices in context of financial firms in India. The dataset for firm performance and corporate governance is quite contemporary. There are some implications for decision-makers, investors, and researchers in this study as findings show impact of corporate governance practices on financial firms' performance. Both foreign and domestic investors should consider this study as it indicates what makes companies give better results. Investors should focus on those companies which have stakes controlled by promoters as they are supposed to show better financial performance. They should consider companies with diversified and optimal board of directors. Foreign investors can help develop good corporate governance by coming with improved practices and latest technologies.

The study further reiterates that the dynamics of board meetings impact the mechanism and structure of CG practices. These finer threads and dynamics are usually not disclosed in public domain and cannot be identified by investors and academicians easily. The decision-making process of the board and monitoring for making such decisions can affect the relationship with corporate governance performance. Hence, further studies may highlight those factors and parameters of corporate governance.

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