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Corporate Governance and Financial Performance of Select Industries

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Abstract

Introduction: The idea of corporate governance, which places an emphasis on responsibility and openness within the system, is becoming more popular in India.

Aim of the study: the main aim of the study is Corporate Governance And Financial Performance Of Select Industries

Material and method: The effect of corporate governance practices on company financial performance is examined by modifying EBIT over a period of eight years (2012-2020).

Conclusion: In this section, we look at how different Corporate Governance Practices might affect a company's bottom line.

1. INTRODUCTION

1.1 OVERVIEW

The idea of corporate governance, which places an emphasis on responsibility and openness within the system, is becoming more popular in India. Disclosures made through corporate governance are the only factor that should be considered when making investment decisions by the average person, such as shareholders (people who invest in the company), creditors (people who fund the company by way of loans), financial analysts (people who analyze the company's position in the market), and security consultants (people who offer consulting services on the purchase of shares and securities). After clause 49 was changed in 2006, the idea of corporate governance became legally binding in India. This revision made it essential for all listed firms to implement corporate governance, which immediately contributes to the maximizing of shareholder wealth, which in turn results in greater values of the organization's shares. Investors will almost always want to put their money into huge organizations that are run efficiently.

1.2 CORPORATE GOVERNANCE IN INDIA

The systems, procedures, and interactions that are used to regulate and guide companies are collectively referred to as "corporate governance." It includes the guidelines and protocols for making choices in corporate affairs, as well as the methods by which the goals of businesses are determined and pursued in the context of the social, regulatory, and commercial environment. Monitoring the policies, procedures, and choices made by businesses, their agents, and other stakeholders is one of the primary responsibilities of governance processes. The governance structures and principles of a company define the allocation of rights and obligations among the many players in the organization. These participants include the board of directors, management, shareholders, creditors, auditors, regulators, and other stakeholders. Fairness, openness, accountability, and responsibility are the four pillars upon which good corporate governance is built, and each one plays an equally important role. Since they go beyond company law, ethics are crucial. Various nations have developed their own unique approaches to the management of corporations. The form of corporate governance in a particular nation is governed by several elements, including the legal and regulatory framework, the business climate in the country, and the articles of association for each organization. The structure of corporate governance that is used in each nation has features that set it apart from the structures utilized in the other nations.

2. LITERATURE REVIEW

Dissanayake, Hiranya & Iddagoda (2023) Increased economic sustainability requires a commitment to best practices in Corporate Governance. Stakeholder-focused research on the obstacles to establishing effective corporate governance in developing countries is lacking. In light of the present bankruptcy scenario in the rising economy of Sri Lanka, this paper analyzes the difficulties of corporate governance in the country. Using a quantitative methodology in the form of a questionnaire poll, this research identified insider trading, conflicts of interest among directors, political influence among regulatory bodies, and a lack of investor protection and trust as the most pressing problems in the financial services industry. Identifying and addressing obstacles on the path to greater sustainable development, this research is crucial to the stakeholder theory and has consequences for policymakers in developing countries.

Irshad, Ateeq & Safdar (2023) Shareholders and other interested parties should take an interest in a company's environmental performance. However, it is important to investigate whether or not the present methods of corporate governance safeguard shareholders' and environmental stakeholders' most vital interests. The effects of corporate governance on the environmental and sustainable performance of businesses are the focus of this research. The research adopts a new approach by classifying organizations into three groups according to different environmental sustainability business scenarios and then assessing the impact of corporate governance on each group. The findings suggest that the success of corporate governance is conditional on how long a firm is expected to be able to function in its existing setting. Corporate governance has been shown to be beneficial empirically only in ecologically sustainable business as usual and extremely environmentally sustainable future scenarios.

Gutterman, Alan (2023) Harvard Law Professor E. Merrick Dodd is credited with popularizing the concept of "stakeholder" in the 1930s when he proposed that firms had at least four primary categories of stakeholders: shareowners, workers, consumers, and the general public. Stakeholder theory, as explained by Maon et al., has been a cornerstone of the corporate social responsibility ("CSR") movement for decades, stressing the importance of an organization's ability to generate sufficient wealth, value, or satisfaction for all of its primary stakeholders rather than focusing solely on shareholders. According to stakeholder theory, companies are embedded in a web of relationships that are essential to their survival and the creation of value for all of their constituents. Shareholder primacy, for instance, has been a guiding principle for decades, but it is now apparent that sustainable shareholder value cannot be achieved without strong and constructive relationships with other stakeholders (such as customers, suppliers, employees, communities, etc.), relationships that must be forged through engagement to achieve alignment throughout the ecosystem on goals and strategy.

Le, Thanh Tiep & Van Kha, Nguyen (2022) Due to its significance in determining the future of businesses, corporate governance is gaining a lot of attention across the globe. Stakeholders of businesses throughout the world are increasingly concerned about how companies are controlled in order to strike a fair balance between economic, social, and environmental principles in light of growing environmental and social crises. This research attempts to delve deeply into the connection between corporate governance and company value by investigating the role of CSR and organizational identity as mediators of that connection. Because of its applicability to studies of organizations and management, the covariance-based structural equation modeling (CB-SEM) analytical method was used for this study. Because of the significance of SMEs in developing economies, this research will concentrate on such businesses. This research adds to the existing body of empirical data demonstrating corporate governance's critical function in maximizing the value of a company. The major focus of this research should be on the empirical data linking corporate governance and company value through the moderating effects of corporate social responsibility and organizational identity.

Ormazabal, Gaizka (2018) Each stakeholder's motivations for influencing management behavior are discussed, as are the stakeholders' respective strategies for responding to managerial actions and any related issues. Although it seems that all the investigated stakeholders have some influence on management activities, the effectiveness of stakeholders' monitoring role is debatable. Several variables are shown by empirical study to reduce the incentives for stakeholders to punish corporate managers. Moreover, in other circumstances, the motivations of stakeholders do not seem to be aligned with shareholders' interests or the public good. When taken as a whole, the analyzed information reveals that many other parties outside the board of directors and capital suppliers have a role in monitoring. Stakeholder monitoring is still a relatively new field, as this review highlights.

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3. METHODOLOGY

3.1 Period of Study

The effect of corporate governance practices on company financial performance is examined by modifying EBIT over a period of eight years (2012-2020).

3.2 Sample

During the study period of 8 years, we looked at 87 non-financial businesses from the Nifty 500.

3.3 Data

Both Prowess and the corporations' annual reports were mined for information on corporate governance and financial metrics.

4. RESULTS

The outcomes of the Regression Model are shown in Table 4.1. Discretionary Accruals are subtracted from reported financial results (EBIT) to arrive at Financial Performance (EBIT_DA), the dependent variable in the research. Corporate Governance Variables serve as the study's independent variables. The GMM model's predictions on the impact of both executive and non-executive directors on companies' financial performance were generally favorable. As a result, it's clear that Board Members play a special and crucial function in improving the firms' bottom lines. Since Corporate Governance factors do have an influence on businesses' Financial Performance, we reject the null hypothesis.

Table 4.1 Results of Panel Regression for Financial Performance

	RE	FE	GMM
VARIABLES	EBIT_DA	EBIT_DA	EBIT_DA
B_Size	1,147*	503.3	307.7
	(666.0)	(740.6)	(1,217)
Meet_Att	436.1	384.9	1,060
	(613.4)	(1,256)	(1,952)
No_meet	1,452***	638.9	1,053
	(508.4)	(1,225)	(1,807)
Audit_Com	8,852**	593.2	3,422
	(3,813)	(5,401)	(9,008)
Ind_Pro	585.3**	1,174**	168.7
	(252.0)	(461.9)	(865.3)
For_Prom	583.4**	1,172**	330.6
	(281.7)	(569.8)	(1,075)
Instit	135.0	1,355***	1,258
	(251.1)	(429.0)	(776.2)
Non_Instit	15.98	1,014**	273.4
	(272.2)	(450.0)	(787.8)
Dual_Cha	1,723	10,931	3,115
	(3,569)	(8,268)	(13,559)
Non_Indep	449.0**	739.4*	443.1**
	(225.7)	(405.5)	(219.2)
Exec	207.5	418.8*	809.3**
	(225.9)	(229.4)	(347.5)
NON_EXE	138.9	559.2***	738.4***
	(155.2)	(116.5)	(148.9)
Prom	159.9	64.55	154.0
	(104.8)	(164.8)	(269.5)
Non_Prom	14.75	88.84*	100.5
	(59.60)	(46.14)	(81.57)

Indep	53.68	420.5	
	(211.1)	(400.5)	
L.EBIT_DA			0.0277
			(0.0498)
Constant	28,088	198,263***	103,357
	(35,146)	(59,325)	(78,466)
Observations	153	742	575
Rsquared		0.065	
No.ofCompanCode	17	85	83

Table 4.2 Regression Results of Automobile Sector

Number of obs	45	
Rsquared	0.4568	
Adj Rsquared	0.2033	
EBIT_DA	Coef.	p value
B_Size	2220.228	0.29
Meet_Att	828.682	0.92
No_meet	3435.613	0.62
Audit_Com	10254.09	0.64
Ind_Pro	302.435	0.65
For_Prom	251.8407	0.73
Instit	1268.952	0.08
Non_Instit	1028.793	0.2
Dual_Cha	20832.94	0.24
Non_Indep	60.60446	0.87
Exec	1251.549	0.24
Non_Exe	970.6104	0.31
Prom	409.207	0.16
Non_Prom	49.86618	0.7
_cons	221965.5	0.05

The results of the regression analyses for the automotive industry are shown in Table 4.2. The presence of institutional investors is the only significant and positively correlated Corporate Governance indicator with Financial Performance. This may be due to the fact that institutional investors play a more active role in the decision-making processes and keep a close eye on company performance when they put their money at stake. Since Corporate Governance factors do have an influence on businesses' Financial Performance, we reject the null hypothesis.

Table 4.3 Regression Results of Pharmaceutical Sector

Number of obs	99	
Rsquared	0.371	
Adj Rsquared	0.2662	
EBIT_DA	EBIT_DA	p value
B_Size	967.2563	0.75
Meet_Att	13152.17	0.25
No_meet	871.9276	0.93
Audit_Com	5968.909	0.72
Ind_Pro	2521.581	0.14
For_Prom	2698.646	0.08
Instit	1525.749	0.47
Non_Instit	1953.867	0.41

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Dual_Cha	11558	0.55
Exec	1938.353	0.05
Non_Exe	2509.739	0.00
Prom	130.9037	0.89
Non_Prom	88.67921	0.66
Indep	678.1318	0.38
_cons	96709.27	0.58

The pharmaceutical industry's regression findings are shown in Table 4.3. Firm financial performance is significantly impacted by factors such as the percentage of foreign ownership and the number of executive and non-executive directors on the board. The company's financial performance deteriorated as foreign ownership increased. This is due to the fact that FIIs put money into firms with the only goal of profit and play no role in management. If investors' primary goal is to collect dividends, rather than participate in and keep an eye on the company's operations, this is what they can expect to happen. The presence of executive Directors on the Board, on the other hand, is beneficial because it allows management to keep a close eye on the company's operations and make choices that are consistent with the best interests of all shareholders. Since Corporate Governance factors do have an influence on businesses' Financial Performance, we reject the null hypothesis.

Table 4.4 Regression Results of Construction Sector

Number of obs	45	
Rsquared	0.6497	
Adj Rsquared	0.5028	
EBIT_DA	Coef.	p value
B_Size	1057.04	0.15
Meet_Att	1932.374	0.51
No_meet	1840.628	0.49
Audit_Com	1455.147	0.79
Ind_Pro	2509.573	0.51
Instit	2282.419	0.55
Non_Instit	2283.754	0.56
Dual_Cha	12004.54	0.33
Non_Indep	283.5221	0.15
Exec	33.91233	0.89
Non_Exe	33.48556	0.72
Prom	33.91917	0.87
Non_Prom	39.10602	0.52
_cons	208350	0.58

Regression findings for the Construction industry are shown in Table 4.4. There was no correlation between a company's corporate governance practices and its financial performance in this industry. There is no substantial relationship between Corporate Governance characteristics and firm financial performance, hence the null hypothesis is accepted.

Table 4.5 Regression Results of Energy Sector

Number of obs	89	
Rsquared	0.5822	
Adj Rsquared	0.5032	
EBIT_DA	Coef.	p value
B_Size	6249.815	0.09

Meet_Att	4081.04	0.73
No_meet	4145.706	0.62
Audit_Com	84203.57	0.00
Ind_Pro	906.9579	0.75
For_Prom	3880.94	0.3
Instit	7.403734	0.71
Non_Instit	2879.93	0.44
Dual_Cha	164349.1	0.00
Non_Indep	2009.446	0.03
Exec	1238.724	0.48
Non_Exe	967.0571	0.21
Prom	1072.263	0.58
Non_Prom	1058.951	0.04
_cons	50550.08	0.87

The Energy sector regression findings are shown in Table 4.5. The financial performance of energy sector enterprises improved when the board was larger and there was a financial expert on the Audit Committee. The businesses' financial performance suffered when there was a dual chairman, a lack of independent directors, or directors who were not the firm's promoters. On average, energy industry companies have 13 people on their board of directors, which provides a diverse set of perspectives and facilitates more informed decisions. Since Corporate Governance factors do have an influence on businesses' Financial Performance, we reject the null hypothesis.

Table 4.6 Regression Results of Metals Sector

Number of obs	45	
Rsquared	0.7507	
Adj Rsquared	0.6462	
EBIT_DA	Coef.	p value
B_Size	7581.135	0.03
Meet_Att	1939.15	0.78
No_meet	2745.022	0.66
Audit_Com	19820.22	0.3
Ind_Pro	930.6286	0.47
For_Prom	2590.83	0.57
Instit	2095.772	0.1
Non_Instit	3247.931	0.06
Non_Indep	978.778	0.15
Exec	314.7082	0.72
Non_Exe	26.28603	0.95
Prom	715.3103	0.57
Non_Prom	64.2021	0.81
_cons	250842.5	0.02

The Metals sector regression findings are shown in Table 4.6. There was a favorable correlation between Financial Performance and Board Size, Institutional Ownership, and Non-Institutional Ownership among businesses in this industry. Since Corporate Governance factors do have an influence on businesses' Financial Performance, we reject the null hypothesis.

5. CONCLUSION

In this section, we look at how different Corporate Governance Practices might affect a company's bottom line. The Indian firm has a history of Earnings Management Practices, as seen here. Investors who put all their faith in a company's reported financial indicators are setting themselves up for disappointment if they examine financial performance without also taking earnings management practices into account. That's why it's crucial to factor in the managers' discretion when calculating profits and examine the impact of good corporate governance on a company's bottom line. From this investigation, we see that companies' bottom lines are significantly affected by their corporate governance practices. In order to improve a company's financial performance, the Board of Directors' independence can be bolstered by increasing the frequency of board meetings, increasing the attendance of Directors at Board meetings, separating the CEO-Chairperson post, and linking the interest of shareholders at large with the interest of the company.

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