# A study on effective corporate governance in India: Its implication and performance

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**Abstract:**
The purpose of this study is to find out the effect of implication of effective corporate governance on the firm's performance in India. The study tries on framing out the best possible corporate governance strategy, which can be effectively implemented. It has used the framework of corporate governance strategies (both internal and external) implemented and directed as per the competent authorities of an organization. Corporate Governance as a tool adapted by different organizations as to bring transparency and uplifting the image of an organization in front of the public and government. This study focuses on revealing the importance of managerial role in not only development but also in implementing the corporate governance strategy efficaciously. Hence, the outcome of our study will set up the relationship between the effective implication of corporate governance policies by managers and its impact on firm's performance in the economy. Therefore, the result of this study is believed to be beneficial for the corporate sector in policymaking.

***Keywords**:* corporate governance, efficacious, firm's performance, Board of Directors

## Introduction

Corporate Governance has evolved as one of the most crucial field in the modern and economically developing corporate world. It has a very clear and long lasting effect on the society in improving the image of any organization. Everybody knows the value of good and effective corporate governance implication and it is unquestionable.

Corporate governance is the blend of rules, processes and policies, by which a firm is directed, controlled and managed. The soul of corporate governance lies in balancing the interests of the parties, which are directly or indirectly related to any organization. It involves ensuring the safeguard of all the stakeholders of the company such as shareholders, customers, employees, suppliers etc. Corporate governance also serves as a tool with the help of which a company reached to its objectives in prescribed manners. It mostly influences all the aspects of management like planning, implementing and controlling. Governance refers specifically to the set of rules, controls, policies, and resolutions put in place to dictate corporate behavior. The board of directors is the soul in governance, and has to play an important role

The COVID-19 pandemic and its aftereffect on the society and corporate world globally creates a turmoil and it shook the social and business world and will definitely have long lasting impact on business. Corporate governance trends vary somewhat across the globe, but the corporations are calculating and redefining their roles in societies.

(e.g., Guha et al., 2019; Gupta & Shallu, 2014; Khanna & Palepu, 2004; Shikha, 2017; Srivastava et al., 2018). Shikha (2017) implies that the discussion on corporate governance is increasing day by day and it needs to change in order to be effectively address the ever-changing global nature of capital market., Gupta and Shallu (2014) states that the major problem to the corporate governance in India is the lobby and power exercised by dominant shareholders which would collectively influence the political system of the country. In addition India is lacking good monitoring network. It was proved by a large number of corporate frauds.

**Literature Review**

In India, various corporate governance studies reveals the fact that there are lack of uniformity among various disciplines weather they are marketing and finance, implementation of corporate governance policies, transparency in the work of social concern and environmental ethics. Some of the results of the major studies on corporate governance are as follows.

- Arora & Sharma, 2016; Bansal & Sharma, 2016; Bhatt & Bhattacharya, 2015; Kandukuri et al., 2015; Mishra & Mohanty, 2014; Palaniappan, 2017; Rani et al., 2014; Sanan, 2016; Singla & Singh, 2019; Yameen et al., 2019). The outcomes of the above studies are not consistent and there are some sought of contradiction shown by the results of above studies however some relations are found in various corporate governance parameters and their financial performance. (Arora & Sharma, 2016; Kandukuri et al., 2015; Rani et al., 2014).
- Some other studies shows that some corporate governance traits have a positive impact on the firm performance; larger board size and attendance of the board members (Bhatt & Bhattacharya, 2015), promoters' ownership (Mishra & Kapil, 2017), board age diversity (Kagzi & Guha, 2018), board size and CEO Chairman dual role (Bansal & Sharma, 2016), independent women directors (Sanan, 2016), board independence, board size and busyness (Mishra & Kapil, 2018).
- On the other hand some corporate governance studies reflect that there is no association between various traits of corporate governance and firm's performance. For example, Mishra and Mohanty (2014), Kagzi and Guha (2018), Bansal and Sharma (2016), Bhatt and Bhattacharya (2015), and Mishra and Kapil (2017) respectively states that gender and tenure diversity of the board, audit committee independence and its meetings frequency, independent directors in the board, and board independence have no significant impact on firm's performance.
- Bhatt and Bhattacharya (2017) depicts that board structure have a negative effect on firm performance especially in case of family firm in comparison to non-family firm.
- Further, Palaniappan (2017) reveals negative relationship between board size and firm performance. Kagzi and Guha (2018) find out that diversity in educational background have a negative impact on firm performance.
- Various studies on firm value had already done in India which is also an important area of corporate governance studies. (e.g., Chauhan & Kumar, 2017; Khosa, 2017; Kumar & Singh, 2013; Mishra & Kapil, 2017, 2018, 2018). Kumar and Singh (2013) state a positive relation between promoter ownership level and firm corporate performance and negative relation between firm value and board size.
- Khosa (2017) revealed that there is a negative relationship between board independence and firm value of group-affiliated firms in India
- Singla and Singh (2019) depicts that on one hand board independence had a negative relationship with firm value while on other hand audit committee independence was positively related to the firm value.

**Objectives of study**

- To study the effect of corporate governance on firm's performance.
- To study the intimation and performance of corporate governance in India
- To study the negative effect of corporate governance on firm's performance

**Research Methodology**

The study is done on the analysis of secondary information collected from various sources such as books, journals, government reports, publication from various websites, which focused on corporate governance.

**The role of market mechanisms**

The Market mechanism developed by the SEBI and other governing bodies for the regulations of corporate governance in India and abroad plays an important role in understanding and regulating the governance in the firm's performance. The market for corporate control is much more effective disciplinary device than either monitoring by institutional investors or by the board of directors. The capital markets in external corporate governance play a key role in influencing the behavior of participants in the corporate governance framework. When management of a firm is inefficient or failing to maximize shareholder value, this exposes the company to the threat of a take-over bid, with the consequential removal of inefficient management. In merger & acquisitions in India has been Average deal value during the first nine months of 2021 totaled $105 million, up 14.4% year-on-year, as 17 deals above $1 billion were announced during this period. These 17 deals reached a cumulative $38.8 billion, compared to 12 deals worth above $1 billion with a total of $30.1 billion in the first nine months of last year. While up until now the market for corporate control has not been a key feature of insider systems of corporate governance, this is gradually beginning to change, as mergers and acquisition activity is increasing and hostile takeovers are becoming more common. India in particular has an active market for corporate control as witnessed by its active market in mergers and acquisitions, including a significant number of hostile take-overs. Therefore, it is not always correct to assume that a buoyant market for corporate control reflects the true extent of corporate monitoring. Even if this were not the case, it should not be forgotten that with legal, advisory, and financing costs constituting on average 8% of the purchase price, this is a particularly expensive way of aligning the interests of management with those of shareholders. Nevertheless, the mechanism is effective and should not be inhibited.

While some of the advantages of dispersed ownership include enhanced liquidity of stocks and better risk diversification possibilities for investors, it is also argue that the focus in this type of a system can be excessively short-term, reducing overall investment to a level lower that is considered efficient. Although an active market for corporate control can act as a disciplining device on managerial behavior, in an economy characterized by frequent take-overs, long-term commitments between stakeholders may be more difficult to sustain. Not only may this reduce overall investment by providing weak incentives for stakeholders to provide firm-specific investments, but it may also create biases in the type of investment projects undertaken, and there are tradeoffs between short-run benefits and long-run impacts on performance.

Product market competition to some extent act to reduce the scope for managerial inefficiency and opportunism. This is because there are fewer rents to be expropriated when markets are competitive. Competition also provides a benchmark by which the performance of the firm can be judged when compared with the performance of other firms in a similar sector. However, the effects of product market competition are slow to act, forcing inefficient companies into bankruptcy only after a long period of time has elapsed, by which point most shareholder value has been eradicated. Therefore, bankruptcy legislation, by influencing the claims and control of different investors in the event of insolvency, also plays an important role in corporate governance.

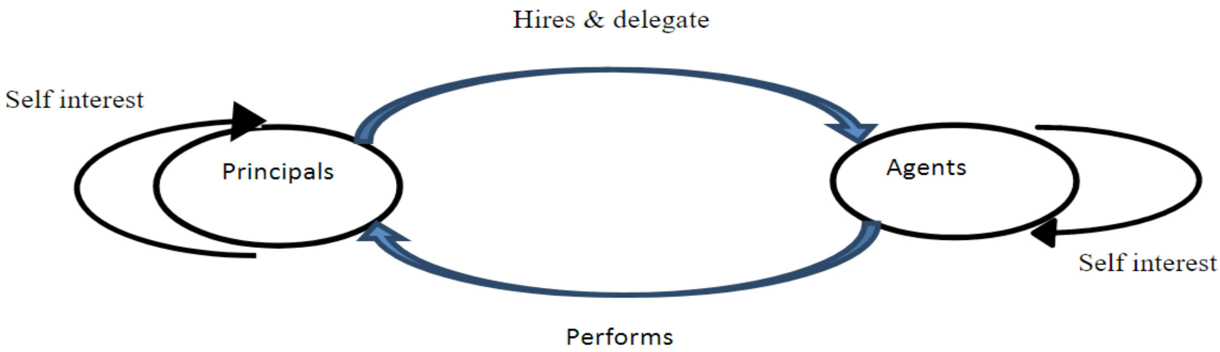
**Conceptual framework of corporate governance -**

The conceptual approach of corporate governance research studies in India discuss various issues of corporate governance such as governance regulations, governance reforms or compare Indian with some other countries. The term 'Corporate Governance' was coined by Bob Tricker in 1984. He is regarded as the Father of Corporate Governance. In the decades of 80's and 90's, many corporate scandals and failures were noticed. The Satyam scandal was the biggest corporate fraud in India, and this is the commencement of corporate governance failure in India. As , a result a need was felt to uplift not only the standard of corporate governance application but also to develop a flawless regulatory infrastructure for good corporate governance.

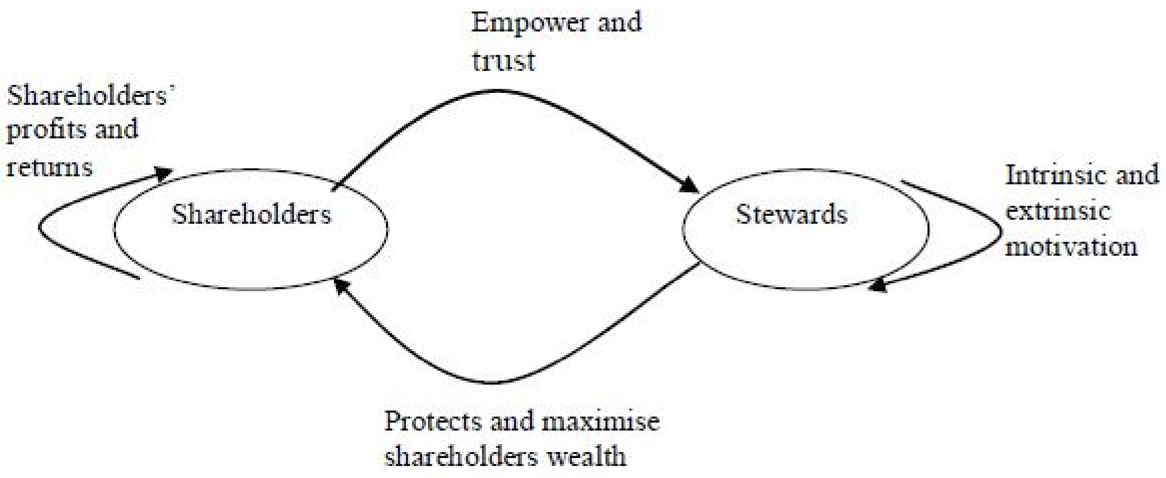
According to the Cadbury Committee Report -"Corporate governance is the system by which business/ corporations are directed and controlled and the effective and efficient application of this system is the responsibility of Board of Directors. The role of the shareholders is to appoint directors as well as auditors, which have a crucial role to play in application of corporate governance.

In terms of Institute of Company Secretaries of India "Corporate Governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders".

- The Agency/Shareholder theory of corporate governance Adapted from Abdallah and Valentine (2009) -




- The Stewardship Theory of corporate governance Adapted from Abdallah and Valentine (2009)

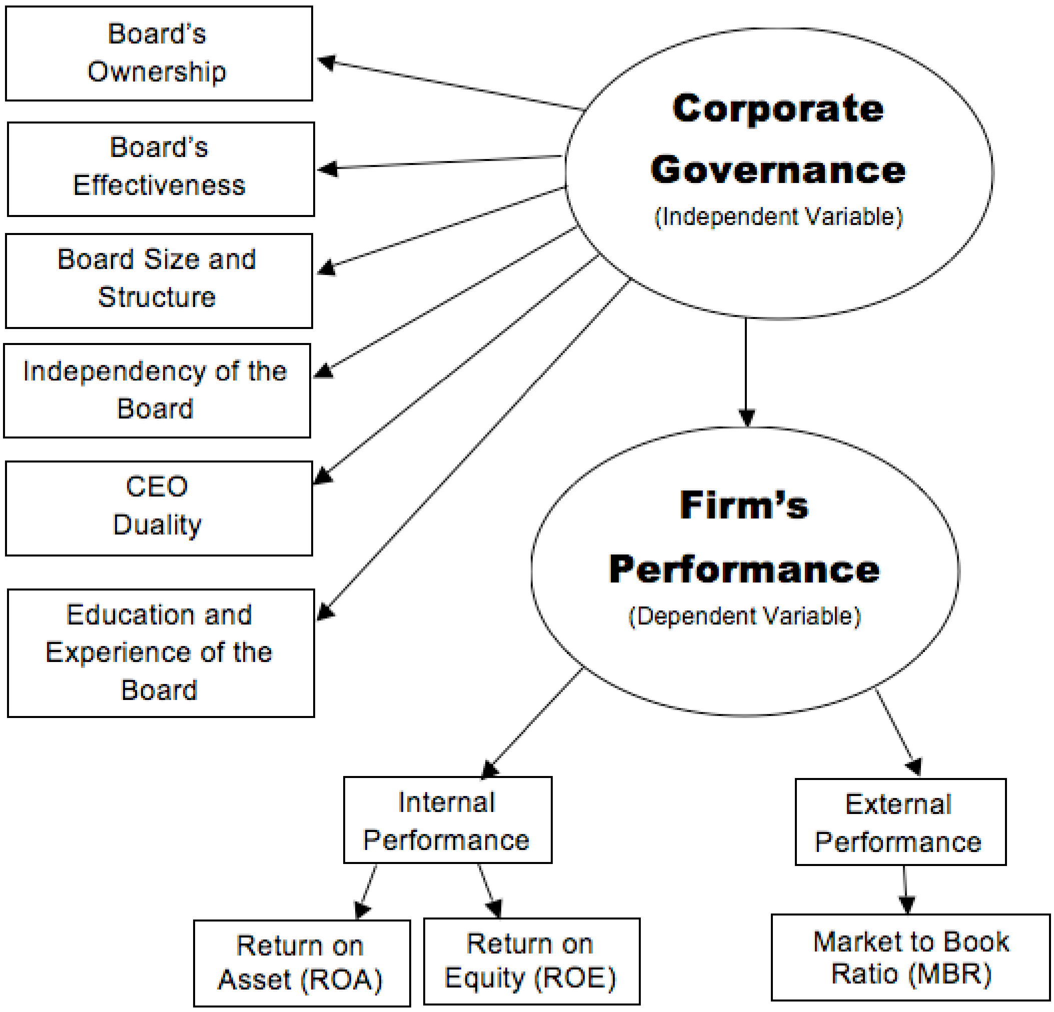



- The Stakeholder theory said that there is the effect of corporate activity on all the stakeholders of the corporation. This theory insists that corporate managers should work in to safeguard of the interests of every stakeholders to minimize the possibility of chances of conflicts between the corporate and stakeholder's interest. Stakeholders are of two types

i) Internal Stakeholders: They are the part of the company like Directors and Employees, who are actually involved in implementation of corporate governance
ii) External Stakeholders: They are the parties outside the company like, Creditors, customers, suppliers ,government agencies and society at large

**Impact**

The SEBI (Securities and Exchange Board of India) adopted clause 49 in 1999 from the code of governance developed by Confederation of Indian Industry (CII). It has been observed, analyzed and amended time to time to ensure its effectiveness and overcome any loopholes disclosures to ensure good governance. It is right to say that "The era of low standards and false profits are over", Indian Industry groups and regulating bodies advised and are in the favour of a number of reforms which makes Government of India to frame corporate governance voluntary guidelines in 2009 to motivate and guide companies to act accordingly. The impact of corporate governance on firm's performance may be states below -




(Theoretical frame work of corporate governance impact on firm's performance)

**Implications**

Corporate governance is the regulatory framework, practices, and processes by which a firm is directed and controlled. The soul of corporate governance lies in balancing the interests of a company's internal and external stakeholders, such as shareholders, customers, suppliers, government agencies and society.

Audit committees should work with the external auditors, internal auditors and accounting management to make the independent audit process as transparent and non-biasing. For example, many audit firms use a similar audit plan every year. As a result, management got a clue what is there to be asked and analyzed. The audit committee should bring variations in his auditing plan every year so that it might be done very effectively. The audit committee should encourage the auditor to be more practical and intelligently using his skills and rely less on data provided by management. Internal auditors should perform work in those areas which are not reviewed by external auditors. He is also believed to review the work of external auditor in a different manner. Assignments and works should be distributed among the members of auditing teams. Also, guest auditor programs should be employed so that each other's accounting operations can be reviewed.

Some of the firm have internal audit department, in that case executive management and the audit committee should realize that their efficiency is important for the success of the company.

Independence and transparency are two important issues which affects the efficiency of audit. The chief audit executive should report to the audit committee and have frequent meetings without executive management present. If a "dotted line" reporting to management is necessary, the audit committee should consider having the internal audit function report outside of the CFO (Chief Financial Officer) organization, even though the CFO often has the best background to provide direction. Over the last decade, the CFO's job has evolved. Initially it was transaction oriented but now a days it is strategically focused. Recent events suggest that CFOs need to allocate more time and resources to traditional accounting and reporting duties and need to work with strategically set objectives. In addition, every company should make sure that at least one person in the accounting department is a GAAP (Generally Accepted Accounting Principles) expert. With the increasing complexity of GAAP, companies are now relying more on their external auditors to keep them up to date on accounting changes that happens time to time.. This practice of employing at least one GAAP expert would help in ensuring that all unique accounting weaknesses are timely addressed and resolved

It is quite obvious that the new guideline significantly changes the corporate governance practices. However, the new rules do not take away the ultimate responsibility and authority from the board to decide what is needed to bring the company's corporate governance up to par in these demanding times. As William W. George, former chairman & CEO of Medtronic, Inc., said during his acceptance speech for the National Association of Corporate Directors' 2002 Director of the Year Award, "Boards must have the will, the persistence and the commitment to get it done … [they] are ultimately responsible and have the power to act accordingly".

**Result and discussion**

The researchers in this paper has discussed and tries to find out whether the research in India reflects the growing interest on corporate governance and its impact on firm's performance and the research published in the top journals in India reflect the differences vis-à-vis the global scenario on corporate governance. There are sufficient numbers of research papers on corporate governance but very few have some relationship with firm's performance. In the International journals the top five themes on corporate governance reflects the performance of the company, corporate sustainability, governance model and discloser and regulatory mechanism that needs to be reformed. The themes reflect the maturation of the field of corporate governance literature. The maximum number of papers exploring relationship between corporate governance and firm's performance are either replication research or extension of a concept with few new variables. These studies allow testing of corporate governance on firm's performance.

**Limitations of the study and future research**

This research is an exploratory type which may include gathering all relevant information and compiling them in an accessible format that has not been made available previously. This study is to understand the position of corporate governance in India as reflected by different studies published in different journals and a detailed analysis of the specific research design, methodology used in the different studies, variables studied and the validity of the findings require further exploration. The local diversity reflected in the institutional context of the Indian states, the corporate governance practices of mid-sized companies is still not well understood. The relative impact of corporate governance and its reforms in India under the mentorship of SEBI offers an opportunity to explore a number of themes that have historically been studied and implemented.

## Suggestions

- The Governing Body of the company implementing corporate governance needs a balanced approach in compliance with legislation, regulation and codes of practice with performance aspects of the board's work for improving the performance of the organization through strategy formulation and policy making. It needs to elaborate its position and understanding of the major functions it performs as opposed to those performed by management. These specifics will vary from board to board and requires a specific approach to handle the details corporate governance.
- The most essential function of a board is to monitor the organization's performance and ensure legal compliance in all major aspects of board's monitoring role that ensures corporate decision making is consistent with the strategy of the organization and with owners' expectations it can be best performed by identifying the organization's key performance drivers and establishing appropriate measures for determining success.the director should report all established facts.
- The line of responsibility between Board of directors and management must be clearly delineated in the mandatory discloser as business policy of the company and ensure to develop policies in relation to delegations.
- This study depict that the board structure and formal governance regulations are less important in preventing governance breaches and corporate wrongdoing than the culture and trust created by the by the top Management of the company. As the "leader" of the board, the chairperson should denote a strong and acknowledged leadership ability, to establish a sound relationship with the CEO, and have the capacity to conduct meetings and lead group decision-making processes.
- It is also suggested that state or central government should opt plans and policies in this regard for positive implementation and their result.
- The presence of large shareholders improves the supervision of management and thereby, enhances firm's performance

## Conclusions

In this study the mechanism of corporate governance implemented by the different companies and organizations studied under different research papers has been examined with reference of firm's performance and to explore the influence of managerial overconfidence on the relationship of firms' performance and the relationship of corporate governance with firm's performance.

It has been found that the internal and external corporate governance control mechanism has affected the firm's performance based on theoretical assumption and literature. This study also state that the literature of the company on corporate governance makes important contribution on firm's performance. The study which has been conducted earlier on the firm's performance in relationship with corporate governance is based on panel data of emerging markets by providing comprehensive empirical evidence of the literature on corporate governance using unique characteristics of SEBI listed firms between 2015-2020

The study also depict that the earlier concepts of corporate governance which was based on the protection of shareholder's rights to a firm's need for survival are changing and shifted to the relationship between corporate governance and cost of capital. The study also extends the developing stream of corporate governance requires to be explored in much wider context in relation to the firm performance literature in emerging economies that most of the listed companies give less attention to the external governance mechanisms, like product market competition and debt financing are limited from emerging market corporate governance literature; therefore, this study provided comprehensive empirical evidence. Furthermore, this study briefly indicated how the bias corporate governance behavior of top management and middle level management can influence the monitoring, controlling, and corporate decisions of corporate firms. So to the best knowledge of researcher no study investigated interaction effect of corporate governance measure adopted by the listed firms on managerial interference which has affected the firms' performance. Thus, the current study provides an insight into how the corporate governance affect/ demonstrate the relationship between firm's performance and governance mechanism in India and other developing economies in an emerging market scenario.

Hence, the study will help all the managers and owners of listed companies in which situation managerial behavior helps more for firm's value and protecting shareholders' wealth.

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