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The Effect of Corporate Governance Practice on Firms' Profitability

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Abstract

Corporate Governance has been framed in organization which basically define relationship between board members, management team and shareholders, to carry out duties at utmost transparency, ethical and accountability. It is always expected that the corporate governance should meet the global standard for better corporate success. Therefore, it is very necessary to have good corporate governance in order to manage effectively in global market. Companies put in lot of effort to build and adopt a good corporate governance model in order to catch the eye of investors. A good corporate governance practice can help companies perform better than competitors and so does it impact on profitability. This research paper focuses on finding the impact on corporate governance practices on profitability of firms. Here statistical methods like descriptive statistics and Pearson correlation methodology are used to find the direct link. Independent variables are board committee, board size, CEO duality, audit committee, non-executive director and dependent variables are PAT, EPS, ROA.

Index terms— ethical, corporate success, profitability.

1 Introduction

orporate Governance is a process that mandates a particular set of ethical governance and practice in corporate. It is a process that controls and governs an organization. Corporate governance has majorly impacted the growth of economies in countries where private sector is responsible for driving the growth of economy. Catastrophic failure of private sector seen in the past was because of the bad corporate governance. It has certainly impacted the profit and earning of shareholders and the company. Well framed corporate governance gives predictable growth rate for the firm. Therefore it is very necessary that in developing countries where startup are getting into unicorn club, should make a note keeping their practices and governance to avoid catastrophic failure in future. (Okoye 2016).

Global market particularly looks into the ethics and governance of the organization to rely for partnership and business in their countries. We can see that corporate governance is also considered when there is partnership, takeovers, institutional investor activism, financial restructuring, so here the whole idea is that a strong corporate governance gives predictable rate of return on investments. If such ethics are not maintained, investing bond market, buying equity shares, becomes questionable. In such situation where corporate governance are not strong enough, companies have to rely on the internal cash stock, securities, and other financial resources for its ongoing operational work. Therefore, overall financial resources for firm get affected. On a larger scale, economies get affected as many good business opportunity are missed. (Okoye et al., 2016) We have seen that an improved corporate governance has helped improve market liquidity, increase investor confidence, more capital resource, and there by a better financial disclosure. Major financial crime, frauds, can be avoided with better Corporate Governance and in return this can help in better inflow of foreign capital. There are evidences which has shown that, a strong corporate governance has increased chance of high fund allocation, better accessibility. Thereby increasing the valuation and goodwill of the company.

Here in this study, we would like to find out if there could be a direct link between corporate governance and profitability.

2 II.

3 Review of Literature

Many researchers, government regulators, global agencies have taken major interest in creating stringent corporate governance after major financial crises in 2008, some of institution in India that collapsed due to bad corporate governance are Kingfisher, Jet Airways, Sahara, DHFL. In US we have seen the same case in Enron and Arthur and in UK similar situation was in case of Marconi, now because of which corporate governance has become critically important in different parts of the world, but the regulation is different in different parts of the world. As the legal system are different in different parts of the world, therefore regulation of corporate governance tends to be different. (Mohammad & Yousef, 2016) The author found a relationship between firm profitability and the corporate governance of the firm. Here the corporate governance mechanism includes board independence, characteristics, size, growth. Statistical analysis like multiple regression methodology was used, and its result was 0.05 level which statistically significant.

The result of the study lead to confirmation that corporate governance has direct impact on the firms' profitability. The findings also the explained the model, one of its finding was the F statistic which was found to be 1.036.

(Ahmed Adesina Babatunde 2016) In this paper, the author obtained data from annual report of 37 companies, which is the sample size, out of top 50 listed companies. The data so obtained were analyzed using Spearman's correlation and analysis was done using variance. In this paper, author found that there was positive correlation between corporate governance and financial performance for example return on equity and board composition, board committees. When such corporate governance practices were implemented, it resulted in positive share price performance and higher profitability. (Heenetigala 2012) Corporate governance play major role in minimizing the risk of misconduct in the firm; therefore, it has positive contribute in the company. In this paper the author found a positive relation between corporate governance and firm performance, here there was positive effect on return on asset, return on equity and return on stock. The result was analyzed using multiple hierarchical regression analysis, it was found to be significant and positive.

(W.A.D.K Jayendrika 2020) has analyzed the impact of corporate governance practices on firm's financial performance where Earnings per share was used as a dependent variable and CEO duality, number of shares held by the directors, ratio of non-executive directors to total directors in the firm were some of the independent variables. Correlation and regression analysis used by the researcher in the study proves that ownership concentration and CEO duality has positive relationship with the financial performance of the firm.

Martin Kyere (2019), did a study on impact of corporate governance on financial performance of non-financial listed companies in UK. Agency and stewardship theory of corporate governance is used as a basis for the study. The dependent variables were ROA and Tobin's Q and some of the independent variables were insider shareholding, board size, CEO duality etc. The author has used descriptive statistics, correlation and regression techniques to prove that strong independent board is one of the solutions to agency problem by reducing cost, thereby improving financial performance.

Afshan (2016), studied the impact of corporate governance of financial performance of firms belonging to textile industry in Pakistan. 60 companies were selected out of 156 listed companies of Pakistan stock exchange. The researcher has used similar statistical techniques and variables and concluded the study that it depends on the capabilities of managers in utilizing the assets of the firm effectively.

Aswathy Mohan (2018), has used certain variables like ROE (Return on Equity), PB ratio (Price to book ratio), board composition, board size and CEO duality. The study has used OLS regression model for analyzing the impact of corporate governance on financial performance of BSE Sensex companies. The study indicates the need for firms to separate the post of CEO and Chair in order to ensure optimal performance. Dr. Giriraj Kiradoo (2019), has studied the relationship between CEO duality, board size and ownership concentration with financial performance of the firm. It also considers the concept of internal and external controls which helps in building good corporate governance practice. The researcher concludes the study by stating that it is purely the responsibility of the board to improve the financial performance by being more accountable and attract investors.

4 III.

Objectives 1. To understand the importance of corporate governance for successful functioning of a company. 2. To analyze the impact of corporate governance on firm's profitability.

IV.

5 Research Methodlogy

In this study, corporate governance link with profitability of the firm is measured, which is basically performed using statistical methodology like descriptive statistics and correlation. In order to perform this process, independent variable and dependent variable is taken under consideration. Here the independent variable are CEO Duality, Board Committee, Board Size, Non-Executive Director, Audit Committee are used, and dependent variable like ROA, EPS, PAT.

6 a) Sample Selection and Data

There are 30 manufacturing companies listed under NSE and here we have taken five companies (16.66% is the sample size). Those are UPL, Ultra Tech Cement, Tata Steel, Bajaj Auto, JSW Steel. Annual report of the respective companies was used from the year of 2016 to 2020. i. Independent variables CEO Duality: If the same person who hold the title of chairman is also CEO, then the value to be assigned is 1 else 0.

Non-Executive Director: These are non-executive directors in the board of directors. They are majorly involved policy making and planning.

Audit Committee: It is the number of members in the committee who look after the audit through financial reports.

ii. Dependent Variables Profit after Tax (PAT): These are profit after deducting expenses and tax. This profit meant for shareholders.

7 Return on

8 c) Descriptive Statistics

Here the descriptive statistic basically summarizes the data in simple form, which is in the form of mean, median, skewness, maximum, minimum, standard deviation, kurtosis. It is just representation of data and it is not based on any theory of probability.

9 d) Regression Analysis

It is a type of predictive analysis where we basically find the relation between the independent variable and dependent variable using coefficient value and P-value with significance at 5% (0.05).

V. Here, it can be seen that mean, median, maximum, minimum and standard deviation is zero.

10 Results

11 ii. Board Committee

From the above table it can be seen that mean value is 7.5, median is 6. The maximum and minimum range for board committee is 14 and 5. The standard deviation is found to be 3.

12 iii. Board Size

From the above table it can be seen that mean value is 12.1, median is 12. The maximum and minimum range for board size is 16 and 9. The standard deviation is found to be 2.

13 iv. Non-Executive Directors

From the above table it can be seen that mean value is 6.5, median is 6. The maximum and minimum range for non-executive directors is 13 and 2. The standard deviation is found to be 3.

14 v. Audit Committee Members

From the above table it can be seen that mean value is 4, median is 4. The maximum and minimum range for audit committee is 5 and 3. The standard deviation is found to be 0.6.

15 vi. Profit after tax (PAT in Lakhs)

From the above table it can be seen that mean value is 350090.8, median is 314968.5. The maximum and minimum range for PAT is 1326090 and -434258. The standard deviation is found to be 369802.5.

16 vii. Earnings per share (EPS)

From the above table it can be seen that mean value is 69.3, median is 60.4. The maximum and minimum range for EPS is 201.6 and -44.77. The standard deviation is found to be 69.5

17 viii. Return on Asset (ROA)

From the above table it can be seen that mean value is 0.1, median is 0.1. The maximum and minimum range for ROA is 0.23 and -0.03. The standard deviation is found to be 0.1.

18 b) Correlation Analysis

Correlation statistical tool helps to understand the relationship between dependent and independent variables and on the basis of which analysis are made. After the data analysis, information that we get help us to see the relationship between variables, for example, some of them between corporate governance and firm financial performance (profitability measure). From the above table, we can clearly see that, PAT is positively correlated with all the independent variable i.e. CEO Duality, Board Committee, Board Size, Non-Executive Director, Audit Committee.

In case of EPS, we see that it is negatively correlated with board committee and audit committee, where as it is positively correlated with CEO Duality, Board size, Non-Executive Director.

Same is the case with ROA, that we can clearly see, it is negatively correlated with board committee and audit committee, where as it is positively correlated with CEO Duality, Board size, Non-Executive Director.

Here, we can summarize that dependent variable like PAT, EPS, ROA have positive correlation with CEO Duality, Board size, Non-Executive Director.

But we can see that EPS, ROA have negative correlation with board committee and audit committee.

So few factors of corporate governance has positive correlation with profitability of the firm but not all of them.

19 c) Regression Analysis

Regression analysis is a statistical method, through which positive and negative relationship between dependent variable and independent variable are analyzed, and on basis of the P value , null hypothesis is either rejected or accepted. The significance of P value is 0.05.

20 Null Hypothesis

H1: There is no relationship between ROA and CEO Duality, Board Committee, Board Size, Non-Executive Director, Audit Committee. H2: There is no relationship between EPS and CEO Duality, Board Committee, Board Size, Non-Executive Director, Audit Committee.

H3: There is no relationship between PAT and CEO Duality, Board Committee, Board Size, Non-Executive Director, Audit Committee. Here, there is negative correlation between ROA and Board Committee, Audit Committee, but there is positive correlation between ROA and Board size, Non-Executive Director and CEO duality. Here it can be seen that the P value is less than the significant value (0.05) for CEO duality, Board Committee, Board size, therefore in such situation the null hypothesis is rejected and the alternate hypothesis is accepted.

Here, there is negative correlation between PAT and Board size, and positive correlation between PAT and Board committee, Audit Committee, Non-Executive Director and CEO duality. seen that P value is less than the significant value (0.05) for CEO duality, therefore null hypothesis is rejected and the alternate hypothesis is accepted.

Board size, therefore in such situation the null hypothesis is rejected and the alternate hypothesis is accepted. ? It can be seen that there is negative correlation between PAT and Board size, and positive correlation between PAT and Board committee, Audit Committee, Non-Executive Director and CEO duality. From the above, it can be seen that P value is less than the significant value (0.05) for CEO duality, therefore the null hypothesis is rejected and the alternate hypothesis is accepted. ? It can be seen that there is negative correlation between EPS and Board Committee and positive correlation between EPS and Board Size, Audit Committee, Non-Executive Director and CEO duality. The P value is less than the significant value (0.05) for CEO duality, Board Committee, Board Size, the null hypothesis is rejected and the alternate hypothesis is accepted.

VII.

21 Conclusion

Corporate governance has major significance in firm valuation. It has increased profitability by controlling risk in business. In this study we have found that there is positive correlation between corporate governance and profitability but not all factors of corporate governance were positively correlated with all the profitability. Most of the companies that was taken were from manufacturing sector where there is frequent change in policies in order keep ethics and transparency strong. Therefore, we can conclude that there is significant link between the independent and dependent variable, but still explore more with other factors of corporate governance like board meeting and director remuneration. There is also scope to study different industries and compare how corporate governance affect profitability. [1]

[1] The Effect of Corporate Governance Practice on Firms' Profitability

	CEO Duality	Board Committee	Board Size	Non-Executive Directors	Audit Committee Members	PAT(in Lakhs)	EPS	ROA
Mean	0	7.5	12.1	6.5	4.0	350090.8	69.3	0.1
Standard Error	0	0.6	0.4	0.7	0.1	75485.6	14.2	0.0
Median	0	6.0	12.0	6.0	4.0	314968.5	60.4	0.1
Standard Deviation	0	3.0	2.0	3.3	0.6	369802.5	69.5	0.1
Kurtosis	0	0.4	-0.2	-0.8	-0.1	1.8	-0.8	0.1
Skewness	0	1.5	0.7	0.6	0.0	0.4	0.2	0.9
Range	0	9	7	11	2	1760348	246.38	0.26
Minimum	0	5	9	2	3	-434258	-44.77	-0.03
Maximum	0	14	16	13	5	1326090	201.61	0.23
Sum	0	180	290	155	95	8402179	1664	1.71
Count	24	24	24	24	24	24	24	24
Confidence Level(95.0%)	0	1.27	0.83	1.41	0.26	156153.90	29.35	0.03

Figure 1:

	CEO Duality	Board Committee	Board Size	Non-Executive Directors	Audit Committee	PAT(in Lakhs)	EPS	ROA
CEO Duality	1							
Board Committee	0	1						
Board Size	0	-0.05	1					
Non-Executive Directors	0	-0.13	0.78	1				
Audit Committee Members	0	0.09	-0.20	-0.54	1			
PAT(in Lakhs)	0	0.07	0.00	0.04	0.03	1		
EPS	0	-0.45	0.43	0.37	-0.02	0.58	1	
ROA	0	-0.31	0.77	0.82	-0.41	0.32	0.71	1

Figure 2:

SUMMARY OUTPUT

Regression Statistics	
Multiple R	0.879557
R Square	0.77362
Adjusted R Square	0.678344
Standard Error	0.036869
Observations	25

ANOVA

	df	*SS*	*MS*	*F*	*gnificance F*
Regression	5	0.092904	0.0185807	17.08673546	1.885E-06
Residual	20	0.027186	0.0013593		
Total	25	0.12009			

	Coefficie nts	*Standar d Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	-0.09	0.08	-1.24	0.23	-0.25	0.06	-0.25	0.06
CEO Duality	0.00	0.00	65535.00	0.00	0.00	0.00	0.00	0.00
Board Committee	-0.01	0.00	-2.09	0.05	-0.01	0.00	-0.01	0.00
Board Size	0.02	0.01	2.17	0.04	0.00	0.03	0.00	0.03
Non-Executive Directors	0.01	0.00	1.95	0.07	0.00	0.02	0.00	0.02
Audit Committee Members	-0.01	0.02	-0.54	0.59	-0.04	0.02	-0.04	0.02

Figure 3:

SUMMARY OUTPUT

Regression Statistics	
Multiple R	0.14
R Square	0.02
Adjusted R Square	-0.23
Standard Error	395342.24
Observations	25

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	5	64134647837	1.283E+10	0.1025856	0.99038865
Residual	20	3.12591E+12	1.563E+11		
Total	25	3.19004E+12			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	164136.9	812357.0	0.2	0.8	-1530410.0	1858683.9	-1530410.0	1858683.9
CEO Duality	0.0	0.0	65535.0	0.0	0.0	0.0	0.0	0.0
Board Committee	10728.8	27594.8	0.4	0.7	-46832.8	68290.5	-46832.8	68290.5
Board Size	-29829.6	74352.3	-0.4	0.7	-184925.7	125266.6	-184925.7	125266.6
Non-Executive Directors	26430.5	50153.5	0.5	0.6	-78188.0	131049.0	-78188.0	131049.0
Audit Committee Members	72295.8	165749.3	0.4	0.7	-273451.2	418042.9	-273451.2	418042.9

Figure 4:

SUMMARY OUTPUT

Regression Statistics	
Multiple R	0.621697
R Square	0.386507
Adjusted R Square	0.213808
Standard Error	58.74197
Observations	25

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	5	43478.53	8695.707	3.150053	0.03083
Residual	20	69012.39	3450.619		
Total	25	112490.9			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	-87.08	120.70	-0.72	0.48	-338.87	164.70	-338.87	164.70
CEO Duality	0.00	0.00	65535.00	0.00	0.00	0.00	0.00	0.00
Board Committee	-9.96	4.10	-2.43	0.02	-18.51	-1.41	-18.51	-1.41
Board Size	12.24	11.05	1.11	0.28	-10.80	35.29	-10.80	35.29
Non-Executive Directors	2.52	7.45	0.34	0.74	-13.03	18.06	-13.03	18.06
Audit Committee Members	16.46	24.63	0.67	0.51	-34.91	67.83	-34.91	67.83

Figure 5:

Earnings per Share (EPS): It is calculated by dividing the profit after tax by number of outstanding shares. Here relationship of corporate governance and EPS is measured and studied.

b) Correlation Matrix

Figure 6:

No

PAT Audit Committee Members 0 6 4
2019 PAT EPS 83.33 0.06 -304,9
2020 ROA
0
0
EPS -33.23
ROA Table No. 4.3: Fi
JSW Steel Ltd
CEO Duality 0 Table No. 4.6:
Board Committee Board Size Years CEO Duality Non-E

2017 0
United Phosphorus Ltd CEO Duality Board Committee Board Size Non-Executive Directors Audit Commit

Board Size Board Committee 2020 0 6 7

Tata Steel Ltd Non-Executive Directors Audit Committee Members Bo

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[Note: C 35]

Figure 8: Table No .

No

Figure 9: Table No .

No

Figure 10: Table No .

There is negative correlation between EPS and Board Committee and positive correlation between EPS and Board Size, Audit Committee, Non-Executive Director and CEO duality. The P value is less than the significant value (0.05) for CEO duality, Board Committee, Board Size, the null hypothesis is rejected and the alternate hypothesis is accepted.

.1 VI.

.2 Findings

From the above study and statistical analysis few things can deduced from here that, these statistical tools have shown significant link between corporate governance and profitability.

Few factors of corporate governance were not significant linked with profitability. But we can see that EPS, ROA have negative correlation with board committee and audit committee. So few factors of corporate governance has positive correlation with profitability of the firm but not all of them. ? In case of regression analysis, it was seen that there is negative correlation between ROA and Board committee, Audit Committee, but there is negative correlation between ROA and Board size, Non-Executive Director and CEO duality. Here it can be seen that the P value is less than the significant value (0.05) for CEO duality, Board Committee,

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