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CORPORATE GOVERNANCE DISCLOSURE PRACTICES AND FIRM'S FINANCIAL PERFORMANCE

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Abstract

The present study investigates the relationship between corporate governance and the overall financial performance in the emerging Indian context. The relevance of corporate governance increased in the liberalized economic environment due to the integration of countries into the world market. Fast Moving Consumer Goods (FMCG) sector is India's fourth largest industry, contributing almost 20 percent to Gross Domestic Product (GDP). The study is to evaluate the influence of corporate governance in the overall financial performance of the selected organizations in the FMCG sector. Corporate Governance Disclosure Index (CGDI), used for identifying the corporate governance compliance status and panel data technique is used to investigate the extent of influence by corporate governance on the financial performance.

Keywords: *Corporate governance, FMCG sector, CGDI, Financial performance.*

1 Introduction:

In the liberalized economic environment, the relevance of CG has risen as a result of the entries of countries into the world market. Weak governance and negligence of duties by management results in the occurrence of numerous scandals like the one after the other collapses of Robert Maxwell, Enron, Satyam, etc, which drags the attention of investors towards corporate governance. Corporate governance is the structure which encompasses beliefs, standards, ideals, morals, laws, legislations, etc. that regulates and guides an organization. It is the interaction among various stakeholders of the organization.

In the growing market climate, it emerged as a vital tool of ensuring competitiveness and sustainability. It is a crucial element underpinning the reputation and efficiency. It deals with the balancing of economic as well as societal goals. Transparency, accountability and ethical conducts are the major factors ensuring corporate governance (Kibirango, 1999). Today's diverse financial world relies on corporate governance standards and values not only to strengthen their financial efficiency but also as a way to achieve a stronger public profile (Rogers, 2006). CG as the mechanism for decision making, is an efficient managerial arrangement within the organizational ethics to boost the firm's efficiency for the sake of all the stakeholders (Adedokun, 2003). Strong governance framework is essential for young and inexperienced financial institutions, as it influences the efficiency of institutions (Otieno, 2012). Improving CG is generally accepted to be the major factors in enhancing the stability of countries and corporation's long term economic success (Ibrahim, Rehman, & Raoof, 2010). To reduce systematic risk in an economy, CG has an important role. (Kaur, & Viji, 2014).

CG not only means fair, efficient and transparent management to achieve organizational goals but also it refers to the system, structure, or mechanism to satisfy stakeholders by complying all legal and regulatory requirements.(Bairathi, 2009). A firm with good CG ensures efficient utilization of resources, fair return to shareholders, effective management, efficiency and enhanced corporate performance (Tai, 2015). Effective CG boost the organizational capital structure by attracting foreign investors (Makokha, 2014). CG characteristics are the strong forecasters of financial performance (Guzeh, 2012).

A large number of empirical studies are conducted to find out whether the CG practices have any

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influence on the financial performance. Brown & Caylor (2004), Lee & Yeh (2004), Gruszczynski (2006), Ranti (2011), Aggarwal (2013), Wanyama & Olweny (2013) and Lekaram (2014) were some of the significant studies argued that CG activities had a beneficial effect on financial effects. Akodo & Moya (2009, Adekunle & Aghedo (2014) and (El-Chaarani, 2014) were the studies argued certain CG attributes have significant association while other attributes have negative insignificant association with financial performance. While, Reddy et al., (2010), Sayilir (2012), Paul et al., (2015) and Shahwan (2015) investigated CG practices have insignificant negative association with financial performance.

In 1996, CG emerged in India as a result of the recommendations of various committees and in 2001, SEBI adopted Clause-49 to enforce the suggestions of Kumar Mangalam Birla Committee.

FMCG Sector has a vital part to play in the Indian economy as it holds the fourth position and which has generated massive job opportunities to the economy (IBEF Report). The present study seeks to shed light on the role of CG activities on the financial output of the FMCG sector in the emerging Indian context.

2 Review of Literature

Various empirical research studies were conducted by adopting diverse research methodologies to evaluate the role of CG on financial performance in different country contexts. Intense debate took place among the academicians, researchers and practitioners regarding whether the CG practices influence the financial efficiency.

Brown & Caylor, (2004) stated that the most significant motivating force among the key variables of the Corporate Governance Quotient (CGQ) was board composition. Poor CG companies are prone to recession and as CG deteriorate, the risk of dropping into financial difficulties continues to rise (Lee & Yeh, 2004). Gruszczynski (2006) empirically evidenced that CG of the polish companies do not have significant association with their financial performance. Ranti, 2011 implies that CG practices are positively correlated with the Nigerian bank’s performance. According to Aggarwal, (2013) CG rating has a beneficial effect in an emerging Indian context through regression and correlation. The effect of CG characteristics of the Kenyan insurance firms is significant (Wanyama & Olweny, 2013). CG variables such as board size and non-executive members proportion positively associated with firm performance (Lekaram, 2014).

Board size negatively affect while policy and decision making have positive association (Akodo & Moya, 2009). According to Adekunle & Aghedo, (2014) CG variables such as board size and board member have a positive linkage while CEO status and ownership concentration do not have significant linkage by OLS regression method. Operate a profitable commercial bank without the CG mechanism is impossible (El-Chaarani, 2014).

CG attributes have insignificant linkage (Reddy et al., 2010). Sayilir, 2012 proved better CG practices of the Turkish companies listed on Istanbul Stock Exchange do not correlated with enhanced financial results and higher valuation of the firm. Pearson correlation coefficient shows CG variables positively correlated with firm performance while OLS regression model shows CG variables have insignificant association (Paul et al., (2015). Shahwan, 2015 investigated CG practices have insignificant negative association.

From reviewing the existing literature, evidential research on the effect of CG activities on financial output have been conducted but contradicting results were produced by this available literature. So the question remains unsolved and results in debate among the researchers. Empirical evidence regarding the above problem was not supplied by any of these works. The present study has been conducted to fill this research gap and thereby this study is more relevant.

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3 Objectives

- To develop a Corporate Governance Disclosure Index (CGDI).
- To find out the CG compliance status of chosen companies in the FMCG sector.
- To explore the significant association between CG compliance status and financial performance of the selected organizations in the FMCG sector.

4 Lımitations

Only 6 companies from the FMCG sector were studied and this inflicts constraints on the findings and conclusions. Period of study is limited to 8 years due to the lack of data. For the present study, only one value-based performance measure is studied. All these inflict constraints on the results and conclusions of the study.

5 Hypothesis

H0 : There is no significant association between CGDI and EPS

H1 : There is significant association between CGDI and EPS

6 Scope of the Study

Contradictory results on the effect of CG activities were provided by previous studies. Effect of CG practices towards financial results was not supplied by any prior studies in the emerging Indian context. The current research carried out to meet the above research gap.

7 Research Methodology

The sample size comprises of 6 companies in the FMCG sector during the eight-year study period of 2012-2019. FMCG sector was firstly classified into two strata namely large cap and mid cap on the basis of stratified sampling. From each stratum, 3 companies were selected using purposive sampling method. Capital and net profits were the criteria used for purposive sampling.

The list of selected companies from FMCG sector is as follows:

LARGE CAP FMCG COMPANIES

- Hindustan Unilever Limited (HUL)
- Dabur India Limited (DIL)
- ITC ltd

MID CAP FMCG COMPANIES

- Britannia ltd
- Marico ltd
- Jyothi Laboratories ltd

The entire research focused on secondary data collected from reliable sources like corresponding companies websites. Annual reports, corporate governance reports, business responsibility reports and

ISSN: 2005-4238 IJAST

capitaline database were the major source of the data.

MEASUREMENT OF CORPORATE GOVERNANCE

Corporate governance compliance requirements are studied by developing a disclosure index after carefully studying the annual reports of the selected companies by taking certain corporate governance requirements as key parameters for corporate governance and assign value to such parameters on the basis of their relevance. The compliance of companies towards the norms of corporate governance can be studied through this index. For data evaluation, firstly the annual reports were analyzed and then the disclosure index has been prepared by considering that key parameters for CG. CGDI has been calculated for each company in every year by considering all the parameters.

TABLE NO:1

KEY CORPORATE GOVERNANCE PARAMETERS AND CORPORATE GOVERNANCE DISCLOSURE INDEX VALUE

	PARTICULARS		**CORPORATE GOVERNANCE PARAMETER**	**INDEX VALUE**
1	COMPANY'S PHILOSOPHY ON CODE OF CORPORATE GOVERNANCE		MANDATORY	1
2	BOARD OF DIRECTORS			
	a	COMPOSITION OF BOARD	MANDATORY	1
	b	TOTAL NUMBER OF DIRECTORS	MINIMUM 3 DIRECTORS (PUBLIC) MINIMUM 2 DIRECTORS (PRIVATE) ONE (ONE PERSON COMPANY) MAXIMUM 15	1
	c	NUMBER OF EXECUTIVE & NON EXECUTIVE DIRECTORS	INDEPENDENT DIRECTORS ---ONE THIRD OF THE BOARD – IF NON-EXECUTIVE DIRECTOR AS CHAIRMAN. ONE HALF – IF EXECUTIVE DIRECTOR AS CHAIRMAN	3
3	MEETINGS			
	a	NUMBER OF BORAD MEETINGS HELD	ATLEAST 4 MEETINGS A YEAR & TIME GAP 4 MONTHS BETWEEN 2 BOARD	1
	b	NUMBER OF INDEPENDENT		1

ISSN: 2005-4238 IJAST

		DIRECTORS MEETING		
4	AUDIT COMMITTEE			
	a	QUALIFIED AND INDEPENDENT AUDIT COMMITTEE	MANDATORY	1
	b	MEETING OF AUDIT COMMITTEE		1
	c	POWERS OF AUDIT COMMITTEE	MANDATORY	1
	d	ROLE	MANDATORY	1
	e	REVIEW OF INFORMATION BY AUDIT COMMITTEE	MANDATORY	1
5	CHAIRMAN & CEO DUALITY		NEVER REQUIRED	1
6	OTHER COMMITTEES			
	a	REMMUNERATION COMMITTEE	FORMATION OF COMMITTEES	1
	b	SHAREHOLDERS/ INVESTORS GRIEVANCE COMMITTEE	FORMATION OF COMMITTEES	1
	c	RISK MANAGEMENT COMMITTEE	FORMATION OF COMMITTEES	1
	d	SPECIAL COMMITTEE FOR MONITORING FRAUDS	FORMATION OF COMMITTEES	1
	e	NOMINATION COMMITTEE	FORMATION OF COMMITTEES	1
7	DISCLOSURE			
	a	RELATED PARTY TRANSACTIONS	DISCLOSURE OF INFORMATION	1
	b	WHISTLE BLOWER POLICY	DISCLOSURE OF INFORMATION	1

ISSN: 2005-4238 IJAST

	c	SUBSIDIARY COMPANIES	DISCLOSURE OF INFORMATION	1
	d	CONTIGENT LIABILITIES	DISCLOSURE OF INFORMATION	1
	e	CEO/CFO CERTIFICATION	DISCLOSURE OF INFORMATION	1
	f	COMPLIANCE INFORMATION	DISCLOSURE OF INFORMATION	1
	g	AUDITOR'S CERTIFICATE ON CORPORATE GOVERNANCE	DISCLOSURE OF INFORMATION	1
	h	DIRECTOR'S RESPONSIBILITY STATEMENT	DISCLOSURE OF INFORMATION	1
	i	RISK MANAGEMENT & INTERNAL CONTROLS	DISCLOSURE OF INFORMATION	1
8	MEANS OF COMMUNICATION			
	a	QUARTERLY RESULTS	COMMUNICATING THROUGH SUCH MEANS	1
	b	NEWSPAPER WHERE IN RESULTS PUBLISHED NORMALLY	COMMUNICATING THROUGH SUCH MEANS	1
	c	ANY WEBSITE	COMMUNICATING THROUGH SUCH MEANS	1
	d	DISPLAYS OFFICIAL NEWS	COMMUNICATING THROUGH SUCH MEANS	1
	E	PRESENTATION MADE TO INSTITUTIONAL INVESTORS OR TO ANALYSTS	COMMUNICATING THROUGH SUCH MEANS	1
9		CORPORATE SOCIAL RESPONSIBILITY		
	a	QUARTERLY	REQUIRED	1

ISSN: 2005-4238 IJAST

		REPORT		
	b	AVERAGE PROFIT PERCENTAGE SPEND	ATLEAST 2% OF AVERAGE PROFIT OF LAST THREE YEARS	1
TOTAL DISCLOSURE INDEX				35

Source: compiled from provisions of companies act,2013 and SEBI's clause 49

CG AND FINANCIAL PERFORMANCE

A firm with good CG ensures efficient utilization of resources, fair return to shareholders, effective management, efficiency and enhanced corporate performance (Tai, 2015). CG characteristics are the strong forecasters of financial performance (Guzeh, 2012). The above studies reveal that the CG positively associated with the financial success.

MODEL SPECIFICATION

Panel data regression model is used to find out the fluctuations in cross-sectional data over various time series. Pure cross-sectional data or pure time-series data alone cannot identify the variations over time. The study attempts to find out how the relationships between the identified variables change over time.

A panel regression model is developed to find out the correct impact of CG on EPS.

Model 1: $\log EPS_{it} = \alpha + \beta \log CGDI_{it} + \varepsilon_{it}$ (1)

In the above equations (1), EPS indicates Earning Per Share, subscript i denotes the company, subscript denotes the year (period of time), α and β are the parameters to be estimated, CGDI denotes Corporate Governance Disclosure Index and ε it indicates error term.

8 RESULTS AND DISCUSSIONS

Statistical evidence on the effect of CG practices disclosed with the financial performance of the six organizations belongs to FMCG sector over the eight years.

DESCRIPTIVE STATISTICS

Table 1: Descriptive statistics on EVA, Cost of capital, Stock return

Table 1: Descriptive statistics on EVA, Cost of capital, Stock return				
Variables	Mean	Median	SD	Skewness
CGDI	30.708	31.000	2.4141	-0.62525
EPS	16.052	9.0800	17.518	2.2451

Table 1 provides the statistical characteristics of the variables. To explain the volatility and normality, Standard deviation and skewness are to be computed. Generally, the normal distribution of the observed data shows zero skewness. The mean and median values of EVA are higher than EPS. However, the skewness coefficient shows that the variables of the firms under study are not normally distributed. CGDI values are negatively skewed while EPS values are highly positively skewed. The EPS and CGDI values of the firms show extreme variations. Normalization of the data is essential to convert all of these values into a specific range. The min-max normalization method is applied to normalize the data.

ISSN: 2005-4238 IJAST

PANEL REGRESSION RESULTS

Model (1) is framed to find out the influence of CGDI on EPS. Current year EPS regressed against the current year value of CGDI in the regression analysis.

Table 2: Panel Regression Model 1 Results- CGDI on EPS:

Variables	**B**	**Standard error**	**t-statistic**	**p-value**
Constant	-0.842088	0.0595571	-14.14	2.32e-017
CGDI	0.824507	0.244463	3.373	0.0016
Sum Squared Residual				2.819461
S.E. of residuals				0.262235
R-Squared				0.782809
Adjusted R-squared				0.217188
F-statistic				3.87e-12
P-value (F)				4.74407e-012
Log-Likelihood				-0.077326
Akaike Criterion				-23.69198
Schwarz Criterion				27.25306
Hannan-Quinn				19.10456

The above model indicates the relationship of current year CGDI on the EPS and its interpretation can be made as follows:

The panel regression model indicates the relationship of current year CGDI on the EPS.
Coefficient: The intercept coefficient of -0.842088 denotes stock return will decrease by 0.842088% while assuming CGDI is constant. CGDI coefficient of 0.824507 depicts EPS increases by 0.824507% while the CGDI increases by 1%.
Coefficient of Determination: it depicts the variation of EPS explained by the current-year CGDI. R-square value of 78.2808% means CGDI can explain the variations in EPS by 78.2809% which depicts other variables (outside the research) that can explain the rest of 21.791%.

F test: The influence of current year CGDI on the EPS can be determined through the F test. F statistic of 3.87e-12 < 0.05 (significance level) depicts reject the H0, which implies CGDI have a large impact on the EPS.

The overall p-value (4.74407e-012) from the model is less than the 5% significance level which depicts that there is strong relationship among the current year EPS with the current year value of CGDI. In the

ISSN: 2005-4238 IJAST

case of current-year CGDI, the P-value obtained is smaller than 5% significance level shows that there is strong evidence against the null hypothesis.

The results obtained from both the panel regression model support the theory the current year CGDI strongly associated with financial success. The value of R2 of the regression model is very high, which depicts the financial performance variations could be explained by the current year CGDI.

CONCLUSION

Contradictory results are obtained from the previous researches regarding the influence of CGDI on EPS. Some of the previous studies validated the theory that the EPS are positively influenced by CGDI. While some other previous studies questioned the validation of this theory. Most of the previous year studies suggested that the CG practices have insignificant association with financial performance. Panel regression model evidenced that the CG practices have a major impact on financial performance. The present study provides useful information to all stakeholders as well as to the corporate. The yard stick for CGDI in the present study is the provisions of CA 2013 and the SEBI's Clause 49 deals with mandatory requirements. The MCA, SEBI, ICAI, Stock Exchanges etc creates a potential for regulatory ambiguity and weakens the scope for scam and other malpractices. The present study influence more firms to disclose the CG practices by strengthening the CG mechanism in the organization.
Future Scope: Examine the influence of CG practices by including other methods for the measurement of CG practices, other performance metrics, expand the sample size by including more companies, more sectors, increase the sample period and conduct the study in other emerging economies. All of these are feasible and worthwhile for future research.

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