CORPORATE GOVERNANCE AND FIRM VALUE: AN EMPIRICAL ANALYSIS OF INDIAN ENERGY SECTOR

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ABSTRACT

This study intends to investigate the relationship of corporate governance with firm performance for a sample of 13 BSE listed energy sector firms. The main sources of data collection have been annual reports and prowess database maintained by CMIE. A composite measure of corporate governance is constructed involving three indicators: board composition, board monitoring and ownership structure. Panel data methodology is adopted to examine the relationship of corporate governance with firm performance. Firm value is measured through Tobin's Q. Findings proposed negative relation of composite corporate governance with firm performance and among sub-parameters board composition and ownership structure have significant negative impact on firm value. Findings imply weak adherence with corporate governance norms and companies need to enhance their corporate governance mechanism. This study contributes to the extant literature by constructing composite measure of corporate governance.

Keywords: Corporate Governance, Firm Performance, Energy Sector, Board Composition, Board Monitoring, Ownership Structure

INTRODUCTION

Corporate governance is a set of framework for managing the activities of an enterprise and its stakeholders (Cadbury Report, 1992). Key reasons for adoption of corporate governance norms is to guard the interests of various stakeholders of firm. Good governance can impede frauds, scams and any other unethical practices by the management of firms, if implemented properly. A company becomes more liable for its activities with governance norms in place and aid individuals in control to stay more mindful of the public image of enterprise. Investors put high level of trust in a company that gives access to complete information and provide full disclosure. The main aim of a good corporate governance policy is to protect the interest of all stakeholders such as owners, management, investors and government.

In India, an extensive dialogue on corporate governance began after the infamous Harshad Mehta stock market scam and Satyam scandal. SEBI and the Ministry of Corporate Affairs are two regulating and monitoring government bodies to oversee the governance of listed companies in India. Remembering the unfortunate events of various scams or scandals and changing global business environment several committees set up to upgrade the overall corporate governance scenario (Srivastava, Das, and Pattanayak 2019). In 1999, the CII provide a discretional code for improving corporate governance practices, at the same time Kumar Manglam Birla Committee was established and SEBI incorporated the recommendations of the committee in Clause 49 of the listings agreement. In 2003, on the basis of directions suggested by the Naresh Chandra Committee, SEBI amended clause 49 of the listing agreement. The newly introduced companies act, 2013 is a milestone in improving the corporate governance‗s practices in India, various austere provisions pertaining to related party transactions, disclosures, auditing, and reporting were introduced. SEBI amended the clauses of listing agreements to match the bar set by the Companies Act, 2013.

More recently in 2017, the Kotak committee on corporate governance was constituted and its recommendations regarding secretarial audit and related party transactions have been accepted by SEBI.

A large of research have been undertaken to examine the association of corporate governance with firm performance(Berthelot, Morris, and Morrill 2010; Bishnoi and Sh 2016; Dwivedi and Jain 2005; Iren and Bathala 2009; Kohli and Saha 2008; Krafft et al. 2014). Abundant literature in this area is available in developed countries as compared to emerging economies(Bhatt and Bhatt 2017; Kohli and Saha 2008; Mishra and Mohanty 2014; Roy 2014). This paper examine the association of governance practices with firm value and provides empirical evidence in support the findings. This paper attempts to develop a corporate governance measure and appraise its relationship with firm performance. Numerous research has developed various corporate governance indices to examine the relationship of corporate governance with firm performance (Bebchuk et al. 2009; Ishii et al. 2003; Mishra et al. 2016; Varshney et al. 2012). This paper attach significant importance to literature as a very meagre number of research attempting to develop corporate governance indices has been conducted in emerging economies such as India. As per the author‗s best knowledge and belief, there are no studies attempting to develop corporate governance indices for Indian energy sector firms. In this paper, an attempt has been made to develop corporate governance measure using the panel data of energy sector firms for the years 2011 to 2020. Major circumstances which led us to examine corporate governance issues in energy sector of India are discussed below.

A great number of research have been conducted to examine the relationship of corporate governance with firm performance, however, no major study was found that examine the corporate governance scenario of India‗s energy sector. As per India energy outlook 2021 ―India is the third-largest energy-consuming country in the world and there is great potential for technological advancement in the energy sector". An attempt has been made in this paper to develop corporate governance indices for energy sector firms and analyse its relationship with firm value through Tobin‗ s q. The energy sector is growth-oriented having a large number of companies in control of central or state governments. It is perceived that adherence to the governance norms by government-controlled companies is not so robust. Therefore, it becomes relevant to examine the corporate governance practices of India‗s energy sector.

In the second part of paper, we review the literature and provide support for hypothesis development. The third part outlines the research methodology and mechanism for developing corporate governance indices. Forth section discusses the results and findings of empirical analysis.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

This part presents the review of studies examining the association of corporate governance with firm performance. This paper try to include most of the studies that has attempted to construct corporate governance indices.

Larcker et al. (2005) constructed corporate governance indices by considering 38 governance measures for US listed firms. Gompers et al. (2003)

used 24 governance measures for constructing corporate governance indices covering 1500 firms. In an another study Sawicki (2009) developed corporate governance indices by using nine corporate governance parameters based on five Asian countries. In India, Mishra and Mohanty (2014) developed a composite corporate governance indices encompassing three indicators: legal, board and proactive, by considering 13 governance measures for 141 companies from ―A group" stock listed in Mumbai Stock Exchange. Srivastava et al. (2019) developed a CG index for companies listed in Mumbai Stock Exchange and found corporate governance impacts negatively performance of firms measured by cost of equity.

This study follow the methodology of Mishra and Mohanty (2014) and constructed a corporate governance indices encompassing three indicators: board efficiency, board monitoring and ownership structure.

Chen et al. (2009) found a negative significant relationship between corporate governance and firm performance measured through cost of equity. A significant positive association is found between corporate governance and firm performance with regard to board attributes however, established a weak association with legal parameters in a study conducted by (Mishra and Mohanty 2014) in India. Past literature provides mixed results with regard to correlation of corporate governance with firm performance. In emerging economies like India, a proper mechanism of corporate governance exist but adherence to governance norms is not as strong as in developed economies. This study takes into account all the latest and current changes in laws regarding corporate governance in India. Arora and Sharma (2016) analysed 20 industries and revealed that weak relationship exist between various board attributes and firm performance. In an another study conducted in Indian economy by (Srivastava et al. 2019) established a weak association of corporate governance index with firm performance.

H_1: Corporate governance has a negative impact on the firm value.

Board of Directors and Firm Performance

Gulzar and Haque (2020) analyzed Indian textile sector firms for the year 2014-2018 and found large boards significantly increase value of firm, while board independence have negative significance on firm performance means independent directors do not add to the profitability of firms whereas ceo duality do not have significant association with firm performance. Grace et al. (2012) established negative association of board independence with firm performance. Ahmadi et al. (2018) found board size and board independence has positive impact on return on equity, whereas ceo duality have negative impact on firm performance and inclusion of woman director seems to have positive impact for firm performance. Mishra et al. (2010) supports the argument of board size having negative impact on firm performance measured by Tobin‘s q and return on assets whereas a significant and positive relation is found with non-executive directors in the board. Kumar and Singh (2013) found negative association of board attributes with Tobin‘s Q. Chauhan and Pasricha (2010) proportion of independent directors had positive impact but found not to be significant whereas board size has positive impact on firm performance.

In an another study conducted by (Varghese and Sasidharan 2020) taking into account companies listed in India and China it was found ceo duality is has positive association with firm value in China while negative in India. In another study conducted in India for the period 2009 to 2014 corporate governance index has negative impact on performance of firms measured through ROA whereas significant and positive association on return on net worth. In this paper, we considered eight variables for board structure. ―1" is assigned if a particular attribute exist and ―0" otherwise. For example, if chairman and ceo are different people, we assign ―1" or ―0" if chairman and ceo are same person.

H_2: Board attributes has a negative impact on the firm value.

Board Monitoring and Firm Performance

The companies act, 2013 stipulates four meetings in a year is required to be conducted and gap between two successive meetings should not exceed 120 days. Regular meetings of board make sure operating activities of company is being monitored. Gulzar and Haque (2020) found that large number of meetings have no significance for the profitability of firm and association with firm performance is not significant. Chauhan et al. (2010) find that increased rate of attendance of independent directors in board meetings impacts positively the performance of firms but not significant. In another study conducted by (Lin, Liao, and Chang 2011) it was found board meetings can impact positively if directors attend board meetings themselves rather than sending their proxies, whereas highly educated directors are more likely to attend the meetings.

In this study, we consider three parameters of board monitoring. We assign “1” if a particular attribute is present and “0” if not. For example, a score of “1” is assigned if board conducts more than four meetings in a year and “0” otherwise.

H_3: Board meetings have no significant association with firm performance.

Ownership Structure and Firm Performance

Haldar et al. (2009) analysed BSE listed firms for the year 2001 -2008 and measured impact of corporate governance on firm performance through ROA and Tobin‘s Q and it was found promoter shareholdings has significant positive impact on firm performance whereas non promoter shareholdings has negative impact on firm performance measured through Tobin‘ s Q. Rebecca and Maggie (2017) analyzed Chinese listed firms and their results found foreign and institutional shareholders impacts firm performance in a significant positive manner, than small shareholders and it reduces the insider ownership in firm. Wang et al. (2019) found foreign institutional ownership promotes diversification in firm which leads to positive impact for firm performance. Public share holdings has a significant negative association on Tobin‘ Q in an another study (Chauhan and Pasricha 2010).

(Sheikh and Khan 2013; Cho and Kim 2007; Mak and Kusnadi 2005; Short and Keasey 1999) found that ownership structure has positive impact on performance of firms whereas (Abor et al. 2007; Belkhir 2009; Lefort and Urzúa 2008; Welch 2001) found the negative correlation of ownership structure with firm performance.

In this study, we consider three parameters of ownership structure. We assign “1” if a particular attribute is present whereas “0” if not present. For example, we assign “1” if promoter ownership is there and “0” if it is not.

H_4: Ownership structure has a negative impact on the firm value.

DATA SOURCE AND METHODOLOGY

The sample of this study is “A group” stock listed companies of Indian energy sector for the period 2010 to 2020. There were 17 “A group” stock companies listed on BSE in energy sector however four companies were removed as data was not available for those firms. So our final sample size is 13 companies. In this study empirical analysis is done on the basis of secondary data. Required secondary data is extracted from the annual reports and prowess database supported by CMIE. It provides financial data, governance data and other relevant information for Indian listed companies.

Performance of firms has been measured by Tobin‘s Q, this measure has been used in numerous studies (Mishra Rakesh 2010; Gu et al. 2019; Varghese and Sasidharan 2020; Rebecca and Maggie 2017). Tobin‘s Q measures the market based performance of firms and prowess database gives the value of Tobin‘s Q by running the formula of it in their system. For this study the value of Tobin‘s Q is obtained from prowess by putting this formula ((bse_market_cap+debt)/ total_assets).

For construction of composite corporate governance score we follow the methodology adopted by Mishra et al. (2014). This study uses 14 governance parameters combined in three indicators: board composition, board monitoring and ownership structure. All the parameters elucidated in the form of “yes” or “no”. A score of “1” is assigned if answer is yes or “0” if answer is no.

CG Indicator

In this section we explains the various parameters used to construct the corporate governance indices having three indicators: board composition, board monitoring and ownership structure.

1. Board Composition: This indicator comprises eight parameters which are aggregated to get the score of board composition indicator.

- Chairman is Promoter: If chairman is promoter a score of 1 is given else 0.
- At least 8 directors in the board: If a company has eight or more directors it gets a score of 1 and 0 is assigned if it has less than eight number of directors.

- CEO and chairman are different people: If a company different individuals as chairman and CEO it gets a score of 1 and if it has same person as chairman and CEO it gets a score of 0.
- More than one third independent directors: If a company has more than one third independent directors it gets a score of 1 and if it has less than one third independent directors it gets a score of 0.
- Chairman of board committee: If independent director serves as the chairman of any of the board committees a score of 1 is given otherwise 0 is assigned.
- Busyness of independent directors: If independent directors does not serve as member of more than seven listed firms a score of 1 is assigned and 0 is assigned if independent directors become members of more than seven listed firms.
- Female director in the board: If there is female director in the board a score of 1 is given otherwise 0 is assigned.
- Female director in board committee: If female director is included in board committees a score of 1 is assigned otherwise 0.

2. Board Monitoring: This indicator contains three parameters score of which is aggregated to get the score of board monitoring indicator.

- More than four meetings conducted in a year: If a company arrange more than four meetings in a year it gets a score of 1 and 0 is assigned if it arranges less than four meetings in year.
- Quorum of meeting: If more than one third directors are present in board meetings a score of 1 is assigned and 0 if attendance is less than one third of directors.
- Gap between board meetings: If gap between two successive meetings is less than 120 days a score of 1 is given and 0 if gap is more than 120 days.

3. Ownership Structure: This indicator comprises three parameters the score of which is aggregated to get the score the ownership structure indicator.

- Promoter ownership: A score of 1 is given if promoter ownership exist else 0 is assigned.
- Non- promoter institutional ownership: A score of 1 is assigned if non- promoter institutional ownership exit in a firm, otherwise 0 is assigned.
- Non- promoter foreign ownership: Value of 1 is assigned if non – promoter foreign ownership exist else 0 is given.

4. Financial Performance Measure: Tobin‘s Q is used as a measure of financial performance. It is a market based performance measure and has been used extensively in the previous literature.

5. Control Variable: Financial leverage has been used as control variable in this study. Financial performance of a firm is affected by the leverage ratio. Leverage has been used in various important studies as control variables (Mishra et al. 2010; Srivastava et al. 2019).

EMPIRICAL ANALYSIS

This study is based on the panel data, so panel data methodology is used to analyse the relationship of corporate governance with firm performance. Mainly two types of model are used to analyse the panel data fixed effect model and random effects model, whereas Hausman test(1978) is used to find the suitability of model(Gujarti, 2003). For this study Hausman test suggested fixed effect model is appropriate. We have shown the results of OLS, fixed effect and random effect model in Table 3.

Tobin‘s Q: $\alpha_i + \beta 1CGI_{it} + \beta 2LEV_{it} + \varepsilon_{it}$

Tobin‘s Q: $\alpha_i + \beta 1BC_{it} + \beta 2BM_{it} + \beta 3OC_{it} + + \beta 7LEV_{it} + \varepsilon_{it}$

In the first equation, Tobin‘s Q is regressed against the corporate governance indices score, LEV is the control variable whereas ε is the error term. In the second equation Tobin‘s Q is regressed against the three governance indicator score, BC represents board composition, BM represents board monitoring and OC represents organisation structure.

Descriptive Statistics

Descriptive statistics for all the variables is given in Table 1. The mean value of composite CG score is 9.69 with a standard deviation of 2.37. In the same manner, respective value of mean and standard deviation for board composition, board monitoring and ownership structure is 4.78 and 1.78, 2.35 and .67, 2.56 and .75. Tobin‘s Q goes maximum to 15.64 with a mean value of 1.86 having 2.64 as standard deviation.

Table 1: Descriptive Statistics

Variables	Observations	Mean	Std. Deviation	Minimum	Maximum
Composite CG	130	9.69	2.37	4	14
Board Composition	130	4.78	1.78	1	8
Board Monitoring	130	2.35	.67	0	3
Ownership Structure	130	2.56	.75	1	3
Tobin‘s Q	130	1.86	2.64	18	15.64
Leverage	130	1.76	1.48	1.48	7.37

Table 2: Correlation Matrix

Variables	Composite CG	BC	BM	OC	Tobin's Q	Leverage
Composite CG	1.00					
BC	0.699	1.00				
BM	0.3422	-0.0020	1.00			
OC	0.7238	0.4698	0.1980	1.00		
Tobin‘s Q	–0.6404	-0.4382	-0.2428	-0.7707	1.00	
Leverage	0.4394	0.3611	0.2533	0.3072	-0.2159	

Panel Regression Results

Pearson correlation among the explanatory variable, dependent variable and control variable is given in Table 2. Composite CG is negatively related to dependent variable that is Tobin‘s Q. Table 3 represents the results of all three models of panel regression. Hausman test suggested fixed effect model is suitable for our data, but for the robustness of results we ran three parallel regressions for all three models of panel regression. The results of fixed model is negative. The results indicate corporate governance indices is negative and significantly related to firm value. This result is also confirmed by random effect model are in support of H1 hypothesis.

Table 3: Results of Regression Analysis

Variables	OLS	Fixed Effect	Random Effect
Composite CG	.161(.0004)	-0.249(.000)	-0.291(.0000)
Board Composition	0.284(0.0535)	-0.155(0.0181)	-0.164(0.0113)
Board Monitoring	1.61 (.0000)	-0.025(0.8910)	-0.142(0.4209)
Ownership Structure	-1.333(0.0001)	-0.895(0.0000)	-1.154(0.0000)
Tobin‘s Q	-0.152	0.118(0.2843)	0.097(0.3481)
Leverage	0.015	0.882	0.287994

On the other hand, board composition also does not increase the firm value represented by Tobin‘s Q. So we failed to reject the H2 hypothesis. Overall our results are in support of (Srivastava et al. 2019) study who found negative relationship of overall corporate governance index with firm performance and also sub- indices of board composition and ownership structure have significant negative correlation with firm performance. Our study supports the findings of that study as overall composite corporate governance indices have negative impact on firm value, whereas board composition and ownership structure also has significant negative association with Tobin‘s Q. This result confirmed by random effect panel regression, results of which is presented in

Table 3. However our results are in contrast to the findings of (Mishra and Mohanty, 2014) who found there is a positive relationship of corporate governance with firm performance measured through ROA.

DISCUSSION AND CONCLUSION

In this study, efforts been made to construct corporate governance indices for India‘s energy sector firms. As in extant literature, we did not find any significant study covering the energy sector as an individual sector. India‘s energy sector is understudied in terms of the relationship of corporate governance with firm value. Therefore, this study using panel data for the year 2010-2020 analysed the energy sector exclusively.

The sample that we use for the study is 13 A group energy sector firms listed in Bombay Stock Exchange. Various studies in the past have examined the relationship of corporate governance with firm performance (Berthelot et al. 2010; Farhan, Obaid, and Azlan 2017; Malik and Makhdoom 2016; Palaniappan 2017; Panchasara and Bharadia 2013; Zhao 2003). Prior literature provides mixed results pertaining to corporate governance relationship with firm performance. Moreover, excess number of studies were carried out in advanced countries as compared to emerging nations like India (Gulzar et al. 2020).

Findings of this study proposes a negative relationship of corporate governance with firm value. Governance indices have a significant negative association with Tobin‘s Q. Findings of the study suggests weak adherence of corporate governance norms in energy sector firms, though a robust mechanism for corporate governance is present in the country. In developing nations like India, a strong corporate governance mechanism exist but is not implemented effectively. Board composition and ownership structure also have a significant negative association with the firm value measured through Tobin‘s Q. Findings of this study are in concord with other studies undertaken in India. Arora et al. (2018) constructed corporate governance index by taking the parameters of board and ownership structure indicators and concluded overall corporate governance index has negative relationship with firm performance measured through return on assets. In one more study (Srivastava et al. 2019) constructed a comprehensive corporate governance index for listed firms in India, wherein it considered almost all the parameters of corporate governance suggested by Companies act, 2013 and various listing agreements issued by SEBI from time to time and findings suggest CGI has negative relation with return on equity, moreover ownership structure and board composition found significantly negative with firm performance while board meetings do not have strong relationship with return on equity. So findings suggest if firm emphasis more on improving board composition they will be able to improve firm value.

This study adds value to the prior literature in this area in India. In this paper, we developed a composite corporate governance score to analyse the relationship of corporate governance of Indian energy sector with firm performance. Before this, (Mishra and Mohanty, 2014) developed one such composite governance score for Indian listed companies. But after this many changes have occurred pertaining to corporate governance parameters as suggested by amended clause 49 and new companies act, 2013. This study incorporates all the current and latest changes in governance norms. Further this study, exclusively analyse an individual sector, as per the author best knowledge no this is the first of its kind study developing corporate governance indices for sector specific firms.

IMPLICATIONS AND LIMITATIONS

This study has vast implications for policymakers. This study developed corporate governance indices for energy sector firms by considering board composition, board monitoring, and ownership structure parameters. Regulators in India keep upgrading the governance norms to match the global standards but findings of the study suggest current regulations are not enough to have a significant impact on firm performance. The findings of the study can be used to improve the corporate governance practices specifically for India‘s energy sector firms. Over the last decade, corporate governance has emerged as the main deciding factor for investment decisions. Corporate governance ratings play an important role while making investment decisions by overseas investors. So the government has to keep the governance norms in line with the international standards to attract foreign investment in the economy and an individual entity has to follow good governance norms to raise capital at lower cost and to create a public image in the eyes of various stakeholders. Governance parameters used in this study are a major part of the overall corporate governance framework.

This study suffers from several limitations. This study considers only ―A group" stock listed companies of the energy sector. We have excluded a great number of smaller companies. Second, this study is entirely based on secondary data and can be further extended to primary data for a large sample of firms. Third, only one market-based performance measure has been used that is Tobin‘s Q, and while developing corporate governance indices this study considers the parameters of three indicators only board composition, board monitoring, and ownership structure however there are many more indicators that form a major part of the overall corporate governance framework.

FUTURE RESEARCH DIRECTIONS

This study can be extended to other important sectors of the economy. Further future researchers can measure the performance of firms from various performance measures not just Tobin‘s Q. There are many other performance measures reported in previous literature. Second, an author can develop corporate governance indices for a large sample of firms using the methodology of this paper. In addition to this, future research can be undertaken considering other parameters of corporate governance which are not used in this study.

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