Corporate Governance and Operational Performance: Case Study of Highly Governed Companies Listed in India

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ABSTRACT:

Governance refers to adhering with to the specific rules and norms of society. Many Companies have made proactive initiatives to introduce good governance norms and standards, even before these became mandatory. The Indian Government has constituted a strong financial atmosphere through SEBl to publicize and emphasize latest regulations in Corporate Governance.

Operational efficiency of five highly Governed Listed companies is undertaken for the purpose of this study. This paper is an attempt to observe the impact of Corporate Governance practices on Operational efficiency of the listed companies.

Keywords: *Corporate Governance, Operational efficiency, highly governed companies, Return on capital employed.*

INTRODUCTION

'Governance' is much more than just adherence to specific rules and norms of society, a country and the entire world at large. Governance skill in each area includes far beyond the ability to handle a small number of key issues. Corporate Governance is concerned with both - Internal aspects of the company which includes attitude and the values cherished by the management of the company; and its External aspects which include the legislation relating to functioning of business enterprises, covering the entire spectrum from registration of companies, their structure, and settlement of disputes, laws relating to the capital market and punishment for bad practices.

There are a number of companies which have made proactive initiatives to introduce good governance norms and standards, even before these became mandatory. Highly Governed Companies include those companies which have proactively followed governance norms and set an example for other companies to follow them. The Indian Government constituted a strong financial atmosphere and securities market through Securities Exchange Board of India (SEBI), to emphasize on the latest regulations in Corporate Governance. In India, Corporate Governance operates as a form of checklist; and even if one manages to fulfill all the requirements, it does not mean that the goal is achieved.

The Indian Government constituted a strong financial atmosphere and securities market through a Regulator - The Securities Exchange Board of

India (commonly known as SEBI), to publicize and emphasize the latest regulations in Corporate Governance. Performance of the Company is affected by practicing good Corporate Governance policies. This agreement contains a combination of mandatory and non-mandatory rules. India has moved even further towards the 'Mandatory Approach'. The new Companies Act has used the 'Comply or Explain' Approach in exhorting companies to practice Corporate Philanthropy. This paper is an attempt to observe the impact of Corporate Governance practices on Operational performance of the listed companies.

REVIEW OF LITERATURE

According to Spanos (2005), Corporate Governance is considered to have significant implications on the growth prospects of an economy, because best practice reduces risks for investors, attracts investment capital and improves the performance of companies.

Pearce and Zahra (2006) reported a positive association between Board size and Performance.

According to Paul Lee (2003)Corporate Governance can lead to improved share price performance. Investors are keener to invest in well-governed companies.

Rashid (2008) designed a stakeholder model wherein he concluded that, "Essence of Corporate Governance is to make sure that the key shareholder objective-wealth maximization is implemented"

Maharm (2008) measured Firm performance (using accounting ratios) with Corporate Governance and suggested that, "Performance is usually evaluated by estimating the values of qualitative and quantitative performance indicators."

OBJECTIVES OF THE STUDY

- Analyze the Corporate Governance practices followed by the listed companies for the period 2010-2011 to 2014-2015.
- Observe impact of such practices on operational performance of the company.

Scope of Study

- The study is restricted to Corporate Governance practices considering a Case Study of five highly governed listed companies in India.
- Period of study covers five years from 2010-2011 till 2014-2015.

Data from published sources - Annual reports, Websites and Journals have been used for data collection.

Limitations

The study focuses only on Corporate Governance practices with the help of a Case Study of Listed Companies for past five years (2010-2011 to 2014-2015).

It also restricts its analysis to operational performance of the company during period of survey.

RESEARCH DESIGN

The study is descriptive and analytical in nature because the study is a comparative analysis of expected vis a vis actual returns and an attempt has been made to explore the relation between Corporate Governance Parameters and Returns on Capital Employed. Five highly governed listed companies were considered for analysis. Relationship between Corporate Governance Parameters and Return on Capital employed was measured. Data has been analyzed using Correlation and Regression.

RESULTS:

Five best-governed companies were selected in a manner that they represent separate sectors for the study. The main reason to select these companies is that their scripts dominate among sectors thereby influencing stock movement of the country. The study is based on Corporate Governance parameters under mandatory and non-mandatory regulations as prescribed under the Companies Act 2013 and Clause 49 of the Listing Agreement as applicable to the financial year 2014-2015. Corporate Governance parameters cover aspects related to the Company's Policy, Board Matters, Audit related matters, Investor Relations and Disclosure & Communication. Return on Capital Employed is a profitability ratio, which measures how efficiently a company can generate profits from its capital employed by comparing Net Operating Profit to Capital Employed. It is calculated by dividing Net Operating Profit or EBIT by the Capital Employed. In other words, Return on Capital Employed shows investors extent of profit each Rupee of Capital Employed generates. This ratio measures the Returns against the Book Value of Assets in the Business.lt has been observed under various studies that there is a positive correlation between Company performance and Return on Capital employed. To validate this, the same has been applied on Corporate Governance Parameters and Return on Capital employed in five sample Companies listed on NSE.

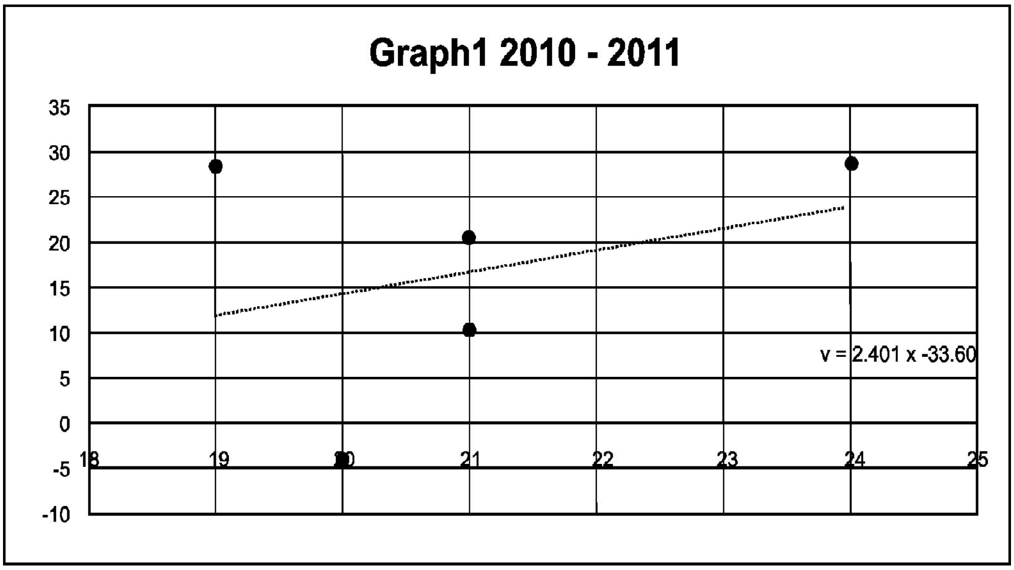
Company	Sector
INDIAN OIL	Refineries
ONGC	Oil Drilling / Allied Services
CMC LTD	Computers - Hardware
HCL	Computers - Software - Large
POWER GRID	Power Generation And Supply

Table 1: List of Sample Companies with respective sectors

S.No	Company	Corporate Governance Parameters (X axis)	ROCE(Y axis)
1	INDIAN OIL	21	10.32
2	ONGC	19	28.38
3	CMC LTD	24	28.77
4	HCL	21	20.74
5	POWER GRID	20	-4.07

Table 2: Corporate Governance Parameters and ROCE for 2010-2011

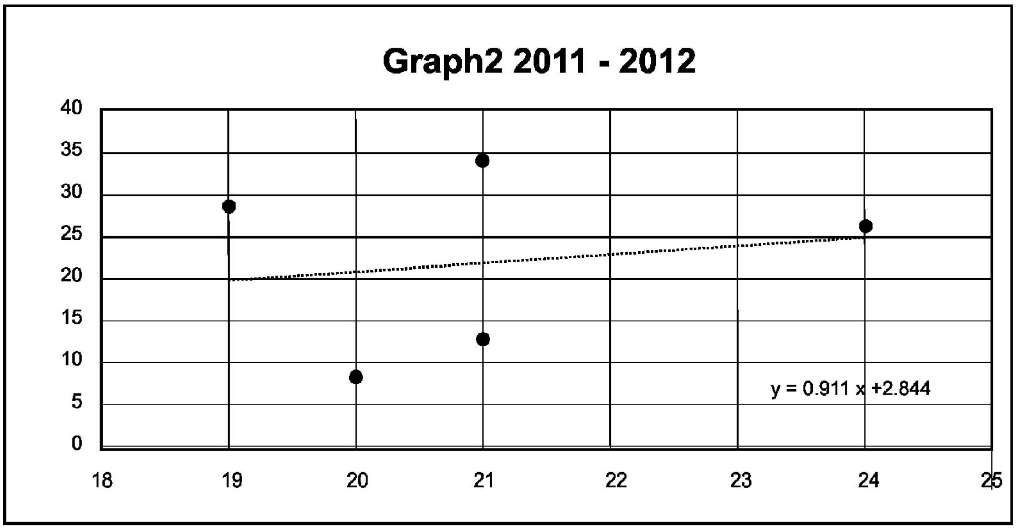
r_1=0.3237



S.No	Company	Corporate Governance Parameters (X axis)	ROCE(Y axis)
1	INDIAN OIL	21	13.08
2	ONGC	19	28.56
3	CMC LTD	24	26.13
4	HCL	21	33.64
5	POWER GRID	20	8.51

Table 3: Corporate Governance Parameters and ROCE for 2011-2012

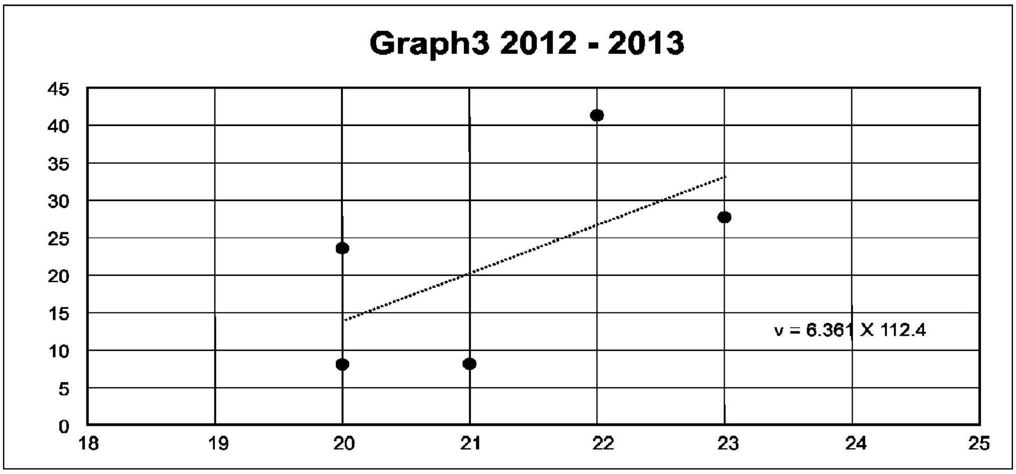
r_2=0.1595



S.No	Company	Corporate Governance Parameters (X axis)	ROCE(Y axis)
1	INDIAN OIL	21	8.64
2	ONGC	20	24.58
3	CMC LTD	23	28.56
4	HCL	22	41.71
5	POWER GRID	20	8.58

Table 4: Corporate Governance Parameters and ROCE for 2012-2013

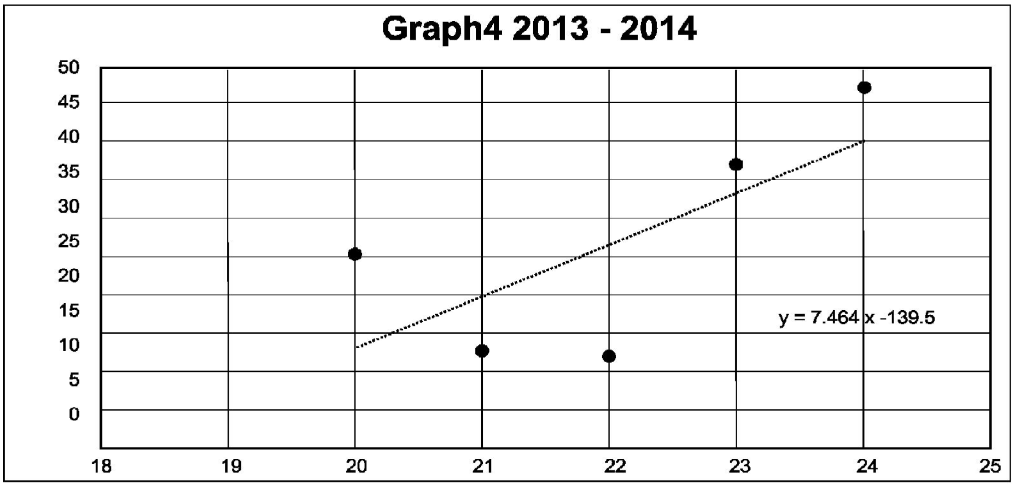
$r_3 = 0.5880$



S.No	Company	Corporate Governance Parameters (X axis)	ROCE(Y axis)
1	INDIAN OIL	21	9.11
2	ONGC	20	23.34
3	CMC LTD	23	35.83
4	HCL	24	47.3
5	POWER GRID	22	7.97

Table 5: Corporate Governance Parameters and ROCE for 2013-2014

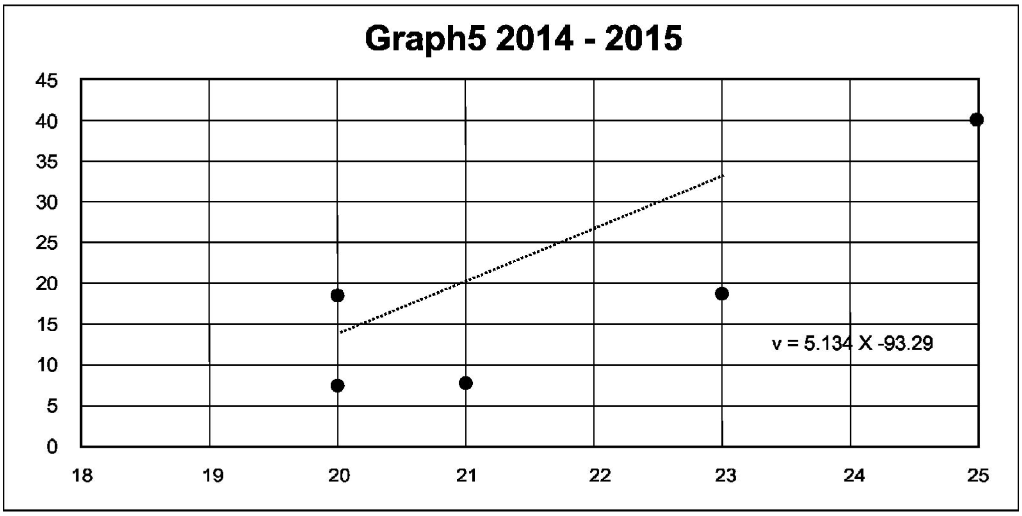
$r_4 = 0.69319$



S.No	Company	Corporate Governance Parameters (X axis)	ROCE(Y axis)
1	INDIAN OIL	21	8.3
2	ONGC	20	18.45
3	CMC LTD	23	18.77
4	HCL	25	39.92
5	POWER GRID	20	7.72

Table 6: Corporate Governance Parameters and ROCE for 2014-2015

$r_5 = 0.8543$



Analysis of Correlation and Regression Equations of Corporate Governance parameters and ROCE:

By application of Pearson Correlation Coefficient(r), it is found that the coefficient value is positive in all five years; however, in the last 3 years there is high (r > 0.50) positive correlation between two variables -Corporate Governance Parameters and Return on Capital employed. It reflects that Corporate Governance has been increasingly strengthening the Return on Capital Employed.This indicates that over the years of Sample period, there is a linear relationship between Corporate Governance and the Companies' operating performance.

Analysis of Graphs 1 to 5 reflect that Corporate Governance parameters (x)being Independent variables and ROCE being Dependent variables (y) are positively related.lt has been observed that over the years, the slope is becoming steeper and rising continuously except for 2014-2015. However, in the year 2011-2012 the slope is increasing, but at a slow pace. Intercept is negative for all the years except 2011-2012. This reflects that in case of absence of Corporate Governance parameters in the company, ROCE of the sample companies becomes negative. Hence, it can be concluded that over the years the relation between Corporate Governance parameter and ROCE has been increasing. However, as the Corporate Governance regulations and recommendations increased, its impact was observed positively on company's operational performance.

CONCLUSION

Corporate Governance parameters are one of the major contributors for analyzing performance and can be used to help in restoring investor confidence in markets that have experienced financial crisis. In spite of 'Comply and Explain approach' for Corporate Governance, the company should try to comply with all Corporate Governance parameters to effectively increase its operational efficiency. This will increase the overall profitability and value of the concern ensuring longevity and survival in competitive markets.

From the above analysis, it can be concluded that over the years, Corporate Governance practices, will improve ROCE and the firms operating performance of the company significantly. The process of achievement for excellence in governance should be adopted in spirit and cannot be enforced upon any corporate by regulators by prescribing certain rules and regulations. To attract and retain the commitment of Investors, Customers, Partners, Competitors and Employees, companies are required to match with the global standards of Corporate Governance. Society also expects management to develop transparency and work for welfare and interest of the stakeholders. To conclude, despite the regulatory efforts of regulators to discipline the corporates, we are still on the journey towards achieving quality in the management of companies.

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