Impact of Corporate Governance on Firm's Financial Performance and adoption readiness in MSME Sector

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ABSTRACT

Corporate governance has caught the attention of the business world in both the developed and the developing nations. The last two decades have witnessed rise in big corporate scandals that essentially revolve around the existence and efficacy of governance systems in business firms. Several committees were formed for the purpose of framing the best code of governance. In India Clause 49 of the Equity Listing Agreement was introduced in order to lay down certain mandatory and voluntary clauses of corporate governance for companies in India. There are arguments in the implementation of corporate governance norms: (i) corporate governance is to be a monitoring and control mechanism and would such monitoring and control hurt the firm value and (ii) corporate governance has its own cost, so what are the returns to this cost. Apart from these arguments, corporate governance is also understood to build investor confidence and reduce cost of capital for a firm. The arguments have time and again been assessed by researchers by studying the impact of corporate governance on firm value. Impact of both internal and external corporate governance mechanisms on firm value has been examined by researchers. Mixed results have been reported in the previous literature regarding impact of corporate governance variables on firm value.

This research aims to study the regulatory and institutional framework of corporate governance in Indian companies including corporate governance practices in Small and Medium Enterprises. It further aims to assess the impact of board structure and transparency & disclosure variables on firm value. The specific corporate governance variables considered in the study are (i) Board Leadership Structure (ii) Board Independence (iii) Board Committees and (iv) Corporate Reporting. The financial performance variables are (i) Tobin's Q (ii) Return on Equity (ROE) and (iii) Return on Assets (ROA). The sample is drawn from CNX 200 firms excluding financial companies and delisted companies. The firms are studied for year 2005-06 and 2014-15. Analysis of covariance (ANCOVA) is applied to identify the impact of specific governance variables on firm performance.

The results reveal insignificant difference for board leadership structure on firm performance. However, the results are significant for board independence, board committees and corporate reporting with respect to market based measure – Tobin's Q. No significance is reported for accounting based measures (ROA & ROE) of firm performance. It could be reasoned that investors and analysts value the firms with independent board, board committees and CSR disclosures as reflected by significant difference with respect to TOQ, but such valuations by market analysts do not influence the efficiency of management in improving accounting ratios. Based on the results of the study, the recommendations for Code of Best Practice are made. The recommendations are made regarding the board independence, board competency, tenure of board members and CSR committee. Additionally, recommendations are offered for improving the state of corporate governance among Indian SMEs.

Key Words: *Corporate Governance, Board Independence, Leadership Structure, Board Committees and Corporate Reporting*