

**CORPORATE GOVERNANCE MECHANISMS AND THEIR IMPACT ON
FIRM PERFORMANCE: EVIDENCE FROM INDIA**

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IMPACT ON FIRM PERFORMANCE: EVIDENCE FROM INDIA**

by

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CERTIFICATE

The thesis entitled, “**Corporate Governance Mechanisms and Their Impact on Firm Performance: Evidence from India**”, being submitted by **Ms. Monika Singla** to the Indian Institute of Technology Delhi, for the award of the degree of **Doctor of Philosophy**, is a record of bonafide research work carried out by her. She has worked under my guidance and supervision, and has fulfilled all the requirements for the submission of this thesis, which has attained the standard required for a Ph.D. degree of this institute. The results presented in this thesis have not been submitted elsewhere for the award of any degree or diploma.

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ABSTRACT

Corporate governance deals with the ways in which suppliers of finance to corporations (shareholders) assure themselves of getting a return on their investment (Shleifer and Vishny, 1997). In the context of this thesis, these multiple ways are termed *corporate governance mechanisms*. Any such mechanism, which reduces the information asymmetry, and thus, the agency issues, is termed as a corporate governance mechanism. In common parlance, corporate governance mechanisms can be visualized as the remedy to deal with various agency issues (principal-agent and principal-principal issues).

In the domain of corporate governance, the principal-agent issues refer to the conflict of interest between the shareholders and the management (also termed as Type I agency issues). The principal-principal issues refer to the expropriation of the small shareholders from the large shareholders (also termed as the Type II agency issues). While the former are prevalent in the developed economies (the U.S. and the U.K.), the latter are widespread especially in the developing economies due to the share ownership of companies being concentrated in the hands of a few shareholders.

The broad governance mechanisms can be seen to function at country and firm levels. The most important country-level governance mechanism is the regulatory regime (through regulatory mandates and enforcement). Indian companies have also witnessed a plethora of regulatory initiatives in the past decade aimed at strengthening the firms' governance structure. Thus, the first objective of the thesis relates to the analysis of the compliance behavior and the efficacy of the recent regulations Clause 49 in strengthening the firms' governance structure.

Further, certain firm-level governance mechanisms include board monitoring, ownership structure, audit quality and product market competition. Another objective of the study is to analyze the effectiveness of these governance mechanisms in enhancing the firm performance.

The third and fourth objectives of the study are based on the analysis of board independence and its relationship with other governance mechanisms. The rationale behind the detailed analysis of the monitoring role of board independence is based on multiple factors: the ability of the independent directors to protect the interests of the minority shareholders, the increased thrust of the regulators in enhancing the board independence and the growing concerns over the monitoring efficacy of the independent directors in India. The analysis of board independence in relation to other governance mechanisms is based on the concept of the *bundle of governance mechanisms*. This concept advocates that the governance mechanisms, instead of working in isolation of each other, function as a bundle.

The governance role of board independence is analyzed in greater detail in two broad sub-parts. In the first part, we have analyzed the constraints that can dilute the effectiveness of board independence in enhancing the firm performance. The second part relates to the analysis of the possible performance enhancement effect of independent directors on other governance mechanisms. The study is based on the secondary data analysis of the non-financial firms of the National Stock Exchange (NSE) 500 index over a period of 11 years (2007-2017). Firm value (Tobin's Q ratio) is used as the primary measure of firm performance.

One of the notable findings of the empirical analysis is that the mean compliance level of the sample firms with the various provisions of the revised Clause 49 is 92 per cent. Young and small firms are more likely to stay compliant with the regulatory mandates compared to the very large and old firms respectively. The firms belonging to the oil, gas and power sector have a significantly lower level of compliance compared to the other firms of other industries. A significantly lower level of compliance of these firms is traced to the dominance of public sector companies in this sector. A detailed code-wise analysis indicates certain areas of concern in corporate governance compliance. The lack of compliance with various provisions related to board composition and the Nomination and Remuneration Committee is one such area. Further analysis reveals that the nature of the provisions is such that a substantial set of companies do not fall under the purview of the provisions related to subsidiary companies and related party transactions.

Empirical results related to the analysis of effectiveness of various governance mechanisms on firm performance indicate that board independence has a significantly negative relationship with firm value. Product market competition has an insignificant effect on firm value. Audit quality is positively related to firm value when measured with the auditors' affiliation to the Big-Four auditors and total audit fee. However, auditor's independence (measured with percentage non-audit fee) is not significantly related to firm value. The ownership structure of the large shareholders is significantly related to firm value. Promoter ownership¹ has a U-shaped relationship with firm value. Also, foreign institutional ownership plays a more active role in enhancing the firm value compared to their domestic counterparts.

A detailed analysis of the monitoring role of board independence in relation to other governance mechanisms highlights that promoter ownership dilutes the effectiveness of board independence in enhancing the firm value. However, in contrast to the expectations, the product market competition has an insignificant moderating effect on the board independence and firm value relationship.

A detailed analysis of the possible value enhancement effect of board independence indicates that board independence enhances firm value to some extent by enhancing the audit quality. Further, the mediation relationship (board independence and firm value through audit quality) gets strengthened with the increase in promoter ownership. Also, board independence enhances firm value to some extent by enhancing the foreign institutional investment. The mediation relationship (board independence and firm value through foreign institutional investment) gets further diluted with the increase in promoter ownership.

¹ Promoter ownership refers to the percentage shareholding of the promoter and promoter group. The promoter and promoter group are defined under regulations 2(1) (za) and (zb) of Issue of Capital and Disclosure Requirements, 2009 by SEBI (SEBI, 2009). The detailed definitions of promoter and promoter group have been provided in Chapter 1.

सार

कॉर्पोरेट प्रशासन उन तरीकों से संबंधित है जिनसे वित्त के आपूर्तिकर्ता निगमों (शेयरधारकों) को अपने निवेश (श्लेफ़र और विनी, 1997) पर प्रतिफल प्राप्त करने का आश्वासन देते हैं। इस थीसिस के संदर्भ में, इन कई तरीकों को कॉर्पोरेट प्रशासन तंत्र कहा जाता है। ऐसा कोई भी तंत्र, जो सूचना की विषमता को, और इस प्रकार, एजेंसी के मुद्दों को कम करता है, उसको कॉर्पोरेट प्रशासन तंत्र कहा जाता है। आम बोलचाल में, कॉर्पोरेट प्रशासन तंत्र को विभिन्न एजेंसी मुद्दों (प्रिंसिपल-एजेंट और प्रिंसिपल-प्रिंसिपल मुद्दों) से निपटने के उपाय के रूप में देखा जा सकता है।

कॉर्पोरेट प्रशासन के क्षेत्र में, प्रिंसिपल-एजेंट मुद्दे शेयरधारकों और प्रबंधन के बीच हितों के टकराव को संदर्भित करते हैं (जिसे टाइप I एजेंसी मुद्दे भी कहा जाता है)। प्रिंसिपल-प्रिंसिपल मुद्दे बड़े शेयरधारकों से छोटे शेयरधारकों के निष्कासन को संदर्भित करते हैं (जिसे टाइप II एजेंसी मुद्दे भी कहा जाता है)। प्रिंसिपल-एजेंट मुद्दे पूर्व विकसित अर्थव्यवस्थाओं (अमेरीका और ग्रेटब्रिटेन) में प्रचलित हैं, प्रिंसिपल-प्रिंसिपल मुद्दे विशेष रूप से विकासशील अर्थव्यवस्थाओं में व्यापक हैं, क्योंकि कंपनियों के शेयर स्वामित्व कुछ शेयरधारकों के हाथों में केंद्रित हैं।

व्यापक शासन तंत्र को देश और फर्म स्तरों पर कार्य करते देखा जा सकता है। सबसे महत्वपूर्ण देश-स्तरीय शासन तंत्र नियामक शासन (नियामक जनादेश और प्रवर्तन के माध्यम से) है। भारतीय कंपनियों ने पिछले एक दशक में विनियामक पहलों का ढेर देखा है, जिसका उद्देश्य कंपनियों के शासन ढांचे को मजबूत करना है। इस प्रकार, थीसिस का पहला उद्देश्य अनुपालन व्यवहार के विश्लेषण और हाल के नियमों की प्रभावकारिता से संबंधित है।

इसके अलावा, कुछ फर्म-स्तरीय शासन तंत्र में बोर्ड की निगरानी, स्वामित्व संरचना, ऑडिट गुणवत्ता और उत्पाद बाजार प्रतियोगिता शामिल हैं। अध्ययन का एक अन्य उद्देश्य फर्म के प्रदर्शन को बढ़ाने में इन शासन तंत्रों की प्रभावशीलता का विश्लेषण करना है।

अध्ययन के तीसरे और चौथे उद्देश्य बोर्ड की स्वतंत्रता के विश्लेषण और अन्य शासन तंत्र के साथ इसके संबंधों पर आधारित हैं। बोर्ड की स्वतंत्रता की निगरानी की भूमिका के विस्तृत विश्लेषण के पीछे तर्क कई कारकों पर आधारित है: अल्पसंख्यक शेयरधारकों के हितों की रक्षा के लिए स्वतंत्र निदेशकों की क्षमता, बोर्ड की स्वतंत्रता बढ़ाने में नियामकों का बढ़ता जोर और बढ़ती चिंताओं पर भारत में स्वतंत्र निदेशकों की निगरानी प्रभावकारिता। अन्य शासन

तंत्रों के संबंध में बोर्ड की स्वतंत्रता का विश्लेषण, शासन तंत्रों के बंडल की अवधारणा पर आधारित है। यह अवधारणा इस बात की वकालत करती है कि शासन तंत्र, एक दूसरे के अलगाव में काम करने के बजाय एक बंडल के रूप में कार्य करते हैं।

बोर्ड की स्वतंत्रता की शासन भूमिका का दो विस्तृत उप-भागों में अधिक विस्तार से विश्लेषण किया गया है। पहले भाग में, हमने उन बाधाओं का विश्लेषण किया है जो फर्म के प्रदर्शन को बढ़ाने में बोर्ड की स्वतंत्रता की प्रभावशीलता को कम कर सकते हैं। दूसरा भाग अन्य शासन तंत्रों पर स्वतंत्र निदेशकों के संभावित प्रदर्शन वृद्धि प्रभाव के विश्लेषण से संबंधित है। अध्ययन 11 साल (2007-2017) की अवधि में नेशनल स्टॉक एक्सचेंज (एनएसई) के 500 सूचकांक के गैर-वित्तीय फर्मों के द्वितीयक डेटा विश्लेषण पर आधारित है। फर्म मूल्य (टोबिन-क्यू अनुपात) का उपयोग फर्म प्रदर्शन के प्राथमिक उपाय के रूप में किया जाता है।

अनुभवजन्य विश्लेषण के उल्लेखनीय निष्कर्षों में से एक यह है कि संशोधित क्लॉज 49 के विभिन्न प्रावधानों के साथ नमूना फर्मों का औसत अनुपालन स्तर 92 प्रतिशत है। क्रमशः बहुत बड़ी और पुरानी फर्मों की तुलना में युवा और छोटी फर्मों को नियामक जनादेश के अनुरूप रहने की अधिक संभावना है। अन्य उद्योगों की अन्य कंपनियों की तुलना में तेल, गैस और बिजली क्षेत्र से संबंधित फर्मों का अनुपालन काफी निम्न स्तर का है। इन फर्मों के अनुपालन का काफी निचला स्तर इस क्षेत्र में सार्वजनिक क्षेत्र की कंपनियों के प्रभुत्व का पता लगाता है। एक विस्तृत कोड-वार विश्लेषण कॉर्पोरेट प्रशासन अनुपालन में चिंता के कुछ क्षेत्रों को इंगित करता है। बोर्ड की संरचना और नामांकन और पारिश्रमिक समिति से संबंधित विभिन्न प्रावधानों के अनुपालन की कमी एक ऐसा क्षेत्र है। आगे के विश्लेषण से पता चलता है कि प्रावधानों की प्रकृति ऐसी है कि कंपनियों का एक बड़ा समूह सहायक कंपनियों और संबंधित पार्टि लेनदेन से संबंधित प्रावधानों के दायरे में नहीं आता है।

फर्म के प्रदर्शन पर विभिन्न शासन तंत्रों की प्रभावशीलता के विश्लेषण से संबंधित अनुभवजन्य परिणाम बताते हैं कि बोर्ड की स्वतंत्रता का फर्म के मूल्य के साथ काफी नकारात्मक संबंध है। उत्पाद बाजार प्रतियोगिता का फर्म मूल्य पर एक नगण्य प्रभाव है। ऑडिट की गुणवत्ता सकारात्मक रूप से फर्म मूल्य से संबंधित है जब ऑडिटर्स की बिग-फोर ऑडिटर्स से संबद्धता और कुल ऑडिट शुल्क के साथ मापा जाता है। हालांकि, ऑडिटर की स्वतंत्रता (प्रतिशत गैर-ऑडिट शुल्क के साथ मापा जाता है) फर्म से महत्वपूर्ण रूप से संबंधित नहीं है।

बड़े शेयरधारकों की स्वामित्व संरचना फर्म मूल्य से काफी संबंधित है। प्रमोटर स्वामित्व का फर्म मूल्य के साथ यू-आकार का संबंध है। इसके अलावा, विदेशी संस्थागत स्वामित्व अपने घरेलू समकक्षों की तुलना में फर्म मूल्य को बढ़ाने में अधिक सक्रिय भूमिका निभाता है।

अन्य शासन तंत्रों के संबंध में बोर्ड की स्वतंत्रता की निगरानी की भूमिका का एक विस्तृत विश्लेषण इस बात पर प्रकाश डालता है कि प्रवर्तक स्वामित्व बोर्ड के स्वतंत्रता की प्रभावशीलता को मजबूत करता है। हालांकि, उम्मीदों के विपरीत, उत्पाद बाजार की प्रतिस्पर्धा का बोर्ड की स्वतंत्रता और फर्म मूल्य संबंध पर एक नगण्य मध्यम प्रभाव पड़ता है।

बोर्ड स्वतंत्रता के संभावित मूल्य वृद्धि प्रभाव का एक विस्तृत विश्लेषण बताता है कि बोर्ड की स्वतंत्रता ऑडिट गुणवत्ता को बढ़ाकर कुछ हद तक फर्म मूल्य को बढ़ाती है। इसके अलावा, मध्यस्थता संबंध (बोर्ड की स्वतंत्रता और ऑडिट गुणवत्ता के माध्यम से मजबूती) प्रमोटर के स्वामित्व में वृद्धि के साथ मजबूत हो जाता है। इसके अलावा, बोर्ड की स्वतंत्रता विदेशी संस्थागत निवेश को बढ़ाकर कुछ हद तक फर्म मूल्य को बढ़ाती है। मध्यस्थता संबंध (बोर्ड की स्वतंत्रता और विदेशी संस्थागत निवेश के माध्यम से दृढ़ मूल्य) प्रमोटर स्वामित्व में वृद्धि के साथ और कम हो जाता है।

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ABBREVIATIONS

AGM	Annual General Meeting
ANOVA	Analysis of Variance
BSE	Bombay Stock Exchange
CEO	Chief Executive Officer
CFA	Confirmatory Factor Analysis
CII	Confederation of Indian Industry
CIL	Coal India Limited
CMIE	Centre for Monitoring Indian Economy
DVR	Differential Voting Right
EGM	Extraordinary General Meeting
EU	European Union
E&Y	Ernst and Young
FII	Foreign Institutional Investment
FMCG	Fast Moving Consumer Goods
GCGC	German Corporate Governance Code
HHI	Herfindahl-Hirschman Index

ICT	Internet, Communications and Technology
IIAS	Institutional Investors Advisory Services
IPO	Initial Public Offering
KPMG	Klynveld Peat Marwick Goerdeler
KSE	Korean Stock Exchange
LODR	Listing Obligations and Disclosure Requirements
MCA	Ministry of Corporate Affairs
MD	Managing Director
NA	Not Applicable
NIC	National Industry Classification
NSE	National Stock Exchange
NYSE	New York Stock Exchange
NZSE	New Zealand Stock Exchange
OECD	Organization for Economic Co-operation and Development
OLS	Ordinary Least Square
PESB	Public Enterprises Selection Board
PwC	PricewaterhouseCoopers

RBI	Reserve Bank of India
ROA	Return on Assets
RPT	Related Party Transaction
SEBI	Securities and Exchange Board of India
S.D.	Standard Deviation
SEC	Securities and Exchange Commission
SEM	Structural Equation Modeling
SOX	Sarbanes Oxley Act
SSRN	Social Science Research Network
S&P	Standard & Poor
TCI	The Children's Investment Fund
U.S.	United States of America
U.K.	United Kingdom
UTI	Unit Trust of India
VIF	Variance Inflation Factor
ZSE	Zimbabwe Stock Exchange

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