An empirical study on impact of corporate governance disclosure practices on financial performance of select financial banks

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Abstract

In the past, so many organizations in India have been involved in unethical practices, which put the credibility of their corporate image in doubt. Many researchers into the subject have brought to light the poor governance of so many companies with indebted accounts in the Indian economy. The poor governance has led to the collapse of so many companies in India. Hence, there is a need to study Corporate Governance practices and its impact on the financial performance of the companies. Corporate governance impact on the financial performance of the firms' is a very vital and important issue in India. The main idea of this research paper is to examine whether or not there is an impact of Corporate Governance disclosures on the firm performance.

Keyword: empirical study, corporate governance, financial performance, financial banks

Introduction

Thus the main aim of this research paper is to find out whether the Corporate Governance disclosure practices of the firms lead to better financial performance. This study also seeks to investigate whether there is any relationship between the corporate disclosures and financial performance of the companies taking into account various financial variables measuring the financial performance of the companies in the financial services sector on NSE. This study is based only on the companies listed in the financial services sector on NSE and the number of variables used for measuring the financial performance is limited to seven variables namely return on equity, return on assets, return on capital, book price per share, market price per share, dividend per share and earnings per share.

Literature Review

Chugh L. (2009) [5] has analyzed Board structure and financial performance of major 41 companies on the NSE for the year 2009. Regression Analysis and Correlation Matrix has been used to analyze the relationship between the variables under study. The study concluded that a governance structure incorporating larger board size creates better opportunities and more resources, thus enhancing financial performance.

Subramanyam M. (2014) [6] studied the corporate governance and disclosure practices of IT companies in India. It was evident from the study that there are some factors which influence board related matters. It was also observed that the companies gradually improves their disclosure practices in their annual reports with respect to quality, transparency, full disclosure and in-depth reporting for ensuring good corporate governance practices towards the shareholders.

Saravanan (2012) [9] has examined the impact of corporate governance in the determination of firm value in the manufacturing firms listed on BSE. An attempt was also made to test the differentiation in the corporate governance practices between the manufacturing and non-manufacturing firms. Results of the regression revealed that the firm value is found

to be significantly affected by the corporate governance factors and that there is a significant difference in the average shareholding between manufacturing and non-manufacturing firms.

Kaur D. (2009) [3] has analyzed the difference in the corporate governance disclosure practices of private and public sector banks in India. A disclosure index of 8 broad parameters has been prepared according to the clause 49 of the SEBI using content analysis. The results for each of the 8 parameters were different across the banks. Each parameter under the study had a different impact on Audit Committee, Role of Audit committee, Finance committee etc.

Aggarwal P. (2013) [1] examined the relationship between corporate governance and corporate profitability using a sample of 20 listed companies on S&P CNX Nifty 50 Index. Various tests like regression, correlation, F test and T test have been performed using secondary data over a period of two years. The results of the study reveal that corporate governance ratings have had a significant impact on the financial performance of the companies to a greater extent.

Objectives of the study

1. To assess corporate governance ranks of the companies in the financial services sector on NSE.
2. To assess the financial performance of the companies on the basis of seven financial performance measurement variables.
3. To know the impact of Corporate Governance Disclosure Scores on the financial performance measurement variables.

Research Methodology

The study is based on secondary data. The yearly data on various financial measures such as Return on Equity (ROE), Return on Assets (ROA), and Return on Capital (ROC), Book price per share (BPS), Market price per share (MPS), Dividend per share (DPS), and Earnings per share (EPS) was collected

from the annual reports of the company. Further, the corporate governance disclosure scores are obtained from the Bloomberg database. A period of 10 years i.e. from 2006 to 2015 has been chosen for the purpose of the study. A sample of 14 companies having a background of different financial services from the financial services sector is used for the study. The sample chosen is selected from the financial services sector listed on NSE. The financial services sector was chosen because it is the sector having the highest market capitalization on Nifty.

Statistical Tools and Techniques Used
Descriptive statistic shave been generated using Gretl to identify the mean and standard deviation.
Augmented Dickey-Fuller test has been applied to identify whether the data collected for the study is stationary or not using Eviews.
Correlation Matrix is used to find out the interrelationship between the Corporate Governance Disclosure Scores and Financial Variables such as ROE, ROA, ROC, BPS, MPS, DPS, and EPS
Perfect positive correlation having a correlation coefficient of +1 implies that as one variable moves up or down, the other variable will also move in the same direction. Alternatively, perfect negative correlation means that if one variable moves in either direction the variable that is perfectly negatively correlated will move in the opposite direction. If the correlation is 0, the movements of the variables are said to have no correlation.
Simple Regression Analysis has been performed using Gretl to identify the relationship between the disclosure scores and financial performance indicators such as Return on Equity (ROE), Return on Assets (ROA), Return on Capital (ROC), Book Price per share (BPS), Market Price per share (MPS), Dividend per share (DPS) and Earnings per share (EPS),

Ordinary Least Square (OLS) regression is a generalized linear modeling technique used to model a single response variable which has been recorded on an interval scale. The interpretation is done on the basis of the "p value" obtained at 95% confidence interval using Gretl.

Financial Performance Measurement Variables

$$\text{Return on Equity} = \frac{\text{Net Income}}{\text{Shareholders equity}}$$

$$\text{Return on Assets} = \frac{\text{Net Income}}{\text{Average Total Assets}}$$

$$\text{Return on Capital} = \frac{\text{Net operating profit}}{\text{Capital employed}}$$

$$\text{Book Price per Share} = \frac{\text{Shareholders' equity} - \text{Preferred Stock}}{\text{Average shares outstanding}}$$

$$\text{Market Price per Share} = \frac{\text{Net Income} - \text{Preferred Dividends}}{\text{No.of shares outstanding}}$$

$$\text{Dividend per Share} = \frac{\text{Dividends paid}}{\text{Number of shares}}$$

$$\text{Earnings per Share} = \frac{\text{Net Income} - \text{Dividends on preferred stocks}}{\text{Average outstanding shares}}$$

Data Analysis and Interpretation
Ranking of the companies on the basis of Corporate Governance Disclosure scores
The below Table 1 provides the rankings assigned to the companies after computing the average of their corporate governance disclosure scores obtained from Bloomberg data base for a period of ten years.

Table 1: The Ranking of Companies on the basis of average of Corporate Governance Disclosure Scores

Company Name	Average of CGDS	Ranks
Axis Bank Ltd.	44.86	9
Bajaj Financial Services Ltd.	45.98	7
Bajaj Finance Ltd.	44.64	10
HDFC Bank Ltd.	46.72	6
HDFC Ltd.	43.75	11
ICICI Bank Ltd.	51.79	1
Kotak Mahindra Bank Ltd.	45.24	8
LIC Housing Finance Ltd.	44.64	10
Mahindra & Mahindra Financial Services Ltd.	50.89	2
Power Finance Corporation Ltd.	48.21	3
Reliance Capital Ltd.	47.54	4
Rural Electrification Ltd.	47.1	5
Shriram Transport Finance Co Ltd.	44.64	10
State Bank of India	30.36	12

Source: Compilation by Authors

From the table, it is clear that the companies are provided with the ranks as per the average of their governance disclosure scores. It is observed that ICICI Bank Ltd is assigned the first rank in case of corporate governance disclosure with the average score of 51.79. It means that the company is very efficient in disclosing its corporate governance policies and is effectively complying with the provisions of corporate governance as stipulated in the Clause 49 of the listing agreement. The lowest average disclosure score is 30.36 of

State Bank of India and has been provided with the lowest rank of 12. It reflects the low level of compliance of corporate governance norms and policies. However, there are a few companies after ICICI Bank ltd which are moderately successful in complying with the corporate governance disclosures. The three companies namely Bajaj Finance Ltd, LIC Housing Finance Ltd; Shriram Transport Finance Co Ltd has been assigned the same ranks on the basis of their disclosure scores. It implies that the three companies are equal

in terms of complying with the provisions of corporate governance norms.

Ranks assigned to the companies on the basis of its financial performance
Necessary rankings has been provided to the companies on the basis of various selected financial performance measurement variables namely Return on Equity, Return on Assets, Return on Capital, Book Price per Share, Market Price per Share, Dividend per Share and Earnings per Share for a period of ten years.
Further a regression analysis has been performed to identify whether the corporate governance disclosure scores are impacting the selected financial performance measurement variables. In order to observe the nature of relationship between the variables under consideration, correlation matrix has also been performed.
The numbers of companies chosen are 14. Therefore the ranks have been assigned to the companies in the range of 1to 14.

From the Table 2 it can be observed that Axis Bank Ltd is the only company from the financial services sector that has been assigned first ranking in case of Return on Assets and Earnings per Share. It implies that the company is managing its assets very efficiently. As compared to the earnings of the other companies, the earnings power of the Axis Bank Ltd is better than the rest. It shows that the company is functioning effectively and is in a healthy financial condition. However, the ranking assigned to the company in terms of disclosure scores, it is quite satisfactory. Bajaj Finance Services Ltd has been assigned the highest ranking in case of Return on Equity which implies that the company is generating better profits and is in a good position to satisfy its shareholders. Further the company which has showed a remarkable performance in terms of conducting business operations, investment and growth is the LIC Housing Finance Ltd. It means that the company is able to generate high rate of returns as compared to the rate of its borrowings.

Table 2: Showing Ranks of the Companies on the Basis of their Financial Performance

Company Name	Return on Equity	Return on Assets	Return on Capital	Book Price Per Share	Market Price Per Share	Dividend Per Share	Earnings Per Share
Axis Bank Ltd.	5	1	6	7	12	9	1
Bajaj Financial Services Ltd.	1	14	8	2	10	13	3
Bajaj Finance Ltd.	13	2	5	1	4	3	4
HDFC Bank Ltd.	7	8	11	13	8	11	6
HDFC Ltd.	3	3	3	12	1	2	5
ICICI Bank Ltd.	12	13	12	3	2	12	8
Kotak Mahindra Bank Ltd.	10	1	7	8	5	14	10
LIC Housing Finance Ltd.	4	4	1	5	14	5	9
Mahindra & Mahindra Financial Services Ltd.	8	12	9	14	11	7	13
Power Finance Corporation Ltd.	6	10	10	9	9	8	14
Reliance Capital Ltd.	14	7	13	4	7	6	12
Rural Electrification Ltd.	9	6	14	10	13	4	11
Shriram Transport Finance Co Ltd.	2	9	2	6	3	10	7
State Bank of India	11	5	4	11	6	1	2

Source: Compilation by Authors

Bajaj Finance Ltd has been assigned the first ranking in terms of Book Price per Share. It is able to provide sufficient information to the investors who are evaluating the price of the company's stocks. The stocks of the company are of high value. The highest ranking in case of Market Price per Share has been assigned to HDFC Ltd implying that the share prices of the company are rising over a period of time because of the well conducted operations of the company. The company is trustworthy towards its investors. It is also evident from the table that the State Bank of India has the highest position as compared to others in terms of distributing dividend to its shareholders. If the dividends are increasing over a period of time than it means that the bank is in a sound financial condition and the investors are more likely to keep their investment in such a scenario.

Though ICICI Bank Ltd holds the first rank in case of corporate governance but its performance in case of financial terms is lower. State Bank of India is satisfactory in financial performance but when compared to corporate governance; its score is the lowest among all other companies. The descriptive statistics for key variables used for the purpose of the study have been summarized in the above table. From the table, it is observed that the mean value for corporate governance disclosure scores is 45.45%, which is a quite low rating. Thus, the companies in the financial services

Table 3: Showing the Descriptive Statistics

	Corporate Governance Disclosure Scores	Return on Equity	Return on Assets	Return on Capital	Book Price Per Share	Market Price Per Share	Dividend Per Share	Earnings Per Share
Mean	45.4543	0.1765	0.0272	0.0464	2.4707	5.915	0.0671	0.5793
Standard Deviation	1.325	0.0111	0.003	0.0075	0.4121	0.8328	0.0157	0.1695

Sector should strive to improve their governance by emphasizing on ethics, transparency and accountability, so as to achieve higher ratings. The financial health of the companies is in a stable position as evident by a smaller amount of standard deviation. The standard deviation of the companies with respect to the variables under consideration is lower than its mean values.

Correlation Analysis

Table 4: Showing the Correlation Analysis between the variables

	CGDS	ROE	ROA	ROC	BPS	MPS	DPS	EPS
CGDS	1							
ROE	-0.0184822	1						
ROA	-0.3351844	-0.0715573	1					
ROC	-0.2989685	0.4911483	0.2054903	1				
BPS	0.19272329	-0.3292096	-0.2763347	0.094437	1			
MPS	0.00451099	-0.1762674	-0.0496382	0.001708	0.1407338	1		
DPS	-0.8348866	-0.2048781	0.3547396	0.132742	-0.3019031	0.0608677	1	
EPS	-0.2882913	0.0767781	0.5727363	0.074315	-0.0403475	-0.1763931	0.1235836	1
DA	0.38589935	0.1827001	-0.8829193	-0.21026	0.1365791	-0.0509588	-0.4214593	-0.63623

Source: Compilation by Authors

Correlation Analysis is used to find out the interrelationship between the corporate governance disclosure scores and the financial performance measurement variables such as Return on Equity, Return on Assets, Return on Capital, Book Price per Share, Market Price per Share, Dividend per Share and Earnings per Share. Correlation Analysis is used to measure the relationship between the key variables. Financial Performance Variables like Return on Equity, Return on Assets, Return on Capital, and Dividend per Share and Earnings per Share, there is an existence of a negative correlation with the corporate governance disclosure scores. This indicates that as the level of corporate governance increases the financial performance of the companies with respect to the said variables decreases and vice versa.

Augmented Dickey Fuller Test (ADF)
The results of the Augmented Dickey Fuller Test has been displayed in the Table 5 which is performed to know whether there exist unit root in the data collected with respect to the variables chosen for the study. If the variables are non-stationary then the results from OLS will be spurious results. In order to avoid that the unit root test is conducted. The results displayed in the table indicate that the variables such as Return on Equity, Return on Assets, Return on Capital and Book Price per Share are stationary at level whereas the variables such as Market Price per Share, Dividend per Share and Earnings per Share which are stationary at first difference. Therefore, the variables are stationary and there exist no unit root problem in the data. Through the results obtained it can be concluded that when using the variables in the estimation of the Model; then the results obtained will not be spurious.

Table 5: Showing the results of Augmented Dickey Fuller (ADF) Test

Variables	Level		First Difference	
	t-statistic	p-value	t-statistic	p-value
CGDS	-1.2987	0.5964	-3.1497	0.0496
Return on Equity	-5.2859	0.0016	-	-
Return on Assets	-6.5852	0.0002	-	-
Return on Capital	-3.9535	0.012	-	-
Book Price per Share	-3.7458	0.0171	-	-
Market Price per Share	-2.4163	0.1562	-3.8179	0.0165
Dividend per Share	-2.5667	0.1239	-4.4424	0.006
Earnings per Share	-0.0919	0.9296	-8.9121	0

Source: Compilation by Authors

Regression Analysis
In order to examine the significant influence of the corporate governance disclosure scores on the financial performance measurement variables, simple regression analysis has been performed to find out the amount of significance in respect of each of the selected variables. The analysis has been performed with the help of the average of the disclosure scores and financial performance measurement variables. Since the disclosure scores are stationary at first difference, the regression has been performed by taking the first difference of the corporate governance disclosure scores.

Corporate governance disclosure scores average and Return on Equity average
H_0: There is no significant impact of corporate governance disclosure scores on Return on Equity
H_1: There is a significant impact of corporate governance disclosure scores on Return on Equity
Dependent variable: Return on Equity
Independent variable: Corporate governance disclosure scores
From the Table 6, it is clearly observed that the corporate governance disclosure scores do not have any influence on the

Return on Equity of the firms. Since the p value obtained is more than 0.05, accept the null hypothesis. Thus, there is no significant impact of corporate governance disclosure scores on the Return on Equity.

Table 6: OLS, using observations 1- 14 Dependent variable: ROE (Return on Equity)

	Coefficient	Std. Error	t-ratio	p-value
Constant	10.0183	2.52264	3.9713	0.00185
D (CGDS)	-0.359756	0.32375	-1.111	0.28824
R-Squared	0.093299			

Corporate governance disclosure scores average and Return on Assets average

H_0: There is no significant impact of corporate governance disclosure scores on Return on Assets
H_1: There is a significant impact of corporate governance disclosure scores on Return on Assets
Dependent variable: Return on Assets
Independent variable: Corporate governance disclosure scores
From the above Table 7, the result of the analysis shows that Return on Assets is found to be significantly affected by corporate governance disclosure scores. Since the p value obtained is less than 0.05, reject null hypothesis. Therefore there is a significant impact of corporate governance disclosure scores on Return on Assets of the firm.

Table 7: OLS, using observations 1- 14 Dependent variable: ROA (Return on Assets)

	Coefficient	Std. Error	t-ratio	p-value
Constant	12.7927	2.03128	6.2978	0.00004
D(CGDS)	-0.7561	0.26069	-2.9004	0.01332
R-Squared	0.412115			

Corporate governance disclosure scores average and Return on Capital average

H_0: There is no significant impact of corporate governance disclosure scores on Return on Capital
H_1: There is a significant impact of corporate governance disclosure scores on Return on Capital
Dependent variable: Return on Capital
Independent variable: Corporate governance disclosure scores
From the above Table 8, it is observed that the p value is less than 0.05. Thus reject null hypothesis. It can be concluded that the corporate governance disclosure scores has a significant impact on the Return on Capital of the firms.

Table 8: OLS, using observations 1-14 Dependent variable: ROC (Return on Capital)

	Coefficient	Std. Error	t-ratio	p-value
Constant	14.3293	1.48419	9.6546	0.00001
C(CGDS)	-0.97561	0.19048	-5.122	0.00025
R-Squared	0.686143			

Corporate governance disclosure scores average and Book Price per Share average

H_0: There is no significant impact of corporate governance disclosure scores on Book Price per Share.

H_1: There is a significant impact of corporate governance disclosure scores on Book Price per Share.
Dependent variable: Book Price per Share
Independent variable: Corporate governance disclosure scores
From the above Table 9 it is evident that the Book Price per Share of the companies is not affected by the corporate governance disclosure scores. Since the p value is more than 0.05, accept the null hypothesis. Therefore corporate governance disclosure scores do not have any impact on Book Price per Share of the firms.

Table 9: OLS, using observations 1-14 Dependent variable: BPS (Book Price per Share)

	Coefficient	Std. Error	t-ratio	p-value
Constant	7.84146	2.64698	2.9624	0.0119
C(CGDS)	-0.048781	0.33971	-0.144	0.8882
R-Squared	0.001715			

Corporate governance disclosure scores average and Book Price per Share average

H_0: There is no significant impact of corporate governance disclosure scores on Market Price per Share
H_1: There is a significant impact of corporate governance disclosure scores on Market Price per Share
Dependent variable: Market Price per Share
Independent variable: Corporate governance disclosure scores
From the above Table 10, since the p value obtained is more than 0.05, accept the null hypothesis. It is concluded that there is no significant impact of corporate governance disclosure scores on the Market Price per Share of the companies.

Table 10: OLS, using observations 1-14 Dependent variable: D (MPS) (Market Price per Share)

	Coefficient	Std. Error	t-ratio	p-value
Constant	8.86585	2.61265	3.3934	0.00533
D(CGDS)	-0.195122	0.335301	-0.582	0.57138
R-Squared	0.027446			

Corporate governance disclosure scores average and Dividend per Share average

H_0: There is no significant impact of corporate governance disclosure scores on Dividend per Share
H_1: There is a significant impact of corporate governance disclosure scores on Dividend per Share
Dependent variable: Dividend per Share
Independent variable: Corporate governance disclosure scores
From the above Table 11, it is found that the p value obtained is more 0.05. Therefore accept null hypothesis. It can be concluded that there is no significant impact of corporate governance disclosure scores on the Dividend per Share of the companies.

Table 11: OLS, using observations 1-14 Dependent variable: D (DPS) (Dividend per Share)

	Coefficient	Std. Error	t-ratio	p-value
Const	10.7866	2.42965	4.4396	0.0008
D(CGDS)	-0.46951	0.31182	-1.506	0.158
R-Squared	0.158912			

Corporate governance disclosure scores average and Earnings per Share average

H_0: There is no significant impact of corporate governance disclosure scores on Earnings per Share

H_1: There is a significant impact of corporate governance disclosure scores on Earnings per Share

Dependent variable: Earnings per Share

Independent variable: Corporate governance disclosure scores

From the analysis, it is quite clear that the corporate governance disclosure scores of the firm have a significant impact on the Earnings per Share of the firms. Since the p value obtained is less than 0.05, reject the null hypothesis. Therefore, the earnings per share of the firm is highly influenced by the disclosure scores.

Table 12: OLS, using observations 1-14 Dependent variable: D (EPS) (Earnings per Share)

	Coefficient	Std. Error	t-ratio	p-value
Const	13.0915	1.94687	6.7244	2E-05
D(CGDS)	-0.79878	0.24986	-3.197	0.0077
R-Squared	0.459957			

Interpretations

On the basis of the rankings assigned to the companies with respect to the corporate governance disclosure scores, it was found that ICICI Bank Ltd had the highest ranking whereas State Bank of India had the lowest ranking. It shows the level of compliance of the corporate governance disclosure norms. Further on the basis of ranks assigned to the companies with respect to the various financial performance measurement variables, it can be said that the ranks vary across the companies. The companies are in a stable financial position except some.

On the basis of the descriptive statistics, it can be said that the companies are in a stable position because the standard deviation of the companies with respect to all the various financial measurement variables is less than the mean values. The correlation analysis provided evidence that there is a strong positive correlation between the corporate governance disclosure scores and Discretionary accruals. Which implies that if the corporate governance is higher than the discretionary accruals will be lesser and vice versa. It was also observed that the corporate governance disclosure scores had a negative correlation with some variables. On the basis of the Augmented Dickey Fuller test performed, it can be observed that the variables were stationary at level except some which were stationary at first difference. Therefore, it can be said that the data was free from the problem of unit root. The regression analysis performed will not provide a spurious result. The results of the simple regression analysis display that there exist a significant impact of corporate governance disclosure scores on the financial performance measurement variables such as Return on Assets, Return on Capital and Earnings per Share. Whereas it was observed that the variables such as Return on Equity, Book Price per Share, Market Price per share and Dividend per Share were not significantly influenced by corporate governance disclosure scores.

Conclusions

Corporate Governance plays a key role in keeping a tract on the companies that they are protecting the interest of its stakeholders. The main aim of the research paper was to find if the Corporate Governance practices have any effect on the Financial Performance of the Companies. From the analysis its quiet evident that the Corporate Governance has an impact on the financial performance of the companies. Thus the companies have to adhere strictly to the Corporate Governance norms that would help the in enhancing the Financial Performance and provide better returns to its investors.

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