Corporate Governance and Financial Performance: Case Study of Indian Cement Industry

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Abstract

This paper is an attempt to evaluate the Corporate Governance and Financial performance among Indian Cement industries. In order to analyse this, Case study approach is used and sample companies listed on National Stock exchange with the cement industry have been selected. Period considered for the study includes five years ending 2017-18. The objective of this paper is to arrive at statistically significant relationship between Corporate Governance and Financial Performance. The findings reflect a positive correlation of Corporate Governance and performance among Cement companies in India.

Keywords: *Corporate Governance, Independent directors, Board Size, ROCE.*

Type: *Empirical*

Introduction

Governance refers to adhering to the specific rules and norms of society. Many companies have made proactive initiatives to introduce good governance norms prior to it being mandatory as per law. The Indian Government has constituted a strong financial atmosphere through SEBI, to emphasize latest regulations in Corporate Governance.

According to Business Standard, Ministry of External Affairs, DIPP, India has been reported as the second largest cement producer in the world. Due to initiative taken by the Government of India to arrive at Infrastructure development, demand for Cement sector is expected to boost in the coming years. Also, India has 575 operational cement plants as on Financial year 2017. Major changes in Government regulations have been implemented to safeguard investors interest and improve Corporate Governance which gave way to study sectoral impact of the parameters laid on the basis of their performance.

Need of The Current Situation

Boards are responsible for care and diligence, including ensuring that financial controls are effective. Boards may give management, strategic guidelines and may even act to review and ratify management proposals (Jonsson, 2005). Composition of the Board of Directors characterises the nature of the directors, who act as agent on behalf of the shareholders.

Independent directors are appointed considering their personal and professional qualities, who perform their functions without being conditioned by relationships with the company, and its stakeholders. The ultimate purpose of the independent director is to objectively safeguard the interests of the shareholders on the Board of Directors.

Literature Review

Various studies have been laid down to analyse Corporate Board and Firm Performance relationship.

1. Beasley, M. S. (1996) in an analysis of the relation between the board of director composition and financial statement fraud found that increase in number of outside director leads to reduction in frauds.
2. Clarke (2006) studied the listed companies on Chinese stock exchange and presented the role of independent directors to sort decisions through Board meetings.
3. Garg (2007) investigated listed companies on BSE and found that there exists an inverse relationship between board size and firm performance.
4. Jackling, B., & Johl, S. (2009) found that larger board size has a positive impact on performance. Hence concluded that board structure has positive correlation with Firm performance.
5. Masulis & Mobbs (2014) analysed directors' reputation using directorships ranking, board attendance and subsequent performance as parameters. The analysis revealed that efforts brought in by directors are unequal in case of multiple directorships. Also board attendance rate and subsequent performance proportionately increase with the increase in their experience. Studies conclude that most powerful incentive for independent directors include their image and reputation created through multiple directorships.
6. McCabe & Nowak (2008) studied the role of independent director on the board of Australian Public listed companies. The researchers examined the independent director's role and its significance considering Board Composition by interviewing 30 directors. The studies found that maximum Non-executive directors safeguarded balanced board relationship. Researchers concluded that majority of independent members in the board structure contribute to best practice governance.
7. Nowak & McCabe (2003) examined the perceptions of directors in Australian public listed companies with reference to their access towards sensitive information in their capacity as directors. Primary Data was collected by interviewing 45 directors from Public listed companies covering aspects like relationship between the Board composition, Board role and the information requirements. Studies found that CEO and Executive directors have the controlling power over information.
8. Pearce and Zahra (2006) in their study of Board composition, reported a positive association between Board size and Performance.
9. Rashid (2018) in his study on Board independence and firm performance examined the impact of board independence on economic performance among listed firms on Dhaka Stock exchange. Findings stated that board size has significant positive influence on both board independence and

firm performance. The study concluded that Board independence and firm performance does not positively influence each other.

10. Saibaba M D, (2011) studied listed companies on BSE and found that larger Board size has a positive impact on Firm performance. Researcher concluded that there is a positive relation between Corporate Governance and Financial Performance of Indian firms.

11. Vafeas (1999) in study on frequency of Board Meetings and Firm performance found that board meetings conducted are inversely related to Firm performance. Also Board activity is one of the important board dimension.

Objectives of The Study

1. Study the Corporate Governance of sample companies in Cement sector for the period 2012-2013 to 2016-2017.
2. Analyze the key parameters reflecting effective Governance and financial performance among sample companies.
3. To evaluate the relationship between Corporate Governance parameters and financial performance parameters.

Scope of Study

The study is restricted to Corporate Governance practices considering a sample of ten Cement companies Listed on NSE. Period of study covers five years from 2012-2013 to 2016-2017.

Research Plan for Data Collection

Data is collected from published sources like Reports, Journals, Websites and newspapers for the purpose of this study. Financial parameter (ROCE) is collected from Bloomberg database for the purpose of research.

Research Design

An attempt has been made to explore the relation between Corporate Governance Parameters and Performance Parameters through comprehensive analysis. Ten cement listed companies were considered for analysis. Corporate Governance is measured using Board Size and Independent Directors %. Performance is measured using Return on Capital Employed. Relationship between Corporate Governance Parameters and Return on Capital employed has been measured. Data has been arrived at using Correlation with the help of SPSS.

Methodology

1. Legal Regulations on Corporate Governance in India

   In India, listed companies are regulated through Regulatory Institutions like SEBI, RBI and MCA. Companies Amendment Act 2017 and SEBI (Listing Obligations and Disclosure Requirement) has tightened the Corporate Governance norms for Indian Listed companies.

2. Analysis of Secondary Data

a. Sample for the study constitutes data of selected Cement companies Listed on NSE. The following documents of the company are relied upon for evaluating the Corporate Governance compliance of the Companies:

- Directors Report
- Auditors Report
- Directors Report on Corporate Governance
- Website of the respective companies
- Applicable regulations w.r.t Corporate Governance etc.

b. An attempt has been made to study Corporate Governance by choosing sample cement companies from cement sectors from 2012-2013 to 2016-2017.

c. Ten sample companies were selected considering their market capitalization in cement sector. The main reason to select these companies is that their scripts dominate among sectors thereby influencing stock movement of the country.

Table 1: SAMPLE CEMENT COMPANIES FOR STUDY

Sr. No	SAMPLE COMPANIES
1	ACC
2	AMBUJA CEMENT
3	CENTURY
4	GRASIM
5	J. K. LAKSHMI CEMENT
6	KCP
7	RAMCO
8	SANGI CEMENT
9	SHREE CEMENT
10	ULTRA TECH CEMENT

(Source: Compiled by Researcher)

d. VARIABLES STUDIED

i. Independent Variables

- ASIZE: Average Board Size of 10 sample cement companies for selected period.
- AINDIR%: Average Independent directors as a percentage of Total directors of 10 sample cement companies for selected period.

ii. Dependent Variable

- AROCE: Average Return on Capital Employed of 10 sample cement companies for selected period.

TABLE 2: PERFORMANCE & GOVERNANCE PARAMETERS

Sr. No.	PERFORMANCE PARAMETERS (Y)	GOVERNANCE PARAMETERS (X)	
	AROCE	ASIZE	AINDIR%
1	11.37	12.2	52.56
2	11.22	11.8	44.09
3	3.25	7	51.43
4	9.58	12.4	50.00
5	6.69	10.4	55.45
6	3.4	8.8	54.44
7	9.62	6.2	58.10
8	8.53	12	53.22
9	13.9	10.6	62.18
10	10.55	12.4	50.00

(Source: Compiled by Researcher)

Findings

3. Corporate Governance parameters cover Board Size and Directors Independence Percentage. ROCE is a financial ratio that measures a company's long-term profitability and the efficiency with which its capital is employed. It aims at long-term financing. This ratio is based on two important calculations- Operating profit (before tax and interest) and Average Capital Employed of the company. Also return on Capital Employed shows investors how many rupees in profits each rupee of Capital Employed generates. It 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 sample Companies selected for the study.

TABLE3: CORRELATION OF PARAMETER

	ASIZE	**AINDIR%**	**AROCE**
ASIZE	1		
AINDIR%	-0.4067203	1	
AROCE	0.528183446	0.107233	1

(Source: Compiled by Researcher)

4. By application of Pearson Correlation Coefficient(r), it is found that ASIZE is positively related to AROCE. AINDIR% is positively related to AROCE. The coefficient value is positive among selected cement companies for the sample period of five years in selected cement companies.

5. The output reflects a high positive correlation between two variables – Board size and Return on Capital employed. These findings are in whereas Independent directors % and Return on Capital

employed has a low positive correlation. Studies reflects that there is positive relation between Board Size and Firm performance in supporting findings by Jackling, B., & Johl, S. (2009), Pearce and Zahra (2006), Saibaba M D, (2011). Also, studies reflect that there exists positive relationship between Independent Directors % and Firm performance supporting the findings by Beasley (1996) and McCabe & Nowak (2008). These findings don't match with recent study made by Rashid (2018) on Independent Directors and Firm performance.

6. It reflects that Corporate Governance has been increasingly strengthening the Return on Capital Employed. Also, over the years of sample period, there is a linear relationship between Corporate Governance and the Company's Financial performance among Cement companies.

7. Analysis reflects that Corporate Governance parameters – Board size and Independent directors% being Independent variables and ROCE being Dependent variables are positively related.

Limitations

The study focuses only on Corporate Governance practices with the help of a sample of Listed Companies from 2012-2013 to 2016-2017.

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

Conclusion

Corporate Governance parameters are one of the major contributors for analysing performance and can be used to restore investor confidence in markets. It is observed that that board size and independent directors are positively associated with corporate performance in Cement companies. Hence it can be concluded that over the years the relation between Corporate Governance parameter and ROCE has been increasing among Cement companies. The studies are consistent with findings by Jackling, B., & Johl, S. (2009), Pearce and Zahra (2006), Saibaba M D, (2011).

Analysis states that implementation of regulations in sample period of five years has assisted in improving Corporate Governance thereby creating a positive impact on Firms financial performance to a significant extent. It needs to be observed that governance needs to be adopted by companies in true spirit rather than just a tick box exercise. With international standards coming up and the generation of Global markets, there is a need to increase efficiency in quality of Corporate Governance and retain commitment towards stakeholders.

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