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An Investigation into Firm Performance and Characteristics of Corporate Governance—the Case of India

Lal C. Chugh, Professor of Finance, University of Massachusetts Boston

Joseph W. Meador, Professor Finance, Northeastern University

Ashwini Shanth Kumar, University of Massachusetts Boston

Abstract

Much recent published research into corporate governance and firm performance has focused primarily on US firms and others in developed countries. Less attention has been devoted to firms in emerging markets. This research investigates the relationship between the performance of Indian firms and certain characteristics of corporate governance of these firms. India has undertaken extensive reform of corporate governance as embodied in Clause 49 (2005) for listed firms, to enforce greater financial and managerial transparency and thereby achieve greater FDI. Clause 49 in analogous to the US's Sarbanes-Oxley Act of 2002. It mandates higher standards of corporate governance, as related to board independence, the dual roles of the CEO and board chairman, CEO/CFO certification and the independence of audit committees. It also limits conflicts of interest by restricting the number of boards on which directors may serve. This study investigates differential performance of Indian firms in terms of return on assets. Relevant corporate governance variables were selected in light of two theories: agency cost and resource dependency. The paper hypothesizes that larger size of the board will ensure better performance of the firm as more managerial and supervisory expertise is available. On the other hand, the proportion of independent directors and the independence of the roles of the CEO and the chairman of the board will minimize agency costs and thereby enhance performance. The paper undertakes a cross-sectional analysis of large firms listed on the Indian national stock exchange (NSE) as represented in the S&P CRISIL 50. The sample size is 41 firms, as nine highly regulated financial firms have been excluded. The remaining 41 firms comprise 60 percent of total market capitalization on the NSE. Data were collected from the individual company annual reports for 2009 and regressions have been performed, after controlling for asset size and industry classification. The study also investigates interaction effects amongst the independent variables. The paper discusses the empirical results in terms of both the agency cost and the resource dependency theories, as explained in the paper.

Selected references:

Chugh, Lal and J. Meador. " Corporate Governance and Firm Performance: 1990-2006" Journal of Business and Economics Research, Sept. 2010

Chugh, Lal and J. Meador. "Analysis of Levels and Patterns of Shareholder Rights: 1990-2006" Journal of Business and Economics Research May 2008