Corporate Governance Mechanisms: An Empirical Study of Modus Operandi in Selected Indian Companies Based on Higher Market Capitalization

Abilash
Lecturer, Dept. of Business & Accounting, Muscat College
abilashraji@gmail.com
Dr. Dure Najaf
Lecturer, Dept of Business & Accounting Muscat College
najaf_1980@yahoo.com

Abstract: Corporate governance is termed as a significant impetus of any entity performance. This study aims at investigating and analyzing reasons of practices followed by selected top Ten Indian companies based on market capitalization for the period of 2018-19. Researcher has chosen some of the Kotak Committee recommendations published in the recent report and how these norms are followed accordingly in the selected organization. The purpose of this article is to provide precise information about the modus operandi been followed by the selected companies and how it differs from others. For analysis purpose, simple regression method has been used to find the relationship between selected variables. The uniqueness of this study will provide a better understanding of policies which are regulated and how does it corporate scenario more transparent to its stakeholders.

Keywords: Corporate Governance, Modus Operandi, Market Capitalization, Kotak Committee

1. INTRODUCTION

Governance of every entity is highly significant for any country economic growth than the government of countries (*Wolfensohn, 2008*). This kind of good governance will play a pivotal role in economic performance by providing mechanisms affecting with the return on investment by suppliers of external finance to firms.Currently, in the competitive world, rapid changes are able to occur at any time due to innovation and technology and it requires prompt and strategic decision making to combat all such tedious task. In such a situation every firm needs their executive directors to be highly proactive and the level of expertise should able to understand the necessity of changes in business. In order to make long term perspective management decision, (*Strange et al 2009, Filatotchev. et al 2018*) board will employ with independent directors to concentrate with abundant expertise skills in various domain such as finance, health care and others respectively. Till to date many researchers had extensive study of Corporate Governance, but very few authors were concentrated much on board of directors activities (*Andres & Vallelado 2008*). Financial crisis of Asia in past years affected several countries. In India the government has started paying significant attention towardstasks implementing corporate governance in every firm through with the help of Securities Exchange Board of India.(*Bushman et al 2004,Claessens ,Fan 2002*) In order to project effective performance in a firm an audit committee needs an independent influence to produce unbiased results and level of integrity in financial statements can improve by increasing the number and size of directors to act as independent directors (*Lara et al 2009, Nawafly & Alarussi 2016*), However a firm with higher institutional ownership and independent boards had worse stock returns than any other firms during financial crisis(*Erkens, Hung, Matos 2012*). So, the current study seeks to examine the various kinds of committees are established in selected companies and how it differs with others and its directors responsibilities on each function.

1.1 Objectives of Study:

The researcher has initiated this article with below objectives:

- To identify the effective level obtained by board of directors in terms of monitoring functions.

- To analyse the efficiency of auditor's independence and performance level in audit process.
- To examine the parameters optimized to advocate good governance in Indian market.

2. LITERATURE REVIEW

2.1 *Definition Corporate Governance*: Goergen and Renneboog, 2006 defines a system which combines ideal mechanisms to ensure with management operates the firm for the benefit of one or more stakeholders with whom the firm deal it business. Corporate governance plays a significant role due to the uniqueness of practices as suggested by Securities exchange board of India 2015 (SEBI) with regulations of 17 to 27 clause under listing obligations and disclosure requirements (LODR) to acknowledge the exist implications toward firm opacity or complexity in terms of defining precise disclosures about the organization practices.

2.2 *Evolution of Corporate Governance in India*

The concept Corporate Governance gets rooted from ancient period during 4th Century BC by Kautilya's Arthashastra. The lessons which were written during the ancient time are getting relevant today and integrate in current corporate governance to achieve the ultimate aim of this concept to provide value to shareholder and stakeholders. (*Muniapan & Shaikh 2007*) The economy of India had undergone with important policy shift during the time of 1990s. The new model of economic reforms is commonly known as LPG that is Liberalization, Privatization, and Globalization model. From there corporate governance concept emerged in India after 1996 due to deregulation of industry and business. (*Soni, 2011*)

2.3 Kotak Committee Recommendations

The Companies Act 2013 regulates company incorporation, responsibilities of company, and other directors of each committee. The act replaced Companies Act 1956 and came into force with stipulations for increasing responsibilities of corporate executives, increasing India safeguards against organized crime. Securities Exchange Board of India (SEBI) during 2002 constituted a committee in order to assess current corporate governance practices. Based on committee recommendations SEBI issued a modified clause 49 in the year 2004 which came into effective operation during 2006. In the year of 2017 with the aim of improving standards of corporate governance a committee was constituted by SEBI under the chairmanship of Mr. Uday Kotak which is none other than Kotak Committee and released its recommendations for public comments such as (i) composition and role of board directors (ii) Board Committees (iii) Investor participation (iv) Transparency in Disclosures (v) Institution of independent directors (vi) Monitoring group entities and related parties (vii) Accounting and audit related matters (*KPMG)*

2.4 Theoretical Framework and hypothesis

2.4.1 Agency Theory: From the view of economist such as Alchian and Demsetz (1972) it started get root and Williamson (1970, 1975) who contributed his ideas towards it and further developed by Jensen and Meckling (1976) stated with context of corporation about the principle agent problem. Agents will be appointed to work allocate their time between productive effort and shrinking and company resources between valuable investments and consumption of any benefit or payment. (*Aras & Crowther 2012, Filatotchev & Wright 2011*) Management is self-interested and board of directors focused on monitoring to minimize issues of any conflict occurs between the principal-agent relationships. In agency theory, literature towards corporate governance has two factor attributes that is Corporations are curious to reduce the members involved in organization and making them as two participants such as firm managers and equity holders whose interest to be stable and precise. A second factor is humans are highly self-obsessed and reluctant to sacrifice their interest on behalf of others interest. (*Dennis & McConnell 2003,Turnbull 1997*). In terms of functioning firm activities with efficient performance, audit committee is considered as crucial and it also produces with impartial results only if it is not entangled with any of influence. (*Mamatzakis & Bermpei 2015, Alexander Maune 2017*). The responsibilities of audit committee includes examine the financial statements and auditors report to ensure fairness, sufficiency, and credibility to review and quarterly and annual financial statements before submission to board.

2.4.2 Stakeholder Theory: Many researchers have recognized that corporate entity activity will have an impact on external environment requiring the wider audience than simply its shareholders defining with their accountability towards organization. In more recent business models the firm converts their employees, suppliers and inputs of investors into form of saleable customers, and return back to its shareholders. With an original view of entity, shareholders are considered as the

owners of companies in most of the countries as stipulated in business law.(*Larcker et al 2007,Turnbull 1997*) In stakeholder theory, it insisted with the parties should include in governmental bodies, political groups, trade associations, trade unions, communities, associated corporations, prospective employees of firm and the general public. Performance of firm should not get measured only by its stakeholder gains, rather than other key issues new to be added such as flow of information from senior management to lower ranks, working environment, interpersonal relationship are all critical issues should be considered. (*Wan Fauzia & Idris 2012*)

2.4.3 Stewardship Theory: It stems from organizational sociology and organization psychology posits that agents are more likely to want to do a good job because they are intrinsically motivated by successfully performing challenging tasks, recognition from peers bosses, responsibility and authority. Stewardship theory highly signifies with relationship between manager and success of firm, and thus it mentioned about managers as stewards who secure and increase shareholder wealth through by firm performance. It focus with structures to facilitate the responsibility of single person and empower them rather than monitor and control. (*Grosman et al 2016, Subramanian 2018*). In terms of behavior steward is pro-organizational and collectivists, where steward behavior will not disembark from the interest of organization, because his ultimate aim is to reach and accomplish the objectives of organization. (*Donaldson & Davis 1991, Turnbull 1997*)

2.4.4 Market Capitalization: Market Capitalization is a significant indicator which shares value and companies' value in general. (*Pavone, 2019*). From the different literature, it is evident that macroeconomic environment has a significant effect on the stock market capitalization rate. It also influences growth and development of economy.

Company Name	Market Capitalization
Reliance	977600.27
TCS	824830.44
HDFC Bank	698082.67
HUL	422127.53
ICICI Bank	355310.36
Kotak Mahindra	321917.97
Infosys	313763.09
SBI	300982.52
ITC	291195.05
Bajaj Finance	255880.31

Source: Money control.com

3.0 RESEARCH METHODOLOGY

This article seeks to describe the study of modus operandi practices in selected Indian companies through econometric analysis of secondary data.

3.1 Sample Selection and Sources of Data:

In this study, data was obtained from company annual report about its market capitalization, corporate governance indicators and other control variables from kotak committee. Ten (10) companies were selected based on the higher market capitalization and analyzed with corporate governance indicators to know its relationship among them. The following simple multiple regression models were obtained:

Market Capitalization (MC) $= \beta_1 + \beta_2\, MIB + \beta_3\, AIM + \beta_4\, TD + \beta_5\, MER + \mu_t$

Where, Market Capitalization being the dependent variable representing company share value to its highest, other corporate governance indicators are MIB – Members independence in supervisory board, AIM- Auditor independence in Management, TD- Transparency in Disclosure, MER- Monitoring group entities and related parties, μ_t – Random disturbance term, and the coefficient estimates are the parameters which quantify the effect of each of these variables on market capitalization.

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Table 3.3

Figure 1: Annual meetings held by committee in year of 2018-19

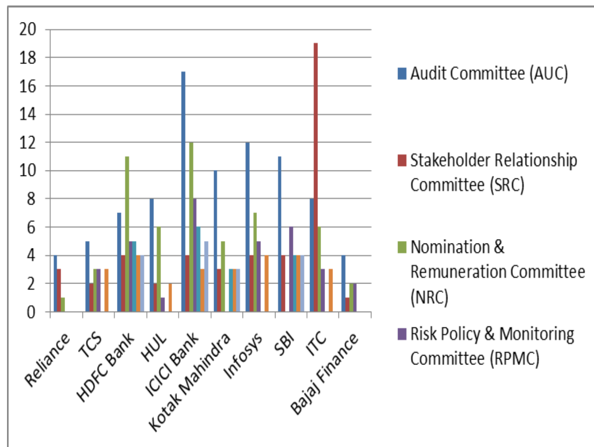

Table 3.2

Variables	Explanations
Market Capitalization (MC)	Number of shares allotted by the company multiplied with current market price of each share
Corporate Governance Indicators	
Members independence in Supervisory board (MIB)	Dummy variables coded 0 if independent members are not in committee and
Auditor independence in Management (AIM)	Dummy variables coded 0 if auditor does not have much independence
Transparency in Disclosures (TD)	Dummy variables coded 0 if firm does not disclose corporate matters in annual report
Monitoring group entities and related parties transaction(MER)	Dummy variables coded 0 if director fails to monitor group entity

4.0 DATA ANALYSIS AND INTERPRETATION

In this article multiple regressions was carried out to examine the governance practises of selected Indian companies. From the table 4.1 it is confirmed that member's independence in supervisory board gives more power to monitor the activities of group entities and interfere with their function to ameliorate. The regression model shows an R= 0.649 means that 42% of the variance (0.6492 = 0.422) and in Table 4.3 R = 0.532 means that 28% of variance (0.5322 = 0.283) which indicates a good deal of variability of market capitalization is captured by regression model. Durbin-Watson test of correlation provides here among residuals are no substantial correlations. From the table 4.1 shows that 2.208 and in table 4.3 shows that 2.180, as per the test, if there is no autocorrelation then Durbin Watson will be between 1.5 to 2.5 , since the data falls in between of above figures, here the study concludes with there is no autocorrelation between the selected variables.

Companies	AUC	SRC	NRC	RPMC	FMC	CSR	CSC
Reliance	4	3	1	0	0	0	0
TCS	5	2	3	3	0	3	0
HDFC Bank	7	4	11	5	5	4	4
HUL	8	2	6	1	0	2	0
ICICI Bank	17	4	12	8	6	3	5

AUC- Audit Committee, SRC- Stakeholder committee, NRC-Nomination Remuneration Committee, RPMC- Risk policy monitoring committee, FMC-Fraud monitoring committee, CSR-Corporate Social responsibility, CSC-Customer Service committee **Source : Author (data from Annual report)**

Table 4.1 Regression Analysis, Members independence in Supervisory Board and monitoring group entities and related parties transactions

R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
				R Square Change	F Change	df1	df2	Sig. F Change	
.649[a]	0.422	0.306	4.830	0.422	3.645	1	5	0.115	2.208

Table 4.2 ANOVA method, Members independence in Supervisory Board and monitoring group entities and related parties transactions

ANOVA[a]					
Model		df	Mean Square	F	Sig.
1	Regression	1	85.051	3.645	.115[b]
	Residual	5	23.333		
	Total	6			

Table 4.3 Regression Analysis using, Auditor independence in Management and transparency of disclosures

R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
				R Square Change	F Change	df1	df2	Sig. F Change	
.532[a]	0.283	0.140	1.962	0.283	1.974	1	5	0.219	2.180

Table 4.4 ANOVA method, Auditor independence in Management and transparency of disclosures

ANOVA[a]					
Model		df	Mean Square	F	Sig.
1	Regression	1	7.602	1.974	.219[b]
	Residual	5	3.851		
	Total	6			

5. CONCLUSION

The aim of this study is to investigate the practices in selected Indian companies and how it assist the companies to perform their operations in terms of maintaining good governance structure in organization and how does it depict to represent efficient activities in a firm. The value analyzed in data analysis has been gathered from annual report of ten companies which is mentioned in literature review and empirically the statistical calculation has been done using SPSS software. Therefore the firm who creates with independent committee need to delegate the responsibilities precisely and frequent meeting need to be conducted annually, which can support the firm to address any issue without much interference from others and this, elevates the company to reach its higher level.

The author is however aware the limitations of this study using the data for one year and the situation can amend at any circumstances. Secondly, the statistical calculation has been measured only with limited variable, where there are other ways of measuring firm best practices as well. However, it is author prediction that study can contribute at some extent regard on establishing new committee and conducting regular meetings in future to perform their operations effectively.

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About the author: Abilash is working as a Lecturer in Department of Business & Accounting, Muscat College Oman since 2016. He has acquired B.Com (2007), MBA (2009), DMM (2011), M.Com (2012), M.Phil. (2011). In teaching 6 years of experience, 2.7 years in industry.

Dr. Dure Najaf is working as Lecturer in Department of Business & Accounting, Muscat College, Oman since 2018. She obtained her Phd in Economics and she has 5 years of experience in teaching and 5 years in industry.