

A Study on Corporate Governance and Capital Structure in India

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ABSTRACT

Corporate governance is an integral part for creating a corporate culture of consciousness, openness and transparency. It is a mechanism of laws, regulations, procedures and practices to ensure firms long term value of shareholders. Corporations have large impact on citizens of several countries across the world, so it is necessary to see and examine the corporate problems at larger view through corporate governance mechanism. This study attempts to find out significant difference in corporate governance and capital structure among the sectors of selected listed companies in India.

1. Introduction

"Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stake holders corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objective and monitoring performance are determined"(OECD 2004)

Corporate governance gains momentum notability in 1980s and 90s due to global corporate failures across the world. The failure of giant corporate such as Enron, World com and Bank of Credit and Commerce International among others revived the concept of corporate governance.

The history of corporate governance in India can be divided into two time periods: period before economic reforms and after economic reforms of 1992. In Pre 1992 era, the corporate governance mechanism is very weak because of market inefficiency, poorly governed firms and fear of takeovers. Corporate governance gained its pace during liberalization and introduced in full swing by Confederation of Indian Industry (CII). In 2000, clause 49 of the listing agreement was introduced, as all listed companies are required to comply with the clause. Presently corporate governance is focusing towards attaining global convergence by developing pertinent addressable system to redress the Indian specific challenges.

This paper tries to find out the significant difference in corporate governance and capital structure among the sectors of selected listed companies in India. This paper is divided into four parts including introduction, literature review, methodology, analysis and results, and conclusion.

2. Literature Review

There are number of indicators that serve as a proxy for corporate governance. The size of board as an indicator of governance has been emphasized in literature. **Jaradat (2015)** examined corporate governance variables affect the capital structure in Jordanian firms. The result revealed that board

size, board diversity and outside director was positively related to the leverage. CEO duality had not significantly related with leverage. **Jani et al (2015)** examined the effect of Debt-Equity ratios on other ratio. They found that there was a positive relationship between firm size and leverage. They also found service sector companies more rely on the equity and less on the debt than manufacturing companies. **Ranti (2013)** studied the effect of board size and CEO Duality on the capital structure of listed firms in Nigeria. They considered a total of 40 listed firms in the Nigerian stock exchange market. The researcher revealed that there was a significant negative relationship between board size and the capital structure of listed firms in Nigeria. **Gill, Mand, , Sharma, and Mathur. (2012)** sampled small business owners from India and found that small business growth and family positively influence capital structure of small business firms. **Vakilifard, Gerayli, Yanesari, and Ma'atoofi, (2011)** took data from Tehran Stock Exchange (TSE), Iran over the over the period 2005–2010. They found a positive relationship between CEO duality and leverage, and a negative relationship between board size and leverage took data from Tehran Stock Exchange (TSE), Iran over the over the period 2005–2010. They found a positive relationship between CEO duality and leverage, and a negative relationship between board size and leverage. **Saad (2010)** carried out a sample of 126 Malaysian publically listed companies from four industries i) consumer products, ii) industrial products, iii) trading/services, and iv) plantations for the period from 1998 to 2006. Through multiple regression analysis, Saad found a negative relationship between CEO duality and capital structure, and positive relationships between board size and capital structure. **Bodaghi and Ahmadvpour (2010)** collected data from 50 Iranian firms listed at Tehran Stock Exchange to examine the relationship between corporate governance and capital structure. They concluded a negative relationship between board size and debt to equity ratio. Authors also found that CEO duality does not significantly influence corporate financing behavior. **Rehman, M. A., Rehman, R. U., and Raof, A.. (2010)** investigated the relationship between corporate governance and capital structure of randomly selected 19 banks of Pakistan from 2005-2006. They found a positive relationship between board size

and capital structure **Wen , Rwegasir and Bilderbeek (2002) and Abor (2007)** also show a positive relationship between board size and financial leverage (capital structure). **Pfeffer and Salancick (1978) and Lipton and Lorsch (1992)**, there is a significant relationship between capital structure and board size.

3. Methodology

Variables: The variables that were selected for analysis are given below:

Corporate governance: Taking reference from previous studies, we have taken board size, board committee and board meetings as indicators of corporate governance.

- **Board size:** Board size plays a strategic role in deciding financing mix of the company. Therefore, it is considered as an important variable for the study. Board size is measured as logarithm of board number of board members.
- **Board committee:** Board committees are responsible for ensuring the maintenance of effective corporate governance in the firms. Committees are appointed by the board. Committee reviews the strategic issues and matters pertaining to operational and financial activities of the firm. Board committees are measured as number of committees formed in the company
- **Board meeting:** Intensity of board activities can be seen from the number of meetings held in the year. Board meeting is measured by the number of meeting held in the year.

Capital structure: Consistent with previous studies, we used two popular measures debt equity ratio and debt ratio for measuring financing mix efficiency.

Data: The data sources were the annual reports of the companies, corporate database (PROWESS) and the reports filed by the companies with the Bombay Stock Exchange. The population of the study was top 100 companies, out of these companies financial and banking firms were excluded. The sample of 56 companies has met the criteria. The banking and financial companies were

excluded because of their different financial structure. The sample period is 2014 to 2015. The companies are categorized into 10 different sectors Power, Automobiles and Accessories, Textile, Cement, Computer and Software, Electricals, Pharmaceuticals, Chemicals, Refineries, Telecom.

Hypothesis

- **H₀ 1:** *There exists no significant difference in corporate governance among the sectors of selected Indian companies.*
- **H₀ 2:** *There exists no significant difference in capital structure among the sectors of selected Indian companies.*

The one way ANOVA (f test) is used to find out the significant mean difference in capital structure and corporate governance practices among different sectors.

Variables used to study the corporate governance among different sectors in selected companies are:

Variables	Measure	Abbreviation used
Board committee	number of board committees	BC
Board size	number of directors	BS
board meeting	number of meetings	BM

Variables used to study the Capital structure in different sectors in selected companies are:

Variables	Measure	Abbreviation used
debt ratio	total debt/(total debt+total equity)	DR
debt equity ratio	total debt/equity	DER

4. Analysis and Results

A One way ANOVA was conducted to find out the significant difference in corporate governance and capital structure among sectors of selected Indian listed companies.

ANOVA Table

ANOVA						
		Sum of Squares	df	Mean Square	F	Sig.
Board Committee	Between Groups	16.546	9	.771	1.554	.001
	Within Groups	90.870	64	.528		
	Total	107.416	84			
Board Size	Between Groups	9.902	9	.508	1.175	.003
	Within Groups	72.542	64	.424		
	Total	82.444	84			

Board Meeting	Between Groups	20.861	9	1.099	2.054	.002
	Within Groups	88.466	64	.493		
	Total	109.327	84			
Debt Equity Ratio	Between Groups	29.222	9	1.510	2.236	.001
	Within Groups	114.120	64	.618		
	Total	143.342	84			
Debt Ratio	Between Groups	12.178	9	.598	1.523	.001
	Within Groups	67.368	64	.366		
	Total	79.546	84			

Comparisons between various sectors on continuous outcomes (board committees, board meetings, board size, debt ratio and debt equity ratio) were made using One Way ANOVA. The significance level for the analysis was 0.05.

The purpose of this research was to see the significant difference in corporate governance and capital structure among different sectors of Indian listed firms. The above table presents the sum of squares, f value, mean value and significance level of corporate governance and capital structure.

Board committee (BC): The results revealed that there is significant mean difference in board committee among the sectors as $F=1.554$ and P value is less than 0.05. It can be concluded that the number of board committee varies in different sectors.

Board size (BS): As we see in the table the $F=1.175$ AND $P<0.05$, which shows that there is difference in board size among different sectors. It can be inferred that there is variation in the board size in different sectors.

Board meetings (BM): the F value is 2.054 and P value is less than 0.05. It indicates that there is difference in no. board meetings held among different sectors.

ANOVA table also shows that there is significant difference in capital structure among different sectors, as the value is less than 0.05 in both parameters of capital structure that debt

equity ratio and a debt ratio. It shows that every sector follows a different pattern of financing.

5. Conclusion

In recent years, corporate governance has become hottest topic of discussion. Indian corporation's mindset has shifted to simple management to effective governance. Indian corporations have made tremendous and significant improvements in maintain good governance. As we see, the self-interests of the promoter family precede the interests of stakeholders. The changes made through legal enforcements will ensure sound governance systems across all listed companies. The study has been able to find out the difference in corporate governance and capital structure of different sectors of Indian listed companies. Overall we find that there is significant difference in corporate governance variables and capital structure variables in different sectors of listed firms, which suggests that as corporate governance mechanism is different in different sectors of listed companies. Results also confirmed that there is difference in capital structure among the sectors.

For the recommendations, the study has found still some listed companies did not disclose their number of directors and number of meetings in their annual reports, for future research more samples can be used and more variables can be taken into consideration. It is highly recommended that companies should comply with clause 49 clause which helps in building trust and confidence among investors in the company.

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