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Corporate Governance Practices and Its Impact on Financial Performance of the Family Managed Medium Size Firms

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Abstract:
Corporate governance is about managing the business of the organization in a way which promotes transparency and fair business. According to the American Management Association, "Corporate governance is about relationship between managers of organization, directors, providers of capital, institutions etc who invests in company". It helps in ensuring that business is managed in the ethical manner. Effective corporate governance not only helps in defining, implementation and monitoring company's objective but also helps in providing a structure that will ensure accountability to the stakeholders involved in the organization. Therefore our paper focuses on importance of corporate especially for the family managed medium sized firms.

1. Introduction

We are living in a world of globalization where there is a compulsory requirement of world class governance system which will not only help in promoting ethics, fairness and transparency in the business but will also help in improving overall transparency in business operations as well as it will promote accountability. Various corporate scandals in the companies like Enron, WorldCom, Satyam, Reebok etc have created a environment where there is a lack of trust among the investors towards the company. Not only does it creates a feeling of distrust but is also bad for the economy on the whole. These scandals promote an unethical environment due to lack of effective code of conduct which promotes unethical and criminal activities practised by key managerial personnel. Effective corporate governance will not only help in promoting an environment where there is proper code of conduct being followed but also help in promoting confidence among the stakeholders.

The word corporate governance is derived from ancient Greek and Latin. Corporate is derived from Latin word Corpus meaning body while governance is derived from Latinized Greek gubernatio which means management or government. Corporate governance can be defined as the way consisting of systems, principles, processes by which an organization is governed. Not only will this provide them direction but will also guide on how the company is to be managed in order to manage the business in an effective manner. This will add value to the organization and be fruitful for the various stakeholders in long run. Stakeholders refers to various people who are involved in the working of an organization may be directly or indirectly starting from customers, shareholders to employees and to the society at large.

Management of the company plays an important role in effective implementation of an environment where adequate focus is given in the working of the organization thereby promoting the environment of trust, mutual understanding, ethics, value etc. The Cadbury committee of U.K. in January 2000 has defined Corporate Governance as –"the system by which companies are directed & controlled"

According to the American Management Association, "Corporate governance is about relationship between managers of organization, directors, providers of capital, institutions etc who invsets in company". Corporate governanace is about ensuring that board of directors are held accountable for their actions and they are able to achieve corporate objectives within the limits of rules and regulations.

Effective corporate governance not only helps in defining, implementation and monitoring company's objective but also helps in providing a structure that will ensure accountability to the stakeholders involved in the organisation. Therefore directors play an important role as they act as guardians of the company's assets. For a developing country like India it is even more important to have an effective corporate governace code to be followed by firms. Therefore directors play an important role as they help in avoiding conflicts between interest of shareholders and of management. They are also entitled the responsibility of protecting minority shareholders interest in the organization. Generally the problem of corporate governance or the need for corporate governance arises due to the fact that there is a lack of trust among shareholders, directors and managers. Some investors believe that directors and senior management work for their own benefits etc which causes lack of distrust among them. This problem can be overcome by

creating trust among each other which can be done through following 4 pillars of corporate governance which are namely: accountability, fairness, transparency and responsibility etc. These 4 pillars will help in providing 6 principles of corporate governance namely:

- Ensuring basis of an effective corporate governance framework.
- Protection of rights of shareholders and key ownership functions.
- Equitable treatment of shareholders.
- Role of all stakeholders in corporate governance.
- Disclosures and transparency.
- Responsibility of the board.

So if seen from the broader perspective i.e. economic, political and legal perspective companies should operate in this environment. If they have effective corporate governance practice being followed worldwide it will help in strengthening global markets and lead to equitable and effective resource allocation.

(Aras & Crowther, 2008) There are four principles of good corporate governance namely:

- Transparency
- Accountability
- Responsibility
- Fairness

The companies are required to disclose their governance structure in their corporate reports. The Standard Disclosures under Governance Aspect as per G4 Sustainability Reporting Guidelines by Global Reporting Initiative (GRI) include:

- Governance Structure and its Composition;
- Role of highest governance body in setting organization’s purpose, values, and strategy
- Competencies and Performance Evaluation of highest governance body
- Role of highest governance body in Risk Management
- Role of highest governance body in Sustainability Reporting
- Role of highest governance body in evaluating Sustainability Performance
- Remuneration and Incentives (Global Reporting Initiative, 2013

The quality of corporate governance primarily depends on the following factors, which consequently affect the corporate performance:

- Integrity of the management
- Size of the Board (the larger the board, the better it is)
- Ability of the board i.e. the qualifications/expertise and commitment of the board members

A corporate governance system defines who owns the firm, and dictates the rules by which economic returns are distributed among shareholders, employees, managers, and other stakeholders” (Attiya & Robina, 2005)

Corporate governance is to a certain extent a set of mechanisms through which outside investors protect themselves against exploitation by the insiders. They define the insider as both managers and controlling shareholders.(La Porta et al. 2000)

Corporate governance helps to ensure that organization achieve their objective of maximizing wealth of stakeholders but making it sure that it is not achieved at the cost of others concerned and involved in the organisation.

2. Review of Literature

- Lawrence, Brown and Caylor (2003) measures the strength of corporate governance of American firms using 51 factors that indicate corporate governance practices of firms. They are then converted into binary from and then a corporate score card is derived , then they are grouped under 8 broader governance categories namely Audit, Board of Directors, Charter/By-laws, Director Education, Executive and Director Compensation, Ownership, Progressive practices and State of Incorporation. These are then associated with 6 financial performance indicators namely Return on Equity, Net profit margin, Sales growth, Tobin’s Q, Dividend yield and Share repurchases. They concludes that overall good governance has high ROE, high profits and those firms are more valuable than compared to those firms which have poor governance.
- Beiner, Drobetz, Schmid, Immermann (2004) identifies relationship between corporate governance & firm valuation for Swiss Firms. They have constructed corporate governance index which is based on survey of firms listed in Swiss Stock Exchange. Results can be interpreted as firms with higher governance practices are valued more.
- Larcker, Richardson and Tuna (2007) have used exploratory study to find relation between corporate governance and financial performance. They have used datasheet which contains various observable characteristics of corporate governance arrangements in order to derive 14 factors that represent different aspects of corporate governance. After selecting the factors regression analysis is done in order to find the relation between the two.
- Coles et al. (2008) studies the role of board taking it as one of the parameter to measure corporate governance. He has studied observable attributes like structure of the board , composition of the board etc in order to understand the role that the board plays in the working of the organization, and concluded that the board of directors play a very crucial role in effective working of the organisation.
- Khatab et all (2011) found relationship between corporate governance & financial performance for 20 listed firms of Karachi Stock Exchange using pooled ordinary least square method from 2005-2009. For the study Tobin’s Q on asset and Return On

Equity are taken as dependent variable while firm size, leverage and growth are taken as independent variable. Results can be interpreted as leverage & growth which have positive impact on Tobins's Q and R.O.A.

- Adnan, Htay, Rashid and Meera (2011) talks about importance of corporate governance in Malaysian banks. They talk of importance of corporate governance in banking sector and concentrate on importance of efficient corporate governance practices on the bank's efficiency. They study the impact of corporate governance on bank's efficiency using panel data analysis. For the same corporate governance variables used are board leadership structure, board composition, board size, director ownership, institutional ownership and block ownership. Bank's efficiency is measured through the ratio of non-performing loans to total loans and the ratio of operating expenses to total assets. It is found that smaller board size and higher percentage of block ownership lead to better efficiency of Malaysian banks.
- Wessels, Wansbeek (2014) says that corporate governance is very important for the organization. They have studied its relation with financial performance of the company for which they have used various variables like number of members in the board of directors, CEO's compensation package, number of institutions holding shares in the firm etc. in order to study they have used return on assets, market value of the firm etc. After applying regression analysis, correlation and t-test they found that firms having large investment opportunities follow better corporate governance practices and larger the board of directors composition, more effective is the corporate governance framework. They also found that compensation package is negatively related with corporate governance and lastly share ownership pattern do affect the latter.
- Sharma (2011) in his book "Corporate Governance, Business Ethics and CSR" has shown a broad vision on corporate governance in the easiest manner possible. They have started with giving a historical background, then he has given conceptual framework, various scams in the corporate that have taken in the past like Enron, World.Com, Satyam etc. Not only this, but he has also highlighted corporate governance initiatives in India. The book is an immense source of knowledge as it gives historical background and also gives an elaborate knowledge on the subject matter. He also incorporates CSR and Business Ethics in his book thereby relating all three aspects so as to highlight its need in today's competitive environment.

3. Data Methodology

The main aim of paper is to understand the effect of corporate governance practices, practiced by family managed medium size firms from the period of 2007-2013. We aspired to study how the corporate governance practices of the family managed medium size firms affect their financial performance.

For the rationale of understanding corporate practices, paper is divided into various practices categorized into- mandatory practices, non-mandatory practices and voluntary practices and beyond compliance practices. To define family managed medium size business they are those having promoters' shareholding at 25 percent or more of the total shareholding and total assets ranging from Rs. 200 crore to Rs. 2,000 crore and then sample to 50 family managed medium size business which are listed in stock exchange. Then regression technique is applied.

4. Data Analysis

To accomplish the purpose of the paper regression analysis is used, to study the impact of corporate governance practices on financial performance of companies. The results are shown in Table 1. Findings show signs of a strong relationship between some of the corporate governance parameters of sample firms and their financial performance even with the constraints of data availability and smaller size of the sample.

Dependent variable	R-Square	Independent variable	t-value	p-value
Total Assets	0.3215	CBC	2.09	0.003
		CRC	2.22	0.001
		CIBC	2.45	0.002
Sales	0.2901	DNED	2.41	0.01
		CIBC	2.61	0.004
Interest Coverage Ratio	0.331	MMD	-4.42	0.022
		DRD	2.71	0.003
		WBP	3.71	0.002
Profit after tax (PAT)	0.1789	CRC	-2.41	0.001
		MDSHRI	3.17	0.002
Average annualized EPS	.1921	DRPT	-4.20	0.001
		CB	2.70	0.002

Table1

From the table we can see that there is rise in corporate practices followed by companies from 2007-2013.

5. Conclusion

We saw that though formerly companies were not following corporate governance practices mentioned in clause 49 but progressively companies have understood that it is in their favour to follow corporate practices. It will not only help in building good relations with the investors but also build environment of trust, accountability in the organization.

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