



Does Corporate Governance Affect Financial Performance: A Study of Select Indian Companies

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Abstract

Aim: The purpose of this study is to examine the effect of corporate governance on financial performance. The objective of this study is to provide insight into relation between financial performance of Indian banks and current corporate governance.

Background: Corporate governance is a key process influencing the organization's financial performance. The observation from the literature has asserted that banking sectors are in a prime position to impact corporate governance directly. Debt issues, director issues, the board size, agency and stakeholders and shareholders are major challenges for corporate governance. The theories of agency and stakeholders have been identified to reduce the challenges and develop firm performance.

Methodology: The research philosophy interpretivism has been taken for this study, and the inductive approach is used to provide theory. The design of this study is followed by a descriptive research design. The secondary data collection and qualitative data analysis are used to provide confirmation. The search strategy followed inclusion and exclusion criteria and constructed the selection procedure of 6 articles. Articles have been selected through PRISMA model followed by Boolean strategy. Identified articles have been chosen from different database such as Google scholar, Proquest and all are develop as per primary findings.

Results: Secondary findings highlight that board size changes decision-making, an attribute of corporate governance. Additionally, average remuneration and female directors have different impacts on financial performance.

Conclusion: This research concludes that corporate governance has a crucial role in directing the operations of Indian banking sector.

Keywords: Corporate governance, Financial performance, Board size, Return on assets (ROA), Return on equity (ROE), and Indian banks

Introduction

Corporate governance is a system or process by which companies are controlled and regulated, directed by a board of directors. Corporate governance is emerging, which is setting a benchmark for comparing corporate excellence in terms of international and national practice. Principles of corporate governance include shareholders, other stakeholders, directors' remuneration, audit and accountability. Indian banks are the linking factor of the Indian financial system and imperative for balancing the Indian economy. This research is focused on current corporate governance and the effect of corporate governance (CG) on financial performance.

Background

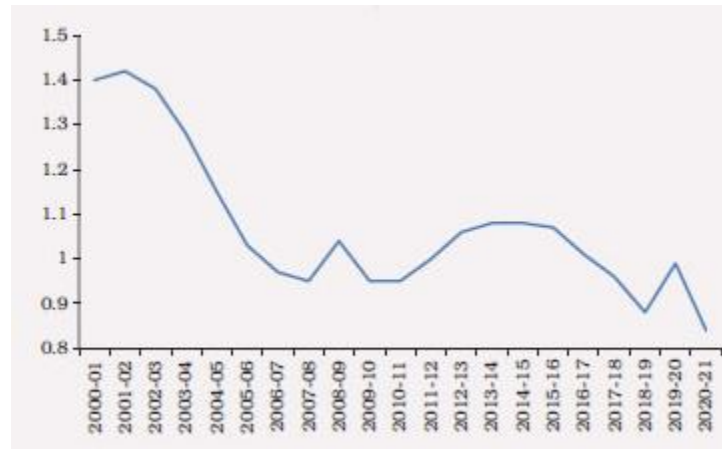


Figure 1: Debt to equity ratio

(Source: Rbi, 2022)

Several banks collapsed in 1997 due to poor corporate governance, which led people to concentrate on improving corporate governance to alleviate the crisis. Considering this matter, Asian Corporate Governance Association (ACGA) produced a report regarding state affairs from 2004 to 2005, highlighting some key determinants of Asian financial market CG standards such as political and regulatory environment, acceptance of international accounting standards, and culture of CG and rules and regulations. According to Almaqtari *et al.* (2020), commercial banks are found to dominate the Indian financial system and public sector banks account for about 70 to 73% assets of banking institutions. Regulator of Indian financial market is the Securities exchange commission of India, which includes the “*Kumaramangalam Birla Corporate Governance Committee*”.

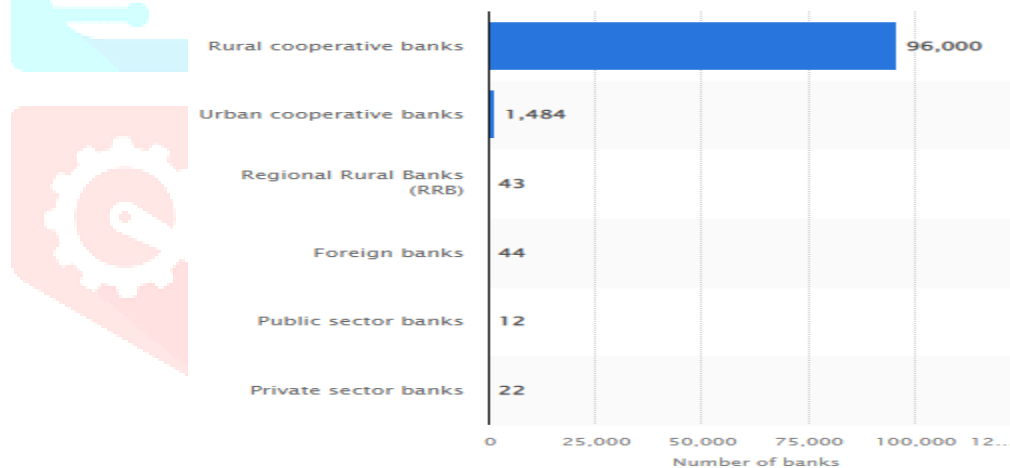


Figure 2: Number of Indian banks

(Source: Statista, 2022)

The above figure indicates the current number of banks that exist in India. The current report of Reserve bank of India indicates that debt to equity ratio has been reduced, which indicates increased profitability and better inventory management.

Rationale

The major problem is the worsening financial performance of Indian banking institutions that is causing the collapse of banks. As per the Reserve bank of India's annual report, a sharp decline in “*non-performing assets (NPA)*” of public sector banks was observed in 2017 (Almaqtari *et al.* 2020). Additionally, about 12.1% advance in 2017 has been extended, which creates stress on local banks. This increasing trend of NPA determines profitability. An increase in liabilities and deposits to loans causes an increase in borrowing amounts of Indian banks. Moreover, “*return on assets (ROA)*” and “*return on equity (ROE)*” have been observed to worsen in 2017. Due to improper corporate governance, various Indian banks are leaving the financial market. Poor corporate governance is a problem now, as financial intermediation has declined after the pandemic. Empirical estimation also shows that due to the pandemic, growth has been lost in terms of credit to GDP ratio (0.5).

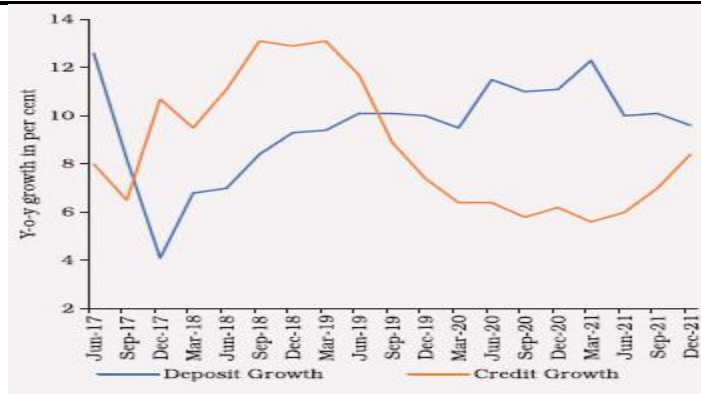


Figure 3: Effect of the pandemic on financial intermediation

(Source: Rbi, 2022)

The above figure indicates that the pandemic has reduced financial intermediates. Additionally, deterioration signs are estimated in the assets quality of the banks in the first quarter of the pandemic outbreak.



Figure 4: Asset quality of retail banks

(Source: Rbi, 2022)

The above figure indicates the reduction of asset quality. This research has been considered to shed light on actions required to improve the existing corporate governance system to enhance annual financial performance.

Aims and objectives

The research aims to analyze corporate governance attributes concerning the Indian banking sector to improve overall financial performance.

Objectives

- To find the current corporate governance status of the Indian banking sector.
- To measure the impact of corporate governance on the overall financial performance of Indian banks.
- To identify challenges encountered by Indian banks in implementing corporate governance.
- To suggest ways to improve corporate governance system and its implication process to achieve desired financial performance.

Research question

- What is the current status of Indian banking institutions in corporate governance?
- What are the attributes that hinder the financial performance of Indian banks?
- What are the complications that arise with the implementation of corporate governance in the Indian banking sector?
- What are mitigation strategies to improve financial performance by correcting problems with the corporate governance of banks in India?

Research significance

This study attempts to highlight the impact of corporate governance on financial performance. Various corporate governance committees have proposed various codes and regulations, such as optimal should be maintained by non-executive and executive directors. Additionally, individual Indian banks must appoint an independent committee of audit, which includes a director, chairman and non-executive directors (Sebi, 2022). Moreover, remuneration plans for directors must define benefits, incentives, pensions, wages and stock options. The significance of this research is corporate governance attributes in context of the performance of Indian banks.

Literature review

Corporate governance and impacts on banks

The essence of control and direction for the firm has been performed with effective governance of corporate influence. According to Bezawada (2020) and Iqbal *et al.* (2019), the post-financial crisis in 2008 developed the importance of corporate governance implementation. The financial and banking sectors experienced a significant crisis with an inventory crisis due to external incompetence's. Corporate governance is the key to success for Microfinancial firms as the startups with banks seem to have a greater responsibility for development. "**Good Corporate Governance**" (GCG) influences the firm's financial performance. In contrast, according to Singh and Das (2018), the merging intervention is asserted as the other process of developing the firm's performance. Hence, the accumulated interferences of studies reflect the efficiency development of firms in regulated GCGH influences. The relations between infrastructure and external structure effectively drive the overall firm's performance. The operational management, HRM, financial and service dimensions are interlinked with positive corporate governance. As pointed out by Goel (2018), the financial aspect of a firm is significantly incorporated with social performance development. Similarly, the study of Maharani and Soewarno (2018), CSR application with corporate governance, developed the firm's financial performance. Therefore, the potential impact is merging with differentiated parts of the organization as well. Unlike other sectors, observation has asserted that the banking sector has been in greater need of having a precise structure of corporate governance for performance, motivation and services management.

Effects of corporate governance on the financial aspect

Corporate governance in a firm is controlled by the overall structure, performance and directorial function. In the case of banks, corporate governance principles have been identified with responsibilities distribution within the firm. According to Kyere and Ausloos (2021), the board's responsibility is interpreted as constructing the objectives, corporate culture and framework of governance. Customer management and services development are critically adjusted with GCG. Therefore, the financial issues related to funding destruction and inventory management are the centralized issues that negatively affect the banking and other financial sectors. In another way, as represented by Greening and Bratanovic (2020), ownership concentration and direct performance have positively affected the financial dimension as well as another dimension of the firm. The policies and soft principles of the organization affect the performance of employees in the bank. The huge size of the board results in decision-making issues and services management issues. Moreover, corporate governance's impact is recognized as a shared major concern with financial segments.

Corporate governance implementation issues in banks to sustain financial performance

The driving force for the economic growth of the banking sector is considered to have had an impact on corporate governance in the last two decades. As the **agency's issues** with shareholders and stakeholders, management has limited corporate governance at a normal functional level (Felício *et al.* 2018). However, from this, shareholder and stakeholders' issues in banks are linked to the secondary issues related to **distance development** has been evident. The strategies of monitoring and relationship management are common actions to take against agency regulation. As pointed out by Goel (2018), the implementation of corporate governance is the most viable way to limit every action of the firm with specific principles of management. Other issues are described as **debt and takeover** are two common issues in banking sectors to reduce the outcomes and financial performance. On the other hand, Maharani and Soewarno (2019) have mentioned that debt is increased with improper **decision-making**.

Theoretical framework

The challenges associated with Agencies in association with banks have been asserted as the key relationship management issues. The theory related to the agency is described the manager's and stakeholders' relationship issues. The "**Agency theory**" states that the resolving of conflicts is relevant to promote the financial performance of the organization (Felício *et al.* 2018). Therefore, corporate control and market development are influenced by this theory of agency management. Therefore, the principal, agency cost, agency losses and agents are four elements of this theory. In a bank, these four elements act according to corporate governance for conflict resolved, market growth and financial performance sustainability.

The shareholder issues and stakeholder issues within the banking sectors commonly affect the outcomes of services. According to Maharani and Soewarno (2018), the "**Shareholders and stakeholders model and theory**" are being applied to the bank to ensure the services outcomes with competency development. The relationship between shareholders of the bank and stakeholders of the bank is important to the sustenance of major financial performance.

Literature gap

The existing literature lacks a major concentration on different performance outcomes of the financial dimension. Poor decision-making about investment and control directive actions are common threats to the organization. The interconnection between corporate governance and the financial performance of banks is not investigated properly. Lowered evidence about the Indian context required to be filled in. The particular limitation of the previous is to reflect the thick description and evaluation flaws among the major literature.

Summary

The overall description has suggested that corporate governance within existing literature is mentioned as the key governance to maintain financial performance.

Methodology

Research Philosophy, design and approach

The *interpretivism philosophy* is used for the overall structured research. Interpretivism refers to the interpretation based on real-world observation of a phenomenon (Alharahsheh and Pius, 2020). Therefore, the research design has been adopted with *descriptive research design*. This has significant usage to represent a descriptive evaluation of the overall structure of the study. Hence, the *inductive approach* of research allowed us to perform thick observation and new theory development. According to Sileyew (2019), the interpretivism philosophy is effectively incorporated with descriptive design and inductive approach research. Moreover, the data collection and data analysis are selected with all these research elements.

Data collection

The data collection process of this study has followed the *secondary data collection*. The secondary data collection is performed through online database searching. The literature searched with specific strategies of searching. The below mention table has mentioned details of searching for literature as a secondary resource of the study:

Search strategy

Database	Keywords	Boolean operator	Filters
Google Scholar	"Corporate governance", "Financial performance", and "Banking."	And	<ul style="list-style-type: none"> ● 2018 to 2022 ● English ● India
Researchgate	"Financial performance" and "Corporate governance"	Or	<ul style="list-style-type: none"> ● 2018 to 2022 ● English
Proquest	"Financial performance", "banking sectors", "Indian corporate governance", and "Corporate governance principles "	"And" and "or."	<ul style="list-style-type: none"> ● 2018 to 2022 ● English ● India

Table 1: Search strategy

(Source: Self-created)

Inclusion and exclusion

Criteria	Inclusion	Exclusion
Location	India	Other countries than India
Sector	Banking	Other sectors than banking
Language	English	Other languages than English
Time scale	Recent five years	Before 2018
Peer reviewed	Peer reviewed	Non-peer review
Participants	Banking employees	Others
Fulltext	Full-text availability	Abstract and fragments of part
Research type	Primary	Secondary and reviewed

Table 2: Inclusion and exclusion criteria
(Source: Self-created)

PRISMA



PRISMA 2009 Flow Diagram

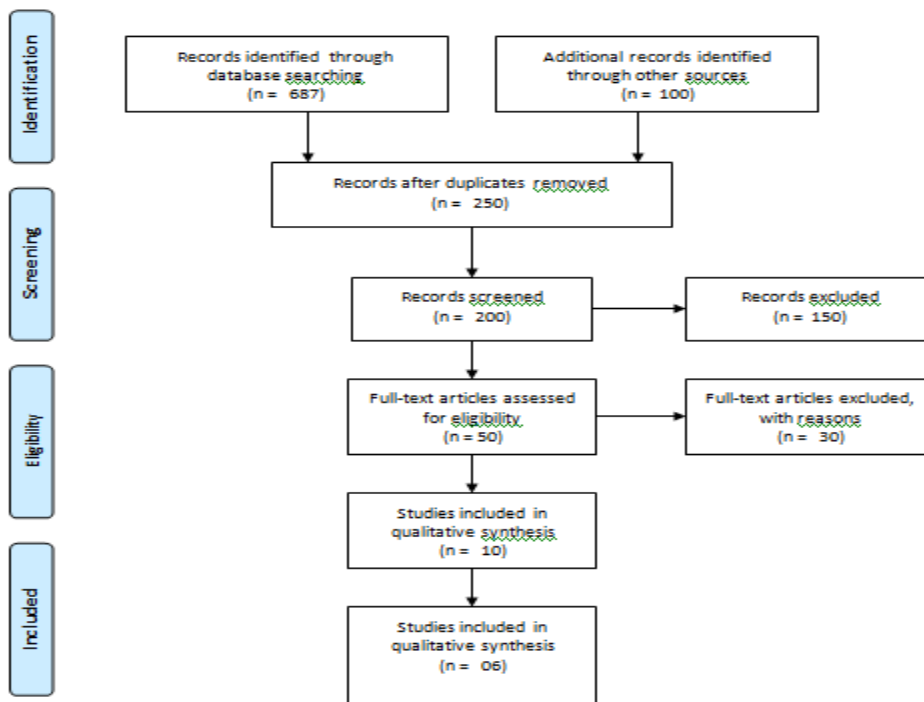


Figure 8: PRISMA framework
(Source: self-developed)

Data analysis

The literature collected with a specific search strategy is further extracted into major parts for data analysis. The data analysis of secondary resources has been followed by qualitative analysis. The quantitative analysis is significantly performed with the most advanced tool of *descriptive analysis* (Castleberry and Nolen, 2018). The articles are critically analyzed with descriptive analysis processes and outline the importance of evaluation.

Ethical Consideration

The ethics for secondary research design is performed with bias maintenance. The sampling bias has been controlled with research aims and objectives. Therefore, the proposed recommendation and intervention are safe to adopt. The data used in this study are authentic, which are a major ethical concern. Used datasets are well cited with full-text variables for supporting evidence mentioned for an ethical prospect.

Summary

The overall methodology has been mentioned with interpretivism philosophy, indicative approach and descriptive research design for this study. The secondary data collection and descriptive analysis of qualitative data have been used throughout the study.

Result

Introduction

Secondary research has been performed to find corporate government objectives affecting India's financial performance. 6 articles have been considered, which are primary in nature and have been analyzed in result section in tabular format. [Refer to Appendix]

The productivity of Indian banking has been improved with reformed corporate governance. As stated by Goel (2018), change of stock returns depend on corporate social responsibility. Encouraging a better working environment influences the improvement of financial performance for banks which is the role of a board of directors. Similarly, as opined by Almaqtari *et al.* (2021), firm's profitability varied with macroeconomic factors, which are measured using ROA and profit after tax. Capital invested and per capita income determines the financial performance. According to Agnihotri and Gupta (2019), corporate governance protects stakeholders' interests. Smaller board size produces better financial efficiency. Therefore, ICICI and HDFC banks scored higher. Business and ethics balance is maintained with good corporate governance. Therefore, it can be stated that maintaining good corporate governance is required by Indian banking sectors to get more return on assets, reflecting higher profitability.

Corporate governance attributes represent a strict authorization structure of the Indian banking sector. Literature findings indicate that financial performance is also related to corporate social responsibility. The secondary research analysis also indicates that CSR affects banking operations, which helps in obtaining competitiveness (Maqbool and Zameer, 2018). On the other hand, as mentioned by Molla *et al.* (2021), board independence must be present in a percentage of 20%. This produces better financial performance. A higher percentage of board is associated with reduced financial performance. Moreover, the director's stock ownership is correlated with financial performance. Secondary results indicate a positive impact when the directors hold a higher percentage of ownership (Agnihotri and Gupta, 2019). Therefore, it can be stated that corporate governance attributes such as board size, ownership and others affect return of assets and profitability.

Challenges come with the implementation of corporate governance, which negatively impacts profitability and overall financial performance. The literature review highlights that distance management, monitoring and corporate relationship management with stakeholders, decision making and director's performance are major challenges tagged with corporate governance in the Indian financial banking sector (Maharani and Soewarno, 2019). Along with mentioned factors, board size and committee development create challenges with initial performances. Results show that the board of directors makes decisions that decide the bank's operations direction (Kumar and Prakash, 2018). Henceforth, board size problems and board directors' inability can cause a loss of profitability.

Conclusion

The research concludes that the banking sector is different from other sectors as it directly operates the economic system of the country. As stated by Gupta and Sharma (2022), country-level CG is responsible for affecting the profitability of banks in India. Private Indian banks produce higher financial performance compared to public banks. Poor CG is reflected in ROE and ROA in Indian banks. However, the net interest margin is less affected by corporate governance.

Recommendation

- It can be suggested that Indian banks can reduce independent direct to strengthen the corporate governance structure which will improve financial performance.
- It can be recommended that female directors can be a choice for Indian banking sector which products maximum be benefits in financial performance.

Linking with objectives

- The first objectives have been obtained as research highlights that Indian corporate governments follow Sebi guidelines.
- Research provides insights into attributes of CG, which are board size, rules and regulations and others that meet this research's second objective.
- Results indicative of changing CG with respect to overall banking performance indicate the achievement of third objective.
- The fourth objective has also been achieved, as research findings state that restructuring corporate governance can improve profitability.

Research limitation

The limitation of this research is sustainable practice of corporate governance-related information. Moreover, technology involvement in CG has remained unexplored, an emerging attribute in corporate governance in the Indian banking sector. The information has been gathered from secondary resources. A primary research article has been considered for this research which has been conducted based on financial reports of Indian banks. Therefore, the validity of financial disclosure limits the quality of this research.

Future scope

Primary research on this topic can be conducted in future, which will help gather information about the current corporate governance structure after the pandemic followed by Indian banks. Moreover, sustainable banking performance can also be explored with additional objectives in future.

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Appendix: Results Table

Author and year	Country	Aims/objective	Methodology	Sample	Findings	Conclusion
Handa, 2018	India	This study aimed to explore board structure's impact on financial performance in banking sector.	Primary research method	9 Indian banks	Average remuneration was increased to 15.95 INR in 2015. However, the board size has been reduced from 10.56 to 10.22. ROA was 1.41%, and ROE was 14.73%.	The study concludes that ROE is a financial performance measurement component that changes with changing board members. Additionally, average remuneration, board committees, CEO duality and the percentage of female directors affect financial performance.
Kumar and Prakash, 2018	India	Purpose of this study was to find a sustainable banking environment.	Primary research method	21 private banks and 45 foreign banks	Based on sustainable banking performance analysis state bank of India received the highest score, 14.8 and Indian overseas bank received lowest score, 4.4. On the other hand, among foreign banks active in India, Yes bank received the highest score of 16 in sustainable banking performance, while Tamilnad mercantile scored 4.6.	This study concludes that financial operation carried out by board members and decision-making decides the sustainability of Indian banking sector.

Agnihotri and Gupta, 2019	India	Purpose of this study was to conduct an empirical analysis of relationship between corporate governance and public and private sector banks.	Primary research method	12 f listed banks in the Bombay stock exchange	The mean value of director ownership was 0.02, while institutional ownership was 17. Only 2% share of banks are estimated to be owned by directors.	Overall, study findings conclude that corporate governance and NPA are correlated, which affects banks' financial performance.
Goel, 2018	India	This study explored impact of corporate governance reforms in two years of financial performance.	Primary research method	100 companies	The Mean of shareholders is 59.606. The mean score of total CG performance is 69.772.	Findings depict that reformation of CG has an impact on bureaucracy. With reformation of CG process, corporate governance has improved as investors are able to identify good companies.
Bezawada, 2018	India	This study examined impact of board characteristics and CG practices on asset quality and performance.	Primary research method	34 commercial banks	With panel regression measured ROA was 0.70 (mean). Mean board size was 14.33.	Results conclude that with an increasing percentage of busy directors improved performance. However, several settings and board size produce a negative impact on bank's performance.
Maqbool and Zameer, 2018	India	The purpose was to examine impact of corporate social responsibilities and financial performance.	Primary research method	28 Indian commercial banks enlisted in Reserve bank of India	Profitability and ROE were 0.374, while the ROA profitability variable was 3.367.	Findings state that corporate social responsibility has an impact on market rates and profitability.