5.1 Summary of Findings

This chapter provides the main findings and draws conclusions from the study:

1) The study reveals that there is a positive and statistically significant relationship between Corporate Governance Index and financial performance of Indian firms over a period of five years in both cross sectional regressions and panel data regressions. The results are also robust to different estimation methods. The Corporate Governance Index is found to be positively related to Tobin’s Q. These findings are in line with Gompers et al., (2003): Balasubramanian et al., (2010) and others both in developed and emerging markets. With respect to the financial measure of MVBV the relationship was found to be positive but not significant. However Balasubramanian et al., (2010) report the relationship with this financial measure to be positive and significant. In consonance with the findings of Brown and Caylor (2006), the Corporate Governance index is found to be positively and significantly related with ROA.

The analysis shows absence of non-linear relation between CGI and firm values/performance. The reason for this is not difficult to find as firm valuations are affected by variety of other factors and CGI is one of them. The bifurcation of the firms on the basis of the mean values of CGI scores suggests that firms belonging to below CGI mean scores have no impact on firm valuations. This implies that there is a threshold level of governance score beyond which CGI contributes positively to firm valuation.

In the Dynamic Panel Data estimations the lagged one value of Tobin’s Q is positive and significant and the coefficients of MVBV/ROA are negative and not significant.
2) The results show that the relationship between sales and Tobin’s Q is positive and significant. The relationship between sales dummy and Tobin’s Q is found to be positive and significant. This implies that firm valuations are relatively higher for those firms which have a higher amount of sales. In the case of relationship with MVBV, for both the variables of sales and sales dummy, it was found to be not significant. The relationship between sales dummy and ROA is positive but not significant. It can be interpreted that higher sales may not impact firm performance measured by ROA.

3) The relationship between assets and firm values show negative relationship with Tobin’s Q, indicating that firm valuations with lesser amount of assets are relatively higher. This could be due to unreported intangible assets in the balance sheets or ‘e-capital’ (term coined by Stanford Economist, Hall, 1993). Further, while analyzing the differences in firm values of large and small tangible asset intensive companies with Tobin’s Q, the relationship was found to be not significant which underlines the impact of intangible assets. The relationship between asset/asset dummy and MVBV is not significant indicating that there is no relationship between the two. However in the case of assets the firm performance measured by ROA is negative and significant implying that firms having lower assets have higher firm performance measured by ROA.

4) The results show that the relationship between Margin/Margin dummy and Tobin’s Q is positive but not significant. In the case of MVBV also the relationship is not significant. The relationship with financial measure of ROA is positive and significant implying that higher margins of firms results in increase in returns on assets.

5) The study finds that there are no differences in firm valuations measured by Tobin’s Q between firms which have issued Depository receipts and those which have not. This is in line with the findings of Balasubramanian et al., (2010) in the Indian context. In the case of MVBV also significant relationship is observed. In the case of ROA, the relationship is found to be positive but not significant implying that there are no differences in firm
performance measured by ROA between firms which have issued the Depository receipts and which have not issued.

6) The overall results show that valuation of service sector firms in comparison to manufacturing is higher in terms of Tobin’s Q. However the firm valuations measured by MVBV and ROA show no significant relationship implying that there are no differences between the manufacturing and service sectors with respect to these financial measures.

7) The relationship between promoters’ holding and financial performance proxied by Tobin’s Q was found to be positive and significant at the overall level. However the segmented analyses shows that the relationship is negative when the holdings are between 0-40 percent and then turns positive and significant between 40-60 percent level and then positive but not significant at higher level. This could be interpreted as being caused by two opposing influences, incentive alignment effect and entrenchment effect (Pattanayak, 2008).

8) Board of directors play an important role in Corporate Governance. The study shows larger board size has a positive impact on firm valuations which is in consonance with the findings of Indian researchers like Jackling and Johl (2009). Further analysis showed an optimum board size ranging between 9 and 20, both inclusive, in the Indian context. Brown and Caylor’s (2006) study indicates a range of 6 to 15 as optimum. Overall, the results of this study reflect the nature of the environment in which firms operate in India whereby greater board size supports the resource dependence theory.

9) The proportion of independent directors in the board composition does not seem to influence firm valuations. According to Balasubramanian et al., (2010); Kaur and Gill (2008); Lange and Sahu; Sarkar and Sarkar (2005), greater board independence has no significant influence on firm valuations. While the resource dependency theory is valid in case of larger board size, it is not so with respect to independent directors being on the board. In contrast,
the findings of Jackling and Johl (2009) indicate that greater board independence improves firm valuations.

10) The separation of duties of the CEO and board chairman has generated many discussions across the globe and India is no exception. The analysis of data shows that there is no relationship between CEO duality and firm valuations. According to Jackling and Johl (2009), “Given the uncertainty of India’s institutional transitions, the answer to the complex question about the impact of CEO duality/Non duality is not obvious”. This captures the essence of the findings. Chaine and Tohme (2009) find that CEO duality is beneficial when there is effective monitoring, thereby alleviating agency costs associated with CEO duality. Thus the notion of separating the roles in a manner consistent with agency theory is not supported.

5.2 Implications of the study

This study demonstrates the economic importance of the valuation effect of Corporate Governance. Investors can use these indices along with other information about the financial performance of firms for making investment decisions. The benefits of a larger board sizes has some synergies and relevance to emerging economies, such as India. This will avoid overlapping of functions of directors in the operations of the various committees.

5.3 Limitations

The results of this research study are subject to some limitations that should be taken into consideration when generalizing and interpreting the results.

1) CGI is a single measure of Corporate Governance and there is no unanimity in the construction of the Corporate Governance index. Hence the CG index suffers from some limitations.

2) Broader index incorporating CSR attributes would have provided better measure of Governance.

3) The sample size and period of the study are small.
4) Corporate Governance is influenced by external environmental factors such as industry structure, product market competition etc, which this study has not considered.

5) Studies in Corporate Governance are associated with endogeneity concerns. One problem is the potential for reverse causation, in which firm performance predicts governance practices or board structure, rather than vice versa. A second possible form of endogeneity is that optimal governance practices vary because of differences in firm specific characteristics. A third possibility is that firms may adopt good governance practices to signal good underlying attributes, but governance has no separate effect on value or performance. In order to overcome the problem, simultaneous equation method suggested by Bhagat and Bolton (2008) would have produced better results which have not been considered in this study.

6) Survey methods can capture some good governance practices which are not available in the public domain and these have been not considered in this study.

The research findings must, therefore, be interpreted in the light of the above limitations.

5.4 Directions for further research

1) Application of simultaneous equation method to study the relationship between CGI and firm values: By developing a system of simultaneous equations, where all control mechanisms are allowed to affect each other as well as Tobin’s Q, while at the same time Tobin’s Q is allowed to affect the choice of each mechanism is a comprehensive system, which can improve the quality of regression results and control for possible endogeneity.

2) In India there have been no studies on Corporate Governance characteristics, idiosyncratic risk and corporate investment decision making. Research in this aspect assumes importance in view of the spurt in Mergers and Acquisitions activities in India.
3) In their study Gompers et al.,(2003) have ranked the firms based on governance index values and found that investments in firms in the top decile group, which adopt better governance practices, have earned significant long-term abnormal returns per year in comparison to the investment in the firms in the lower decile group. A similar study on these lines will be fruitful.

4) The existence of a large number of family businesses in India warrants a further investigation regarding the role of independent directors.