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CORPORATE GOVERNANCE PRACTICES: AN OVERVIEW

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ABSTRACT

Corporate governance practices are the strategies which are based on governance models followed by firms in a specific business environment. These strategies should be formulated, in line with the short, medium and long term objectives of the firm, while focusing on promoting the overall interest of the stakeholders. Efficiency in Working Capital management is one of the principal short term objective of the companies and is viewed as one of the vital issues in financial decision making process of any firm. On the other hand, corporate governance plays an important role in the optimum management of working capital as it is the board of directors and the management that is responsible for undertaking decisions related to short-term aspects like the receivables, inventories, payables and cash. The collapse of these companies has attracted worldwide public concern over issues like can these scams be controlled? What do we mean by good corporate governance? What are the parameter to measure it's efficiency? and so on. The existing literature tries to provide answers to some of them. Corporate Governance is about putting in place the most appropriate structures, processes and mechanisms in any organisation. This helps to enhance the accountability of the managers which further ensures that the firm is being managed and directed in a way that promotes long term share holder interest

KEY WORD: *Accountability, Corporate Governance, Optimum Management, Working Capital Efficiency.*

INTRODUCTION:-

The issue was highlighted by one of the whistleblower and the firm was found defying the basic financial reporting principle of 'fair and complete disclosure' in the annual statements. The list of instances of corporate failures would be incomplete without including an important revelation that was made by Volkswagen, one of the leading global car manufacturers, in 2015, that they had been using a software called "defeat device" in the manufacturing process of their diesel cars, so that they could easily clear the strict emission tests which the cars have to pass through before they can enter the final consumer market. Since the spread of the news in the media, the value of the company shrank by around £22 billion (Spence, 2015). Frauds done by promoters of Satyam Computers and Global Trust Bank in 3 India have opened the eyes of the investors and the regulators. The collapse of these companies has attracted worldwide public concern over issues like can these scams be controlled? What do we mean by good corporate governance? What are the parameter to measure it's efficiency? and so on. The existing literature tries to provide answers to some of them. Corporate Governance is about putting in place the most appropriate structures, processes and mechanisms in any organisation. This helps to enhance the accountability of the managers which further ensures that the firm is being managed and directed in a way that promotes long term share holder interest (Velnampy, 2013).

Globalization of the businesses has made corporate governance an international issue. Because of the differences in the political, economic and cultural conditions, it is recommended that every country should develop their own corporate governance models (Mulili and Wong, 2011). As a result, the governance practices in different countries are based on the models developed by each of them on the basis of their socio-economic-political environment. Various structural corporate governance models have been developed which are primarily based upon the cultural, historical and technological features of a particular economy. They reflect the influence of economic and political institutions over the functioning of the corporates (Ungureanu, 2012). However, there is no single model which can provide a solution to overcome a wide range of issues that arise as a result of agency problem (Maher & Andersson, 2002). These models are broadly categorized into outsider-based and insider-based models. The former is represented by the Anglo-American type and the U.K. based model and the latter by Japanese and German type of corporate governance models. Apart from these there are two other models of corporate governance viz., The Asian Family-Based Model (Overseas Chinese and Chaebol Groups in South Korea) and The Indian Model (Sidhu, 2016).

OBJECTIVES

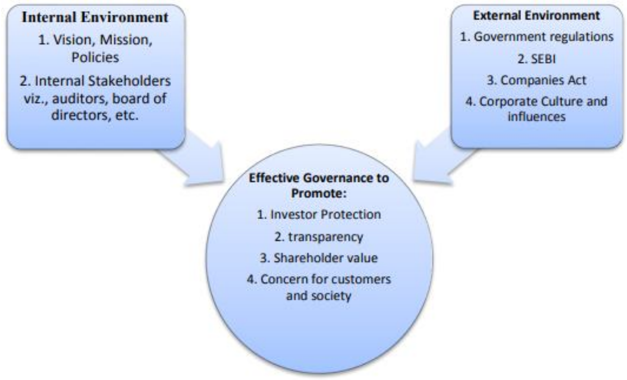
- To pertained to examining the corporate governance practices.
- To Analyse a sector wise working capital efficiency.
- To Show the relationship between corporate Governance Practices and Working Capital Efficiency

The Indian Model

The Indian framework on corporate governance has been primarily built on the foundations of the Anglo-Saxon model of governance as the recommendations of the various committee like Kumar Mangalam Birla Committee (2000), Naresh Chandra Committee (2003) and The Narayana Murthy Committee (2003) are similar to those of US's Sarbanes-Oxley Act (2002) and UK's Cadbury Committee (1992). In terms of external reforms (greater transparency and independent scrutiny of corporate accounts), internal reforms (emphasized role of non-executive directors and curtailment of interlocking directorates) and institutional reforms (development of audit, remuneration and compensation committees), the recommendations are centred on Anglo-American practice.

However, it has got certain limitations with respect to its applicability in the Indian environment. For instance, the central governance issue in Britain and the United States is that of disciplining the top management which has become ineffective in attaining its basic objective of liability to manage the shareholder capital in the most efficient way and maximize their wealth. The shareholders in such economies are dispersed and largely spread. However, in a developing nation like India, the basic snag in corporate governance is protecting the interest of all the parties viz., the dominant shareholders (who are the principal blockholders), the minority shareholders plus the other stakeholders (Sarkar & Sarkar, 2011). This issue, along with the complexity arising from the adaptation of an alien governance model, is further exaggerated by the weak enforcement of the governance norms and regulations, defined by the Indian legal system (Pande & Kaushik, 2011). These regulations have not been able to control the atmosphere of corporate financial misbehaviour in India. Consequently, the success of these regulations is still under debate. In other words, there are no set and final answers. They are in flux and are still evolving.

The Indian Corporate Governance Model



*Source: Sidhu, 2016

After 1990's, the Indian economy had embracing globalization and liberalization. It underwent an aggressive transformation and had been converted into a new economy, where the private sector participation was encouraged over the traditional state owned enterprises, in all business spheres (Mishra & Mohanty, 2014). Since then, effective monitoring of these organisations has been a crucial task. For this, The Securities and Exchange Board of India (SEBI) had been established in 1992. Since then, according to the required situations, its norms and provisions have been amended in order to empower it gradually for promoting discipline in the corporate functioning. After the formation and recommendation of committees like the Kumar Mangalam Birla Committee, the Narayana Murthy Committee, etc, the most recent solution has been provided in the form of clause 49 which lays down the rules and regulations governing the corporate conduct in India. However, the quest for good governance is a matter of on-going concern. It is a challenge which needs to be studied and measured constantly, providing practicable solutions which can be thoroughly applied. In the light of this issue, the first objective of this study is to examine and measure the corporate governance of the selected sample firms. Focussing primarily on the internal governance characteristics viz., the size of the board, number of independence directors on the board, presence of CEO Duality, CEO-Tenure, size of the audit committee and audit committee independence have been taken as the corporate governance measures to be evaluated.

CORPORATE GOVERNANCE MECHANISMS

Automobile Industry

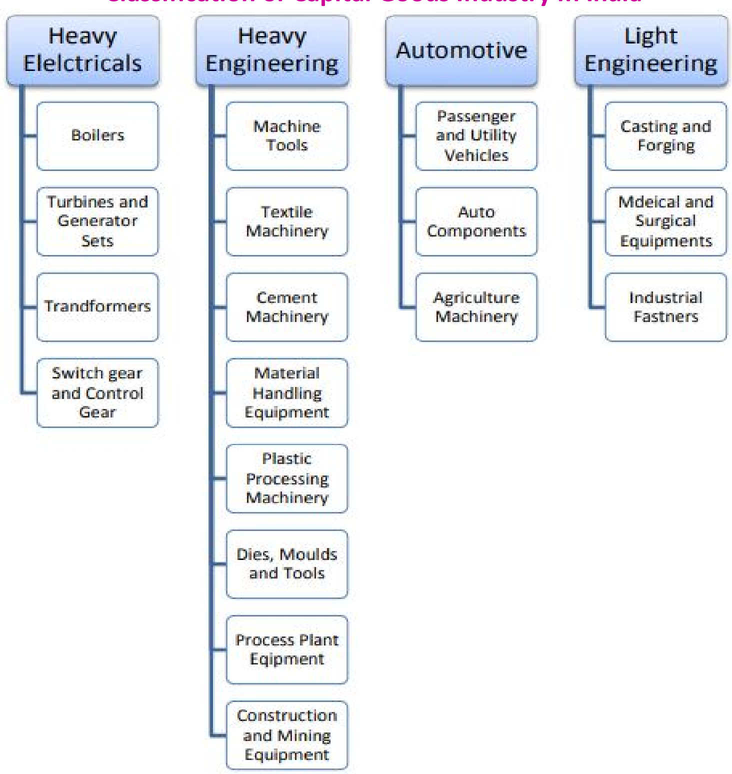
Established in 1982 with only five major players, the Indian Automobile industry was a very closed market which was dominated by the sellers. Establishment of Maruti Udyog Limited, which was a collaboration of Maruti Suzuki with the Indian Government, in 1983 was a turning point in the development of this industry. It was after this event that various other component manufacturers entered the Indian market by the way of joint ventures. From a seller dominated market, it became a buyers market. This industry has experienced an immense growth in the Indian business environment after happening of two major events viz., de-licensing of this industry in 1991 and permission of 100 percent FDI through automatic route subsequently. In 2001, the government permitted imports of various components from other countries due to which Major Original Equipment Manufacturers (OEM) started establishing their assembly operations in India.

There are various factors which favoured the growth of the automobile industry in India. Rising income, increased portion of population falling in the middle-class segment and a gradual rise in the young population of our country have been the principal drivers for increased demand of automobiles in India. Apart from this, when the firms manufacture/assemble in India, they gain competitive advantages in the form of significant cost reductions, by almost 10-20 percent, as compared to production costs in the rest of world like Europe and Latin American countries like Brazil, Mexico, etc (IBEF, 2018). The Automotive Mission Plan 2016-2026, shows the clear vision of the government to convert and project India as a globally competitive Research and Development hub throughout the world. Lastly, technological innovation are expected to escalate in the engine technology & alternative fuels as the government of India aims to electrify the entire automobile market by 2030. Initiatives like these provide an intensive boost to the players in this industry.

Capital Goods

The capital goods sector, in an emerging economy like India, is of strategic importance because it has a proliferated impact on the overall rate of economic growth. It facilitates development of other industries also by providing essential inputs like machinery and equipment required for manufacturing. This industry is divided into two major segments viz., heavy engineering and light engineering. Heavy engineering is further divided into three segments which are heavy electricals, heavy engineering and machine tools and automotives. Light engineering has two subsegments viz., low technology products and high technology products. The performance of this industry in India has not been very stable. The global financial troubles lead to an intense slowdown in the growth rate of our country's real economy. For instance, as per a report by CSO in 2018, "Capital goods sector in India grew at 9.2% in April-August 2008-09, slowing down from the 20.1% growth achieved during April-August 2007-08." However, post-crisis, this industry experienced a significant growth of 15 percent in the year ending 2011 from mere one percent during 2009-10 (EXIM, 2014). Interestingly, this growth curve could not be sustained for long as the output of this industry dropped by 4 percent in 2011-12 and further by 6.1 percent in the year 2013.

Classification of Capital Goods Industry in India



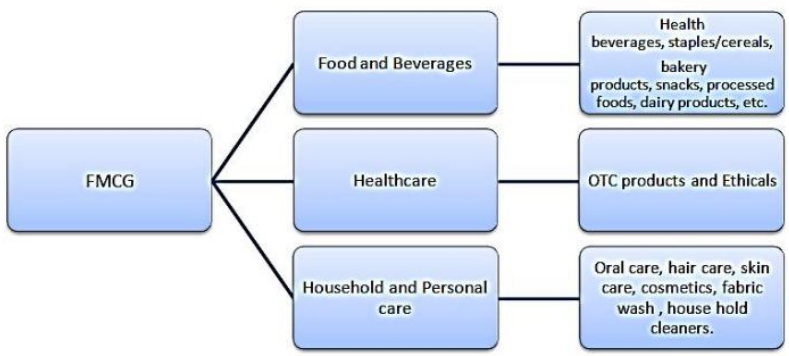
*Source: IBEF, 2017

Fast Moving Consumer Goods (FMCG)

During the period starting from 1950 till 1980, the Indian Fast Moving Consumer Goods (FMCG) industry grew only significantly as it was not very attractive from investor's point of view because of two prime causes viz., low purchasing power of the people and the government's policies which were unsupportive of the growth of the small-scale sector (IBEF, 2018). The growth of this industry began to shape after the deregulation of the Indian economy in 1990's, when a number of new brands emerged domestically with the lower amount of invested capital and technological requirements. Furthermore, the relaxed FDI norms and conditions also favoured investment of business operations by multinationals in the Indian market segment. The Indian FMCG sector has grown phenomenally between 2006 to 2013 with a CAGR of approximately 16 percent (IBEF, 2018).

Over the last ten years, the industry has almost tripled in size, growing at a much faster pace than ever before. Presently, FMCG stands in the fourth position in context of industry size and is expected to expand at an compounded growth of 20.6 per cent during the decade ending 2020 (IBEF, 2017). Moreover, this industry has proved its strength by registering a growth rate of 14.5 percent in 2007-08, when the entire economy was in a slowdown mode (IBEF, 2018). The FMCG market in India is divided into three main segments viz., food and beverages, healthcare and household and personal care. According to a report by ICRA, 2018, "Household and Personal Care is the leading segment out of the three as it accounts for 50 per cent of the overall market share followed by Healthcare (31 per cent) and Food & Beverages (19 per cent)."

FMCG Market Segment



*Source: IBEF, 2017

Infrastructure Development

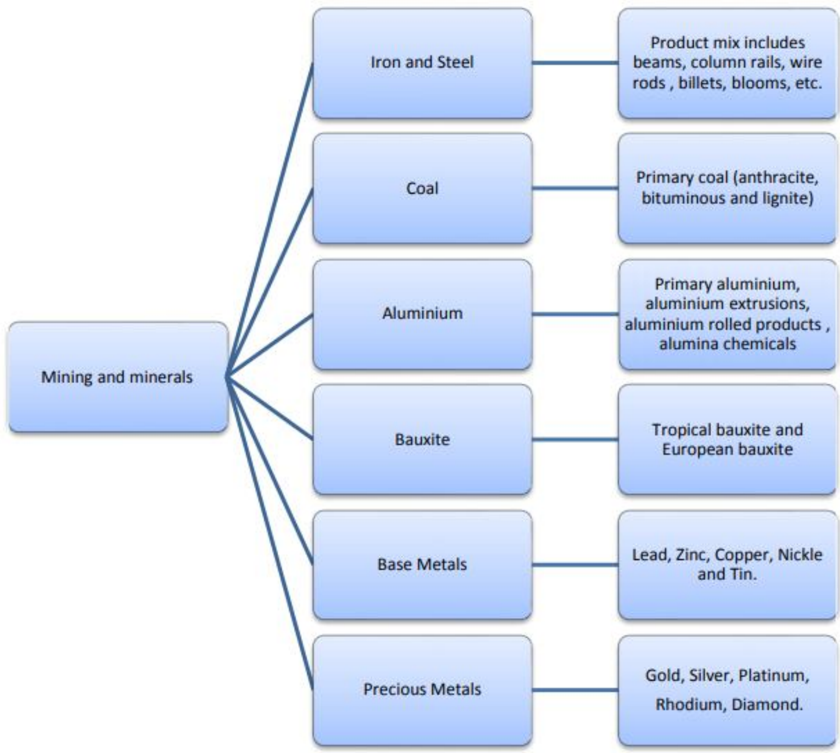
Infrastructure sector is a key driver and the backbone of the Indian economy. Given this fact, it was only in the 10th and 11th five year plans that the government shifted it's focus to infrastructure development, because it was then that the planning commission identified that inadequate infrastructure was a major barrier to growth. Since then, infrastructure development has enjoyed an intense focus in all the government initiatives. The most recent allocation of Rs 5.97 lakh crore by government of India in it's union budget for the FY2018-19 is a clear evidence to the same (IBEF, 2018). The World Bank's Logistics Performance Index (LPI) ranking highlight a huge leap taken by the Indian infrastructure industry in terms of its ranking globally. In 2016, it was ranked 35th, up by nineteen places, amongst the total 160 countries (IBEF, 2018).

Mining and Mineral Products

Being the third largest steel producer, third largest coal producer and fourth largest iron-ore producer in the world, the mining and minerals product industry is the major contributor of the manufacturing sector output in our country (IBEF, 2018). Globally, the steel industry had experienced a major slowdown even before the financial shock of 2007-08 had taken place as the output growth dropped from six per cent in 2000 to minus 15 per cent in 2009 (IBEF, 2018). However, the Indian steel industry grew at an CAGR of 9.6 percent during 2005-06 to 2010-11 which highlights the strength of this industry (Rath, 2015). Domestic availability of raw materials such as iron ore, coupled with low cost-effective labour are considered to be the major growth enhancing factors of this industry in India. During, India's mineral output grew by 6.2 per cent, to reach US$ 28.14 billion during the period April-December, 2017 (IBEF, 2018).

Currently, India produces around 88 minerals which can be categorized into following five segments viz., 50 non-metallic, 24 minor, 10 metallic, 4 fuel and 3 atomic minerals (IBEF, 2018). The entire mining and mineral products industry is divided into six segments viz., iron and steel, coal, aluminium, bauxite, base metals and precious metals and minerals.

Mining and Minerals Market Segment



*Source: IBEF, 2017

Pharmaceuticals

Being the third largest industry in terms of volume and thirteen largest in terms of value, Indian pharmaceuticals industry enjoys a ruling position in the global pharmaceuticals market. It has shown a remarkable growth during a ten year period 2006-2015 by registering a growth rate of 17 percent, but it is expected to fall down by one percent to 16 by the end of 2020 (IBEF, 2018). The market size of the Indian pharmaceutical sector was USD 20 billion in 2017 and is expected to reach USD 55 billion by the year 2020 (Chandra et. al., 2017). Globally, India is expected to be among the top three pharmaceutical markets with respect to increase in growth rate and 6th largest market in terms of absolute increase in size by the end of the year 2020. The most important factor which provides a competitive edge to India over other countries of the world is the cost efficiency. Indian companies incur production costs which are approx. 33 percent lower than what is incurred by their US and the European counterparts. Economised production costs and greater institutional support for R&D are the two major factors which have provided a boost for the growth of this sector in India. Moreover, changes in demographic factors like improved medical infrastructure facilities, rapid emergence of the middle class households and deeper penetration of health insurance in the country have influenced the growth of pharmaceuticals sector in India. Medical Tourism is one of the emerging source of income for the Indian economy as India has become a hub for low cost medical treatment facilities in the world. The pharmaceuticals market in India is primarily segmented into active pharmaceutical ingredients/bulk drugs and drug formulations. Active pharmaceutical ingredients/bulk drugs are further divided into branded drugs and generic drugs. Further, there are two types of drug formulations viz., chronic and acute. Chronic drug formulations include cardiovascular, anti-diabetes, gastro-intestinal and neurological drug manufacturing. However, acute drugs manufacturing includes anti infectives, respiratory drugs, pain relief and gynecology solutions.

CONCLUSION

The analysis of the impact of corporate governance quality, measured by board size, board independence, CEO-Duality, CEO-tenure, audit committee size and audit committee independence, on the efficiency of working capital management of the BSE-500 listed manufacturing firms. The first part of the chapter reports about the descriptive statistics of the dependent, independent and control variables. It includes the examination of the basic characteristics of the sample like the mean, median, standard deviation, minimum and maximum values of the key measures. A lot of variation has been observed in the corporate governance measures over the six year period which is basically due to the more stringent regulatory requirements that have been imposed in the form of The New Companies Act, 2013. The second part of the chapter elucidates the correlation matrix, highlighting the degree of association among the key variables. Pearson coefficient has been a calculated using view which provides some evidence of the relationship between corporate governance and working capital efficiency. All the corporate governance measures have shown a positive but low level of correlation with the working capital efficiency variables except for CEO-Tenure, which has shown a negative but low correlation with average collection and average payment periods, and audit committee independence, which has shown a negative and low association with the cash conversion cycle. However, a positive and high correlation has been observed between Board Size and CEO-Duality. In order to draw some conclusive evidence, a further regression analysis has been performed and has been explained in the third part of the chapter. It has been carried out in two part i.e., an industry-wise analysis of impact of corporate governance mechanisms on working capital efficiency is followed by an overall analysis of the entire sample. The industry wise analysis revealed that all the six governance measures significantly impacted atleast one of six working capital efficiency variables in all the nine industries. Board size positively and significantly impacted average collection period and current ratio, but negatively and significantly impacted the size of the firm cash holdings. Board independence is found to be positively and significantly impacting inventory conversion cycle and significantly but negatively impacting the size of the firm cash holdings.

The governance literature in India focused mainly on the relationship of corporate governance with firm profitability, performance and to some extent with the capital markets. On the other hand, literature available on working capital focused on the relationship of operational efficiency and profitability with management of working capital. Moreover, the existing literatures have tried to study the relationship between corporate governance and working capital management in an absolute manner. To bridge the gap in literature, this study has tried to take a more relative approach as it focuses on the relationship between governance mechanisms and working capital efficiency. This study has four objectives i.e. to examine and measure corporate governance of selected Indian manufacturing firms, to examine and measure working capital efficiency of selected Indian manufacturing firms, to examine the effect of corporate governance practices on the working capital efficiency of selected Indian manufacturing firms and to suggest measures for improvement of corporate governance practices and working capital efficiency.

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