European Economic Letters
ISSN 2323-5233
Vol 14, Issue 2 (2024)
http://eelet.org.uk

Evaluating Governance Structures in Financial Sector

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Abstract

Corporate governance has been acknowledged as critical element for creating an attractive investment climate and for efficient financial markets and is treated as a matter of regulatory compliance (Maheshwari, Maheshwari and Maheshwari, 2011). The main aim of the study is to study the corporate governance practices of selected companies in Banking and Financial Institutions and to find out the relationship between corporate governance and corporate performance of 10 listed banking and financial institutions. Various variables like Independent Variables, Dependent variables and Control variables were used for the study. It was found that some variables like ROA, ROCE, P/E and EPS has positive relation with independent variables while net profit margin has negative relation with independent variables.

Keywords: Governance, Finance, CSR, ROA, ROCE, EPS

Introduction

The organization's policies and processes for making decisions are outlined in the corporate governance structure. Corporate Governance factors are linked with performance of a company and those factors can have both positive and negative effects on organizational performance (Demsetz & Lehn, 1985). Corporate governance has been acknowledged as critical element for creating an attractive investment climate and for efficient financial markets and is treated as a matter of regulatory compliance (Maheshwari, Maheshwari and Maheshwari, 2011). Every corporation should follow the highest degree of transparency because if a corporation does not follow the highest degree of transparency, it will not attract world-class investor which is the dire need of every corporation for surviving for long period in a competitive world.

Review of Literature

Some relevant studies related to the research topic are briefly discussed below:-

Authors	Year	Objectives of the study	Tools used for analysis	Findings
Balasubramaniam and Pradhan	2005	need of Corporate Governance in banking sector		The banking industry benefited from corporate governance since it provided effective investor protection, the capacity to raise capital, maximized shareholder value, and connected the Indian banking system with the global economy.
Antony	2010	To find out the various measures taken by government authorities to reduce the fraudulent activities by the		Good Corporate Governance had improved the value of the stakeholders and shareholders by reducing the various risks and frauds in the banks

		banks		
Pandya and Parmar	2010	To investigate the relation between Corporate Governance and public banks and between Corporate Governance and private banks	Tobin's Q and ROCE	Research findings indicate that public sector banks exhibit comparatively superior implementation of Corporate Governance practices in comparison to their private sector counterparts.
Singh and Weligamage	2011	to investigate the connection between business performance and various aspects of corporate governance.	Tobin's Q ratio, Descriptive, Correlation and Multiple Regression	There was a relationship between ownership concentration, CEO duality and performance of the firm. A strong relation was found between performance and shares owned by largest shareholders.
Deb	2013	To evaluated the implementation of Corporate Governance attributes in 5 banks comprising both public and private sector during 2010-11		Transparency, an appropriate committee structure, governance, a strong independent board, appropriate information disclosure in annual reports, prompt distribution of sensitive information, answering investor questions, the existence of an audit committee, a compensation committee, an investors grievance committee, segment reporting, and the presence of knowledgeable and capable independent directors were all highly valued by respondents.
Gupta and Sharma	2014	To focus on the association between Corporate Governance and bank performance from 2008-09 to 2011-12 of 16 public sector banks	ROE, ROA, market capitalization and market value added, Correlation and Multiple regressions	Age of the bank was significantly related to market capitalization, ratio of independent directors had positive significant impact whereas CEO duality had negative impact on market value added and number of board meetings held during the year had significant positive relation with bank performance
Ranjna	2023	To look into the association between company success and governance practices.	Panel data regression	The correlation between audit meetings and ROA and ROCE is good.

Research Methodology

Research methodology includes variables selected for the study, objectives of the study, scope of the study, selection of the sample, data collection, tools used for the analysis of the data.

Various variables used under study have been discussed as:

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Corporate Governance Variables

Independent Variables

- The share of independent board directors
- number of meetings that took place
- Audit Committee size
- Number of Committees
- Participation Rate

Dependent variables

- Return on assets (ROA)
- Return on capital employed (ROCE)
- Price/ Earnings ratio (P/E)
- Net profit margin in sales
- Earnings per share

Control variables

- Age
- Size
- Growth

Objectives of the study

- To study the corporate governance practices of selected companies under Banking and Financial Institutions.
- To examine the relationship between corporate governance and corporate performance of selected companies under Banking and Financial Institutions.

Scope of the study

The present study is limited to banking and financial institutions in India. The purpose is to determine the level of corporate governance practices employed by these chosen organizations by analyzing the practices of ten listed banking and financial institutions. The National Stock Exchange's (NSE) market capitalization was used to pick these companies.

Tools used for analysis

a) Mean of Individual Series

Mean of individual series is the average of items disclosed by the companies during the period of the study. The arithmetic mean has been calculated by using following formula:

b) **Standard Deviation**

Standard Deviation is a measure of how widely values are dispersed from the mean value. It has been used to study variation in the items disclosed by the companies. The following formula has been used:

$$\sigma = \sqrt{\frac{\Sigma x^2}{N}}$$

Where, $x = \left(X - \overline{X}\right)$, $\overline{X}$ = Actual Mean of Series, $\left(X - \overline{X}\right)$ = Deviations of the Items from the Mean, N = Sample Size

Variance Inflation Factor (VIF)

Multi collinearity means relation among regressors and it may lead to affect results of the model. Variance Inflation Factor (VIF) is used to measure the increased amount of variance of an estimated regression coefficient. If VIF values are below 10 then, there is no problem of collinearity.

Panel Data Regression

Panel data regression has been used on thirteen years' pooled data. The Fixed-effects and Random-effects regression models are two panel data models have been used in present study. The test known as the Variance Inflation Factor (VIF) has been employed to examine the issue of multicollinearity among particular variables. The Hausman's Specification test has been employed to verify if the model is suitable for analysis.

Findings

Descriptive Statistics of different variables

Table 1 show that the mean value of the participation rate is high among the independent variables used in the study. These variables include earnings per share, the firm's growth, the price/earning ratio, net profit margin in sales, the number of committees, the number of meetings held, the number of audit meetings, the ratio of independent directors on the board, the size of the firm, the size of the audit committee, ROCE, ROA and the firm's age.

Table- 1 Descriptive Statistics of different variables under Banking and Financial Institutions

Variables	Mean	S.D.	Min	Max
Ratio of Independent directors on the Board	6.16	2.20	2.00	13.00
Number of Meetings held	8.35	3.47	0.00	23.00
Audit Committee size	4.21	1.41	2.00	9.00
Number of Audit meetings	7.47	2.91	3.00	14.00
Number of Committees	8.42	4.58	2.00	20.00
Participation Rate	61.08	36.18	0.00	100.00
Age of the firm	1.43	0.31	0.78	2.08
Size of the firm	5.00	6.33	1.10	43.90
Growth of the firm	28.04	26.15	-5.14	202.32
Return on Assets (ROA)	2.01	1.00	0.53	6.31
Return on Capital Employed (ROCE)	2.81	1.46	0.67	8.01
Price/ Earning Ratio (P/E)	19.65	14.88	2.58	112.85

Net Profit Margin in Sales	18.85	7.64	6.61	42.07
Earning Per Share (EPS)	41.98	39.06	2.10	215.50

Source: Authors' computation

It also shows that the highest standard deviation is found in earnings per share, which is followed by participation rate, firm growth, price/earning ratio, net profit margin in sales, firm size, number of committees, number of meetings, number of audit meetings, ratio of independent directors on the board, size of the audit committee, return on assets and age of the company. Correlation Matrix has been used for checking the multi-collinearity among independent variables. Problem of multi- collinearity arises if correlation of independent variables with independent variables is more than 0.80.

Table- 2 Results of Random effects GLS Regression

	ROA (2)	**ROCE (3)**	**P/E (4)**	**NPMS (5)**	**EPS (6)**
R-square: Within= 0.4549 Between= 0.9293 Overall= 0.7892 No. of Obs = 130 No. of groups = 10	Wald chi2 (11) = 441.76 Prob>chi2 = 0.0000	Wald chi2 (11) = 216.06 Prob>chi2 = 0.0000	Wald chi2 (11) = 23.40 Prob>chi2 = 0.0155	F (11, 109) = 4.87 Prob>F = 0.0000	F(11,108) = 5.57 Prob>F = 0.0000
VARIABLES	**COEFFICIENT**				
Ratio of Independent Dir. on the Board	-.1397166 (-3.64)*	-.0908221 (-1.22)	1.530375 (0.97)	-.8832643 (-2.11)**	-.4576285 (-0.18)
Number of Meetings held	-.0304244 (-1.71)***	-.0661663 (-1.91)***	-.4300641 (-0.59)	-.093219 (-0.55)	.3647019 (0.35)
Audit Committee size	-.1835998 (-3.23)*	.0435048 (0.39)	-.2105731 (-0.09)	-.410584 (-0.65)	10.9003 (2.83)*
Number of Audit meetings	-.165396 (-8.80)*	-.2357684 (-6.45)*	1.97441 (2.56)*	-1.15466 (-3.68)*	-2.042395 (-1.07)
Number of Committees	-.0415308 (-3.68)*	-.0941023 (-4.29)*	-.3018739 (-0.65)	.0301573 (0.14)	3.426627 (2.64)*
Participation Rate	.0050947 (2.54)**	.0196795 (5.04)*	.1310515 (1.59)	-.0080075 (-0.32)	-.3714482 (-2.47)**
Age	1.032325 (4.22)*	2.770845 (5.82)*	-.8591248 (-0.09)	13.00482 (2.09)**	80.5052 (2.14)**
Size	.0762574 (8.01)*	.0746532 (4.03)*	.254512 (0.65)	.3571283 (3.77)*	-.212584 (-0.37)
Growth	.0009194	-.0073187 (-	.1921725	.0200758	-.0211122 (-

	(0.50)	2.05)**	(2.55)**	(1.21)	0.21)
Constant	3.068248 (5.02)	1.997151 (1.68)	.0958158 (0.00)	7.458817 (0.80)	-153.0842 (-2.71)
Durbin- Watson Test	**1.014499**	**1.284838**	**1.179235**	**1.042076**	**1.056898**

Column 2 presents the findings from a Random Effects GLS Regression of Banking and Financial Institutions across the study period. The results of the Hausman test, which used ROA reveal that the Random Effects GLS Regression was applied to Banking and Financial Institutions. The resultant value was -4.57. The value for each of the chosen variables is less than 10. The Durbin-Watson test result of 1.01 falls inside suggested limit, suggesting auto correlation is not a problem for this model. The Wald chi-square value is 441.75. With R2 value of 0.7892, its results show that a few key factors explain for 78.92% of variations in the dependent variable, Return on Assets (ROA). The participation rate, company age, and firm size have all been shown to have a positive and significant relationship with return on assets. Furthermore, according to Shukla (2011), there is a favorable correlation between size and corporate performance.

The findings from a Random Effects GLS Regression of Banking and Financial Institutions across the study period are displayed in Column 3 with ROCE. The results of the Hausman test, which used ROCE, reveal that the Random Effects GLS Regression was applied to Banking and Financial Institutions. The values of the test are -36.61. When multicollinearity is present in the model, it is tested using the VIF test and it has less than 10. The Durbin-Watson test value is 1.28 and it indicates that auto correlation is not an issue in this model. The Wald chi-square value of 216.06 demonstrates the validity and relevance. Given that value of R2 is 0.6468, the panel data results indicate that certain specific factors account for 64.68% of the changes in the dependent variable, or return on capital employed. It reveals that the performance of the firm has been significantly influenced by four independent variables and three control variables. The returns on capital employed have a significant relationship with participation rate, age of the company, and size of the company at a significance level of 1%.

Column 4 presents the findings from a Random Effects GLS Regression of Banking and Financial Institutions across the study period. The dependent variable in this regression was the Price/Earning ratio (P/E), which was also paired with other independent and control variables. The application of Random Effects GLS Regression on Banking and Financial Institutions with Price/Earning ratio is shown by the Hausman test, which has a value of -12.23. The value for each of the chosen variables is less than 10. It so indicates that multicollinearity is not an issue in this model. Panel data results indicate that certain factors account for 16.55% of fluctuations in the dependent variable, price/earning ratio, as indicated by the R2 value of 0.1655.

In Column 5, the dependent variable in this regression is NPMS. The value for each of the chosen variables is less than 10. The results indicate that multicollinearity is not an issue in this model. With earnings per share (EPS) and other independent and control variables as the other variables over the study period, Column 6 the Fixed Effects GLS Regression is applied to Banking and Financial Institutions, the resultant variable is Earnings per share (EPS). When multicollinearity is present in the model, it is tested using the VIF test. Panel data results indicate that certain factors account for 35.98% of the fluctuations in the dependent variable, earnings per share (EPS), as indicated by the R2 value of 0.3598. It shows that the age of the company and four independent variables have had a major impact on the company's success. Earnings per share are negatively and significantly correlated with the participation rate.

Conclusion

Corporate governance has been acknowledged as critical element for creating an attractive investment climate and for efficient financial markets and is treated as a matter of regulatory compliance (Maheshwari, Maheshwari and Maheshwari, 2011). Every corporation should follow the highest degree of transparency because if a corporation does not follow the highest degree of transparency, it will not attract world-class investor which is the dire need of every corporation for surviving for long period in a competitive world. ROCE has positive and significant relationship with

participation rate while negative and significant relationship with number of meetings held, audit committee size, number of audit meetings and number of committees. P/E ratio has positive and significant relationship with number of audit meetings. Net Profit margin in Sales has negative and significant relationship with ratio of independent directors on the board.

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