Original Research

IMPACT OF CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE OF SELECTED COMPANIES IN PHARMA SECTOR

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Abstract :

The purpose of this paper is to examine the extent to which corporate governance have impact on financial performance of selected companies in pharma sector . The study analyses whether there is any significant relationship between the board meeting, board size, board committee and composition of board with ROCE & EPS of the selected pharma companies. The paper studies the annual reports of top 5 large cap companies, mid cap companies, small cap companies. The study period considered for one year i.e., 2020 to 2021.The score is given on a three-point scale from 0 to 2 . The study shows there is no significant impact of corporate governance on financial performance of selected companies in pharma companies irrespective of their market capitalisation . The selected companies have impressive level of corporate governance practices and all companies follows SEBI LODR regulations 2015 which is mandatory to be followed by all listed companies.

Introduction :

The root of the word Governance comes from the Greek word '***Kubernaein'***, which means to steer and the word corporate is derived from '***corpus'*** Latin word for body or body of people. Corporate governance refers to actions taken by organizations to improve relationships and interactions with various stakeholders of corporations such as investors, workers, government, consumers and business partners, NGOs engaging in community activities and promoting good environmental practices. The concept of corporate governance covers a set of rules, procedures and operational structure that guides the short-term and the long-term actions of companies. These actions include establishing codes of conduct for employees and balancing the interests of all stakeholders. It is a system by which the organs of corporations such as the board, managers, shareholders and other stakeholders spell out the rules and procedures for making decisions on corporate affairs.

Corporate governance caught the attention of researchers during 1998 with the confederation of Indian industry publishing the desirable voluntary code .SEBI made headway in the field of corporate governance by formulating the first ever formal regulatory framework for listed companies on corporate governance in

February 2000 under clause 49 of the listing agreements. These regulations were framed based on the suggestions of Kumara Mangalam Birla committee report 1999 . These regulations were amended in October 2004 based on the proposals of Narayana Murthy committee report 2003. The ministry of corporate affairs formulated guidelines on corporate governance for voluntary adoption by the corporate sector in December 2009.

The relationship between good corporate governance and creation of value for an organization, there is strong evidence in the past to affirm the destruction of good values by bad corporate governance . This was strongly demonstrated by the Satyam scandal in India during 2008-09 and instances in the corporate world such as Enron , WorldCom etc. Hence, weak corporate governance is a red signal which has to be carefully monitored by all stakeholders of corporations as well as government regulatory bodies.

SEBI LODR (Listing Obligations and Disclosure Requirements) is one of the most important regulations mandated by the Securities and Exchange Board of India to enable transparency and fair disclosures by all listed entities in India. It was issued with the aim to consolidate and streamline the provisions of existing listing agreements for different segments of capital markets such as equity shares , non – convertible shares etc. and disclosure norms in relation thereto, thereby ensuring better enforceability. The listing Regulations are applicable to a listed entity who has securities listed on stock exchange. All listed entities shall be required to execute a "Uniform Listing agreement" with recognized stock Exchange within six months from the effective date of the listing agreement.

Corporate Governance Variables/Indicators :

1. **Board Size :**

   Board of directors basically comprises executive, non-executive and independent directors. It is very important to have an appropriate number of directors on board including executive and non-executive directors. According to LODR and Companies Act a listed company can appoint up to 15 directors and can appoint more than 15 after passing a special resolution. The literature reviews support the optimum board size to be of seven to eight directors so that   the board can function effectively.

2. **Composition of Board :**

   The board is composed of various types of directors i.e., dependent and independent. The board is to maintain independence by bringing outside directors (independent directors) into the board. Independent directors can monitor the acts of executive (inside) directors and other key personnel for the protection of stakeholders' interest. Thus, composition of the board requires the right proportion of dependent and independent directors so as to facilitate effective board management (Arosa, Iturralde, & Maseda, 2010).

3. **Board Meeting :**

   The board shall meet at least four times a year, with a time gap of maximum four months between any two meetings. As per the past literature, companies that conducted more frequent board meetings have shown a positive sign of performance (Kajananthan, 2012).

4. **Board Committee :**

   The board committees include various committees under which various members of the board of directors carry out specified programs or functions dispensed by the board. These committees can be, Audit Committee; Nomination and Remuneration Committee; Risk committee; Corporate Social Responsibility (CSR) Committee (Hayes, Mehran, & Schaefer, 2005); and Stakeholders Relationship Committee and so on.

Review of Literature :

Mayur & Saravanan (2017) analysed data from 40 Indian banks for the time frame (2008 to 2012) to assess the relationship between board size and bank performance. The result showed board size bearing a favourable consequence on firm performance only in high and middle range whereas the impact was adverse in intermediate board size. According to Pandya(2011) The study of corporate governance on the financial performance of the Indian banks shows a positive result as there was a significant impact of board independence on the financial performance of the bank.

Significance of the Study :

From general perception it can be understood that there's a significant relationship and impact of the board is on companies' performance. How significant it will be, is the concern of the study. The variables relating to the board, which are considered to be significantly affecting its performance, are undertaken in the study. These variables have been extracted from SEBI LODR regulations of 2015, Companies Act and Revised Clause 49. The variables are Board Size, Composition of Board, Board Meeting, Board Committee .

Research Objective :

To examine the impact of composition of board and board committee and board meetings on EPS and ROCE of selected pharma companies.

Research Methodology :

Research Design :

This is an empirical research of 15 Pharma companies from the BSE 100 Index that includes top 5 Large-cap companies, Mid-cap companies and Small-cap companies. The study used a non-probability technique called judgment sampling. The data for the study has gathered from annual reports of the selected Pharma companies for the period 2020-2021. To achieve the objectives of this study , the correlation, regression, and ANOVA tests are performed to investigate the significant relationships and causal effect of the Board with the financial performance of the selected Pharma companies.MS Excel was used to perform all the tests in this study.

Following are the variables in the study :

Table no.1	
Variables	
Dependent Variables	
ROCE	Return On Capital Employed
EPS	Earnings Per Share
Independent Variables	
BS	Board Size
COB	Composition Of Board
BM	Board Meeting
BC	Board Committee

Hypotheses :

Following Null and Alternative Hypotheses was framed for three categories of companies i.e., for Large-cap companies, Mid-cap companies, and Small-cap companies :

1.   Large - Cap Companies :

H0: There is no significant impact of Composition of Board, Board Meeting, and Board Committee on ROCE.

H1: There is a significant impact of Composition of Board, Board Meeting, and Board Committee on ROCE.

H0: There is no significant impact of Composition of board, Board Meeting, and Board Committee on EPS.

H1: There is a significant impact of Composition of Board, Board Meeting, and Board Committee on EPS.

2.   Mid - Cap Companies:

H0: There is no significant impact of Composition of Board, Board Meeting, and Board Committee on ROCE.

H1: There is a significant impact of Composition of Board, Board Meeting, and Board Committee on ROCE.

H0: There is no significant impact of composition of board, board meeting, and board committee on EPS.

H1: There is a significant impact of composition of board, board meeting, and board committee on EPS.

3.   Small-Cap Companies:

H0: There is no significant impact of Composition of Board on ROCE.

H1: There is a significant impact of Composition of Board ROCE.

H0: There is no significant impact of Composition of Board on EPS.

H1: There is a significant impact of Composition of Board EPS.

H0: There is no significant impact of the Board meeting on ROCE.

H1: There is a significant impact of the Board Meeting ROCE.

H0: There is no significant impact of the Board Meeting on EPS.

H1: There is a significant impact of Board Meetings on EPS.

H0: There is no significant impact of the Board Committee on ROCE.

H1: There is a significant impact of the Board Committee on ROCE.

H0: There is no significant impact of the Board Committee on EPS.

H1: There is a significant impact of the Board Committee on EPS.

Corporate Governance Score Criteria :

The Composition of the Board consists of parameters such as Number of independent directors, Number of Women directors and Proportion of Non-Executive directors. The CG score was given on a 3-point scale from 0 to 2.

The Board Meeting consists of parameters such as Meeting Frequency, Meetings Attended and Annual General Meeting Attendance .The CG score was given on a 3-point scale from 0 to 2 .

The Board Committee consists of the Audit Committee, Nomination Remuneration committee, and Stakeholders Relationship Committee. These Board committees have parameters such as Number of directors, Number of independent directors and Meeting frequency. The score is given using a 3-point scale from 0 to2.

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Limitations :

1. The study is only focused on board components like board meetings, board size, board composition and committee .
2. The study is based on secondary data.
3. The companies taken for study are top 5 companies from large cap, mid cap, and small cap.
4. The period taken for the study is only for one year.
5. The findings are based on judgment sampling and not on census method.
6. The study faced time constraints, as the study was carried out by an individual researcher.

Data Analysis and Interpretation :

The results of the study is divided into three parts

1. The first part deals with large cap companies.
2. The second part deals with mid-cap companies.
3. The third part deals with small- cap companies.

1. Large-Cap Companies :

In this section top five pharma companies having large market capitalization are taken into consideration and these companies are Sun pharma, Divis lab, DR. Reddy's labs, Cipla and Gland pharma.

Table no.2

Sr. No.	Name of Companies	Composition of Board	Board Committe	Board Meetings	Board Size	Roce	EPS
1.	Sun Pharma	5	4.7	7	1	8.15	8.92
2.	Divis Labs	6	5.7	7	2	27.28	73.63
3.	Dr. Reddy's Labs	6	6.7	8	1	18.17	131.84
4.	Cipla	4	6.7	8	2	16.75	30.61
5.	Gland	4	4.7	6	1	22.36	63.07

Above table no.2 shows the corporate governance scores obtained by the companies with regard to their composition of board ,board committee, board meeting and board size while ROCE & EPS are the financial indicators taken as dependent variables

Correlation Analysis :

From correlation Analysis it was found that Composition of Board had a positive weak correlation with ROCE at 0.22 and had a positive moderate correlation with EPS at 0.59.Board Committee has a positive weak correlation with ROCE at 0.15 and had a slightly moderate positive correlation with EPS at 0.48. Board Meetings had a slightly moderate positive correlation with ROCE at 0.44 and had a negative weak correlation with EPS at -0.25.Board Size had a slightly moderate positive correlation at 0.44 with ROCE and had a negative weak correlation with EPS at -0.18.

Summary of Regression and ANOVA Analysis :

Table no. 3

Regression Statistics	p-value	Hypotheses	Results
0.68	0.35	There is no significant impact of Composition of Board, Board Committee and Board Meetings on ROCE of large cap companies.	Accepted
-0.005	0.61	There is no significant impact of Composition of Board, Board Committee and Board Meetings on EPS of large cap companies.	Accepted

Above table no.3 shows summarized Results of Regression and ANOVA Analysis of Large-Cap companies . From the results of Regression Statistics, it was found that only 68% of variance was explained by Predictor variables with ROCE as dependent variable but in case of analysis with EPS as dependent variable the Adjusted – R square was -0.005 thus model was not a good fit model. The ANOVA analysis results shows that the model had an overall p-value of 0.35 and 0.61 thus indicates that there was no significant relation between independent variables and dependent variables i.e., ROCE & EPS as the p-values are greater than the level of significance at 0.05. Hence, it can be inferred that the null hypothesis was Accepted.

2.   **Mid-Cap Companies :**

In this section top five mid cap companies were taken into consideration and these companies are Ajanta pharma, Sanofi India, Alembic pharma , Natco pharma, Glenmark .

Table no.4

Sr. No.	Name of Companies	Composition of Board	Board Committe	Board Meetings	Board Size	Roce	EPS
1	Ajanta Pharma	3	5.3	7	1	30.13	77.59
2	Sanofi India	5	5.7	8	2	32.29	207.38
3	Albemic Pharma	5	6.0	8	1	25.28	60.81
4	Natco Pharma	3	6.0	8	1	9.52	16.99
5	Glenmark	6	6.3	8	2	11.79	58.46

Above table.no 4 shows the overall scores obtained by the companies in regard to their composition of board ,board committee, board meeting and board size . ROCE & EPS are the financial indicators taken as dependent variables.

Correlation Analysis :

From Correlation Analysis it was found that Composition of Board had a weak negative correlation at -0.33 with ROCE and had a weak positive correlation with EPS at 0.341.Board Committee had a moderate negative correlation with ROCE at -0.77 and had a slightly moderate negative correlation with EPS at

-0.41.Board Meetings had a slightly moderate negative correlation at -0.44 with ROCE and had a weak positive correlation with EPS at 0.051. Board Size had a weak positive correlation With ROCE at 0.02 and had a weak moderate positive correlation with EPS at 0.61.

Summary of Regression and ANOVA Analysis :

<p align="center">**Table no. 5**</p>

Regression Statistics	p-value	Hypotheses	Results
0.78	0.29	There is no significant impact of Composition of Board, Board Committee and Board Meetings on ROCE of large cap companies.	**Accepted**
0.66	0.36	There is no significant impact of Composition of Board, Board Committee and Board Meetings on EPS of large cap companies.	**Accepted**

Above table no. 5 shows summarized Results of Regression and ANOVA Analysis of Mid-Cap companies . From the results of Regression Statistics, it was found that 78% of variance was explained by Predictor variables with ROCE as dependent variable and in case of analysis with EPS as dependent variable 66% of variance was explained by predictor variables thus indicating a good fit model. The ANOVA analysis results shows that the model had an overall p-value of 0.29 and 0.36 thus indicating that there was no significant relation between independent variables and dependent variables i.e., ROCE & EPS as the p-values are greater than level of significance at 0.05. Hence, it can be inferred that the null hypothesis was Accepted

3.   Small-Cap Companies

In this section analysis is done for the top five small- cap pharma companies. These companies are Aarti drugs, FDC LTD, Shilpa , wockhardt, and strides pharma.

<p align="center">**Table no.6**</p>

Sr. No.	Name of Companies	Composition of Board	Board Committe	Board Meetings	Board Size	Roce	EPS
1	Aarti Drugs	5	5.7	8	2	32.29	27.65
2	FDC	6	4.7	7	1	22.04	17.32
3	Shilpa	5	3.3	8	1	10.73	18.13
4	Wockhardt	5	6.0	8	2	-12.26	53.57
5	Strides Pharma	5	6.7	8	1	4.87	8.73

Above table.no 6 shows the overall scores obtained by the companies in regard to their composition of board ,board committee, board meeting and board size . ROCE & EPS are the financial indicators taken as dependent variables.

Correlation Analysis :

From correlation Analysis it was found that Composition of Board had a weak positive correlation with ROCE at 0.34 and had a negligible weak negative correlation at -0.25 with EPS. Board Committee had a negligible weak negative correlation with ROCE at -0.26 and had a negligible weak positive correlation at 0.19 with EPS . Board Meetings had a weak negative correlation with ROCE at -0.34 and had a negligible weak positive correlation with EPS at 0.25. Board Size had a negligible weak negative correlation With ROCE at -0.08 and had a highly strong positive correlation with EPS at 0.82.

Summary of Regression and ANOVA Analysis :

Table no. 7

Regression Statistics	p-value	Hypotheses	Results
0.119	0.56	There is no significant impact of Composition of Board on ROCE on small-cap companies.	**Accepted**
0.063	0.68	There is no significant impact of Composition of Board on EPS on small-cap companies.	**Accepted**
0.069	0.66	There is no significant impact of Board Committee on ROCE on small-cap companies.	**Accepted**
0.036	0.75	There is no significant impact of Board Committee on EPS on small-cap companies.	**Accepted**
0.119	0.56	There is no significant impact of Board Meeting on ROCE on small-cap companies.	**Accepted**
0.063	0.68	There is no significant impact of Board Meeting on EPS on small-cap companies.	**Accepted**

Above table.no 7 shows summarized Results of Regression and ANOVA Analysis of Small-Cap companies . From the results of Regression Statistics, it was found that only 11.9% of variance was explained by Composition of board , 6.9% of variance was explained by Board Committee and 11.9% of variance was explained by Board Meeting with ROCE as dependent variable and in case of analysis with EPS as dependent variable only 6.3% of variance was explained by Composition of Board,3.6% of variance was explained by Board Committee and 6.3% of variance was explained by Board Meeting. The ANOVA analysis results show that the model has an overall p-value of 0.56, 0.66, and 0.56 thus indicating there was no significant relation between Composition of board , Board committee , Board Meeting and ROCE . The overall p-value of the model with EPS as dependent variable is 0.68, 0.75 and 0.68 thus indicating there was no significant relationship between Composition of board , Board committee, Board Meeting and EPS. Hence, it can be inferred that the null hypothesis was Accepted.

Conclusion :

From the study it was found that there was no significant impact of corporate governance on financial performance of the selected pharma companies .It was also observed that all the selected companies followed SEBI LODR regulations 2015 . The SEBI LODR regulations was formed in the year 2015 as these regulations were made mandatory to all listed companies. These regulations get updated from time to time. The period taken for the study i.e., 2020-2021 itself speaks volume on how much the corporate governance environment has changed from its initial stages, as all selected companies have an impressive level of corporate governance practices irrespective of their market capitalization. Even though the study had its own limitations it can be concluded that there was no significant impact of corporate governance on financial performance of selected companies in Pharma sector.

Further Areas of Research :

There is scope for further research by adding more corporate governance variables like disclosure practices which is a main component of corporate governance or variables like CEO duality, board diversity , ownership concentration the study can also be extended by using different sectors or financial indicators like ROE, ROA, or other financial indicator ratios. There is always a scope for further research in corporate governance as it is always improving and progressing.

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