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## **CORPORATE GOVERNANCE DISCLOSURE PRACTICES AND ITS IMPACT ON FINANCIAL PERFORMANCE: A CASE STUDY ON FMCG SECTOR IN INDIA**

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### ***Abstract***

In the present study it is examined whether Corporate Governance Score and other financial variable significantly affects MV/BV Ratio, Tobin's Q as well as Market Capitalisation or not. The data relating to nonfinancial parameters have been collected from Corporate Governance Report and for financial parameters Annual reports of the selected companies are studied. The present study is undertaken for the period 2012-13 to 2016-17. Ten Companies belonging to FMCG Sector have been considered for the study. The Disclosure score is calculated by assigning a weight to each of the parameter. Companies are scored out of 100 for their corporate governance practices and disclosures. The data is panel data so for each sector one way Random Effect Model or Fixed Effect Model is used. It is identified that disclosure practices have increased firm performance.

**Keywords :** Corporate Governance, Financial Performance, Corporate Governance Disclosure Score, Tobin's Q, MV/BV Ratio





## INTRODUCTION

Debnath(2018) has discussed in his paper that India is an emerging market economy endeavoring for economic growth where in the recent years, corporate governance has emerged as an important issue. Good governance witness that company is managing its business affairs in responsible and accountable manner towards all its stakeholders. As a result, Corporate governance mechanism is set up to ensure that all external investors receive proper returns on their investments.

Baral & Parida (2018)said in their paper that business world has seen many corporate scandals in past years and till date it hashindered the trust and faith of stakeholders on the governance and controlling mechanism of firms.

Therefore, the present study primarily focuses to analyse the impact of corporate governance on firm performance in India.

## LITERATURE REVIEW:

Joseph & Kumar (2011) have done considerable research to identity the determinants of firm performance. In the present study, It was hypothesized that dividend payout can be determined by the strength of corporate governance. Transparency disclosure Index was used and incorporated suitable sub-indices pertaining to FMCG companies. The analysis indicated strong positive correlation between the Transparency disclosure Index and Dividend payout. So, it was concluded that corporate governance was a significant determinant of dividend policy in the FMCG segment.

Roy (2014) has examined whether the firm's distinctive features has driven companies in India to superior governance and sustainability reporting. A comparison was made of corporate governance with balance sheet model and corporate governance beyond balance sheet model. In the first approach, Standard & Poor's Environmental, Social and Governance (S&P ESG) ranking as on June 29, 2012 and firm's financial ratios were compared for a period of 2008 to 2012. In second approach, regression model was used to know the impact of Market value as measured by Tobin's Q and accounting measures like Sales, RONW, ROCE, Debt/Equity Ratio and PAT on Governance Score. It was observed from the findings that sales and RONW have a significant impact on CG Score at 10% significance level. The firms with higher governance score have high market value as well as they are less leveraged.

Haldar & Raithatha (2017) have examined the impact of CG Practices on the level of financial disclosures made by the 200 large listed Indian Firms. They have also drawn inference from an exhaustive list of disclosures proposed by Indian Accounting Standards to determine the level of disclosures for each firm. The result revealed that 1/3 companies had complied with the majority of stipulated standards wherein 25 companies fell below the satisfactory compliance. Regression analysis confirmed the positive relationship between financial disclosures and CG Practices. In addition, CG score measured for individual sub-indexes were significant with positive co-efficient board sub index and Audit Sub Index which signified that board reduced the dominance of CEO encouraging full disclosure for stakeholders and also emphasis on effectiveness of internal control system.

Kaushik & Jain (2018) had examined the effect of revised Clause 49, 2014 on agriculture and allied firms in India. The study was of eleven years from 2007 to 2017. The analysis was done for two-time frames: 2007 to 2014 and 2015 to 2017. The implications of corporate governance was measured through six variables viz. board size, board independence, number of board meetings attended by the independent directors, percentage of annual general meeting attended by the independent directors, related party income and related party expenses and Firm performance was measured by three variables; ratio of EBIT to assets, ratio of sales to assets, and earning per share (EPS). Panel data regression was used because collected data was a combination of time series and cross-sectional. The results of the study suggested that revised Clause 49, 2014 did not have significant effect on the financial performance of the firms. Hence, regulators need take a note that these firms require different set of practices in managing their operating activities.

Sreenu (2017) has provided an insight into the relationship between financial decision structure, corporate Governance diversification and firm financial performance in the Indian context by exploring the impact of corporate governance on firm's financial performance. The survey was conducted to analyze data





on corporate financial decision, corporate governance, financial performance associated with the capital budgeting techniques to capital structure, cost of capital, and dividend policy. The selection of companies was based on non-probability purposive sampling (Stepwise sampling) from financial year 2005-06 to financial year 2015-16. The findings of the study suggested that corporate governance and corporate financial performance are correlated and governance assessment of company has significant positive impact on its financial performance. Even findings also supported decision of company to improve its governance structure.

### RESEARCH METHODOLOGY:

The present study is analytical in nature. It has examined the Corporate Governance Disclosure Practices followed by the sample companies. The data relating to nonfinancial parameters have been collected from Corporate Governance Report and for financial parameters Annual reports of the selected companies have been studied. The present study has been undertaken for the period 2012-13 to 2016-17. Ten considered companies belonging to FMCG Sector for the study are enumerated as under:

Sr. No.	Name of Companies	Sr. No.	Name of Companies
1	Bajaj Corp Ltd.	6	Emami Ltd.
2	Britannia Industries Ltd.	7	Hindustan Uniliver Ltd.
3	Colgate Palmolive Ltd.	8	ITC Ltd.
4	Dabour India Ltd.	9	Marico Ltd.
5	Godrej Consumer Products Ltd.	10	Asian Paints Ltd.

It has been attempted to evaluate the whole mechanism of the corporate governance adopted by considered companies in the FMCG sector. The Disclosure score is calculated by assigning a weight to each of the parameter. Companies are scored out of 100 for their corporate governance practices and disclosures. Financial parameters apart from nonfinancial parameters used were Return on Assets, Return on Equity, Debt Equity Ratio, Dividend Payout Ratio, Market Value to Book Value Ratio, Tobin's Q, Sales Growth, Net profit Margin, Net Assets Value and Market Capitalisation.

### TOOLS AND TECHNIQUES USED:

For the purpose of analysis of data, the Statistical techniques viz. Shapiro Wilk Test and Panel Data Regression Analysis are used. Statistical Analysis is done using SPSS 21(trial version), SYSTAT 13(trial version) and EViews 10 Student Version Lite.

Correlation Analysis of CG Score with Parameters of Financial Performance:

In the present study it is examined whether Corporate Governance Score and other financial variable significantly affects MV/BV Ratio, Tobin's Q as well as Market Capitalisation or not. For this purpose, significant coefficient of correlation is tested. Using Shapiro Wilk test statistic, normality assumption is tested as data is less than 100. As data is nonnormal, to test the significant correlation coefficient between any two parameters of financial indicators, Kendal Tau test (nonparametric test) is used.

It can be seen from the Table No. 2 that MV/BV Ratio, Tobin's Q and Market Capitalisation have significant positive correlation with CG Score for FMCG Sector. MV/BV Ratio has positive correlation with CG Score, ROA, ROE, Tobin's Q, DPR, Market Capitalisation, NAV whereas negative correlation with D/E Ratio and NPM at 10% sig. level. Tobin's Q has positive correlation with CG Score, ROA, ROE, DPR, NAV and MV/BV





Ratio whereas negative correlation with D/E Ratio and NPM at 5% sig. level. Market Capitalisation has positive correlation with CG Score, NAV and MV/BV Ratio whereas negative correlation with D/E Ratio and Sales Growth at 10% sig. level for FMCG Sector.

**Table No. 2 : Correlation Coefficient : FMCG Sector**

		CG SCORE	ROA	ROE	D/E RATIO	TOBINQ	DPR	SALES GROWTH	NPM	MARKET CAP	NAV	MV/BV RATIO
CG SCORE	r	1.000										
	p value											
ROA	r	.121	1.000									
	p value	.229										
ROE	r	.094	.543	1.000								
	p value	.350	.000									
D/E RATIO	r	-.249	-.398	-.374	1.000							
	p value	.021	.000	.000								
TOBINQ	r	.354	.326	.541	-.322	1.000						
	p value	.000	.001	.000	.002							
DPR	r	.276	.357	.216	-.324	.192	1.000					
	p value	.006	.000	.027	.002	.049						
SALES GROWTH	r	-.320	.039	.064	.022	-.008	-.161	1.000				
	p value	.002	.688	.514	.832	.933	.101					
NPM	r	-.048	.217	-.078	.005	-.238	.231	-.067	1.000			
	p value	.631	.027	.427	.965	.015	.018	.492				
MARKET CAP	r	.457	-.035	-.045	-.287	.159	.109	-.171	-.120	1.000		
	p value	.000	.719	.645	.006	.103	.266	.082	.219			
NAV	r	.398	.058	.143	-.309	.252	.166	-.200	-.205	.685	1.000	
	p value	.000	.553	.143	.003	.010	.089	.041	.036	.000		
MV/BV RATIO	r	.360	.229	.540	-.289	.858	.171	-.031	-.256	.161	.267	1.000
	p value	.000	.019	.000	.006	.000	.080	.750	.009	.099	.006	

**Panel Data Regression Analysis:**  
 Panel data (also known as longitudinal or cross-sectional time-series data) is a dataset in which the behavior of companies is observed across time. Panel data considers individual heterogeneity which leads to efficient estimates. The regression model of panel data is known as panel data regression model. First of all, both Fixed Effect Model and Random Effect Model were fitted then using

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Hausman test it was checked whether Random Effect Model is appropriate or not. If not then Fixed Effect Model is fitted and once again it was tested using Wald test whether Pooled Regression Model or Fixed Effect Model is appropriate. In present study one way Fixed Effect Regression Model or one way Random Effect Regression Model is used for Tobin's Q, MVBV and Market Capitalisation using CG Score as an independent variable and ROA, ROE, D/E Ratio, DPR, Sales Growth, NPM, NAV and Firm Size as controlled variables.

Panel Data Regression Model for Tobin's Q

**Table No. 3: Random Effect Model of Tobin's Q for FMCG Sector**

Dependent Variable: TOBINQ  
 Method: Panel EGLS (Cross-section random effects)  
 Periods included: 5  
 Cross-sections included: 10

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-10.25834	9.779589	-1.048954	0.2998
CG SCORE	0.173937	0.117479	1.480589	0.1457
ROE	0.232508	0.026001	8.942179	0.0000
D/E RATIO	-3.232254	6.233191	-0.518555	0.6066
FIRM SIZE	-0.012197	0.550653	-0.022150	0.9824
R-squared	0.691341	F-statistic	25.19805	
S.E. of regression	3.395894	Prob(F-statistic)	0.000000	

From Table No. 3, it can be observed that p value (0.000) of the F statistic (25.198) is less than 0.05. So model is statistically significant. ROE affects positively to Tobin's Q at 1% level of significance and CG Score





affects positively to Tobin's Q but statistically the effect is not significant. The variation in Tobin's Q is explained 69.13% by the all explanatory and control variables together. Assuming control variables as constant, if CG Score increases by one unit across time and between companies then Tobin's Q goes up on an average by 0.174 percent. Same way, assuming independent and other control variables as constant, if ROE increases by one percent across time and between companies then Tobin's Q goes up on an average by 0.23 percent. D/E Ratio and firm size do not impact significantly on Tobin's Q as p value is greater than 0.05. If all control variables and independent variable are zero then average common value of intercept is -10.26.

$$Tobin's \hat{Q}_{it} = -10.26 + 0.174CGScore_{it} + 0.232ROE_{it} - 3.23D/ERatio_{it} - 0.012FirmSize_{it}$$

$H_0$  : Random Effect Model is appropriate.

$H_1$  : Fixed Effect Model is appropriate.

Table No. 4.: Hausman Test – Tobin's Q for FMCG Sector			
Correlated Random Effects - Hausman Test			
Equation: Untitled			
Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	1.760565	4	0.7797

From the above Table No.4, it can be observed that p value of Hausman chi square test is 0.7797 i.e. greater than 0.05. So,  $H_0$  cannot be rejected. So, the fitted Random Effect Model of Tobin's Q for FMCG Sector is appropriate. Panel Data Regression Model for Market Capitalisation

Table No. 5: Random Effect Model of Market Cap for FMCG Sector				
Dependent Variable: MARKETCAP				
Method: Panel EGLS (Cross-section random effects)				
Periods included: 5				
Cross-sections included: 10				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-5353.542	64244.84	-0.083330	0.9340
CG SCORE	558.8559	668.5128	0.835969	0.4078
DPR	62.99714	208.1242	0.302690	0.7636
SALES GROWTH	-375.0780	419.9937	-0.893056	0.3768
NPM	-886.2171	1147.825	-0.772084	0.4443
NET ASSETS VALUE	20.27742	1.870390	10.84127	0.0000
D/E RATIO	-42641.48	36936.77	-1.154445	0.2547
R-squared	0.746144	F-statistic	21.06459	
S.E. of regression	18745.19	Prob(F-statistic)	0.000000	

For FMCG Sector, it was observed through Hausman test that Random Effect Model is appropriate. From Table No. 5, it can be observed that p value (0.000) of the F statistic (21.06) is less than 0.05 so model is statistically significant. Net Asset Value affect positively to Market Capitalisation at 1% level of significance and CG Score also affects positively to Market Capitalisation but statistically the effect is not significant. The variation in Market Capitalisation is explained 74.61% by the all explanatory and control variables together. Assuming control variables as constant, if CG Score increases by one unit across time and between companies then Market Capitalisation goes up on an average by 558.86 crore rupees. Same way, assuming independent and other control variables as constant, if NAV increases by one crore rupees across time and between





companies then Market Capitalisation goes up on an average by 20.28 crorerupees. D/E Ratio, DPR, CG Score, sales growth and NPM do not impact significantly to Market Capitalisation as p value is greater than 0.05. If all control variables and independent variables are zero then average common value of intercept is -5353.54.

$$\hat{MarketCap}_{it} = -5353.54 + 558.86CGScore_{it} + 62.99DPR_{it} - 375.08SalesGrowth_{it} - 886.22NPM_{it} + 20.28NAV_{it} - 42641.48D / ERatio_{it}$$

$H_0$  : Random Effect Model is appropriate.

$H_1$  : Fixed Effect Model is appropriate.

Table No. 6: Hausman Test – Market Cap for FMCG Sector			
Correlated Random Effects - Hausman Test			
Equation: Untitled			
Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	10.193007	6	0.1168

From the above Table no. 6, it can be observed that p value of Hausman chi square test is 0.1168 i.e. greater than 0.05. So,  $H_0$  cannot be rejected. So, the fitted Random Effect Model of Market Cap for FMCG Sector is appropriate.

Panel Data Regression Model for MV/BV Ratio For FMCG Sector, it was observed through Hausman test that Random Effect Model is not appropriate. So, Fixed Effect Model is fitted. From Table No. 7, it can be observed that p value (0.000) of the F statistic (45.36) is less than 0.05. So model is statistically significant. CG Score and ROE affect positively to MV/BV Ratio at 1% level of significance. The variation in MV/BV Ratio is explained 93.64% by the all explanatory and control Variables together. Assuming control variables as constant, if CG Score increases by one unit across time and between companies then MV/BV Ratio goes up on an average by 0.379 times. Same way, assuming independent and other control variables as constant, if ROE increases by one percent across time and between companies then MV/BV Ratio goes up on an average by 0.256 times. Sales Growth does not impact significantly to MV/BV Ratio as p value is greater than 0.05. The intercept value for Bajaj Corp. Ltd. is -32.07, for Britannia Industries Ltd. is -29.65, for Colgate Palmolive Ltd. is -22.24 and so on. The intercept value for each company is different may be due to unique feature of the company and the difference is statistically significant all companies except two companies. So, again it is tried to check whether Fixed Effect Model is appropriate or not. If Fixed Effect Model is not appropriate then Pooled Regression Model can be considered as appropriate.

Table No. 7: Fixed Effect Model of MV/BV Ratio for FMCG Sector				
Dependent Variable: MVBV				
Method: Panel Least Squares				
Periods included: 5				
Cross-sections included: 10				
MVBV=C(1)+C(2)*CG SCORE+C(3)*ROE+C(4)*SALES GROWTH+C(5) *D2+C(6)*D3+C(7)*D4+C(8)*D5+C(9)*D6+C(10)*D7+C(11)*D8+C(12) *D9+C(13)*D10				
	Coefficient	Std. Error	t-Statistic	Prob.
C(1)	-32.06697	9.426593	-3.401756	0.0016
C(2)-CG Score	0.379230	0.103909	3.649617	0.0008
C(3)-ROE	0.255657	0.038727	6.601550	0.0000
C(4)-Sales Growth	0.092750	0.067259	1.378997	0.1762
C(5)-D2	2.417832	1.854496	1.303768	0.2004





C(6)-D3	9.831409	2.500262	3.932152	0.0004
C(7)-D4	5.172520	1.861232	2.779084	0.0085
C(8)-D5	5.863347	1.931044	3.036362	0.0044
C(9)-D6	4.363887	1.816161	2.402808	0.0214
C(10)-D7	8.560802	3.472317	2.465444	0.0184
C(11)-D8	-0.427483	1.833746	-0.233120	0.8170
C(12)-D9	3.155778	1.867976	1.689411	0.0996
C(13)-D10	5.557665	1.837195	3.025082	0.0045
R-squared	0.936356	F-statistic	45.36300	
S.E. of regression	2.864936	Prob(F-statistic)	0.000000	

$$\widehat{MV / BVRatio}_{it} = -32.07 + 2.417D_{2i} + 9.831D_{3i} + 5.172D_{4i} + 5.863D_{5i} + 4.364D_{6i} + 8.561D_{7i} - 0.427D_{8i} + 3.156D_{9i} + 5.558D_{10i} + 0.379CGScore_{it} + 0.256ROE_{it} + 0.093SalesGrowth_{it}$$

$H_0$  : Pooled OLS Regression Model is appropriate (All dummy variables equal zero)

$H_1$  : Fixed Effect Model is appropriate (All dummy variables does not equal zero)

Wald Test:			
Test Statistic	Value	df	Probability
F-statistic	4.161972	(9, 37)	0.0009
Chi-square	37.45775	9	0.0000

From the above Table No. 8, it can be observed that p value of Wald test is 0.0009 i.e. less than 0.05. So,  $H_0$  can be rejected. So, the fitted Fixed Effect Model of MV/BV Ratio for FMCG Sector is appropriate.

Conclusion:

MV/BV Ratio, Tobin's Q and Market Capitalisation have significant positive correlation with CG Score in FMCG Sector. CG Score positively affects the firm performance parameters in FMCG Sector.

From Random Effect Model, it is revealed that CG Score has little significant positive impact and ROE has significant positive impact on Tobin's Q in FMCG Sector.

From Random Effect Model, it is revealed that NAV has significant positive impact on Market Capitalisation whereas CG Score has little significant positive impact on Market Capitalisation in FMCG Sector.

From Fixed Effect Model, it is revealed that both CG Score and ROE have significant positive impact on MV/BV Ratio in FMCG Sector.

FMCG being a consumer goods industry is directly influenced by its Governance Practices. It is identified from the present study that satisfactory disclosures made by selected companies is reflected through consecutive increase in disclosure score as well as disclosure growth rate. Moreover, disclosure practices have increased firm performance.

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