"Impact of Corporate Governance on Financial Performance of Selected Finance Companies"

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Abstract – Corporate governance is "the system by which companies are directed and controlled". It involves regulatory and market mechanisms, and the roles and relationships between a company's management, its board, its shareholders and other stakeholders, and the goals for which the corporation is governed. The purpose of this article is to investigate the relationship between the financial performance and characteristics of corporate governance for Indian firms.

Keywords: Corporate Governance, Finance, Company

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INTRODUCTION

Corporate governance focuses on the impact of a corporate governance system on economic efficiency, with a strong emphasis on shareholders' welfare. Corporate governance is a relationship among stakeholders that is used to determine and control the strategic direction and performance of organizations, identify the ways to ensure that strategic decisions are made effectively and to establish order between the firm's owners and its top-level managers.

REVIEW OF LITERATURE:

Corporate governance has been a central issue in developing countries long before the recent spate of corporate scandals in advanced economies made headlines. Indeed corporate governance and economic development are intrinsically linked. Effective corporate governance systems promote the development of strong financial systems – irrespective of whether they are largely bank-based or market-based – which, in turn, have an unmistakably positive effect on economic growth and poverty reduction. There are several channels through which the causality works. Effective corporate governance enhances access to external financing by firms, leading to greater investment, as well as higher growth and employment. The proportion of private credit to GDP in countries in the highest quartile of creditor right enactment and enforcement is more than double that in the countries in the lowest quartile. As for equity financing, the ratio of stock market capitalization to GDP in the countries in the highest quartile of shareholder right enactment and enforcement is about four times as large as that for countries in the lowest quartile. Poor corporate governance also hinders the creation and development of new firms.

IMPACT OF CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE:

'Corporate governance is the meeting of the private interest and the public good: Shareholders rely upon effective governance for the investment returns which fund pensions and insurance and protect savings; for companies it underpins both enterprise and accountability; for the wider community transparency and accountability in governance is vital for ensuring prosperity and the contribution to the public purse upon which social welfare relies [2].

A well-developed capital market is an indication of economic growth and many studies have emphasized the linkage between capital market development and improved resource allocation and economic growth. Other studies have evidenced that development of capital market is related to protection of minority investors which is an essential element of good corporate governance. (La Porta et al., 1997, 1998 and Gleaser, Johnson and Shleifer,) [3] , Litvak, 2007 and Romano, 2009 [4] in their studies have supported a more flexible approach to governance, which leaves room for firms to adjust their governance to firm specific needs. This is reflected in the Comply or Explain rules of UK Combined Code of Corporate Governance. (Financial Reporting Council, 2006).

Several studies focusing on developed and emerging markets have concluded that well governed companies have registered better performance in financial terms. Adoption of best practices in Governance has led to:

a) Improved access to external financing resulting in greater efficiencies due to greater knowledge of investors with regard to the company's strategies

b) Lower cost of capital

c) Improved operational performance through more efficient management and better asset allocation

d) Better financial performance and company valuation as seen in:

i) **Improved Economic Value Added (EVA)** - A Credit Lyonnais South Asia (CLSA) 2001[5] study of 100 largest emerging markets, has shown that best corporate governance practices in emerging markets had 8 percentage points higher EVA than the average of all firms in the country.

ii) **Improved Profitability** – An ABN/AMRO Study of Brazil based firms [6] with CG Ratings showed that their P/E ratios were 20 percent higher, RoEs at 45 percent higher and Net margins 76 percent higher than those with below average CG practices. A Study by L Brown and M Caylor of Georgia State University [7] in 2004 has shown that well governed companies outperformed poorly governed ones by 18.7 percent in terms of RoI and 23.8 percent for RoE.

iii) **Higher Returns on Assets** – Research by Sung Je Byun of Columbia University in 2006 [8] concluded that firms with superior corporate governance practices

iv) **Higher Firm Valuation and Share Performance** – Company Valuations were higher and investors were willing to pay higher share premiums ranging up to 30-40 percent for better governed companies. This was concluded by a McKinsey Survey in 2002, [1] across all countries including Eastern Europe, Africa, and Asia.

CONCLUSION:

This article outlines the impact of the Indian corporate governance on financial system. While the Indian legal system provides one of the highest levels of investor protection in the world, the reality is different with slow, over-burdened courts and significant corruption. Much of the country's extensive small and medium enterprises (SME) sector displays relationship-based informal control and governance mechanisms, inhibiting financing and keeping the cost of capital at levels higher than necessary, even though India ranks high on the ease of getting credit, and has a well-functioning banking sector with one of the lowest proportions of non-performing assets.

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