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Relevance of Corporate Governance and Profitability in Innovation Policies of Socio-Economic Transformation: A Study in Indian Context

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Abstract-Corporate Governance is the set of policies that are created for deciding a company's performance and direction.In recent years, the area of corporate governance has been in limelight and has attracted increa sed attention of academicians and researchers worldwide due to high profile scandals and corporate collapses like Enron, WorldCom and Satyam.Further, we find that corporate profitability also has an insignif icant positive impact on governance rating of firm.Before looking at the relationship between corporate gover nance, firm performance, and economic growth, it is useful to have a framework with which to understand how corporate governance can affect firm behavior and economic performance.One of the problems with the current debate on corporate governance is that there are many different, and often conflicting, views on the nature and purpose of the firm.

Keywords---Corporate Governance, Economics,

I. INTRODUCTION

Corporate governance is a multidisciplinary field of study that covers a wide range of disciplines – accounting, consulting, economics, ethics, finance, law, and management. It also includes the relationships among the various stakeholders (e.g. members/shareholders, management and board of directors) involved and the goals for which the corporation is governed. It refers to leadership structure and values that determine corporate direction, ethics and performance. The aim is to align as nearly as possible the interests of individuals, corporations and society. It focuses on how management is committed to sustainability and corporate responsibility at all levels. The term corporate governance has been used in many different ways and the boundaries of the subject vary widely. In the economics debate concerning the impact of corporate governance on performance, there are basically two different models of the corporation, the shareholder model and the stakeholder model. In its narrowest sense (shareholder model), corporate governance often describes the formal system of accountability of senior management to shareholders. In its widest sense (stakeholder model), corporate governance can be used to describe the network of formal and informal relations involving the corporation.

More recently, the stakeholder approach emphasizes contributions by stakeholders that can contribute to the long term performance of the firm and shareholder value, and the shareholder approach also recognizes that business ethics and stakeholder relations can also have an impact on the reputation and long term success of the corporation. Therefore, the difference between these two models is not as stark as it first seems, and it is instead a question of emphasis.

A large number of studies in the past have examined the relationship between corporate governance and corporate financial performance, but the results have been mixed and inconclusive. Eccles et al. (2012) recommended that for sustainability to be embedded in the organizational culture, the governance structure needs to be tailored accordingly. They emphasized on the significance of two key elements of Corporate Governance, i.e. Board of Directors (BOD) and Executive Compensation, to ensure sustainable growth of the organization. The overall study objective is to formulate a broad planning and development framework setting out guidelines and standards for more effective and comprehensive planning for corporate governance.

The main objectives of the study are as

- To study the present unique economic situation in the Corporate World.
- To study the relationship between corporate governance and corporate profitability.
- To enhance the long-term shareholder value in corporate governance.

II. LITERATURE REVIEW

This study will further advance corporate governance by helping people discover more about their planning and development. So in the past by the researchers following are the outcomes. Gompers et al. (2003) performed their study using a governance index for 1500 large US firms, and found that the risk-adjusted returns of firms with strong governance were 8.5% higher than firms with poor governance. Brown and Caylor (2004) found a positive association between corporate governance scores (after adjusting for industry effects) and financial performance of firms (based on dividend payout, yield, profitability and shareholder returns).

One of the key findings of Mani and Sreedharan (2004), a study conducted by CRISIL Ratings in Indian context over a 3 years period was that superior governance practices of firms are positively and significantly correlated to market valuation of firms.

Van de Velde et al. (2005) observed that portfolios with above-average governance scores outperformed the portfolios with below-average governance scores. Governance Metrics

International and Byun (2006) found that companies with higher governance ratings enjoyed higher profits and returns.

Ashaugh-Skaife and Lafond (2006); Derwall and Verwijmeren (2007) analyzed the linkage between Governance Metrics International (GMI) governance ratings and the firm's cost of equity capital. They suggested that firms with higher governance scores demonstrate lower risk to investors, and thus, enjoy lower cost of capital. Sachs (2007) suggested that investments in highly governed companies significantly outperform the investments made in poorly governed companies. Bala Subramanium et al. (2008) found a positive and statistically significant association between their overall India Corporate Governance Index (ICGI) and Tobin's Q value (used as proxy for market value of firm) and further this association was stronger for more profitable firms and firms with higher growth prospects. Selvaggi and Upton (2008) commented on the direction of causality and stated that good governance causes good firm performance, rather than vice versa.

However, Mukherjee and Ghosh (2004) portrayed a dismaying scenario and concluded that corporate governance in India is still in a young and developing stage and that the investment decisions of Indian investors are volatile, not based on governance practices of firms. Chidambaram et al. (2006) found no significant performance difference between firms with good governance changes and firms with bad governance changes and thus, rejected the hypothesis that better governance leads to better financial performance. This result is consistent with those of Core et al. (2006); and Statman and Gluskhov (2009), who found no significant relationship between corporate governance and firm performance. Azim (2012) observed that different governance elements have varying impact on corporate performance and profitability.

Maria Maher and Rhomas Andersson (2016) Corporate governance: effects on firm performance and economic growth Corporate governance has traditionally been associated with the "principal-agent" or "agency" problem. A "principal-agent" relationship arises when the person who owns a firm is not the same as the person who manages or controls it. The purpose of this study is to present a review of the literature on two lines of research, corporate governance and innovation, explaining how different internal corporate governance mechanisms may be determinants of business innovation. It explores the theoretical background and the empirical evidence regarding the influence of both ownership structure and the board of directors on company innovation. Then, conclusions are drawn and possible future research lines are presented. No consensus was observed regarding the relation between corporate governance and innovation, with both positive and negative arguments being found, and with empirical evidence not always pointing in the same direction. Thus, new studies trying to clarify this relationship are needed. Over recent years, interest has grown in the influence of governance mechanisms on innovation decisions taken by the management.

Innovation efforts and results depend on factors that are influenced by corporate governance, such as ownership structure or the functioning of the board of directors. This paper presents an updated state-of-the-art in this field proposing future lines for empirical, however, states that the relation between corporate ownership and innovation activity may work both ways. He argues that ownership structure affects R&D expenditure, which affects company value, which in turn affects ownership structure.

Other studies do not analyze a direct relation between ownership concentration and innovation but consider that the former may moderate another existing relation. For example, find that cash flow control by owners positively moderates the relation between internationalization and innovation in the company, while the entrenchment effect that arises from the diverging interests between control and cash flow rights may negatively moderate this relation.

Other studies propose that R&D expenditure, Ownership concentration and innovations. The prior literature includes arguments supporting both a positive and a negative relation between ownership concentration and R&D activities. An initial argument on a negative relation lies in greater risk aversion. Ownership concentration and combined ownership and management may reduce the pressure that external investors or other supervisors exert on managers in their control of financial statements, information transparency and strategic renewal.

III. RESEARCH METHODOLOGY

Statistical tools such as descriptive statistics and regression have been applied using Microsoft Excel to study the relationship between corporate governance and corporate profitability using secondary data. The average data over a period of three years from FY 2016-17to FY 2020-21has been used to enable cross-sectional analysis.

IV. DATA ANALYSIS AND INTERPRETATION

Table 1: Relationship between Corporate Governance and Corporate Financial Performance

S. No.	Study	Relationship
1.	**Gompers et al. (2003)**	**Positive, but not significant**
2.	**Brown and Caylor (2004)**	**Positive**
3.	**Mani and Sreedharan (2004)**	**Positive and Significant over 3 years period**
4.	**Mukherjee and Ghosh (2004)**	**Not Significant**
5.	**Van de Velde et al. (2005)**	**Positive, but not significant**
6.	**Chidambaram et al. (2006)**	**Not Significant**
7.	**Core et al. (2006)**	**Not Significant**
8.	**Governance Metrics International and Byun (2006)**	**Positive**
9.	**Sachs (2007)**	**Positive and Significant**
10.	**Balasubramanium et al. (2008)**	**Positive and Significant**
11.	**Selvaggi and Upton (2008)**	**Positive and emphasizes one way causality**
12.	**Statman and Gluskhov (2009)**	**Not Significant**
13.	**Eisenhofer (2010)**	**Positive**
14.	**Pande (2011)**	**Mixed and Inconclusive**
15.	**Azim (2012)**	**Mixed results**
16.	**Aggarwal (2013)**	**Positive and Significant over 2 years period**
17.	**Dr. Shamsher Singh**	**Positive and Significant**
18.	**Dr. Neelam Rani**	**Mixed and Inconclusive**

The table 1 shows mixed and inconclusive results on the relationship between corporate governance and financial performance. Thus, we empirically test this relationship in the given paper in an Indian context.

On the one hand, although the legal and regulatory environment affects corporate governance, it is also the case that legal rules and regulations are also, in part, the outcome of different corporate governance systems. For example, systems with dispersed ownership may have a stronger need for regulations that protect shareholder rights. For example, as ownership structure in the US has become more dispersed, the legislative environment has adapted to the particular needs arising from dispersed ownership.

And many European countries are adapting their legislative environments, in particular the strengthening of minority shareholder protection, in response to abuses by controlling shareholders that can arise in their systems of corporate governance. Thus, there is a positive correlation between corporate governance and corporate profitability. Overall, we may conclude that corporate governance has positive but not significant impact on corporate profitability. Hence, we do not reject the first null hypothesis (Ho1).

On the basis of theory and literature review and keeping in view the research objectives, we have formulated the following two hypotheses:

Ho1: Governance rating of a company has no impact on its profitability.

Ha1: Governance rating of a company has an impact on its profitability.

Ho2: Corporate profitability has no impact on the governance rating of a company.

Ha2: Corporate profitability has an impact on the governance rating of a company.

V. FINDINGS AND CONCLUSION

On an analysis and evaluations of the data, the following findings were found:

1) There is a positive correlation between corporate governance and corporate profitability.
2) Governance rating has a positive impact on corporate profitability.
3) Governance rating of a company has a significant impact on Return on Sale.
4) Corporate governance has a positive but not significant impact on corporate profitability.

Thus, we may conclude that corporate profitability has no significant impact on the governance rating of a company. Hence, we do not reject the second null hypothesis (Ho2).

Recommendations:

The following are the recommendations which should be addressed by the future researchers:

1) Limited sample size used in this study so large sample size should be incorporated. Short frame of research covered so frame of research should be large.
2) Short frame of research covered so frame of research should be largely manipulated.
3) Market-based measures such as share prices, stock returns, market value of firms, etc have been ignored. So this hypothetical value should be highlighted.
4) Various control variables (e.g. firm's age, growth, leverage, risk, R&D, industry, etc.) have not been incorporated in our analysis so these must be considered in future research.
5) Comprehensive measures should be considered in corporate governance because corporate governance is a vast concept.

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