

EFFECT OF CORPORATE GOVERNANCE ON VALUE RELEVANCE OF PHARMACEUTICALS COMPANIES IN INDIA

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Abstract *This study seeks to examine the relation between corporate governance and value relevance of pharmaceuticals companies in India. This study includes corporate governance disclosure index as independent variable which is measured with the help of Board of Director Index, Audit Committee Index and Board Committees Index as its sub-variables. On the other hand, dependent variable is value relevance viz. Earnings per share, Book value per Share, Dividend per Share and Price to Earnings ratio. This study has been used the descriptive statistics, and canonical correlation analysis. The sample of the study has been included pharma sector in India, whereas, study period from 2015–16 to 2021–22. The overall result of the study has shown that there is a statistically significant relation between corporate governance and value relevance, as the significance level is less than 0.05. Findings of the study reveal the high degree of correlation (.930) among the variables used in the study. Further, this study can approach to the different aspects, time periods and sectors as well.*

Keywords *Corporate Governance Disclosure Index, Canonical Correlation, Value Relevance*

INTRODUCTION

The implementation of Corporate Governance (CG) has been instrumental in reinstating shareholders' trust in the capital markets. It has provided shareholders with a sense of assurance regarding the preservation and growth of their wealth, resulting in significant capital inflows towards firms those have adopted robust CG practices. Shareholders prioritise firms that prioritise CG, considering it a critical factor influencing their investment decisions and ensuring the protection of their wealth (Aziz, 2023 & Alrabba, 2023). Previous corporate failures, including notable cases like Enron and world com in the USA, as well as global financial crises, has sparked a growing demand for comprehensive legal and regulatory reforms. These cases of corporate fraud have acted as catalysts, prompting the emergence of the concept of CG and highlighting the necessity for legislative changes. CG entails a framework of principles and guidelines that govern, direct and oversee the operations of companies (Dasgupta, 2022). CG serves as a supervisory mechanism, overseeing the implementation of action plans, policies, practices and decisions undertaken by management on behalf of a widely dispersed shareholders

base. Its' significance surpasses the realm of preventing corporate fraud and protecting stakeholders' interests; it also holds significant sway over the day-to-day management and decision-making activities occurring at various levels within an organisation (Busru, 2017 & Shanmugasundaram, 2017). In an ideal context, the notion of "governance" would transcend the boundaries of government and private sector activities, encompassing meaningful involvement from civil society and non-profit organisations. Governments would exhibit wisdom by leveraging the untapped potential of these resources to optimise overall societal benefit (Agal, 2022 & Parwej, 2022). Over a significant period, there has been a wide- ranging global discourse on this subject. The well-known Cadbury committee, in its 1992 report entitled with "financial aspects of corporate governance", put a definition of "corporate governance" as the system responsible for governing and guiding the operations of companies (Vaish & Mehta). The Worldwide Governance Indicators consist of six core dimensions that evaluate governance: voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, the rule of law and control of corruption (Almaqtari et al., 2020). In general, CG set rules for company conduct and stakeholders engagement. Participatory planning involves active

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involvement in idea exchange and validation. It ensures that management acts in the best interests of shareholders, prevents fraudulent activities and strengthens control over stakeholder interests. Ultimately, good CG practices drives profitability (Agal, 2022 & Parwej, 2022).

REVIEW OF LITERATURE

This study investigates the impact of CG on agency costs in Jordanian service companies (Aziz, 2023 & Alrabba, 2023). The analysis is based on a sample of 42 service companies listed on the Amman Stock Exchange from 2012 to 2018. The findings suggest that higher leverage leads to increased agency costs due to ineffective use of borrowed funds (Kumar, 2022 & Kumari, 2022). This study analyses the correlation between CG and mergers and acquisitions (M&A), while exploring the impact of M&A on share prices. The ultimate goal is to identify opportunities for enhancing CG practices within enterprises (Emmanuel et al., 2022). This study examines the relationship between CG and firm performance in Nigeria from 2014 to 2018, specifically focusing on ten selected deposit money banks. The findings reveal that variables like board size, audit committee, number of independent directors and directors' shareholding have no significant impact on firm performance. However, debt is found to have a significant negative effect (Wang, 2022 & Cao, 2022). This study examines the relationship between CG, financial innovation and performance in Taiwan's banking industry from 2011 to 2019. The result shows that banks with stronger CG, including higher institutional investor shareholding, independent directors, director attendance rates, education levels and financial/accounting backgrounds, are more likely to offer innovative financial services. The impact of CG on financial innovation has increased since 2015. Moreover, greater financial innovation is associated with higher profitability and value for banks, especially after 2015. However, the effects of financial innovation on profitability differ between financial-holding subsidiary banks and non-financial-holding banks (Egiyi, 2022 & Amaka, 2022). This study investigates the impact of CG on firm performance in Nigerian publicly traded manufacturing companies. It finds that factors such as board size, audit committee size and audit quality have a significant influence on firm profitability. The study emphasises the need for legislation on institutional and governmental ownership to regulate and improve long-term corporate performance (Holmurodovich, 2021). In this article, the focus is on the challenges of achieving effective CG. It examines different approaches to evaluate the effectiveness of CG and proposes solutions to enhance its effectiveness. The article concludes with recommendations for implementing these solutions in practice (Almaqtari et al., 2020). This study systematically

reviews CG in India based on an analysis of 161 research papers. It identifies key areas of interest including board of directors' issues, ownership structure, audit committee attributes and audit quality. While the relationship between CG and financial performance receives significant attention, there is a scarcity of recent studies and some repetition in the existing literature. The study provides valuable insights for academics and policymakers in the field of CG in India (Almaqtari et al., 2020). This study examines the impact of country-level CG on the profitability of Indian banks, using a sample of 61 banks including both private and public banks. The findings suggest that country-level CG significantly influences bank profitability, with private banks performing better than public banks. The study also highlights the negative impact of demonetization on bank profitability, except for Net Interest Margin. The results have important implications for regulators, policymakers, bankers, analysts and academics, stressing the need for regulatory measures to enhance bank profitability (Dhar, 2019 & Lama, 2019). This research paper focuses on CG practices in the Indian banking industry, specifically in selected banks. It investigates the factors that affect the disclosure score of CG in these banks, using both financial and non-financial disclosure items over a five-year period. The study includes five PSU banks and seven private sector banks listed on the BANKEX [BSE]. Various statistical tests, including Shapiro-Wilk Normality Test, Mann Whitney Test, Kruskal-Wallis Test and Spearman's Rank Correlation, are employed to analyse the data (Saraswat, 2018). Qualitatively compares CG practices in BRICS countries (Brazil, Russia, India, China and South Africa) by analysing their CG codes through document analysis and literature review. The research finds that Brazil, Russia and South Africa have CG codes aligned with recommendations (Thapar, 2017 & Sharma, 2017). CG sets guidelines and principles for corporations, ensuring compliance with social, regulatory and market requirements while maximising profits and benefiting stakeholders. It involves the allocation of rights and responsibilities among participants and the establishment of decision-making rules. In India, the need transparent CG arose due to scandals that eroded shareholder trust. This paper examines CG in India, specifically under the Companies Act 2013, emphasising its importance and exploring significant case laws that have influenced its development.

Research Gap

After studying various previous literatures, it has been observed that were related to the CG and firm performance: a review of existing empirical evidence, impact of CG on financial performance of IT companies in India. Therefore, this study "Effect of CG on value relevance

of pharmaceuticals companies in India” has been taken. Additionally, this literature try to explore by using new technique and include different sector as not incorporated earlier. Further this research will going to help many researchers, accounting professionals and companies as well. Therefore, this study aims to analyse the relation between CG disclosure practices and value relevance of selected companies of pharmaceuticals sector in India.

RESEARCH METHODOLOGY

This study is an initiative to check the relation between CG and value relevance of selected companies of pharmaceuticals in India. So, to conduct this study, top five companies has been selected from NIFTY Pharma Index of National Stock Exchange (NSE) of India. The selection criterion of these companies was the market capitalisation of 1st April 2015. Data of seven years has been obtained from the annual reports of the selected pharmaceutical companies

from the period of 2015–16 to 2021–22. Research design adopted for this research was analytical, descriptive and empirical in nature.

The focal variables consider to attained the objectives of this study includes Corporate Governance Disclosure Index as independent variable which was derive from the three variables *viz.* Board of Director Index (BODI), Audit Committee Index (ACI) and Board Committee Index (BCI). On the other hand, value relevance as dependent variable includes Earnings per share (EPS), Book Value per Share (BVPS), Dividend per Share (DPS) and Price to Earnings ratio (PE ratio). For analysing the relation of CG and value relevance following companies has been selected *viz.* Lupin, Sun Pharma, Dr Reddy, Cipla and Aurobindo Pharma Ltd. Moreover, the data set as we have taken for analysis used descriptive as well as inferential statistics. Therefore, as a part of inferential statistics canonical correlation has been applied to test the relation between CG and value relevance of selected companies.

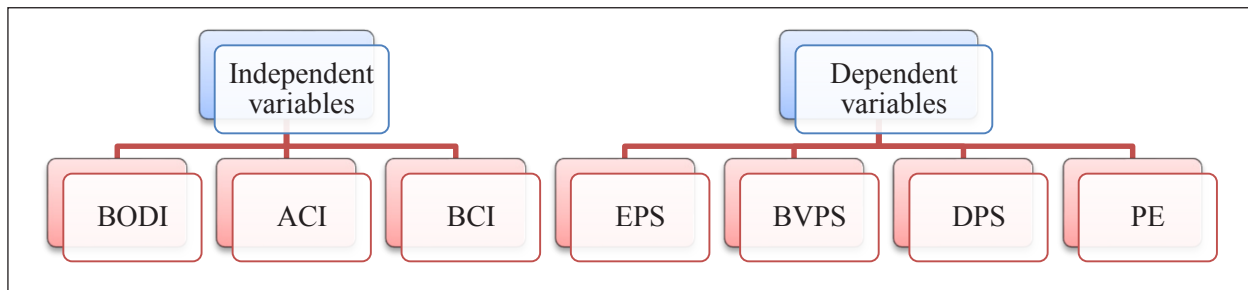


Fig. 1

EMPIRICAL RESULTS AND DISCUSSION

Table 1: Descriptive Statistics

	EPS	DPS	BVPS	PE RATIO	BODI	ACI	BCI
Mean	3.486	1.695	5.540	3.383	4.391	4.262	4.134
Standard Error	0.150	0.147	0.129	0.088	0.021	0.041	0.025
Median	3.405	1.61	5.51	3.305	4.34	4.09	4.02
Standard Deviation	0.825	0.870	0.763	0.482	0.129	0.246	0.149
Kurtosis	0.972	-0.564	-0.856	2.774	-0.730	-0.835	-1.502
Skewness	-0.291	0.492	0.331	1.170	0.646	0.219	0.646
Range	3.96	3.4	2.59	2.39	0.37	0.92	0.33

As the above Table 1 shows that the normal statistical characteristics of the main and other variables, including mean, standard error, median, standard deviation, kurtosis, skewness and range of the sample of selected five companies of pharmaceuticals. The average value of BVPS is 5.540

as highest among other ratios and signifies that companies having approx. 5 times equity available for shareholders. Furthermore, the table reveals that range of the variables EPS, DPS, BVPS and PE ratio are 3.96, 3.4, 2.59 and 2.39, respectively.

Table 2: Results of Canonical Correlations

	Correlation	Eigenvalue	Wilks Statistic	F	Num D.F.	Denom D.F.	Sig.
1	.930	6.398	.058	9.847	12.000	61.144	.000
2	.739	1.200	.429	4.208	6.000	48.000	.002
3	.235	.059	.945

As the Table 2 reports the results of the canonical correlation coefficient and Eigen value of the canonical roots, and also justified the results at a 5% significance level. As Set 1 shows in the table that canonical correlation coefficient is highly positive (.930) between the variables and with the Eigen value of 6.398. Set 2 also shows the highly positive correlation (.739) and Set 3 shows the least positive correlation (.235). The Eigen value of the result as shown in the Table 3 is basically for the predicting power of the model.

If the value is more than 1 has great level of significance. The value of Eigen in the table is $6.398 > 1$. It means that Set 1 has more predictability. Therefore, the results of the canonical correlation concluded that the null hypotheses (H0) will be rejected, as the significance level for first two canonical coefficient is statistically significant ($0.05 > sig$). Hence, it can be interpret that there is significant impact of CG on value relevance of the pharmaceuticals companies.

Table 3: Canonical Loadings of Variables

SET	Dependent Variables				Independent Variables		
	EPS	DPS	PE RATIO	BVPS	BODI	ACI	BCI
1	-.579	-.973	-.369	-.794	-.699	-.597	-.824
2	.766	.162	-.691	.538	.282	.063	-.478
3	.146	-.117	.024	-.273	.657	-.800	.302

Table 3 shows the results of canonical loadings among variables. It explains that correlation between variables and canonical variates. For the dependent variables, EPS, DPS and BVPS is most closely related to the second canonical

function, whether, PE ratio is most closely related to the third canonical function. In independent variables BODI, BCI is most closely related to the third canonical function, whether; ACI is most closely related to the second canonical function.

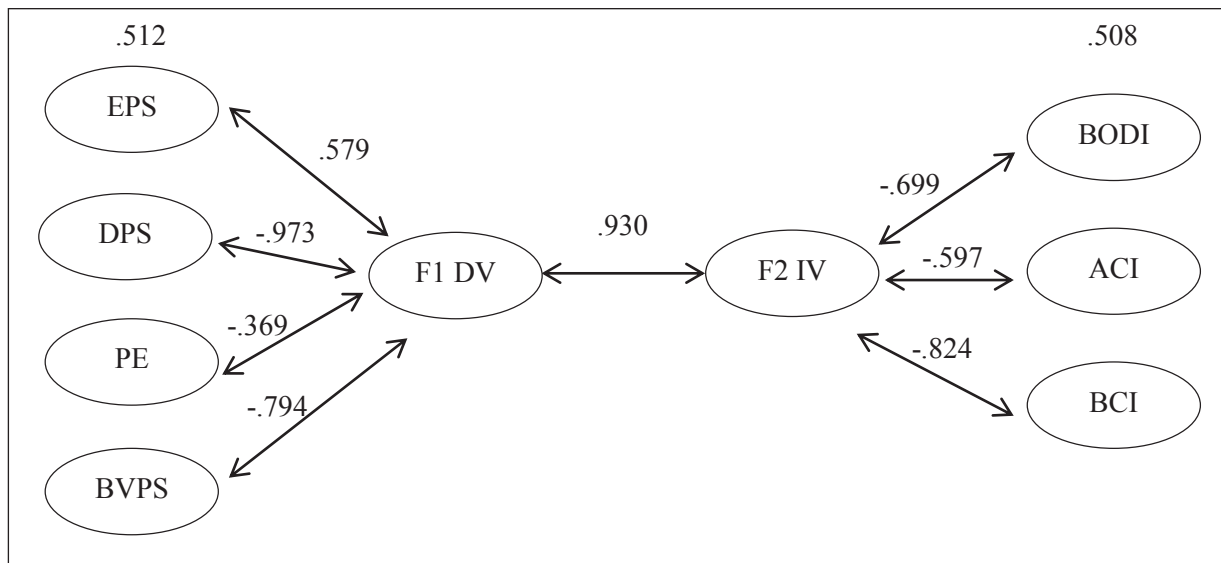


Fig. 2: Canonical Correlation of Set 1

As shown in the above Fig. 2, result of canonical correlation analysis in graphical manner. F1 and F2 are the dependent and independent variables of the study. Fig. 2 also shows the correlation between the variates, that is, .930 it means that variables are highly correlated with each other. canonical loadings among the variables shows that dependent variables have negatively correlated with the DV as the values are

-.579, -.973, -.369, -.794 for EPS, DPS, PE ratio and BVPS, respectively. On the other hand, independent variables also negatively associated with their sub-variables viz. BODI, ACI and BCI shows -.699, -.597, -.824, respectively. Moreover, result shows .512 of variance among the dependent variables and .508 of variance among the independent variable.

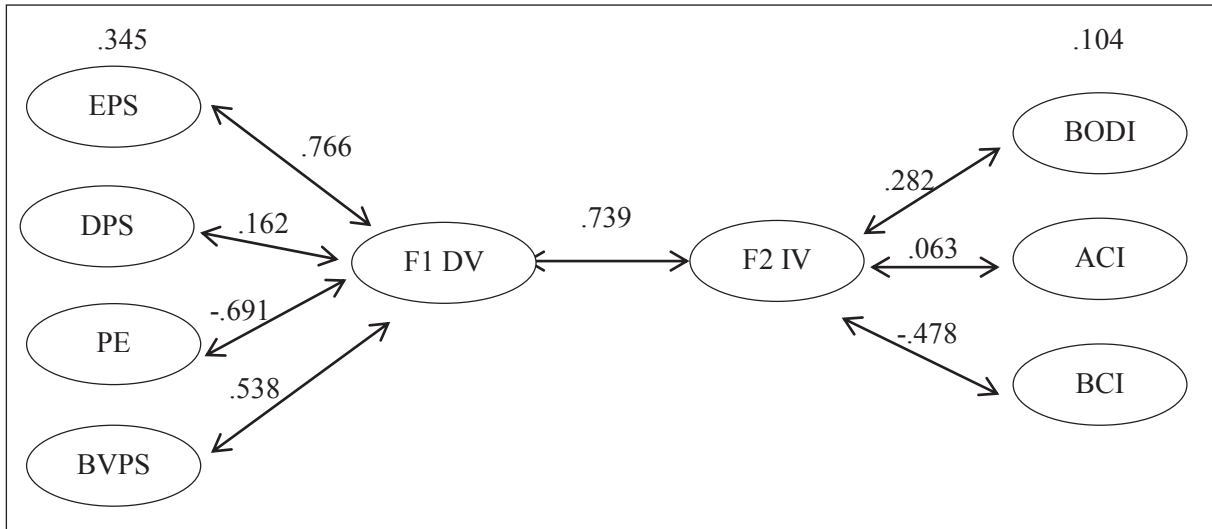


Fig. 3: Canonical Correlation of Set 2

As shown in the above Fig. 3, result of canonical correlation analysis in graphical manner. F1 and F2 are the dependent and independent variables of the study. Fig. 3 also shows the correlation between the variates, that is, .739 means there is high degree of correlation between the variables. Canonical loadings among the variables shows that dependent variables have been positively correlated with the DV as the values are .766, .162, .538 for EPS, DPS and BVPS excluding PE Ratio (-.691) have been negatively associated. On the other hand, independent variables also positively associated with their sub-variables viz. BODI and ACI shows .282, .063 excluded BCI (-.478) have been negatively associated. Moreover, result shows .345 of variance among the dependent variables and .104 of variance among the Independent variable. Therefore, it can be observed that if there is any kind of change in dependent variables, positively changes will be happening in the independent variables.

CONCLUSION

The study entails a favourable retort in the light of past review of literature, that there is a substantial impact of CG on value relevance of selected companies in India. It has been observed that the data has been positively correlated with

each other. On the other hand, sub-variables are negatively correlated with their variables in the set 1 whereas in the set 2 variables are positively correlated with each other. It means there is positive impact of the variable in the set 2. This study mainly focused on the overall analysis of data. Therefore, it can be concluded that the results of the study has been statistically significant. Further, to explore the knowledge in the present study, researchers will try to conduct this study by using different statistical techniques and variables.

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