Three Essays on Corporate Governance in India

Narendra Nath Kushwaha, 1502002,

Doctoral Candidate, Finance & Accounting, IIM Tiruchirappalli

Abstract

This dissertation focuses on various corporate governance issues in the context of related party transactions (RPTs) among Indian firms. RPTs represent transactions between firms and insiders, such as controlling shareholders, executives, directors, and entities under their control. Despite stringent regulatory requirements, such insiders often find loopholes to misuse RPTs for personal gain. This research examines the effect of external shocks, such as corporate failures and regulatory reforms, and other corporate governance mechanisms on various types of RPTs.

In the first essay, I examine the impact of the failure of Satyam Computer Services Ltd. (“Satyam”), a significant corporate governance related event in India, on the related party lending of Indian public companies. Using data from a balanced panel of 794 firms for the years 2006–2012, I find that Satyam’s failure had a significant negative impact on the related party loans provided by Indian firms. Average net related party loans (as a proportion of the total assets) declined from 2.37% in 2008 to 0.23% in 2010. Further, the reduction in related party lending was more prominent in firms with lower levels of external monitoring. Finally, since prior research suggests that there was no significant Satyam effect on the number of, and attendance at, audit committee meetings these results also suggest that there can be substantive changes in governance even without changes in form.

In 2015, the Securities and Exchange Board in India (SEBI) – securities market regulator in India – brought a regulatory change requiring audit committees to scrutinize the inter-corporate loans (ICLs). In the second essay, I study the impact of this regulation on ICLs of Indian listed companies. Further, I examine the effect of audit committee characteristics, namely independence, size, number of meetings, and busyness, on ICLs in the pre- and post-regulation period. Using data from an unbalanced panel of 12,661 firm-year observations from 2,461 publicly listed Indian firms for the years 2006–2019, I show that the new regulation had a significant effect on ICLs. On average, ICLs (as a proportion of the total assets) declined by 0.89% in the post-regulation period. Further, audit committee independence and size were associated with significantly lower ICLs in the post-regulation than the prior period. In contrast,

the audit committee's busyness was associated with higher ICLs before the regulation but not in the post-regulation period. Finally, the results show that firms with fully independent audit committees had significantly lower ICLs in the post-regulation period than those with partially independent audit committees. These results imply that audit committees, especially with fully independent directors, were overall more effective in mitigating questionable transactions, such as ICLs, after the regulatory change.

The third essay examines whether firms with certain board characteristics are more likely to have related party sales (RPS) in Indian publicly listed companies. For this purpose, I examine the effect of gender diversity and other board characteristics, namely busyness, independence, and size, on the likelihood of RPS. Using data from an unbalanced panel of 25,252 firm-year observations from 3,442 publicly listed Indian firms for the years 2002–2019, I find that the probability of RPS in firms with gender-diverse boards is 3.62% lower than those with men-only boards, which is very significant both statistically and economically. Since *the Companies Act of 2013* mandated the appointment of at least one woman director to the board of Indian listed firms, I also examine whether the relationship between gender diversity and the probability of RPS differed in the period before and after this regulation came into effect. The results demonstrate that the likelihood of RPS in firms with gender-diverse boards was significantly lower than those with men-only boards only in the period before *the 2013 Act*, but not after it. The results indicate that mandatory gender diversity weakens overall board competence, at least in terms of the likelihood of RPS. Further, board independence is associated with a lower probability of RPS. On the contrary, the likelihood of RPS increases significantly as the board becomes larger and busier.