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Corporate governance structure and Total debt – with special reference to RBI list of defaulters

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Abstract - India is ranked 5th in the world in terms of bad loans only next to the troubled EU economies namely Portugal, Italy, Ireland and Greece. The NPAs as of Dec 2017 stood at a staggering Rs. 840,958 Crore. As many as 8457 cases are pending at the National company law tribunal as on 31 Dec 2017. RBI first in June 2017 and then in August 2017 sent a list of around 38 companies both listed and unlisted to banks as the biggest defaulters for faster resolution of NPAs through National company law tribunal NCLT. These industries have been hit by muted global markets as well as corporate governance practices that can best be termed as shoddy. There is a need to relook at these as well as other factors of corporate governance for the NPA problem because one way or the other the organization is in the situation due to top management's mismanagement. This is where our research originates. In our study we are trying to understand the corporate governance structure factors responsible for the amount of debt these companies have accumulated. This study will point out as to what further changes can be made in terms of the Corporate Governance structures in the SEBI guidelines and the Companies Act 2013.

Keywords: Bad loans, RBI, NCLT, Corporate Governance, Total Debt

I. INTRODUCTION

The banking system in India is under stress. Once the cornerstone of the robust Indian economy it's turning into one of the biggest headaches for the financial bosses of the country to manage. With problems ranging from loan defaults by the likes of Vijay Malaya, Videocon group etc. to frauds by Nirav Modi, Kanishka Gold etc. the banking system is facing issues at different fronts. During the recession of 2008 the situation was such that this very banking system helped protect the Indian economy from the tumbling financial world around it. But today the situation is very different, today we are ranked 5th in the world in terms of bad loans only next to the troubled EU economies namely Portugal, Italy, Ireland and Greece. The NPAs as of Dec 2017 stood at a staggering Rs. 840,958 Crore. As many as 8457 cases are pending at the National company law tribunal as on 31 Dec 2017. The problem is multifaceted, a mix of environmental and bad corporate governance factors. Out of the total NPAs a little more than 70 percent are industrial loans. The major defaulting industries include mining, steel, power, infrastructure and commodity.

The Government, RBI and also the banks were faced with the magnitude of this problem only in the year of 2015 when then RBI governor ordered the Asset Quality Review for banks. After being alarmed by the intensity of the problem and also foreseeing some of the consequences the Government have given more powers to RBI and banks to deal with defaulters through the passing of NPA ordinance and the insolvency and Bankruptcy Code.

Following on the footsteps of the government RBI first in June 2017 and then in August 2017 sent a list of around 38 companies both listed and unlisted to banks as the biggest defaulters for faster resolution of NPAs through National company law tribunal NCLT.

These industries have been hit by muted global markets as well as corporate governance practices that can best be termed as shoddy. The debt levels have been rising to a stage where the companies have become unmanageable for the management. This has led to a sharp decline in shareholder wealth.

Corporate governance has evolved out of certain difficult situations be it the period after the Enron scandal in the US or after the Satyam scandal in India. After the scandal of Satyam in 2009, Indian government following the suggestions and recommendations of the Narayan Murthi Committee, SEBI etc. incorporated the Companies Act

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2013. The Act established responsibility and accountability for Independent Directors and auditors.

There is a need to relook at these as well as other factors of corporate governance for the NPA problem because one way or the other the organization is in the situation due to top management's mismanagement. This is where our research originates. In our study we are trying to understand the corporate governance structure factors responsible for the amount of debt these companies have accumulated. This study will point out as to what further changes can be made in terms of the Corporate Governance structures in the SEBI guidelines and the Companies Act 2013.

II. REVIEW OF LITERATURE

Highlighting the problem at hand (Kim 1998) indicates that the government backing and a weak corporate governance environment that are the hallmarks of the Indian economy often lead to investments that are more than necessary as well as lower corporate profitability

The research done in the field of how corporate governance factors' impact firm performance has given mixed results.

When we talk about corporate governance structure factors namely Board size, Duality, Women directors, Independent Directors and Family members all have been researched under various studies with a range of results.

Board Size has an impact on firm performance of both small and large scale companies across various countries (Pearce & Zahra 1992, Yermack 1995, Eisenberg, Sundgren & Wells, 1998) but literature on debt management of firms have given contrasting results (Anderson, Mansi & Reeb 2004 , Brenni 2014).

Ho(BS)-There is a no significant effect of board size on Total Debt of an organization.

CEO duality refers to the situation when the CEO also holds the position of the chairman of the board. This has been a bone of contention as researchers have given positive aspects such better decision making as well better control for the individual (Dalton & Kesner 1987). Also the concept of duality brings the challenge of separation of control, ownership and management (Fama & Jensen 1983).

Capital structure differs in their influence by duality across countries. In the case of Pakistan there is no significant relationship between the two (Shah, Butt & Hassan 2009) whereas in the case of a met analysis carried by (Boyd 1995) the results suggest a positive effect on performance under certain industry conditions and a negative effect under other.

Ho(D)-There is a no significant effect of Duality on Total Debt of an organization.

(Adams & Ferraira 2009) studies the role of women directors in the boards and their impact on performance of the firm in detail and finds both negative and positive effects under different shareholder right conditions. (Liu, Wei & Xie 2014) also finds empirical evidence on impact of fraction of women directors as positive but also finds that differently controlled organization to benefit more or less due to women directors. (Smith, Smith & Verner 2006) from a study of 2500 Danish firms finds that for a positive impact on performance the qualification of the woman director is of utmost importance thus highlighting that tokenism wouldn't just be the answer.

Ho(WD) - There is no significant effect of Number of women Directors on Total Debt of an organization.

There have been numerous studies which have discussed the difference in firm performance of family and non-family businesses. These studies majorly identify differences between the two business forms and also its link with firm performance. (San Martin-Reyna & Duran-Encalada 2015) discusses on how family ownership, Debt and Board composition are intertwined with each other. The study uses debt as a mediating variable which with lower or higher levels influences the firm's performance in presence of different board structures. The study (Anderson, Mansi & Reeb 2004) highlights that the best firms are ones which have a balance of both independent and family members. The study also finds that boards with higher founding family members have lower firm performance than otherwise. Thus

Ho(FM) – There is no significant effect of number of family members on total debt of an organization.

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There have contradicting studies when it comes to the independence of the board. The regulations and research evidence are quite the opposite. In a study by (Fernandes 2005) the research questions the affectivity of independent directors through a study of listed Portuguese firms. The study highlights how having no independent director leads to lower agency problems with higher alignment with stakeholder interests. Also the study by (Bhagat & Black 2000) provides a similar insight where the researchers report no evidence towards the conventional thought process of independent directors having a positive correlation with firm performance. The results of the 10 year study of 934 US firms suggested that companies with higher independent boards were not able to reach higher profitability. (Klein 2006) in his study found that audit committee's independence had a negative correlation with manipulation in earnings thus showing opposite empirical results than suggestions by regulators. Thus the factor of number of independent directors has been included in the study to understand if their presence has a positive or negative correlation on the mismanagement of the firm.

Ho(ID) – There is no significant effect of number of independent directors on total debt of the organization.

III. Research Methodology

The study uses multiple regression analysis to study the impact of Corporate Governance factors on Total Debt. The details of the factors under study are –

Dependent Variable: Total Debt of listed companies as given by RBI as defaulters for FY17, FY16 and FY15.

Independent Variables:

1. Total Number of Directors on the board for FY17, FY16 and FY15.
2. Number of Women Directors on the board for FY17, FY16 and FY15.
3. Duality i.e. CEO duality refers to the situation when the CEO also holds the position of the chairman of the board for FY17, FY16 and FY15.
4. Total number of Family members on board as per guidelines of the companies acts 2013 which defines relationship for FY17, FY16 and FY15.
5. Total number of independent directors on the board for FY17, FY16 and FY15.

The **Data collection** was done through Secondary sources i.e.

All **Independent variable** data collected through Annual reports/reports on corporate governance for FY17, FY16 and FY15.

Dependent variable's figures were drawn from Money control balance sheets of each of the companies under study.

The companies with no data at this point of time were not included in the study undertaken.

Due to paucity of data for unlisted firms they have been left out of the ambit of this study. The data has been analyzed using multiple linear regression models.

From a total of 35 firms listed by RBI, a total of 26 firms were selected for the analysis. The list of companies was compiled through Press Trust of India. The Data was studied for 3 years to understand and analyze the effect in a better and comprehensive way. The sample increases to a total of (26*3= 78) which makes it a respectable sample size to conduct regression analysis. The data will first be tested for all the assumptions of regression which include normality as well as multicolinearity. Once the data is able to fulfill the conditions for regression the same will be tested on the analytical software SPSS 20. The regression will be constructed based on the coefficient significance as well loadings. The model will be in the form of a regression equation as follows –

$$Y = \alpha + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 \ldots\ldots\ldots$$

Here Y is the dependent variable whereas X1, X2 and so on are independent variables with α being the constant in the equation and β1, β2 being the coefficients of the independent variables.

	Shapiro- Wilk	
Factors	***Statistics***	***Sig.***
Total Debt	0.651	0.000
Total Number of Directors	0.915	0.030
Number of women directors	0.455	0.000
Duality	0.585	0.000
Number of family members	0.791	0.000

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Independent Directors on Board	0.820	0.001

Table 1

IV. DATA ANALYSIS

One of the most important assumptions in Multivariate Analysis is the concept of Normality.

It indicates the shape of the data distribution and helps in confirming that the items being measured are not much different from the normal distribution (Hair et al., 2010). The statistic test used in analyzing the data is Shapiro-Wilk Test. In order to check whether the data is normal or not, significance levels are determined by the Shapiro-Wilk test. The table 1 shows the figure of significance for the various variables. The value are lower than 0.05 and thus the data is normal for all variables. The slight variation in one of the variables may be due to the small sample size.

Before proceeding further for regression analysis we need to once check for multicollinearity. As per literature no multicollinearity amongst independent variables is one of the assumptions for carrying out regression analysis. In case of multicollinearity the analysis of the data to develop a regression model is inappropriate. Multicollinearity statistics provide Tolerance and VIF (Variance Inflation Factor) levels. Some argue that a tolerance value less than .1 or VIF greater than 5 roughly Indicates significant multicollinearity. Upon multicollinearity analysis the following results as table 2 were attained which indicate that there is no presence of multi colinearity amongst the independent variables.

Variable	***Tolerance***	***VIF***
Total Directors	0.627	1.594
Woman Directors	0.681	1.468
Duality	0.896	1.116
Family Members on board	0.790	1.266
Independent Directors	0.667	1.498

Table. 2

Now we can progress with our regression analysis as the assumption of normality is also fulfilled. While doing so the following results in Table 3 were

Table 3

Model	***Standardized Coefficients Beta***	***t***	***Sig.***
(constant)		0.682	
Total Directors [Ho(TD)] - ***Rejected***	1.109	4.547	**.000**
Woman Directors [Ho(WD)] - ***Rejected***	-0.455	-2.755	**.012**
Duality [Ho(D)] - ***Accepted***	0.151	1.039	**.311**
Family Members on board [Ho(FM)] - ***Accepted***	0.061	0.315	**.756**
Independent Directors [Ho(ID)] - ***Rejected***	-0.797	-3.64	**.002**

attained. The model came out to be significant with p value as 0.004 i.e. less than 0.05. The following table shows the statistic. Now moving forward with exploration of the model to form the equation in the form of –

Model	***Sum of squares***	***df***	***Mean Square***	***F***	***Sig.***
Regression	3620877358.467796	5	724175471.693559	6.818746	.004
Residual	2124072288.628052	20	106203614.431403		
Total	5744949647.095848	25			

$$Y = \alpha + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 \ldots\ldots\ldots\ldots$$

Here, X_1 – Total number of directors on board

X_2 – Total number of woman directors on board

X_3 – Duality of CEO/Chairman

X_4 – Total number of family members on Board

X_5 – Total number of Independent Directors on Board

Table 4

The second important element that we need to consider is the value of R^2 which signifies how much do the independent variables explains the dependent variables.

The value of R^2 for the model is 0.630 which signifies that the five factors explain 63% of the variance in total liabilities.

What we check next is the loading of each of the factors and also the significance of each of these factors. The results were as per Table 4.

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The result suggests three major outcomes, first is that on the issue of Board Size and Independent directors on Board and second is that of women directors on the board. These three factors significantly influence the Total debt of a firm.

Thus the regression equation comes out to be –

FY 17

Total Debt = -4434.49 + 1.337 (Board Size) - 0.735 (No. of Independent Directors)

FY16

Total Debt = 6107.92 + 1.11 (Board Size) - 0.455 (Women Director) – 0.798 (Independent Director)

FY15

Total Debt = 15074.55 + 1.004 (Board Size) - 0.466 (Woman Directors) – 0.869 (Independent Directors)

V. CONCLUSION

The study has shown that board structures are important in terms of managing a firm not only in well run but also mismanaged firms, as is clear from the results of our study. All the factors, Board Size, Independent directors and Women directors have been at the center of debate for a long time now both for governance researchers and practitioners.

There has considerable debate over whether small board sizes or large ones are more efficient. Our study suggests that larger board sizes have led to considerable accumulation of debt by the companies and thus the management when in the hands of a large board hasn't given the desired results.

The study also throws up an interesting result with respect to independent directors where there is an inverse correlation with the accumulation of total debt. This supports the pressure from regulatory bodies to induct more independent directors so that the control can be more effective. The study highlights the importance of independent directors in the effective management of a firm.

Moving on to the third factor that has a significant impact on debt is presence of women directors. With a negative loading for this factor, it indicates that with increase in woman directors the debt is bound to go down. This clearly indicates that the Companies' Act 2013 is in the right light making it compulsory for the organizations to have at least one woman director on board. The organizations need to increase the number and not keep the woman participation in the management of the firm for mere tokenism. It needs to be made sure that women participation is more in terms of both, number and activeness. The study shows that it's in line with the policy maker's mindset of empowering more women to make governance more effective in today's organizations.

It is only fair for the results to highlight how Board sizes and Number of Independent directors can contribute to how well a firm is managed. The firms need to realize the importance of having effective board sizes and also have neutral independent directors which can help them grow and more importantly correct themselves. As for woman directors the debate is about how much can be made compulsory. Reservation at the top management levels also raises questions about the credibility and also capability of the one taking up the role. Thus even after the present results the way forward is not reservation but empowerment and encouragement at all levels so that women can grow up the ladder and become board of directors in their own rights rather than rights given to them through laws/acts.

VI. LIMITATION AND SCOPE

The study while providing a small insight into the matter of how corporate governance structure can influence debt levels for highly mismanaged firms leaves a lot of scope for future research in the field. More factors and comparison studies can be done to get a deeper insight into reasons and also find ways to improve one's firm performance so that the firm doesn't land up in the RBI list in the future.

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