

Impact of Corporate Governance on Financial Performance of Selected Insurance Companies in India

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ABSTRACT

Corporate Governance is the coalescence of rules, laws, processes by which businesses are regulated, operated and controlled. In-essence, corporate governance entails stabilizing the interests of the stakeholders of a company, such as investors, customers, employees, suppliers, communities, governments, or trade associations and the society as a whole. The rudimentary principles of corporate governance are accountability, transparency, fairness, and responsibility. In this study, we have tried to analyze the impact of corporate governance on the financial performance of the Indian insurance industry. For this purpose, a sample of 10 insurance companies has been selected among 56 insurance companies operating in India as per IRDA Annual Report (2021-22) from the accounting year 2018-19 to 2022-23 (5 years) using Purposive Sampling method. This study is fully based on secondary data, derived from annual reports, public disclosures, financial statements of IRDA and selected insurance companies. For analyzing the data, we have used correlation and multiple regression techniques. This study found that Board Mix and Independent Directors are positively and Female Board Members and CEO Duality are negatively associated with the financial performance of the Indian insurance industry.

Keywords : Corporate Governance, Financial Performance, Insurance, CEO Duality, Return on Investment.

I. INTRODUCTION

Corporate governance as a subject is exclusive and flexible in nature. In this particular study, we have analyzed the relationship between corporate

governance and firm financial performance of selected insurance companies operating in India. Corporate governance includes trustworthiness, crystal clearness and well-organized administration of a company to fulfill the objectives and goals of that company. It is a

system which structures, operates, controls an organization with the objective of achieving the long term planned and calculated or strategic goals to please the stakeholders of that organization, which include shareholders, debtors, creditors, employees and general public and society as a whole and also adhere to all the related laws, rules, compliances, legal and regulatory essentials. As per SEBI (Securities and Exchange Board of India), corporate governance is all about adherence to values, about performing business in an ethical way and about distinguishing personal funds and company funds within the management of the company. Life is very uncertain, life insurance provides security and support to the policy holders and their families and loved ones. Not just life insurance, general insurance also provides security and support to the assets of policy holders as accidents can happen anytime and anywhere, general insurance helps us to cope with these sudden losses if they happen. Apart from all these, it also plays a role of saving money for the general public. Insurance industry is one of the most important segments in the service sector, this industry links many financial markets players like banks, financial intermediaries etc. Thus, it stabilizes the financial market of our nation in a positive way. As a result, the insurance industry plays a crucial role in developing our country economically. Since customers are the main pillars of the insurance industry, every company tries to please their existing customers and attract new customers and retain all of them, therefore competition among the insurance companies goes on. Since the hard-earned money and trust of the general public are involved, good corporate governance and its impact on the financial performance are very much essential for the insurance industry.

II. LITERATURE REVIEW

Numerous studies have been conducted to examine the impact of corporate governance on firm performance. *Ahmad et al. (2014)* investigated the relationship between corporate governance and firm

financial performance of Pakistani insurance industry. Sample for this study has been collected from Pak-Qatar Family Takaful (PQFT) Limited for the period of year 2009-2012. This study has taken three corporate governance variables such as CEO Duality, Board Independence and Audit Committee Independence and two financial performance variables like Return on Equity (ROE) and Return on Assets. This study concluded that financial performance of Pak-Qatar Family Takaful has increased due to absence of CEO Duality in the Board. Also, Board Independence and Audit Committee Independence are positively related with financial performance. *Jaiswal and Mondal (2021)* examined the relationship of corporate governance and firm financial performance in the Indian pharmaceutical industry. This study has taken 05 Indian pharmaceutical companies out of 369 listed companies in BSE (Bombay Stock Exchange) as samples for the period of 10 years from 2008-09 to 2017-18. The researchers selected Board Size (BS), Independent Director (ID), Female Board Member (FBM) and Board Meeting (BODMEET) as corporate governance indicators and Return on Assets (ROA), Return on Sales (ROS) and Return on Capital Employed (ROCE) as financial performance indicators. Correlation techniques have been used to analyze the data. The findings of this study concluded that board size should be small, board independence is negatively related to financial performance, female members of board can be increased and board meetings should be occurred frequently. *Malik et al. (2014)* examined the relationship between corporate governance and firm performance, specifically the relationship between board size and firm's performance applying Pareto Approach in Pakistan. 14 listed commercial banks of Pakistan from 2008-2012 were taken as sample for this study. Result of this study shows a significant positive relationship between board size and bank performance, this signifies that a large sized board enhances the bank performance in the Pakistani scenario. *Bennedsen et al. (2008)* examined the impacts of the size of the board in the firm performance in Denmark. Almost 7000

closely held corporations with limited liabilities in Denmark in the year 1999 were considered as sample for this study. This study found a negative relation between board size and firm performance. *Moscu (2013)* examined whether corporate performance is impacted by CEO Duality or not in Romanian companies. 62 Romanian companies listed in Bucharest Stock Exchange have been selected as sample for this study. This study considered Size of the Company, Debt-Equity Ratio, Ownership, CEO as Shareholders, Institutional Ownership and CEO Duality as independent variables and Return on Assets (ROA) as Dependent variable. Multiple regression and 23 other basic statistical tests have been used to analyze the data. The present study found that CEO Duality has both positive and negative impacts on financial performance, it further suggested that if chairman and CEO are two different individuals, both corporate governance and financial performance will be better for the Romanian listed companies. *Brickley et al. (1997)* investigated the impacts or cost of separating the CEO and Chairman on the performance of large U.S. firms. Researchers had selected 737 firms from a survey of executive compensation by Forbes in 1989 as sample for this study but they were able to derive relevant data for 661 firms. The data included the age of the CEOs, their compensation, tenure, stock ownership and net sales of the firms. Authors of this study have used descriptive statistics, ANOVA F-test, Kruskal-Wallis test to analyze the data. This study concluded and suggested that the costs of separating CEO and chairman are higher than the benefits for maximum large firms in the U.S. *Chen et al. (2016)* investigated the relationship between foreign ownership, board independence and innovation performance shaped by the technological diversity strategy and absorptive capacity of the firms in Taiwan. Researchers collected panel data of 138 Taiwanese firms for this study. Findings of this study suggest that technological diversity strategy negatively moderate the association between foreign ownership and innovation performance, this study also found that

board independence and firm performance are positively associated and modified by technological diversity strategy. *Bhagat and Black (2000)* analyzed the correlation of board independence and long-term performance of large corporations in America. Board composition data assembled by Institutional Shareholder Services of 957 large U.S. public corporations in early 1991, board composition data in early 1988 derived from proxy statements of LEXIS/NEXIS for a subsample of randomly selected 205 firms, board data for 928 firms from Compustat, stock price performance data from CRSP and share ownership data for 780 firms from proxy statements were considered for this study. Tobin's q, return on assets, market adjusted stock price returns, ratio of sales to assets were taken as performance variables and board size, percentage of CEO ownership, percentage of outside director ownership, firm size, proxied by log(sales) were chosen as controlled variables in addition to board composition. Spearman correlation coefficients, OLS regression analysis, descriptive statistics have been used to analyze the data for this study. The findings of this study suggest that higher independence of board does not help in improving firm performance. *Smith et al. (2006)* aimed to evaluate the association between managerial diversity and performance of firms in case of women on board and top executive levels. Authors of this study have taken 2500 largest Danish firms for the period 1993 to 2001 as sample for this study. This study found a positive impact of women board and executive members on firm performance. *Puthenpurackal and Upadhyay (2013)* tried to examine the fact that the impact of women directors' performance depends on firms' information environments as well as their prior experience. This study has taken S&P 1500 firms from the period from 1996 to 2000. Descriptive statistics, regressions techniques have been used for data analysis purposes. This study demonstrated that the presence of women directors is significantly associated with higher firm performance for firms with low capacity. However, the performance impact of the presence of

women directors becomes less favorable as firm's information increases and outside women directors with senior corporate experience appear more valuable compared to outside women directors with non-corporate or junior corporate backgrounds.

III. OBJECTIVES OF THE STUDY

The principal objectives of this study are to evaluate the relationship between corporate governance and firm financial performance of selected insurance companies in India. Explicitly, this study searches to accentuate the following matters predominantly:

- To perceive the relationship between corporate governance and firm financial performance of Indian insurance companies.
- To evaluate the impact of corporate governance on firm financial performance of Indian insurance companies.

IV. RESEARCH METHODOLOGY

• Sample Selection

In this study, by applying Purposive Sampling technique, a sample of 10 insurance companies has been selected among 56 insurance companies operating in India as per IRDA Annual Report (2021-22). The sample companies have been chosen categorically viz 1 company among only public life insurance company i.e., LIC, 4 companies among 23 private life insurance companies, 1 company among 4

public general insurance companies, 2 companies among 20 private general insurance companies, 1 company among 2 public specialized general insurance companies and 1 company among 6 private standalone health insurance companies. Sample companies have been selected on the basis of their incorporation dates in their categories, preference given to the older companies. (Annexure 1).

• Data Collection & Study Period

The present study is fully based on secondary data. Data for this study has been derived from authentic sources such as annual reports, public disclosures and financial statements of IRDA and the selected insurance companies. The timeframe for this study is 5 years i.e., from the accounting year 2018-19 to 2022-23.

• Variables Used

In this present study, four corporate governance variables i.e., Board Size (BS), CEO Duality (CEOD), Independent Directors (ID) and Female Board Members (FBM) and three financial performance variables i.e., Return on Assets (ROA), Return on Capital Employed (ROCE), Return on Investment (ROI), have been considered. Among these selected variables, corporate governance variables and financial performance have been considered as Independent Variables and Dependent Variables respectively. These are discussed below –

Variables	Definition	Measurement
Board Size (BS)	Number of total members on the board of directors.	No. of inside and outside directors on the board.
CEO Duality (CEOD)	Chief Executive Officer (CEO) holding both the designations of CEO as well as Chairman of the company.	Taken a dummy variable '1' if CEO also holds the position of Chairman, otherwise taken '0'.
Independent Directors (ID)	Non-executive directors in the board of the companies.	Number of independent directors present on board.

Female Board Members (FBM)	Existence of Female members on Board.	Taken a dummy variable '1' if there is female member(s) on the board, otherwise taken '0'.
Return on Assets (ROA)	ROA expresses a company's profitability with respect to its total assets. It indicates how effectively a company utilizes its total assets to induce profit. Higher ROA implies higher efficiency of using total assets to generate profit.	ROA has been calculated by dividing EBT (Earning before tax) by total assets.
Return on Capital Employed (ROCE)	ROCE measures how competently a company uses or utilizes its capital to produce profits. This ratio informs us the amount of profit a company brings per Rs. 1 of capital employed.	ROCE has been calculated by dividing EBT (Earnings before tax) by capital employed. Capital Employed has been calculated by subtracting current liabilities from total assets.
Return on Investment (ROI)	ROI indicates how the investments of a company have performed to gain profits. The higher the ROI, the better the investments have performed.	ROI has been calculated by dividing EBT (Earnings before tax) by investments.

Statistical techniques

Correlation coefficient technique has been used for analyzing the data to observe the association between independent and dependent variables.

ANALYSIS AND RESULTS:

Correlation analysis is applied as a statistical tool to discover the relationship between two variables. Table 1 displays the correlation between corporate governance variables such as Board Size (BS), CEO Duality (CEOD), Independent Directors (ID), Female Board Members (FBM) and financial performance variables such as Return on Assets (ROA), Return on Capital Employed (ROCE) and Return on Investment (ROI).

Table 1: Correlation Results of Independent and Dependent Variables

		Correlations						
		BS	CEOD	ID	FBM	RO A	ROCE	RO I
ROA	Pearson Correlation	.134	-.287*	.239	-.114	1		
	Sig. (2-tailed)	.354	.044	.095	.432			
ROCE	Pearson Correlation	-.122	-.047	-.020	.096		1	
	Sig. (2-tailed)	.397	.744	.888	.507			

ROI	Pearson Correlation	.080	-.175	.286	-.030			1
	Sig. (2-tailed)	.582	.225	.044	.836			
**. Correlation is significant at the 0.01 level (2-tailed).								
*. Correlation is significant at the 0.05 level (2-tailed).								

V. RESULT & INTERPRETATION

We can observe from the table that the correlation value is 0.134 between Board Size (BS) and Return on Assets (ROA), which has a p-value of 0.354, which indicates that Board Size (BS) and Return on Assets (ROA) are positively correlated but not statistically significant at any levels (5% or 1% levels). The correlation value is -0.287 and p-value is 0.044 between CEO Duality (CEOD) and Return on Assets (ROA), which means CEO Duality (CEOD) and Return on Assets (ROA) are negatively correlated and significant at 5% level. Independent Directors (ID) and Return on Assets (ROA) are positively correlated (0.239) but statistically insignificant (0.095) at both 5% and 1 % levels. Female Board Members (FBM) and Return on Assets (ROA) are negatively correlated (-0.114) and not significant statistically (0.432) at both 5% and 1% levels.

Board Size (BS) and Return on Capital Employed (ROCE) are negatively correlated (-0.122) and not statistically significant (0.397) at any level of significance 5% or 1%. The correlation value is -0.047 between CEO Duality (CEOD) and Return on Capital Employed (ROCE), that means CEO Duality (CEOD) and Solvency Ratio (SR) are negatively correlated. The p-value is 0.744, which indicates non significance in both 5% and 1 % significance levels. Independent Directors (ID) and Return on Capital Employed (ROCE) are negatively correlated (-0.020) and not statistically significant (0.888) at any levels (5% or 1% levels). The value of correlation between Female Board Members (FBM) and Return on Capital Employed (ROCE) is 0.096, which indicates positive correlation between Female Board Members (FBM) and Return on Capital

Employed (ROCE). The p-value is 0.507 indicating non significance at either 5% or 1% levels.

The value of Correlation between Board Size (BS) and Return on Investment (ROI) is 0.080, conveying a positive correlation between them. The p-value is 0.582, meaning the correlation is not statistically significant at any level (5% or 1% levels). CEO Duality (CEOD) and Return on Investment (ROI) are negatively correlated (-0.175) and statistically insignificant (0.225) at both 5% and 1% levels of significance. The correlation coefficient value between Independent Directors (ID) and Return on Investment (ROI) is 0.286 and the p-value is 0.044. These values indicate that Independent Directors (ID) and Return on Investment (ROI) are positively correlated and their correlation is statistically significant at 5% level of significance. Female Board Members (FBM) and Return on Investment (ROI) are negatively correlated as the correlation value between them is -0.030. It also conveys that their correlation is not statistically significant at any level of significance (5% or 1%) as the p-value is 0.836.

VI. FINDINGS AND CONCLUSIONS

Findings of the study show that Board Size (BS) is positively correlated with Return on Assets (ROA) and Return on Investment (ROI) but negatively correlated with Return on Capital Employed (ROCE). None of the correlations is statistically significant. The result in cases of ROA and ROI is supported by the previous study of Malik et al. (2014) and the result in case of ROCE is supported by the previous study of Bennedsen et al. (2008).

CEO Duality (CEOD) is negatively associated with all the financial performance variables (ROA, ROCE, ROI) but statistically significant only with Return on Assets (ROA). This result is supported by the previous findings of the study by Moscu (2013) and denies the findings of Brickley et al. (1997).

Independent Directors (ID) is positively associated with Return on Assets (ROA) and Return on Investment (ROI) but only significant with Return on Investment (ROI). This result supports the findings of Chen et al. (2016). Independent Directors (ID) is negatively associated with Return on Capital Employed (ROCE) and this association is not statistically significant. This result is supported by the findings of Bhagat and Black (2000).

Female Board Members (FBM) is positively correlated only with Return on Capital Employed (ROCE) which supports the findings of Smith et al. (2006) and negatively correlated with both Return on Assets (ROA) and Return on Investment (ROI), all the correlations are non-significant supporting the findings of Puthenpurackal and Upadhyay (2013).

In conclusion, we can state that in maximum cases, Board Size (BS) and Independent Directors (ID) are positively and Female Board Members (FBM) is negatively associated with the financial performance of the Indian insurance sector. CEO Duality (CEOD) is totally negatively correlated with the financial performance of the Indian insurance sector.

VII. RECOMMENDATIONS

From the findings of our study, we have some specific recommendations for Indian insurance industry, these are discussed below:

Insurance companies in India should properly follow the recommendations of the Companies Act 2013 (Sec. 149) regarding board size and organize the board

according to the prescribed recommendations. As per our findings, size of the board should not be small in order to get better financial performance.

Insurance companies in India should look into the number of independent directors in the board, findings of this study recommend to have more independent directors for better financial performance in the Indian insurance sector.

It is recommended to minimize CEO Duality as much as possible to enjoy the better financial performance in Indian insurance companies.

Insurance companies in India should appoint female members in the board as per the regulations of Companies Act, but as per our study, the number of female board members should not be increased for attaining better financial performance.

VIII. LIMITATIONS OF THE STUDY

This study is definitely not without any limitations. The limitations are discussed below-

- The sample of this study is small.
- This study is fully based on secondary data; no primary data has been used here.
- Other market-based financial performance measures such as Tobin-Q, Market Value Added (MVA), and Market- to- Book Value (MTBV), Dividend Yield, and Price - Earnings Ratio (PE) etc. have not been considered in this study.
- We have used Purposive sampling technique for taking samples for this study; this technique is not a probabilistic sampling technique.
- The time period of this study is limited only to 5 years.

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Annexure 1

Sl. No.	Company Names	Date of Incorporation
1	Life Insurance Corporation of India <i>(Public life insurer)</i>	01.09.1956
2	Max Life Insurance Co. Ltd. India <i>(Private life insurer)</i>	11.07.2000
3	ICICI Prudential Life Insurance Co. Ltd. <i>(Private life insurer)</i>	20.07.2000
4	Aditya Birla Sun Life Insurance Co. Ltd. <i>(Private life insurer)</i>	04.08.2000
5	HDFC Life Insurance Co. Ltd. <i>(Private life insurer)</i>	14.08.2000
6	National Insurance Co. Ltd. <i>(Public general insurer)</i>	05.12.1906
7	Reliance General Insurance Co. Ltd. <i>(Private general insurer)</i>	17.08.2000
8	Royal Sundaram General Insurance Co. Ltd. <i>(Private general insurer)</i>	22.08.2000
9	ECGC Ltd. <i>(Public specialized insurer)</i>	30.06.1957
10	Star Health & Allied Insurance Co. Ltd. <i>(Private Standalone Health Insurers)</i>	17.06.2005