The corporate governance reforms finance essay

Finance

Corporations have existed in Mauritius from the early days of colonisation. At the beginning of the French colonial period, Mauritius was in fact administered by a corporation, " La Compagnie des Indes". Hence, it was only in 1984 that Mauritius stepped into the modern era with the introduction of a new Companies' Act in that year. In 1989, there was another step forward with the setting up of The Stock Exchange of Mauritius. However, it was at the beginning of the new millennium that things really started to move ahead. Both government and the private sector realized that for Mauritius to make headway in the global economy, it was essential to adopt laws and conventions that were in tune with the changes taking place in the developed economies of the world (Governance 2004).

3. 2 Corporate Governance Reforms

It has been noticed that investors consider corporate governance to be among the top criteria in their investment decisions. In 2001 itself a range of new measures was already introduced and designed to bring into line where possible the practices of corporate Mauritius with best practice world-wide. These measures were in terms of: Legal Reform: Introduction of a new Companies Act which regulates the companies incorporated in Mauritius. Accounting Reform: Introduction of International Accounting Standards (IAS)Other Reforms: Introduction of new listing rules for companies listed on the Stock Exchange of Mauritius. All Companies listed on the Official List of the Stock Exchange of Mauritius Ltd shall comply with all the provisions of the Code.

The Stock Exchange of Mauritius Ltd (SEM) may, through the Listing Rules, add further requirements in respect of corporate governance. Setting up of a

National Committee on Corporate Governance. The " National Committee on Corporate Governance" (NCCG) was established under section 63 of the financial Reporting act 2004. As the national coordinating body responsible for all matters pertaining to corporate governance. The objectives of the NCCG were to:(a) establish principles and practices of corporate governance;(b) promote the highest standards of corporate governance;(c) promote public awareness about corporate governance principles and practices; and(d) act as the national coordinating body responsible for all matters pertaining to corporate governance. The World Bank was asked to complete a Report on Standards and Codes (R. O. S. C.) on corporate governance in Mauritius that was published in August 2002. Furthermore, since the corporate scandal involving Air Mauritius and Rogers (2002) which in turn negatively affected the financial sector, the attention on proper corporate governance was greatly increased in Mauritius. After the Air Mauritius scandal other corporate frauds also were detected such as the Delphis Bank and Mauritius Commercial Bank (2003) which is closely linked to the National Pension Fund.

3. 3 CG practices

3. 3. 1 Code of Best Practice on CG

In 2001, a Committee was asked to consider the appropriateness of introducing a Code of Best Practice on Corporate Governance for Mauritius. After a review of corporate governance practices in Mauritius, the Committee decided that it was appropriate to prepare a Code of Corporate Governance for Mauritius. In October 2003 the Code of Corporate Governance for Mauritius which was on a " comply or explain basis" was launched whereby the followings were the key requirements: The roles of the Chair and CEO must be separate (Section 2, chapter 3)The code addressed the balance of the board in Section 2 (chapter 1- Board Composition) where the board should have an appropriate balance of executive, non-executive and independent directors. However, the actual proportion and balance will depend on the circumstances and nature of business of the company. But, as stated in the code each board required at least 2 independent directors and at least 2 executive directors. The appointment of Board Committee (section 3) stated each board required an Audit Committee, and a Corporate Governance Committee (whose responsibilities include inter alia remuneration and nomination matters). Otherwise industry and company specific issues will dictate the necessity and requirements for other committees. The Code did not specify an optimum size for the board but generally there should be smaller boards than exist at present. Whereby boards of more than 12, even for the larger companies, could become unmanageable (section 2, Chapter 1).

3. 3. 2 Compliance with the code of CG

According to a Survey by the NCCG (2009) compliance with the Code of Corporate Governance is still not the norm in Mauritius, in that only 30% of the companies state that they currently comply with the Code, whilst 29% do not comply(non-response rate being 41%). Higher compliance with the Code is noted among listed companies (including Banks and Non-Banking Financial Institutions) [83%] and State Owned Enterprises [44%], rather than among DEM Listed companies [36%] and non-listed companies [9%]. An analysis of the Annual Reports of 86 companies for which the Annual Reports could be collected showed that: An improvement in the proportion of the Companies presenting a Corporate Governance Report in their Annual Report was noticed over the last 3 years, implying from 74% in 2006 to 85% in 2008. There was an increase in the proportion of companies setting up Board Committees to address Corporate Governance, Audit, Risk , and Nomination Issues . Whereby, the main committees established within companies were, by order of importance the Audit Committee [84%], Corporate Governance Committee [84%], the Remuneration Committee [70%] and the Board Risk Committee [51%]. Interestingly, the post of Chairman and CEO was seen to be held by different individuals in the majority of the companies [84%]. Average Board size in Mauritian companies responding to the survey was noted to be 8. 9. In most cases, the companies had a mix of Executive and Non- Executive Directors, with an average of 2 Executive Directors and 7 Non- Executive Directors.

3. 4 CG and Firm Performance in Mauritius

The code in Mauritius favors a unitary board however, every board should determine its size and composition for effective execution of its responsibilities . The Code of Corporate Governance was as such revised in April 2004. In particular, a study conducted by Lamport et al. 2009 to find whether there exists a relationship between CG and firm performance for a sample of the Top 100 companies showed that no such relationship was found. Therefore, it can be said that CG does not seem to affect the firm performance of companies in Mauritius.

Listed:

Financial performance of chosen listed company (one company from the sample)

EPS

Commerce

Harel Mallac Ltd

Figure 3. 1: EPS trend

The EPs is one of the most important ratio for investment decision making. From the above figure, the EPS of the company was Rs 8. 74 in the year 2007 and it increased to Rs 20. 50 in 2008, reaching its peak for the period of 2007-2011 toRs 23. 60 in 2009. The EPS then decreased to Rs 13. 32. Implying that the amount of profit available to each ordinary shareholder fell.

NPM

Figure 3. 2: NPM trend

The NPM has increased by 1. 13%, from 5% in 2007 to 6. 13% in 2008 and it continued to rise even in the year 2009, reaching 8. 63%. However, this figure started to decline gradually by 2. 47% for the year 2010, and 2. 4% to come to 3. 76% in 2011.

Figure 3. 3: ROE trend

ROE

For the firm the highest % of ROE was 18. 3 in the year 2008. However, this decreased to 16. 4 in 2009, declined further to 8. 74 in 2010 and finally reaching 3. 69 in 2011.

Figure 3. 4: Debt-To-Equity trendD-E

The D-E ratio for the company for the whole of the period of 2007 to 2011 was low. In this case the company is said to be lowly geared as none of the D-E ratio expressed in terms of percentage was greater than 100%.

ROA

Figure 3. 5: ROA trend

The ROA of the company was 5. 10% in 2007 and increased to 6. 27% in 2008. ROA reached its highest in 2009 to 8. 50% and the lowest being in 2011 at 2. 81%. A decline of about 5. 69% has been noticed from the year 2009-2011. A Conceptual Framework has been developed in this chapter in order to understand the impact of the variables considered on firm performance, and identifies the hypotheses to be used for this study.

4. 0 Objectives of the study

Based on the different aspects of CG and FP the following research objectives have been set: To investigate the impact of Corporate Governance on firm performance. To recognize if firm performance will be at risk until/unless the code of Corporate Governance are fully complied with. To find out about the association between CG variables and firm performance variables. Whether good Corporate Governance enhances the performance of a firm. Investigate the extent to which the selected companies have adopted corporate governance practices. Analyze the board structures of the selected listed companies. To determine whether a firm’s performance can be increased by improving Corporate Governance structure.

4. 1 Research Questions

Based on the extensive literature review two research questions have been formulated and they are listed as follows: What is the association between the corporate governance variables and firm performance variables? What is the impact of Corporate Governance on the firm performance indicators?

4. 2 Development of Conceptual Framework for this study

Like some other authors for example Heenetigala 2011 and Khan et al. 2011, a conceptual framework has been developed for this study and as shown in figure 4. 1 it illustrates the link between the operationalization of the corporate governance variables and firm performance that are being investigated in this study. It comprises of the Board Structure that include board leadership structure, board composition, board committees, board size and also firm size as a controllable variable. Some of the variables identified to measure firm performance are ROA, ROE, EPS, NPM, and Leverage that is debt-to-equity ratio. Board Leadership StructureBoard CommitteesBoard CompositionBoard SizeBoard StructureNPMROEROACorporateGovernanceFirm PerformanceFirm Size: TALeverage: D-EEPS

Figure 4. 1 (adapted from Khan et al. 2011): Conceptual Framework

This framework shows the relationship of variables with one another and assumes that corporate governance is affected by Board Structure. Whereby Board Leadership Structure i. e. the holding of both the top offices of the chairman and the CEO by different persons can affect corporate governance which in turn has an impact on the performance of a firm. Other variables that can have an impact on corporate governance are the number of Non-Executive Directors (including Independent Non-Executive Directors) on the board, number of board committees (audit, CG, nomination, remuneration, risk and others) and the size of the board. On the other hand, the size of the firm has an impact on the size of the board (the bigger the firm, the larger might be the size of the board) which in turn affects CG and firm size is even said to affect firm performance. It has also be shown in this study through this model that the performance of a firm has been measured through ROA, NPM, EPS, ROE, and Debt to Equity ratio (Leverage).

4. 3 Hypotheses of the study

Based on previous studies, the hypotheses have been formulated as follows. Besides, the monitoring mechanism of the CG variables are board leadership structure (H1a), board committee (H1b), board composition (H1c) and board size (H1d) which are to be used in chapter 6.

Table 4. 1: Hypotheses of the study

Variables

Ho

H1

Board Leadership Structure

Separate leadership structure is not associated with firm performance.

Separate leadership structure has a positive impact on firm performance.

Board composition

A board composed of a majority of non-executive directors is not related to firm performance.

A board composed of a majority of non-executive directors is positively related to firm performance.

Board Committees

The number of Board committees comprising of audit, corporate governance (in its terms of reference remuneration and nomination) and other committees are not associated with firm performance.

The number of Board committees comprising of audit, corporate governance (in its term of reference remuneration and nomination) and other committees are positively associated with firm performance.

Board Size

Limiting the size of the Board is not related to firm performance.

Limiting the size of the Board is positively related to firm performance.

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