International Journal for Multidisciplinary Research (IJFMR)
E-ISSN: 2582-2160 ● Website: www.ijfmr.com ● Email: editor@ijfmr.com

Governance Dynamics and Market Performance: Unpacking the Role of Board Independence in Indian Firms

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ABSTRACT

The relationship between board independence, stock returns, and Tobin's Q of 22 companies in the Nifty Microcap 150 index between 2020 and 2024 is examined in this study. By considering the percentage of independent directors on the board as an independent variable, the study investigates the impact of board independence on company market valuation and performance (using Tobin's Q and stock returns). The Capitaline database is the data source, while Jamovi software is used for descriptive statistics, correlation analysis, and path analysis. The findings imply that market performance might not be the main force behind governance since stock returns have no discernible effect on Tobin's Q or board independence. However, a negative, albeit almost significant, correlation between board independence and Tobin's Q indicates that businesses with lower market values are likely to have many independent directors. Additionally, the research contributes to the body of knowledge in corporate governance by introducing board independence, which may have a competitive impact on a company's financial success. The sample size and the particular market conditions during the study period are two of the study's shortcomings that could impact how broadly the results can be applied.

KEYWORDS: Board Independence, Stock Returns, Tobin's Q, Corporate Governance, Financial Performance

INTRODUCTION

Recently, corporate governance has gained attention due to its impact on financial stability, investor confidence, and firm performance. Furthermore, one of the key factors influencing corporate governance processes has been identified as the independence of the governing board (Fama & Jensen, 1983). When a corporation's board includes independent, non-executive directors who focus on strategic management of the company rather than day-to-day operations, this is known as the board's independence. The rationale is that the executive office is subject to oversight by the independent boards, which guarantees that decisions are made with the interests of stakeholders and shareholders in mind (Klapper & Love, 2004). This is especially important when it comes to financial performance and market valuation. Research shows that a company's Q r, which is the ratio of its market value to its replacement cost of assets, can be impacted by the composition of its board (Chung & Pruitt, 1994). A key indicator of a company's overall market performance, stock returns are frequently used as a barometer for corporate governance efficacy and financial success. While some scholars have suggested that board independence and financial

performance are positively correlated, others maintain that there is a more nuanced relationship that may be impacted by firm-specific characteristics as well as external factors like market and industry structure (Bhagat & Bolton, 2008). How board independence, stock returns, and Tobin's Q relate is unclear, particularly in a growing market like India, where governance has changed quickly due to more stringent regulatory reforms and market globalisation.

By investigating the relationship between board independence, stock returns, and Tobin's Q for 22 Indian businesses from the Nifty Micap 150 index between 2020 and 2024, this research adds to the body of literature. The following important topics will be addressed in this study: "Does board independence have a significant impact on stock returns and market valuation? How does Tobin's Q affect corporate governance practices and board structures? Data from the Capitaline database, which includes detailed financial and governance information about Indian-listed companies, is used in the analysis. High-level statistical modelling and testing are then performed on the data using Jamovi software.

This research is significant for several reasons. This is due to at least two factors. First, it provides a perspective on managing Indian businesses and India's evolving market and regulatory landscape. Second, it clarifies the connection between firm performance metrics like stock return and Tobin's Q and board independence. Lastly, it contributes to the body of research discussing how independent boards might improve financial performance and corporate governance. The sample size was relatively small, and the specific market setting in which the research was done may have affected the findings' generalisability, notwithstanding the potential value given by the study.

REVIEW OF LITERATURE

It has been widely accepted that a company's performance and market value correlate with the autonomous character of corporate governance, especially the board's function. According to Fama and Jensen (1983), board independence is the percentage of independent, non-executive members on a company's board who oversee management and operate the business in the best interests of shareholders. Research suggests that more independent directors are linked to improved corporate governance and company performance (Klapper & Love, 2004). The picture is more nuanced regarding the connection between board independence and financial performance across markets, industries, and governance structures, indicating context-specific outcomes.

Board Autonomy and Business Results

Fama and Jensen (1983), one of the first studies in this area, assert that an independent board will lower agency costs by aligning management's and investors' interests. Evidence from studies like Agrawal and Knoeber (1996), which showed a positive correlation between board independence and business performance—specifically, Tobin's Q and profitability—supports this. According to Bhagat and Bolton (2008), businesses with independent boards are more likely to perform better since their members are more objective and adept at keeping an eye on managers. However, according to Hermalin and Weisbach (2003), there is not always a direct correlation between board independence and performance; other elements, including the board's calibre, the company's industry, and external market conditions, could also be important. Particularly in emerging countries like India, the effect of board independence on company success is still unclear. Chakrabarti (2001) noted that although corporate governance in India has undergone constant change, particularly after liberalisation, the effectiveness of independent boards is nonetheless impacted to varying degrees by the strictness of regulations and market dynamics. Suppose board independence is typically likely to result in stronger governance. In that case, it cannot be seen in

isolation from the larger market environment and the competitive dynamics inside product marketplaces, according to more recent research, such as Arora and Sharma (2023).

Independence of the Board and Stock Returns

The effect of board independence on stock performance is less clear. While some research suggests that independent boards enhance decision-making processes, which leads to better market performance (Klein, 2002), other research reveals weak or statistically insignificant associations. However, Bhagat and Bolton (2008) and Klein (1998) contend in the body of current literature that, even adjusting for business size and market volatility, board independence was not always beneficial. Board independence and stock prices may have a very different relationship in emerging markets like India, where the governance and regulatory landscape is still developing, than in developed markets. Since the degree of institutional development and market transparency moderates the influence of board independence on stock returns in emerging evidence markets, a recent study (Hu, Lin, and Tosun 2023) justifies using this approach along with the variations in the entrepreneurial system at work in the nation.

Tobin Q as a Stand-in for Business Effectiveness

A prominent metric for assessing market valuation and investment prospects is Tobin's Q, the ratio of a company's market value to the cost of replacing its assets. According to empirical data, a higher Tobin's Q indicates more prospects for investment and market confidence in the company's expansion prospects (Lang & Stulz, 1994). Development Businesses with a high Q are anticipated to seek expansion since investors view them as having a low market value, according to Chung and Pruitt (1994). Tobin's Q has also been used in other research to assess how well a company performs and how board independence affects corporate governance (Chung & Pruitt, 1994). For example, according to Klein (2002), companies with more independent directors have higher Tobin's Q, suggesting that effective governance positively impacts market valuation.

It is unclear, therefore, how board independence and Tobin's Q relate to one another in the Indian setting. Although a number of studies indicate a positive correlation between board independence and Tobin's Q, Shaba & Yaaba (2024) noted that other factors, like firm size, the state of the market, and regulatory restrictions, may also impact market valuation. These results demonstrate that while institutional variables play a significant role in emerging countries, the relationship between governance and performance is complex.

Current Events and New Perspectives

Recent studies examine the evolving relationship between board independence and business performance. For instance, the stock returns of Nigerian companies are significantly boosted by gender diversity on the board, which is often associated with board independence (Shaba & Maishanu,2023). This suggests that financial success may be impacted by board independence and member diversity. Qadorah and Fadzil (2018) discovered that board characteristics, including independence and meeting frequency, affected earnings management and stock performance.

Furthermore, it is believed that market and regulatory variations influence the relationship between board independence and company performance. For example, studies conducted by Shaba and Yaaba (2024) and Arora and Sharma (2023) demonstrate that the degree of regulatory reforms and the growth of the capital market significantly impact board independence and stock performance in developing nations such as India. These findings suggest that the impact of board independence may vary depending on the situation.

RESEARCH GAP

Despite increasing studies on the topic, nothing is known about the relationship between board independence and Tobin's Q and stock returns in Indian companies. Although earlier research has examined the relationship between these characteristics in Western markets, India is an ideal area for additional study because of its distinct social, economic, regulatory, and cultural context. By investigating the relationship between board independence and the market value (Tobin's Q) and stock returns of companies listed on India's Nifty Midcap 150 index between 2020 and 2024, this study seeks to close this gap. By examining this emerging field, the study contributes to the expanding corpus of research on corporate governance. It also highlights the connection between financial success in developing economies and governance frameworks.

RESEARCH OBJECTIVES

1. To investigate the relationship between the level of board independence and stock returns and Tobin\'s Q.
2. To test the causal effects of Tobin’s Q, stock returns and board independence
3. To assess the impact of stock return and board independence on Tobin’s Q.

RESEARCH METHODOLOGY

The study employs a quantitative methodology to examine the relationships among board independence, stock returns, and Tobin's Q for a sample of 22 companies from the Nifty Midcap 150 index using data gathered between 2020 and 2024. The companies were picked to reflect a variety of industries, including technology, consumer products, and banking. The data source for these companies was the Capitaline database, which provides a wealth of financial information, such as market valuation indicators, board independence, and stock returns. A stand-in for board independence was the percentage of independent directors on each company's board. At the same time, the percentage change in stock prices over the study period was used to calculate stock returns. Tobin's Q, which represents the firm's market valuation of its asset base, was calculated by dividing the market value of an organisation's assets by their replacement cost. The data analysis was conducted using Jamovi software, which facilitated the computation of descriptive statistics, correlation analysis, and path analysis to examine the correlations between the variables. Multiple regression analysis was performed to determine the impact of board independence and stock returns on Tobin's Q, and significance was evaluated using t-tests and p-values. This method enabled a comprehensive examination of the connection between governance and financial success, while acknowledging constraints such as the sample size and the specific market shocks that occurred during the data-gathering period.

DATA ANALYSIS AND INTERPRETATION

Table 01 Descriptives

	% of Board Independence	Stock Returns	Tobins Q
N	22	22	22
Missing	0	0	0
Mean	50.4	3.48	4.51
Median	51.4	3.1	3.9
Standard deviation	7.36	2.65	2.82
Minimum	34.2	-0.78	1.03
Maximum	64.8	10.3	12.4

Source: Author Computation from Jamovi 4.6

Based on 22 companies' data, the table displays descriptive statistics for three variables: Tobin's Q, stock returns, and the percentage of board independence. While the standard deviation of 7.36% suggests some variation across organisations, the average board independence is 50.4%, with a median of 51.4% indicating a balanced distribution. There is moderate fluctuation in the percentage of board independence, which runs from 34.2% to 64.8%. The symmetric distribution of stock returns is indicated by their average of 3.48%, median of 3.1%, and standard deviation of 2.65%, which suggests considerable variation. Both negative and positive returns in the sample are highlighted by the stock returns, which vary from -0.788% to 10.3%. The median for Tobin's Q is 3.9%, marginally lower than the mean of 4.51, indicating a comparatively strong market value in relation to assets. The range of 1.03 to 12.4 indicates a substantial variation across the sample, while the standard deviation of 2.82 indicates diversity in the market-to-book value among companies. These figures point to various traits among the companies in the study concerning market value, stock performance, and board independence.

Table -2: Correlation Matrix

		% of Board Independence	Stock Returns	Tobin's Q
% of Board Independence	**Pearson's r**	—		
	df	—		
	p-value	—		
Stock Returns	**Pearson's r**	0.07	—	
	df	20.00	—	
	p-value	0.75	—	
Tobins Q	**Pearson's r**	-0.41	-0.06	—
	df	20.00	20.00	—
	p-value	0.06	0.78	—

Source: Author Computation from Jamovi 4.6

H1- There is a significant correlation between the variables (Board Independence, Stock Returns, and Tobin's Q).

Interpretation

The correlation matrix shows how board independence, stock returns, and Tobin's Q are related. Board independence and stock returns have a minimal positive connection (r = 0.073), which is statistically insignificant (p-value = 0.746). This implies that the percentage of independent directors on the board does not significantly impact stock returns. Board independence and Tobin's Q show a somewhat negative connection (r = -0.414, p-value = 0.055), suggesting that higher board independence might be linked to lower Tobin's Q. However, the link is only slightly significant. Lastly, there is a slight negative correlation (r = -0.064) and an insignificant p-value (0.777) between stock returns and Tobin's Q, suggesting that stock

returns have little effect on Tobin's Q. These results imply that there is little to no correlation between the variables, which calls for more research to comprehend the underlying dynamics fully.

Table -3: Path Estimates							
			Label	**Estimate**	**SE**	**Z**	**p**
Tobin's Q	→	**Stock Returns**	a	-0.06	0.20	-0.30	0.76
Stock Returns	→	**% of Board Independence**	b	0.13	0.54	0.24	0.81
Tobin's Q	→	**% of Board Independence**	c	-1.07	0.51	-2.12	0.03

Source: Author Computation from Jamovi 4.6

H2: Tobin's Q significantly impacts board independence, and stock returns significantly affect board independence.

Interpretation

The path estimates display the correlations between Tobin's Q, stock returns, and the percentage of board independence. With a p-value of 0.764 and an estimate of -0.06 for Tobin's Q → Stock Returns, it appears that Tobin's Q has no discernible impact on stock returns. Likewise, the path coefficient of 0.1309 and p-value of 0.808 for Stock Returns → % of Board Independence show that stock returns have no discernible impact on board independence. Tobin's Q → % of Board Independence, on the other hand, has a path estimate of -1.0718 with a p-value of 0.034, which is statistically significant at the 5% level. This implies that board independence is negatively impacted by Tobin's Q, suggesting that a higher proportion of independent directors on the board may be linked to a lower Tobin's Q. Board independence is greatly impacted by Tobin's Q. However, neither Tobin's Q nor board independence seems to be impacted by stock returns.

Table -4 Model Coefficients - Tobin's Q				
Predictor	**Estimate**	**SE**	**t**	**p**
Intercept	12.60	4.10	3.07	0.01
Stock Returns	-0.04	0.22	-0.16	0.87
% of Board Independence	-0.16	0.08	-1.97	0.06

Source: Author Computation from Jamovi 4.6

H3: Stock returns and board independence significantly impact Tobin's Q.

Interpretation

The model coefficients for Tobin's Q demonstrate how the percentage of board independence and stock returns affect Tobin's Q. With a p-value of 0.006 and an intercept of 12.5964, Tobin's Q appears to have a substantial baseline value. The results are statistically insignificant with a p-value of 0.873 and a coefficient of -0.036 for stock returns. This suggests that stock returns do not substantially impact Tobin's Q in this model. Near the 0.05 significance level, the coefficient for the percentage of board independence is -0.1578 with a p-value of 0.064, suggesting a marginally significant negative link. This implies that a slightly lower Tobin's Q could be linked to a larger percentage of board independence. At the 5% level,

the association is not strong enough to be regarded as extremely important, nevertheless. The findings show that board independence negatively influences Tobin's Q, whereas stock returns have no discernible effect.

FINDINGS

According to the descriptive statistics, the average percentage of independent directors on the board was 50.4%. The average Tobin's Q was 4.51, and the average stock return was 3.48%. Board independence and stock returns ($r = 0.073$, $p = 0.746$) and Tobin's Q and stock returns ($r = -0.064$, $p = 0.777$) showed weak and non-statistically significant connections. Board independence and Tobin's Q had a significant negative association ($r = -0.414$, $p = 0.055$). According to the mediation study, Tobin's Q had no discernible indirect impact on board independence through stock returns ($a \times b = -0.0079$, $p = 0.85$). Tobin's Q did, however, have a substantial direct impact on board independence ($c = -1.0718$, $p = 0.034$). Regression research revealed that board independence and stock returns had non-significant pathways ($p = 0.064$ and $p = 0.873$, respectively), making them poor predictors of Tobin's Q. Generally speaking, these findings indicate a negative correlation between board independence and Tobin's Q; however, stock returns have little bearing on this relationship. Furthermore, Tobin's Q in the sample cannot be accurately predicted by either board independence or stock returns.

LIMITATIONS

When assessing the findings, it is important to consider this study's limitations. First, between 2020 and 2024, stock returns, market valuations, and governance frameworks might have been impacted by COVID-19 and other global disruptions. The study is restricted to 22 companies in the Nifty Micap 150 index, which may not fully represent the market despite being well-known, but are small in the corporate world. Furthermore, the sample's focus on finance and technology may restrict its generalisability to other sectors. Cross-sectional data gives a snapshot of the variables at a particular time. Consequently, evaluating causality and trend is impossible. Additionally, the study does not account for outside factors that could change the outcomes, such as the macroeconomic environment, governmental regulations, or market-specific shocks. Additionally, the study uses publicly accessible financial data, which could not be a reliable representation of data on private governance or might have measurement errors because of disclosure requirements particular to individual companies. Due to the limitations of this inquiry, care should be taken when extrapolating findings from this study. The sample size, duration, and external variables could all be improved in future research to overcome this study's shortcomings.

SCOPE FOR FURTHER RESEARCH

Although this work takes a practical theoretical approach, it has limitations that need further research. First, a larger sample size or the inclusion of additional governance mechanisms, such as CEO duality, executive compensation, and board diversity, may be required to explain corporate performance and governance setups better, as indicated by the non-significant results on the relationship between board independence and Tobin's Q. In order to represent time-dependent governance and financial success, longer-term longitudinal studies on board independence and stock returns should be considered. Future research could examine company-specific factors influencing financial success and governance. Manufacturing or retail governance may not be the same as tech governance. A more comprehensive understanding of these components' behaviour in various market and governance environments might be

obtained by comparing them across industries. The influence of laws, business cycles, stock market fluctuations, and cross-country sampling may aid in assessing how broadly applicable these results are. Lastly, the impact of return on equity (ROE) and return on assets (ROA) on market valuation, economic performance, and board independence should be investigated. Although this study contributes to the body of knowledge, further research is necessary to fully comprehend the intricate connection between financial performance and corporate governance.

CONCLUSION

The study's findings provide crucial insight into the relationships between board independence, stock returns, and Tobin's Q. Given the weak coefficients and high p values on the Tobin's Q to stock returns paths and the stock returns to board independence paths, it was erroneous to assume that stock returns had no discernible impact on board independence and Tobin's Q. This would suggest that the stock market comparatively less influences the board composition and financial performance of the sample. On the other hand, Tobin's Q and board independence were found to have a marginally significant negative relationship. This implies that a greater percentage of independent directors tended to be present on the boards of companies with lower market valuations (as measured by Tobin's Q). This may signify business organisations taking proactive steps to improve corporate governance and reduce agency issues in underperforming companies. Furthermore, the aforementioned reasons were not strongly supported by the weakly significant association between board independence and Tobin's Q. These findings imply that, although the impact is minimal in comparison to other elements like company performance and external market conditions, governing mechanisms—in particular, board independence—can have an impact on business valuation.

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