

The Changing Landscape: How the Indian Companies Act 2013 is Impacting Small-Cap Firms in India

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ABSTRACT

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The Indian Companies Act, 2013 brought along a set of well-defined norms relating to corporate governance to enhance accountability and transparency in corporate affairs. This paper examines the immediate and long term implications of the implementation of the Indian Companies Act, 2013 on the performance of small firms in India. A new corporate governance score is created, based on the regulations of the Act, for each firm. The sample is divided into compliant and non-compliant firms based on their scores using this new metric prior to the Act. The study finds that firms that complied with the new regulations prior to the enforcement of the Act experienced higher abnormal returns when the new regulations were enacted. Furthermore, firms with higher governance scores also experienced higher long-run returns, post-Act. Governance scores were not significant for non-compliant firms, however, higher audit fees are associated with better performance. For policymakers, businesses, and investors in India and other economies that have adopted similar reforms, these results have significant practical implementations. This study adds to the ongoing discussion about the value of adopting and complying with good governance practices.

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I. INTRODUCTION

In a broader sense, “Corporate governance defines a set of relationships between a company’s management, its board, its shareholders, and its stakeholders” (Maier, 2005). Effective corporate governance is said to consist of transparency, management oversight and control, directors’ involvement in independent reviewing and approving of business strategy and decisions, and protection of the rights of all shareholders. Fairness and transparency in various business operations and improved disclosures are its foundation (Arora & Bodhanwala, 2018). Shareholders’ rights were of primary importance during the development of corporate governance laws, but over time, it has expanded to include the interests of the other stakeholders and society overall (Jizi et al., 2014).

Over the years, many scandals have hit the corporate sector, for example, Enron Scandal, WorldCom Scandal in the US, Parmalat in Italy, and Sanlu in China. Many policies and reforms, such as Sarbanes-Oxley (SOX) Act 2002 in the US and the Cadbury Committee report 1992 in the UK, were put in place to enhance financial transparency and decrease accounting frauds in publicly traded companies. Similarly, Satyam Scandal (2009) in India revealed glaring gaps in the governance structures and auditing practices in the country and brought to light the need to overhaul the old 1956 Companies Act. Also known as the Enron of India, the Satyam scam exposed numerous governance flaws like insider trading, fraudulent accounting, the corrupt role of auditors and the audit committee, unethical conduct, and an ineffective board. This incident acted as a catalyst for modern reforms to strengthen the corporate governance framework in the country.

A major shift in the corporate landscape of India was brought on by the LPG (liberalization, privatization, and globalization) reforms in 1991. India was essentially a closed market economy

before 1991 and relied on internal markets. After the implementation of these reforms, India opened its markets to a wide range of investment opportunities from the global economy. This led to growing interest in corporate governance by both, the investors and the firms, to redefine governance policies and make them more receptive to the world markets.

India's corporate governance environment is a combination of the outsider-dominated market-based system of the UK and the US, and the insider-dominated bank-based system of Japan and Germany (Sarkar & Sarkar, 2000). The Securities and Exchange Board of India (SEBI), established in 1992, post-globalization, is the primary stock market regulator in India. In July 1999, SEBI announced Clause 49 of the listing agreement, which required the reporting and disclosure of various corporate governance attributes, including board and ownership structure, related party transactions, and compensation structures. Before the new Companies Act, 2013 was established, Clause 49 brought a shift in the scenario of corporate governance in India. Black & Khanna (2007) conducted an event study and found that the announcement of the Clause 49 of the listing agreement led to an average gain of 4.5% three days after the announcement and a 10% increase in the stock prices of large Indian firms over a two-week event window.

The new Companies Act, 2013 brought along a set of well-defined norms relating to corporate governance. The new Act is more comprehensive in nature, strengthening the corporate governance framework by introducing new provisions relating to appointment of independent directors, mandatory rotation of auditors, and a mandatory whistle blower policy. The Act also introduces several fines and penalties to ensure better transparency and accountability in operations, which was absent in the previous regulations. Many policies were also rolled out to protect the interests of minority shareholders, including enabling shareholders to bring class action lawsuits against corporations, and requiring a higher threshold for related party transactions. The

Act also made it a requirement for certain companies to contribute a certain amount of their profits to causes such as education, health, and environment.

This study aims to explore if the introduction of the new corporate governance mechanisms can also result in similar announcement returns and if there are any long-term implications of these reforms on the performance of small firms in India. The effect is traced in two ways: short-term and long-term. First, an event study methodology is used to identify the presence of any abnormal announcement returns, right after the act was implemented. Then, a panel regression is performed to evaluate the long-term effects of the Act on the performance of the small-cap firms.

The purpose of this study is to assess the impact of the changes in the Indian Companies Act, 2013 on the performance of small-cap firms in India. While there have been studies in the past to measure the impact of the new Companies Act, 2013, most of the research has been focused on large firms. This study aims to close that gap in the literature. As small firms are usually closely held and may be less exposed to agency issues, not much attention is given to their governance. However, ascertaining the effect of these reforms on small firms is vital, as over 95% of the listed Indian companies are considered small-cap.

II. LITERATURE REVIEW

Agency problem

Any discussion about corporate governance starts from a principal-agent basis. Conflict of interest between the managers of a company and its stakeholders leads to agency costs (Jensen & Meckling, 1976). This conflict arises due to the separation of ownership and control of a company, as an owner generally does not have the skill set and knowledge to make complicated financial decisions for the firm. Managers are hired for their expertise, but they also have the incentive to

use the firm's assets to take on projects that benefit them personally, which may impact the wealth of the shareholders adversely. Shleifer & Vishny (1997) suggest that good governance reduces the 'control rights' creditors and large shareholders have on managers and increases the probability of managers taking up more positive net present value (NPV) projects.

According to market regulators and governance advocates, the reason behind scandals like Enron, WorldCom, and Satyam, was largely due to poor governance mechanisms. Assuming this is true, a market premium for firms with better governance standards and systems should exist. Studies conducted by Gompers, Ishii, & Metrick (2003), Bebchuk et al. (2004) have found that firms having more focus towards stockholders' rights have higher Tobin's Q. There are many other studies done on corporate governance and firm valuations, mentioned in the following paragraphs.

World View

According to a 2013 analysis of companies in the US, the UK, Japan, France, and Italy, listed companies with strong governance had better market value and profitability (Monda & Giorgino, 2013). Similarly, better market performance and foreign ownership are observed for Korean firms with good corporate governance practices (Bae & Goyal, 2010). Better transparency and reporting standards also decrease the cost of financing for a firm (Botosan, 2006; Li, Yan, & Yang, 2012).

There have also been contradicting studies regarding corporate governance and its effect. Roodposhti & Chashmi (2010) investigate how ownership and a board with a majority of outside directors affected the profitability of the companies in Iran and reported a negative relationship between them. For NYSE-listed companies, Bhagat & Bolton (2008) found no link between governance and future stock returns.

Reforms and legislation

Many countries have implemented regulations to improve the corporate governance mechanism of firms in that country and to promote shareholders' rights. One of the leading examples of such regulations is the Sarbanes-Oxley Act (SOX) 2002 in the US.

Li, Pincus, & Rego (2008) investigate how the market reacted to legislative events around SOX and discover that companies with highly managed earnings are more adversely impacted by the implementation of the new reform. Positive abnormal stock returns are observed, especially for companies with a greater extent of earnings management. Hence, indicating that investors anticipated that earnings management in such firms would be eliminated, and the quality of financing would improve.

Switzer (2007) evaluates the difference between the performance of small Canadian firms that have to comply with SOX and the ones that do not. In a multi-year study, firms subjected to SOX have significantly better performance (measured by Tobin's Q). This shows that the enhanced accountability of managers towards shareholders outweighed the compliance cost associated with the implementation of the reforms.

There are studies that examine the impact of such reforms in improving corporate governance in different countries. Monteiro & Guzmán (2010) find that, in Portugal, the level of disclosures has improved, but the number of disclosures is at the same level even after the reforms. Ioannou & Serafeim (2017) assert that in nations like China, Denmark, Malaysia, and South Africa, advances in sustainability disclosures raise the value of firms. According to Kolk (2008), after the introduction of reforms in disclosure regulations, Japan and many countries in Europe have started to pay close supervision to board control, ethics compliance, and external verifications. Chen, Hung, & Wang (2018) note that industrial waste and sulfur dioxide (SO₂)

emissions have dropped since the disclosure mandate was put into effect in China, but companies that have introduced CSR programs have seen a decline in profitability.

Rajagopalan & Zhang (2008) infer that corporate governance reforms in emerging markets like India and China are quickly being adopted, taking inspiration from the western nations, but it still doesn't guarantee that there would be strict implementation of these reforms on a local level to uphold the interests of investors. On another note, Chen et al. (2009) conclude that firm-level corporate governance and country-level shareholder protection can be substitutes in emerging economies. Hence, regulatory reforms, if implemented properly, can significantly improve corporate governance.

Balasubramanian, Black, & Khanna (2010) conducted a very exhaustive study through a survey based on the regulations of the Clause 49 of the listing agreement. The survey was used to study factors like board composition and independence, audit committee, compensation of executives and non-executives, board practices and processes, external auditors, shareholders' rights, related party transactions, cross-listing and financial disclosures, and government enforcement, for more than 300 Indian public-traded companies. This survey was used to form an index to analyze the cross-sectional relationship between measures of corporate governance and measures of firm performance. They concluded that the overall governance index was positively related to firm value and shareholders' rights.

Indian context

Similarly, the implementation of the Indian Companies Act, 2013 is targeted towards improving the corporate governance framework of Indian companies and reducing the number of frauds.

There are studies showing better risk-return trade-offs for investors in firms adopting governance reforms (Mohanty, 2003; Prasanna, 2013). Shivani et al. (2017) examined firms listed on the National Stock Exchange of India (Nifty 500) and found that larger boards have a negative effect on return on assets (ROA) and return on equity (ROE); however, a higher percentage of non-executive directors and the presence of a well-defined whistle-blower policy had a positive impact on firm performance measures.

Das & Dey (2016) analyze the effect of the board's involvement in a company's affairs, board compensations, board diversity, CEO duality, and promoters' involvement in the board, on firm performance of large-cap Indian firms, after the Companies Act, 2013 was implemented. According to their results, board involvement and diversity had a positive impact on firm performance, while other governance parameters did not have any significant impact on a firm's performance.

The Act also requires mandatory Corporate Social Responsibility (CSR) contributions of 2% of average net profits of the prior three years from a company that meets certain thresholds. Manchiraju & Rajgopal (2017) utilize this change in regulation to assess how CSR spendings affect firm value. They conducted an event study paired with regression discontinuity design and find that firms that were forced to adhere to the mandatory CSR expenditure experienced a 4.1% decrease in average stock returns. However, firms that voluntarily spend on CSR maximize shareholder value.

The role and responsibilities of the audit committee are well-defined under the new Act. Bansal & Sharma (2016) study the attributes of the audit committee of a firm, focusing on the percentage of outside directors forming the committee, the number of meetings held in a year, etc., with other governance characteristics and their impact on the performance of a firm. They find that

a significant positive association exists between firm performance and some governance variables like CEO duality and board size, however, there was no significant association between performance and audit committee characteristics.

None of the studies focus on the long-term effects of the Act on small-cap Indian firms. India is an emerging market, and small firms play a vital role in the economy, providing more opportunities to diversify risk. Hence, it is important to understand how these firms react to major reforms and if there are any long-term implications of the Act on such firms.

III. HYPOTHESES

Corporate governance is a significant variable that influences the firms in an economy, best governance practices are said to reduce the risk for investors and improve financial performance (Spanos, 2005). Indian investors have positively responded to clause 49 reforms from 1999, where large firms gained 4.5% average returns three days after the announcement, in contrast to negative market reactions in relation to SOX in the US (Black & Khanna, 2007).

The Indian Companies Act, 2013 was enacted to protect the rights of minority shareholders and to enhance the corporate governance systems of Indian companies. Small companies are generally burdened by such acts because of raised compliance costs. This study focuses on small firms in India to ascertain whether the benefits of these new regulations were experienced by these firms or were limited to large corporations. First, the study focuses on the short-term effects of the new Act on small Indian firms, which motivates the first hypothesis.

H1: There is a positive announcement effect of the new Indian Companies Act, 2013 on small Indian firms.

The study also explores whether the resulting abnormal returns are different for firms that already followed good governance practices, as per the Act. Chhaochharia & Grinstein (2007) investigate how SOX impacted the value of a company. They constructed portfolios for more compliant and less compliant firms, and found that less compliant firms earn larger, positive abnormal returns in the announcement year as compared to more compliant firms. However, within the portfolio of less compliant firms, larger firms earned positive abnormal returns, whereas small firms earned negative abnormal returns.

The sample is divided into compliant and non-compliant firms based on the corporate governance score of the firm in each of the three categories used in the study, the year before the implementation of the Act. If the scores are above a certain limit, the firm is categorized as compliant, otherwise non-compliant. It is expected that there would be a higher positive announcement effect for compliant firms as these firms already have good governance practices in place, before the Act. The second hypothesis is as follows:

H2: The abnormal returns for the firms that were already compliant before the implementation of the Act differ from the abnormal returns for non-compliant firms.

Recent studies show that good corporate governance mechanisms are linked to positive long-term effects. This study considers the performance of small firms over nine years, 2011-2019, to ascertain if the new corporate governance provisions introduced by the Act lead to positive long-term effects on firm performance. It can be that the nature of the relationship between corporate governance and firm performance changed after the implementation of the new Act as it gave way to stricter regulations on reporting and related party transactions. Listing out the role of the audit committee, lining out the selection process for independent directors, reducing the interval between two board meetings, and introducing and increasing the fines for non-compliance made

the new Act more comprehensive in nature. Hence, it is expected that after the introduction of the Act, the improved corporate governance mechanisms will have a positive impact on the performance of small firms.

H3: There is a significant long-term positive impact of corporate governance on the performance of small firms after the implementation of the new Indian Companies Act, 2013

IV. METHODOLOGY

A. Data and sample

The sample of companies is taken from the NIFTY Smallcap 100 Index as on August 30th, 2013. The NIFTY Smallcap 100 index reflects the performance and behavior of small-cap stocks listed on the National Stock Exchange (NSE) of India. From the 100 index constituents, companies from the banking and financial sector are removed, as the leverage ratio of these companies is affected by the minimum capital requirement regulations and other factors. Moreover, high leverage in the banking and financial sector has a different interpretation than for non-financial firms, where higher leverage would generally be a sign of distress (Fama & French, 1993). The final sample of 56 companies is formed after companies with missing data are excluded.

The data for firm-level financial and board-related information was obtained from the Centre for Monitoring Indian Economy's (CMIE) Prowess database and published annual reports of the companies. Data on 91-day treasury bills rate have been taken from the Reserve Bank of India's Database on Indian Economy (RBI-DBIE). The stock returns of the sample firms as well as the market index returns were obtained from the NSE India (National Stock Exchange of India Ltd.) website.

A comprehensive Corporate Governance Score (CGS) is then calculated using the information from the annual reports of a firm and is used further in the analysis. The components of the score are given in **Table I**, and the elements are described in the next section.

B. Measuring Corporate Governance

This study uses a corporate governance score based on the regulations of the new Indian Companies Act, 2013. The index is formulated based on the governance changes required by the Act and takes components from the governance index formed by (Goel, 2018). The study follows the scoring approach used in Cheung et al. (2010), various criteria are credited for the amount of information disclosed and the number of good governance practices adopted by a firm, instead of allocating only a binary score of 0 and 1. The index comprises of three components (board composition, board committees, and stakeholders), each relating to a different governance mechanism tackled by the Act.

The first component focuses on the changes the firms need to implement regarding *board composition*. *Board Size* refers to the number of directors on a firm's board. The board of directors are the highest decision-making body in a firm and is responsible for directing the efforts of senior management.

There is conflicting evidence in the literature on the optimum board size. Many studies have shown that large board sizes are advantageous for shareholders due to stricter monitoring and reduced managerial entrenchment (Singh & Harianto, 1989; Dalton et al., 1999; Fauzi & Locke, 2012). Klein (2002) states that larger boards allow directors to specialize, leading to increased effectiveness. Nonetheless, many researchers have also argued in favor of smaller board sizes. According to these studies, smaller boards experience fewer problems in the transmission and

management of information, which in turn leads to higher efficiency (Lipton & Lorsch, 1992; Jensen, 1993; Cheng, 2008).

This study follows the paper by Varshney et al. (2012) as a basis for scoring this criterion, in which they came up with a grading system for board size based on surveys and opinions of professionals from various agencies and Indian firms. The scores were factored in for this study to match the magnitude of the other criteria.

The *number of board meetings* is used as the Act requires the companies to hold at least one board meeting every quarter, which means a minimum of four board meetings in a financial year. Board meetings act as a channel for directors to acquire information, monitor management activities, and strategize. According to Lipton & Lorsch (1992), a company with regular board meetings would have higher management accountability and better supervision.

The *Percentage of independent directors* measures the fraction of the board that is independent. According to the act, an independent director is a person who is not managing, whole-time or nominee director on the board of the firm and is not a promoter or related to promoter or directors in the company or its holding, subsidiary, or associate company. The independent director should also not have any pecuniary relationship with the company or its holdings, which might compromise their independence.

Fama (1980), Fama & Jensen (1983), Rosenstein & Wyatt (1990) and Brickley (1994) demonstrate that the presence of independent directors on the board reduces agency costs due to stricter monitoring, thereby improving firm performance. Agency theory suggests that outside directors prevent any self-interested actions taken by managers, on behalf of shareholders, and provide independent judgement on various issues related to strategy and performance. The new

Act mandates that one-third of the board should comprise of independent directors for better supervision and transparency.

The presence of heterogeneity across various levels of management in an organisation affects its performance. Board diversity, like managerial diversity, is an important component of organizational behavior research. The new Companies Act, 2013 requires that at least one woman director be present on the board and the *Women directors* part of the score is used to measure the number of women directors on the board of a firm for that year. They bring in immense resources and relationships because of their diverse skillset and keen observational abilities (Smith, Smith, & Verner, 2006). Jyothi & Mangalagiri (2019) show that performance of Indian firms is positively affected by having a woman director on the board.

The second component of CGI focuses on the functioning and administration of *board committees*. While the new Act mandates the formulation of essential board committees, such as audit committee, nomination and remuneration committee, etc., there are other committees that handle various functionalities and address specific areas of concern. These committees lead to better governance practices and increased transparency. Hence, the *Number of committees on the board* is used as a measure in the second component. In addition to the number of committees, the functioning of these committees is also an important factor. As discussed before, independent directors are not motivated by personal or financial interests, and provide a fresh point of view, leading to efficient decision-making. The *Number of committees headed by independent directors* is considered as their presence in board committees also increases accountability and overall governance of a firm.

The old Indian Companies Act, 1956 did not require the establishment of a *Nomination and Remuneration committee*. However, the new Act mandates the formation of this committee

for every listed entity, with the majority of the members being independent directors. This committee is formed to ensure transparency in the disclosure of compensation policies and to identify qualified candidates with appropriate expertise and skills to be appointed as directors.

Wild (1996) found that good quality financial reporting strengthens investor trust and improves firm performance. An independent audit committee would reduce the chance of financial fraud and misappropriation of funds, which would be advantageous for the company (Beasley, 1996). *Audit committee independence* is measured as the percentage of independent directors on the committee.

Corporate ethics are vital for an organization, as these ethics safeguard the interests of management, employees, shareholders, stakeholders, and the community at large. These define the values a company upholds and clarify its objectives while holding the company accountable (Donker, Poff, & Zahir, 2008; Kaptein, 2004). The third dimension of the corporate governance score considers how the Companies Act, 2013 introduced reforms to protect the interests of various *stakeholders* of a firm.

Code of Conduct and *Whistleblower policy* capture if a firm has a comprehensive set of codes for its senior management and other employees, and if it has a well-defined whistleblower policy to protect its employees. Before the Act, there was no legislation for the protection of whistleblowers, and a vigil mechanism was required to safeguard and make provisions for persons reporting illegal activities. The *Percentage of Consumer Grievances Redressed during a Year* is used to ascertain how well the company handles complaints from consumers and shareholders. It measures the effectiveness of a company's redressal programs and the speed at which complaints are processed.

A *Separate meeting of independent directors* is required to evaluate the performance of non-independent directors and the board, as they would take an objective view on performance evaluation. The meeting is done to ensure that the quality and timeliness of the flow of information between management and the board is efficient. The new Act requires that there should be at least one separate meeting of the independent directors, without the presence of non-independent directors and members of management.

C. *Other independent variables*

AuditFee is used to assess the quality of a firm's external control mechanisms after the introduction of the act. There are mixed views in the literature on how audit fees affect firm value. Hay (2013) in their meta-analysis, conclude that corporate governance variables and audit fees have a positive relationship. The reason is attributed to higher quality of independent directors opting for better standard of financial statements and demanding high-quality work from auditors.

The relationship between audit fees and firm performance is complex, and through previous studies, it is known that improving board characteristics can lead to higher compliance costs. After the act, many firms experienced an increase in audit fees over the years. This variable is used to determine if the compliance cost of the act imposes a heavy financial burden on the firms or is associated with improved transparency and audit quality.

CSR Expenditure is taken as the total amount spent by a firm on CSR activities. The new Companies Act, 2013 requires companies that meet a certain threshold to spend 2% of the net profit of the last three years on CSR. This mandatory rule can impose a social and financial burden on companies (Manchiraju & Rajgopal, 2017), especially on small firms.

There are control variables like *Age*, *Growth*, *Leverage*, and *Size* used in the regressions as they are related to firm value, according to the literature. *Age* is the number of years since a firm's date of incorporation. *Growth* is the year-on-year change in revenue. *Leverage* is the firm's total debt scaled by its total assets and *Size* is the natural log of total sales of the firm at the end of each financial year.

The analysis is performed in two parts, the first part deals with the immediate short-term effect of the passing of the act, ascertaining the presence of abnormal announcement returns and if these abnormal returns are related to a firm's corporate governance mechanisms at that time. The second part of the analysis examines the long-term effects of the act on the performance of small-cap firms. The sample is split into compliant and non-compliant firms, based on their corporate governance scores the year before the implementation of the Act, to determine if the companies that were already following these governance guidelines had any advantage over the companies that were not. To label a firm as compliant, it must have a governance score above 60%. This threshold is calculated by adding up the scores for meeting the mandatory criteria according to the Act and dividing it by the total score. The resulting value is rounded up, and the threshold is fixed as 60%.

D. Short-term analysis

The Companies Act, 2013 came into force on 12th September, 2013. The Act received the assent of the President of India on August 29, 2013. However, the Indian Ministry of Corporate Affairs published a notification on 12th September, 2013, announcing that several provision of the Act would take effect on that date. Due to this fact, 12th September, 2013, marks the actual implementation of the Companies Act, 2013. The event study was conducted with different event dates to find if there was any effect on the returns of the firms on those dates, and the results were

not significant, which suggests that there was no clear information revealed to the market on these alternative dates.

The main objective of the Act was to simplify the legislation and provide a clear and comprehensive framework encompassing all aspects of governance in a single law.

An event study methodology is used to estimate the abnormal returns resulting from the passage of the new Indian Companies Act, 2013. The abnormal returns (AR) are estimated using the OLS Market Model as well as the Market Adjusted Returns Model (Brown & Warner, 1985)¹. The monthly yield on 91-day Treasury bills has been used as the risk-free rate, and NIFTY Smallcap 100 Index is used as a proxy for market returns. The ARs are calculated based on the estimation window of (-270, -21). The model used is given in equation (1).

$$R_{it} = R_{ft} + \alpha_i + \beta_i(R_{mt} - R_{ft}) + \varepsilon_{i,t} \quad (1)$$

where R_{it} is the rate of return of the firm i on day t . R_{mt} is the rate of return of the market index on day t , R_{ft} is the risk-free rate, and $\varepsilon_{i,t}$ is the error term.

Abnormal returns (AR) and *cumulative abnormal returns (CAR)* for stock i at time T will be given by equations (2) and (3).

$$AR_{iT} = R_{iT} - (R_{fT} + \hat{\alpha}_i + \hat{\beta}_i(R_{mT} - R_{fT})) \quad (2)$$

$$CAR_{i(T_1T_2)} = \sum_{T=T_1}^{T_2} AR_{iT} \quad (3)$$

¹ Small cap companies are often less followed by analysts and may have less liquidity than larger companies, making it more difficult to obtain accurate beta estimates for these companies for the standard market model approach using any benchmark portfolio (NIFTY 50, BSE SENSEX, etc.). Hence, market adjusted returns model is also used to compute abnormal results and it similar results are found from both models. The AAR and CAAR estimated through market adjusted returns model can be found in the Appendix of the study in **Table A.1**.

where the $\hat{\alpha}_i$ and $\hat{\beta}_i$ are ordinary least squares estimates of the coefficients from equation (1), T is a day in the event window ($T = 0$ on the day of the announcement), R_{iT} is the actual return of firm i on day T and $(R_{fT} + \hat{\alpha}_i + \hat{\beta}_i(R_{mT} - R_{fT}))$ represents the expected return which is calculated using the estimation window for each firm in equation (1).

The *average abnormal returns (AAR)* and *cumulative average abnormal returns (CAAR)* are calculated by taking averages of the ARs and CARs of each firm. The calculation for AAR and CAAR is shown below:

$$AAR_T = \frac{1}{N} \sum_{i=0}^N AR_{iT} \quad (4)$$

$$CAAR_{T_1T_2} = \sum_{T=T_1}^{T_2} AAR_T \quad (5)$$

Various parametric tests are used to assess the robustness of the results. These tests are used to check if the estimated abnormal returns are statistically meaningful. Two robustness tests, namely Patell Z and Adjusted Patell Z test, are utilized. Patell Z test is robust against the way ARs are distributed across the event window (Patell, 1976). However, this test is sensitive to cross-sectional correlation. To account for cross-sectional correlation, adjusted Patell test is also used (Kolari & Pynnönen, 2010).

Finally, to test the main hypothesis, a multiple linear regression model is used as given in equation (6).

$$CAR_i = \beta_1 + \beta_2 CGS_i + \beta_3 Compliance_i + \beta_4 Growth_i + \beta_5 Leverage_i + \beta_6 Size_i + \beta_7 ROA_i + \varepsilon_{i,t} \quad (6)$$

Where, CAR_i is the cumulative abnormal return of a firm i during the announcement window (-1, +1), *Compliance* is a dummy variable equal to 1 if a firm is compliant and 0 otherwise. *Growth*, *Leverage*, *Size*, and *ROA* (Return on Assets) are used as control variables. *ROA* is used as a control variable only in the short-term regression as it is highly correlated to the firm value variable used in the long-term panel regressions and would lead to spurious results.

E. Long-run analysis

This study considers the data for the period 2011-2019 to assess the long-term impact of the new Indian Companies Act, 2013. A panel data regression model² is used to take into account time series as well as the cross-sectional variations in the data. The regression equation (8) is used to assess the impact of the corporate governance score (*CGS*) on the proxy for firm performance, Tobin's Q.

Many studies from around the world have used Tobin's Q to study the empirical association between corporate governance and firm performance (Klapper & Love, 2004; Bhagat & Bolton, 2008; Ammann et al., 2011)). Several studies in the Indian context have also used the same metrics. Balasubramanian et al. (2010) used Tobin's Q to evaluate the impact of corporate governance on Indian firms. Dharmapala & Khanna (2013) also used the same measure as a proxy for firm value. Chung & Pruitt (1994) estimated a simple equation for Tobin's Q, which requires only basic financial and accounting information. They find a high degree of correlation between other methods of estimating Q and the one used in this study. For the purpose of further analysis, Tobin's Q is estimated as,

² The data used for panel data regression is a balanced panel (with equal number of observations for each cross-sectional unit)

$$TobinQ = \frac{MVE + PS + Debt}{TA} \quad (7)$$

where, *MVE* is the market value of a firm's common stock, *PS* is the liquidation value of the firm's preferred stock, *Debt* is the book value of the total liabilities of the firm, and *TA* is the book value of the total assets of the firm.

The model uses two interaction terms to capture how the effect of some variables has changed after the implementation of the Act. An interaction term with *CGS* and *Act* dummy is used to measure the impact governance score had on performance after the introduction of the new Act. Similarly, an interaction term between *AuditFee* and *Act* dummy is used to assess the relationship between audit fee and firm performance, post-act. Equations (9), (10), and (11) use the same model to measure the impact of each component of the governance score on performance.

$$\begin{aligned} TobinQ_{i,t} = & \beta_0 + \beta_1 CGS_{i,t} + \beta_2 CGS * Act_{i,t} + \beta_3 Act_{i,t} + \beta_4 AuditFee_{i,t} \\ & + \beta_5 AuditFee * Act_{i,t} + \beta_6 CSR_{i,t} + \beta_7 Age_{i,t} + \beta_8 Growth_{i,t} \\ & + \beta_9 Leverage_{i,t} + \beta_{10} Size_{i,t,t} + \varepsilon_{i,t} \end{aligned} \quad (8)$$

$$\begin{aligned} TobinQ_{i,t} = & \beta_0 + \beta_1 CGS_c1_{i,t} + \beta_2 CGS_c1 * Act_{i,t} + \beta_3 Act_{i,t} + \beta_4 AuditFee_{i,t} \\ & + \beta_5 AuditFee * Act_{i,t} + \beta_6 CSR_{i,t} + \beta_7 Age_{i,t} + \beta_8 Growth_{i,t} \\ & + \beta_9 Leverage_{i,t} + \beta_{10} Size_{i,t,t} + \varepsilon_{i,t} \end{aligned} \quad (9)$$

$$\begin{aligned}
TobinQ_{i,t} = & \beta_0 + \beta_1 CGS_c2_{i,t} + \beta_2 CGS_c2 * Act_{i,t} + \beta_3 Act_{i,t} + \beta_4 AuditFee_{i,t} \\
& + \beta_5 AuditFee * Act_{i,t} + \beta_6 CSR_{i,t} + \beta_7 Age_{i,t} + \beta_8 Growth_{i,t} \\
& + \beta_9 Leverage_{i,t} + \beta_{10} Size_{i,t} + \varepsilon_{i,t}
\end{aligned} \tag{10}$$

$$\begin{aligned}
TobinQ_{i,t} = & \beta_0 + \beta_1 CGS_c3_{i,t} + \beta_2 CGS_c3 * Act_{i,t} + \beta_3 Act_{i,t} + \beta_4 AuditFee_{i,t} \\
& + \beta_5 AuditFee * Act_{i,t} + \beta_6 CSR_{i,t} + \beta_7 Age_{i,t} + \beta_8 Growth_{i,t} \\
& + \beta_9 Leverage_{i,t} + \beta_{10} Size_{i,t} + \varepsilon_{i,t}
\end{aligned} \tag{11}$$

Estimating a regression model using panel data can be done using three different methods: pooled ordinary least square (Pooled OLS) model, fixed effects model, and random effects model. To select the appropriate model for the study, Lagrange multiplier test and Hausman test are conducted for each equation. Details of these tests are given in **Section V**, after descriptive statistics and the correlation matrix.

V. RESULTS AND ANALYSIS

A. Descriptive statistics

Table II presents the summary statistics for the whole sample and the two sub-samples (compliant and non-compliant firms). Mean Tobin's Q for the full sample reported in *Panel A* is 6.57; compliant firms (*Panel B*) seem to have a higher mean Q (7.8998) than non-compliant firms (4.9246) in *Panel C*. Compliant firms also have a higher mean corporate governance score (CGS) at 71.51%. The mean CGS for the whole sample is 69.02%. It is also observed that compliant firms seem to be older, on average, than non-compliant firms on average. The CSR expenditure and size

of both the sub-samples are almost the same; however, a higher leverage ratio is observed for compliant firms too.

To observe the initial relationship between these variables, a correlation matrix is constructed.

B. Correlation matrix

Table III gives the Pearson correlation matrix for the whole sample and the two sub-samples. Data for the full sample is reported in *Panel A*, and for the sub-samples, compliant and non-compliant, is reported in *Panel B* and *Panel C*, respectively. On the whole, *CGS* seems to have a negative relationship with *TobinQ*. *AuditFee* and *CSR* are also negatively related to *Q*, which is expected. *CGS* is positively related to the *Act* dummy, showing that after the implementation of the Act, the corporate governance score increased. This is true for each sample. The same can be said about *AuditFee* and *CSR*, indicating that firms had to spend more to comply with the requirements of the Act. However, these findings should be considered with caution as bivariate correlation does not take into account the interaction between all of the endogenous variables in the model.

C. Short-term Impact

Event Study

Results of the event study are given in **Table IV**. In *Panel A* of **Table IV**, it is observed that there is a positive and significant announcement effect (1.78%) for all the firms in the sample. This shows that the market reacted positively to the passage of the Act, which is in line with the first hypothesis.

Looking further at the reaction of compliant and non-compliant firms, compliant firms (*Panel B*) experienced a higher positive significant return of 3.4% in the (-1, +1) event window

than the full sample. This can also be seen in **Figure I**, there is a spike in AAR and CAAR for compliant firms on the announcement date, and the CAAR stays positive after the announcement of the Act.

However, for the non-compliant sample (**Figure II**), the CAAR declines after the announcement date. The results in *Panel C* of **Table IV** show that non-compliant firms experienced a negative but insignificant return over the same window. The results indicate that firms with good governance practices in place were affected positively by the announcement, in contrast, non-compliant firms had a negative market reaction to the Act, albeit not significant.

Regression

The CARs from the event study were analyzed further by conducting a regression analysis to ascertain what factors were affecting these abnormal returns. The results in **Table V** indicate that *CGS* is actually negatively related to CAR, however, the *compliance* dummy is positive and significant. This again demonstrates that companies with good governance structures already in place experienced positive abnormal returns than those that did not, proving the second hypothesis. The negative relation with *CGS* could mean that the market wants to invest in firms with less developed corporate governance systems as these firms have a higher potential to improve corporate governance and disclosures, giving higher benefits in the long run (Switzer & Lin, 2009).

D. Long-term Impact

Model Selection

The Lagrange multiplier and Hausman test are used to select the appropriate model for the panel data. Generally, parameter estimation in a regression analysis of cross-sectional data is performed using ordinary least squares (OLS). However, panel data is a combination of time-series

as well as cross-sectional variations in the data. In other words, panel data observes the same individual over a certain period of time.

Lagrange multiplier (LM) test is performed to determine whether common effects (OLS) or random effects model is better for the panel data i.e. to check if any random effects exist in the cross-section or time dimension of the data. Two ways of computing the LM are used, the most popular two-sided Conventional LM Breusch-Pagan (1980) and uniformly most powerful LM Honda (1985) which derives components with one-sided alternatives. The results of the LM test are given in **Table VI**.

The null hypothesis of the LM test is that no random effects exist in the data. In the case of no random effects, pooled OLS approach is employed. Rejecting the null hypothesis would mean that the random effects model is appropriate for the data. From **Table VI**, it is observed that all the p-values for cross-section effects are below 0.05, and all the p-values for time series effects are higher than 0.05. Hence, cross-section random effects exist in the data.

Next, whether the random or fixed effects model is suitable is determined. To ascertain that, Hausman test is used. The null hypothesis for the Hausman test is that the random effects model is suitable for the data as no correlation exists between individual effects and the regressors and the alternate hypothesis is that the fixed effects model is appropriate for the data, meaning that there is correlation between the individual effects and the regressors. As depicted in **Table VII**, p-values for all regressions for the full sample is less than 0.05, hence fixed effects model is appropriate for the regressions with the full sample. For compliant and non-compliant sample regressions, the results are varied across, and appropriate model specification is used based on the Hausman test. Cross-section weights and white cross-section are also employed to compute robust standard errors to cross-equation correlation and heteroskedasticity.

Full sample

Table VIII gives the regression results for equations (8) to (11) for the full sample of companies over the years 2011-2019. The interaction term *CGS*Act* measures how firm performance was related to that firm's corporate governance practices, after the Act's introduction. As shown, there is no significant relationship observed between corporate governance score (*CGS*) and firm performance (*TobinQ*)³, even after the new Companies Act, 2013 was introduced. Only the *board composition* component of the index has a negative and significant effect on the performance, however, after the introduction of the act, the relationship between the two is positive and significant. This shows that after the Act, significant changes in composition of the board did have a positive effect on the performance of small firms.

AuditFee is positively related to firm performance, even after the act, indicating that a higher audit fee is seen as a proxy for better transparency and quality of financial reporting by the investors (Hay, 2013). *CSR* is negatively related to firm performance, showing CSR expenditure imposes a financial burden on small firms and their functioning.

The entire sample is then bifurcated into compliant and non-compliant samples to evaluate the effect of the Act more closely, and how it differed between firms that were already following good governance practices.

Compliant Firms

Table IX has the regression results for the sample of already compliant firms. *CGS* had a negative impact on performance overall, but after the act's introduction, it had a positive and

³ The panel regressions are also estimated using winsorized Tobin's Q (*TobinQ_W*) as a robustness test to ascertain whether the main results are impacted by the presence of outliers. The results are similar to the ones established in the study and can be found in the Appendix A, Table A.2.

significant effect on firm performance. It shows that investors started paying closer attention to the corporate governance practices of firms after the implementation of the Act and firms with good governance systems were doing better in the post-act period. The same relationship exists for board composition and stakeholders component of the index, demonstrating that improvements in the composition of the board, and taking measures for the protection of various stakeholders, positively impacted firm performance in the long run.

AuditFee does not have a significant relationship with firm performance for compliant firms, however, *CSR* still has a negative impact on firm performance.

Non-compliant Firms

For non-compliant firms, it is noted in **Table X** that *CGS* did not have a significant effect on firm performance, even after the implementation of the act. However, board composition improvements positively affect firm performance after the Act is rolled out, in the long run. An increase in audit fees seems to have a positive effect on firm performance, after the Act was implemented, showing that non-compliant firms that are spending more to comply with the act and make better governance decisions are performing better.

Looking at the control variables, growth is positively related to *Q*, showing that a higher firm growth rate leads to better performance. Leverage and age are negatively related to performance. Small firms generally do not have access to capital markets like large firms do and face higher cost of debt. Hence, higher leverage for small firms could be a red signal, as they may be subject to higher default risk. Age being negatively related to performance shows that older firms are negatively affected by the slowdowns in the economy as they cannot rapidly adapt to the changes in the industry (Marshall, 1920). Firm size is negatively related to Tobin's *Q*, this could

mean that smaller firms face fewer governance issues due to stricter monitoring and better coordination.

The results show that non-compliant firms are still trying to implement measures to improve their governance systems and improve their performance. However, in the long-run, compliant firms with sound governance systems are valued by the investors after the Act. This also shows that investors are more careful and aware of the corporate governance structures of the firms they invest in post-act. Changes in board composition had a positive effect on performance in all regressions. Appointing women directors and establishing a more diverse board with a large percentage of independent directors had a positive effect on the firm's long-term performance. A higher number of board meetings are also contributing to the increased focus on monitoring the board.

Based on these results, the third hypothesis, that there is a significant long-term positive impact of corporate governance on the performance of small firms after the implementation of the new Act stands true for compliant firms, whereas non-compliant firms are still working towards improving their governance systems and have increased their spendings for the same.

VI. CONCLUSION

This study explores the effects of the Indian Companies Act, 2013 on the performance of small firms in India. A corporate governance score is formulated, based on the Act's new criteria, to measure a firm's corporate governance performance. The score considers the new regulations put in place to reduce fraud and improve disclosure measures. The sample of firms is divided into compliant and non-compliant firms based on their corporate governance score before the Act was passed. Significant positive abnormal returns are observed for the full sample in the short-term period, just after the introduction of the Act. This finding is consistent with the first hypothesis of

the study that the enactment of the new Companies Act had a positive announcement effect on the returns of small-cap firms.

Further investigation of the returns shows that while compliant firms had high positive abnormal returns, the Act did not have any effect on the returns of non-compliant firms. A cross-sectional analysis is performed to find if certain firm-specific corporate governance attributes can account for the variation of the observed abnormal returns. The results report that even though the corporate governance score is negatively related to abnormal returns, firms that are compliant experience higher abnormal returns. This supports the second hypothesis, which states that abnormal returns for firms that were already complying prior to the Act's implementation differ from abnormal returns for non-compliant firms.

Finally, long term impact of the Act is examined over the years 2011-2019, taking into account the period before and after the Act. It is observed that investors are more vigilant regarding the corporate governance policies of the firms they invest in. After the implementation of the Act, higher corporate governance score led to better performance for small firms in the long run, consistent with the third hypothesis. Similar outcomes are observed for compliant firms, however, the governance score has no significant effect on performance of the non-compliant firms. This could be attributed to less resources available to small firms to make big changes after a new reform. However, these firms are spending money to improve their governance systems and performance as the audit fee after the Act has a positive and significant relationship with the performance. It is also found that CSR expenditure has a negative effect on the performance of these firms, indicating the financial strain CSR spending has on small companies.

Overall, the new Companies Act 2013 had a positive impact on the functioning of small firms in India in the long run and improved the financial disclosure and governance mechanisms

of these firms. These kinds of reforms are believed to impose a huge burden on small companies, however, in the long run, these reforms lead to improved performance and transparency.

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Table I Components of Corporate Governance Score (CGS)

This table explains the various criteria considered to measure corporate governance. Detailed description of each of these variables is also given in Section IV(B). The governance score comprises of three major components, depending on the new regulations of the Indian Companies Act 2013. *Board Composition* component deals with the structure of the board and its functioning. *Board Committees* component measures how efficient the board is in operating and managing the different functions. *Stakeholders* component considers the interests of various stakeholders of a firm

<i>Criterion</i>	<i>Scoring basis</i>	<i>Requirement/Voluntary Norm</i>
<i>Component 1: Board Composition</i>		
Board Size	If the board size is less than 3, the firm gets a score of 0 If the board size is from 3 to 5, the firm gets a score of 1.5 If the board size is 6 or 7, the firm gets a score of 1.95 If the board size is 8 or 9, the firm gets a score of 2.4 If the board size is 10 or 11, the firm gets a score of 3 If the board size is 12 or 13, the firm gets a score of 2.85 If the board size is more than 14, the firm gets a score of 2.7	Minimum 3
Number of board meetings	3 for > 6 meetings 2 for 4–6 meetings 1 for < 4 meetings	Minimum 4 meetings per year
% of independent directors	3 for > 1/2 of Directors 2 for 1/3 -1/2 of Directors 1 for < 1/3rd of Directors	1/3rd of the board
Women Directors on board	2 for > 1 Women Director 1 for 1 Women Director 0 for No Women Director	Minimum 1

Table I cont'd

Component 2: Board Committees		
Number of board committees	3 for > 5 Committees 2 for 3–5 Committees 1 for < 3 Committees	Minimum 4
Number of committees headed by independent directors	3 for > 5 Committees 2 for 2–5 Committees 1 for < 2 Committees	Minimum 2
NomRem committee	2 for NomRem Committee 1 for remuneration committee 0 for none	Nomination and Remuneration committee
Audit Committee independence	3 for > 66.67% of Directors 2 for 50-66.67% of Directors 1 for < 50% of Directors	50% (majority)
Component 3: Stakeholders		
Code of conduct	3 for all Employees 2 for all levels of Management 1 for only Directors and Senior Management	Code of Conduct for Directors and Senior management
Whistle blower policy	1 for Well defined Policy 0 for Not Available	Mandatory
Consumer Grievances Redressed	3 for > 90% Redressal 2 for 70–90 Redressal 1 for < 70% Redressal	100%
Separate meeting of independent directors	2 for > 1 Meetings 1 for 1 Meeting 0 for No Meeting	Minimum 1 meeting per year

Table II Descriptive Statistics

Panel A shows the descriptive statistics for the whole sample. *Panel B* and *Panel C* show the descriptive statistics for compliant and non-compliant subsamples, respectively. *TobinQ* is the proxy for firm performance, measured as (market value of common stock + book value of preferred stock + book value of total liabilities)/(book value of total assets). *CGS* is the corporate governance score. *Act* is a dummy variable equal to one for the years after the introduction of the act or zero otherwise. *AuditFee* is the amount a company spent on audit for the year. *CSR* measures the amount spent on corporate social responsibility by a firm in a year. *Age* is the number of years since a firm's date of incorporation. *Growth* is the year-on-year change in revenue. *Leverage* is the firm's total debt scaled by its total assets. *Size* is the natural log of the firm's total sales at the end of each financial year.

<i>Panel A: Descriptive Statistics for Full Sample</i>					
	<i>Mean</i>	<i>Median</i>	<i>Minimum</i>	<i>Maximum</i>	<i>SD</i>
<i>TobinQ</i>	6.5716	2.9163	0.3002	68.3792	9.1071
<i>CGS</i>	69.0215	70.0337	35.2189	90.2357	9.0471
<i>Act</i>	0.6667	1	0	1	0.4719
<i>AuditFee</i>	5.3742	4.5	0	22.5	3.9821
<i>CSR</i>	15.4278	0	0	222.8	32.3205
<i>Age</i>	41.9464	31	4	160	30.0191
<i>Growth</i>	15.2498	8.0021	-78.4444	941.2328	59.7406
<i>Leverage</i>	35.7910	18.7850	0.8093	381.0632	44.1508
<i>Size</i>	9.5625	9.8638	3.6584	12.1026	1.3620
<i>Panel B: Descriptive Statistics for Compliant firms</i>					
	<i>Mean</i>	<i>Median</i>	<i>Minimum</i>	<i>Maximum</i>	<i>SD</i>
<i>TobinQ</i>	7.8998	3.4659	0.5604	68.3792	10.6823
<i>CGS</i>	71.5052	71.9192	35.2189	90.2357	8.0907
<i>Act</i>	0.6667	1	0	1	0.4723
<i>AuditFee</i>	5.6631	4.8	0	22.5	4.1363
<i>CSR</i>	15.2323	0	0	150.3	29.4122
<i>Age</i>	46.0000	32	5	160	35.5250
<i>Growth</i>	14.2604	8.3485	-77.5369	396.8609	38.9388
<i>Leverage</i>	41.5033	25.6104	1.3987	209.7651	41.3529
<i>Size</i>	9.7708	10.1282	5.6688	12.1026	1.2053
<i>Panel C: Descriptive Statistics for Non-compliant firms</i>					
	<i>Mean</i>	<i>Median</i>	<i>Minimum</i>	<i>Maximum</i>	<i>SD</i>
<i>TobinQ</i>	4.9246	2.3245	0.3002	37.5313	6.3009
<i>CGS</i>	65.9418	67.5253	42.9293	85.3872	9.2382
<i>Act</i>	0.6667	1	0	1	0.4725
<i>AuditFee</i>	5.0160	4.3	0.3	18.9	3.7605
<i>CSR</i>	15.6702	0	0	222.8	35.6650
<i>Age</i>	36.9200	29	4	88	20.2842
<i>Growth</i>	16.4766	7.6715	-78.4444	941.2328	78.2924
<i>Leverage</i>	28.7078	14.8772	0.8093	381.0632	46.5174
<i>Size</i>	9.3043	9.4888	3.6584	11.7022	1.4972

Table III Pearson Correlation Matrix

Panel A shows the Pearson correlation matrix for the whole sample. *Panel B* and *Panel C* show the Pearson correlation matrix for compliant and non-compliant subsamples, respectively. *TobinQ* is the proxy for firm performance, measured as (market value of common stock + book value of preferred stock + book value of total liabilities)/(book value of total assets). *CGS* is the corporate governance score. *Act* is a dummy variable equal to one for the years after the introduction of the act or zero otherwise. *AuditFee* is the amount a company spent on audit for the year. *CSR* measures the amount spent on corporate social responsibility by a firm in a year. *Age* is the number of years since a firm's date of incorporation. *Growth* is the year-on-year change in revenue. *Leverage* is the firm's total debt scaled by its total assets. *Size* is the natural log of the firm's total sales at the end of each financial year.

<i>Panel A: Pearson correlation matrix for Full Sample</i>									
	<i>TobinQ</i>	<i>CGS</i>	<i>Act</i>	<i>AuditFee</i>	<i>CSR</i>	<i>Age</i>	<i>Growth</i>	<i>Leverage</i>	<i>Size</i>
<i>TobinQ</i>	1								
<i>CGS</i>	-0.1132***	1							
<i>Act</i>	-0.1915***	0.6385***	1						
<i>AuditFee</i>	-0.1179***	0.2701***	0.1828***	1					
<i>CSR</i>	-0.0219	0.3498***	0.3379***	0.1589***	1				
<i>Age</i>	-0.1339***	0.1033***	0.0707*	0.1359***	0.04019	1			
<i>Growth</i>	0.0439	-0.0774**	-0.1065***	-0.0688*	0.0049	-0.0660*	1		
<i>Leverage</i>	-0.2549***	0.0499	0.0387	0.2798***	-0.0242	0.1773***	-0.0849**	1	
<i>Size</i>	-0.2583***	0.2056***	0.1005***	0.4542***	0.2772***	0.2428***	-0.0674*	0.3248***	1
<i>Panel B: Pearson correlation matrix for Compliant firms</i>									
	<i>TobinQ</i>	<i>CGS</i>	<i>Act</i>	<i>AuditFee</i>	<i>CSR</i>	<i>Age</i>	<i>Growth</i>	<i>Leverage</i>	<i>Size</i>
<i>TobinQ</i>	1								
<i>CGS</i>	-0.1723***	1							
<i>Act</i>	-0.2195***	0.6119***	1						
<i>AuditFee</i>	-0.0713	0.2880***	0.1915***	1					
<i>CSR</i>	0.0454	0.4283***	0.3669***	0.2416***	1				
<i>Age</i>	-0.1958***	0.0374	0.0598	0.1342***	-0.0458	1			
<i>Growth</i>	0.1037**	-0.1411***	-0.1714***	-0.0902*	-0.0151	-0.0929*	1		
<i>Leverage</i>	-0.3749***	0.0464	0.09229*	0.2952***	-0.0574	0.2766***	-0.1028**	1	
<i>Size</i>	-0.3439***	0.1709***	0.1359***	0.3706***	0.2738***	0.1799***	-0.1189***	0.4725***	1

Table III Cont'd

Panel C: Pearson correlation matrix for Non-compliant firms

	<i>TobinQ</i>	<i>CGS</i>	<i>Act</i>	<i>AuditFee</i>	<i>CSR</i>	<i>Age</i>	<i>Growth</i>	<i>Leverage</i>	<i>Size</i>
<i>TobinQ</i>	1								
<i>CGS</i>	-0.2005***	1							
<i>Act</i>	-0.1590***	0.5976***	1						
<i>AuditFee</i>	-0.2854***	0.2269***	0.1729***	1					
<i>CSR</i>	-0.1398***	0.3174***	0.3114***	0.0717	1				
<i>Age</i>	-0.0391	0.1152**	0.1048	0.1147**	0.2062***	1			
<i>Growth</i>	0.0076	-0.0441	-0.0765	-0.0609	0.0152	-0.0599	1		
<i>Leverage</i>	-0.1563***	-0.0327	-0.0195	0.2470***	0.0073	-0.0438	-0.0774	1	
<i>Size</i>	-0.2617***	0.1573***	0.0693	0.5454***	0.2896***	0.3418***	-0.0411	0.1624***	1

***, **, and * denote significance at the 5%, 10% and 15% levels, respectively.

Table IV AAR and CAAR values for the sample and their significance

This table shows the Average Abnormal Returns (AAR) and Cumulate Average Abnormal Returns (CAAR) for the whole sample and sub-samples. Day 0 is taken as the day the Act was introduced, i.e., 12th September, 2013. The abnormal returns are measured using the OLS Market Model. The monthly yield on 91-day Treasury bills has been used as the risk-free rate, and NIFTY Smallcap 100 Index is used as a proxy for market returns. The ARs are calculated based on the estimation window (-270, -21). Below the AAR and CAAR values, two significance tests, Patell Z and adjusted Patell Z, are taken to test the significance of these abnormal returns.

	AAR(-1)	AAR(0)	AAR(1)	CAAR (-1, +1)
<i>Panel A: Full Sample</i>				
AAR/CAAR value	0.58%	0.99%	0.21%	1.78%
Patell Z	0.5212	2.626***	0.3398	2.0132***
Adjusted Patell Z	0.4948	2.4928***	0.3226	1.9112**
<i>Panel B: Compliant Firms</i>				
AAR/CAAR value	0.76%	1.65%	0.99%	3.40%
Patell Z	1.0965	3.1731***	1.5085*	3.336***
Adjusted Patell Z	1.054	3.0499***	1.4499*	3.2064***
<i>Panel C: Non-compliant Firms</i>				
AAR/CAAR value	0.36%	0.18%	-0.77%	-0.22%
Patell Z	-0.4409	0.3968	-1.1712	-0.7017
Adjusted Patell Z	-0.4097	0.3687	-1.0883	-0.652

***, **, and * denote significance at the 5%, 10% and 15% levels, respectively.

Table V Regression results for short-term impact

This table represents the results of the multiple linear regression model for the full sample with cumulative abnormal returns (CAR) measured over (-1, +1) window as the dependent variable. *CGS* is the corporate governance score. *Compliance* is a dummy variable equal to one for compliant firms or zero otherwise. *Growth* is the year-on-year change in revenue. *Leverage* is the firm's total debt scaled by its total assets. *Size* is the natural log of the firm's total sales at the end of each financial year. *ROA* is calculated as net profit divided by a firm's total assets.

	(1)
<i>CGS</i>	-0.5318** (-1.9098)
<i>Compliance</i>	8.0649*** (2.3702)
<i>Growth</i>	-0.0308 (-1.0633)
<i>Leverage</i>	0.0161 (0.8057)
<i>Size</i>	1.7319*** (2.0114)
<i>ROA</i>	-0.3226 (-0.8391)
<i>c</i>	13.3742 (0.8249)
F-statistic	2.2540
<i>p value</i>	0.05

***, **, and * denote significance at the 5%, 10% and 15% levels, respectively.

Table VI Lagrange Multiplier Test

This table represents the results of the LM test conducted to identify the appropriate model for the panel data. Lagrange multiplier (LM) test is performed to determine whether common effects (OLS) or random effects model is better for the panel data. The null hypothesis of the LM test is that no random effects exist in the data.

		<i>Test Hypothesis</i>		
		<i>Cross Section</i>	<i>Time</i>	<i>Both</i>
<i>Panel A: Full Sample</i>				
CGS	Breusch-Pagan	1185.485***	0.0432	1185.528***
	Honda	34.4309***	-0.2078	24.1993***
Component 1	Breusch-Pagan	1203.731***	0.06251	1203.794***
	Honda	34.6948***	-0.2500	24.3562***
Component 2	Breusch-Pagan	1157.167***	0.4691	1157.636***
	Honda	34.0172***	0.6849	24.5381***
Component 3	Breusch-Pagan	1190.322***	0.6584	1190.981***
	Honda	34.5011***	-0.8114	23.8222***
<i>Panel B: Compliant Firms</i>				
CGS	Breusch-Pagan	506.8049***	0.3907	507.1956***
	Honda	22.5123***	-0.6251	15.4766***
Component 1	Breusch-Pagan	528.1747***	0.0472	528.2219***
	Honda	22.9821***	-0.2173	16.0971***
Component 2	Breusch-Pagan	506.7403***	0.0013	506.7416***
	Honda	22.5109***	0.0355	15.9427***
Component 3	Breusch-Pagan	457.5848***	0.8567	458.4415***
	Honda	21.3912***	-0.9256	14.4714***
<i>Panel C: Non-Compliant firms</i>				
CGS	Breusch-Pagan	593.8544***	3.3673	597.2217***
	Honda	24.3691***	-1.835	15.934***
Component 1	Breusch-Pagan	553.552***	3.6516	557.2035***
	Honda	23.5277***	-1.9109	15.2854***
Component 2	Breusch-Pagan	603.0625***	3.2596	606.3221***
	Honda	24.5573***	-1.8054	16.088***
Component 3	Breusch-Pagan	577.304***	3.2362	580.5401***
	Honda	24.0272***	-1.7989	15.7177***

***, **, and * denote significance at the 5%, 10% and 15% levels, respectively.

Table VII Hausman Test

This table gives the results of the Hausman test conducted to determine if random effects or fixed effects model is suitable for the panel data. The null hypothesis for the Hausman test is that the random effects model is suitable for the data.

	<i>Chi-sq. Statistic</i>	<i>Chi-sq. d.f</i>	<i>p-value</i>
<i>Panel A: Full Sample</i>			
CGS	22.0009	10	0.0151
Component 1	20.0647	10	0.0286
Component 2	24.44	10	0.0065
Component 3	20.8433	10	0.0222
<i>Panel B: Compliant Firms</i>			
CGS	56.4341	10	0.0000
Component 1	0.0000	10	1.0000
Component 2	0.0000	10	1.0000
Component 3	55.3943	10	0.0000
<i>Panel C: Non-Compliant firms</i>			
CGS	17.9607	10	0.0556
Component 1	22.5675	10	0.0125
Component 2	13.4081	10	0.2017
Component 3	17.7187	10	0.0599

Table VIII Long-term impact of the new Indian Companies Act 2013 on the full sample

This table gives the regression results for equation (8), (9), (10), and (11) in column (1), (2), (3), and (4), respectively for the full sample. The dependent variable is Tobin's Q. *TobinQ* is the proxy for firm performance, measured as (market value of common stock + book value of preferred stock + book value of total liabilities)/(book value of total assets). *CGS* is the corporate governance score. *CGS_c1*, *CGS_c2*, and *CGS_c3* are the three components of the governance score. *Act* is a dummy variable equal to one for the years after the introduction of the act or zero otherwise. *AuditFee* is the amount a company spent on audit for the year. *CSR* measures the amount a firm spends on corporate social responsibility in a year. *Age* is the number of years since a firm's date of incorporation. *Growth* is the year-on-year change in revenue. *Leverage* is the firm's total debt scaled by its total assets. *Size* is the natural log of the firm's total sales at the end of each financial year.

	(1)	(2)	(3)	(4)
<i>CGS</i>	0.0018 (0.5726)			
<i>CGS*Act</i>	0.0034 (0.5273)			
<i>CGS_c1</i>		-0.0340*** (-3.3748)		
<i>CGS_c1*Act</i>		0.0335*** (2.9190)		
<i>CGS_c2</i>			0.0191** (1.9257)	
<i>CGS_c2*Act</i>			-0.0154 (-1.4395)	
<i>CGS_c3</i>				0.0152 (1.3854)
<i>CGS_c3*Act</i>				-0.0015 (-0.1960)
<i>Act</i>	-0.6155 (-1.3723)	-2.4475*** (-3.0295)	0.4397 (0.6671)	-0.3230 (-1.0988)
<i>AuditFee</i>	0.0311** (1.9675)	0.0542 (1.4161)	0.0283 (0.6825)	0.0430*** (3.3986)
<i>AuditFee*Act</i>	0.0273*** (2.8228)	-0.0124 (-0.4181)	0.0584** (1.8255)	0.0149 (1.5565)
<i>CSR</i>	-0.0298*** (-10.0293)	-0.0260*** (-8.4183)	-0.0193*** (-5.7903)	-0.0308*** (-9.0696)
<i>Age</i>	-0.143*** (-6.6718)	-0.1242*** (-3.1183)	-0.1929*** (-4.7917)	-0.1507*** (-8.7389)
<i>Growth</i>	0.0041*** (5.3913)	0.0047*** (2.9666)	0.0035*** (2.4245)	0.0042*** (5.1107)
<i>Leverage</i>	-0.0066*** (-3.7541)	-0.0084*** (-3.3008)	-0.0056*** (-2.5261)	-0.0065*** (-3.5005)
<i>Size</i>	-1.7012*** (-10.8021)	-1.8285*** (-9.3098)	-1.7529*** (-8.4559)	-1.7141*** (-13.8252)

Table VIII cont'd

	(1)	(2)	(3)	(4)
<i>c</i>	29.3173*** (18.3236)	32.0617*** (12.4293)	30.5599*** (12.1682)	29.0219*** (20.4624)
F-statistic	104.6404	98.4785	85.1186	104.2091
<i>p value</i>	0.0000	0.0000	0.0000	0.0000

***, **, and * denote significance at the 5%, 10% and 15% levels, respectively.

Table IX Long-term impact of the new Indian Companies Act 2013 on the sample of compliant firms

This table gives the regression results for equation (8), (9), (10), and (11) in column (1), (2), (3), and (4), respectively for the sample of compliant firms. The dependent variable is Tobin's Q. *TobinQ* is the proxy for firm performance, measured as (market value of common stock + book value of preferred stock + book value of total liabilities)/(book value of total assets). *CGS* is the corporate governance score. *CGS_c1*, *CGS_c2*, and *CGS_c3* are the 3 components of the governance score. *Act* is a dummy variable equal to one for the years after the introduction of the act or zero otherwise. *AuditFee* is the amount a company spent on audit for the year. *CSR* measures the amount a firm spends on corporate social responsibility in a year. *Age* is the number of years since a firm's date of incorporation. *Growth* is the year-on-year change in revenue. *Leverage* is the firm's total debt scaled by its total assets. *Size* is the natural log of the firm's total sales at the end of each financial year.

	(1)	(2)	(3)	(4)
<i>CGS</i>	-0.4165*** (-3.4524)			
<i>CGS*Act</i>	0.4458*** (3.5945)			
<i>CGS_c1</i>		-0.1596*** (-3.3717)		
<i>CGS_c1*Act</i>		0.1481*** (2.7329)		
<i>CGS_c2</i>			0.1484 (2.1923)	
<i>CGS_c2*Act</i>			-0.1053 (-1.4428)	
<i>CGS_c3</i>				-0.1903*** (-2.8402)
<i>CGS_c3*Act</i>				0.2125*** (3.1062)
<i>Act</i>	-29.9192*** (-3.7281)	-12.6479*** (-3.2183)	4.6163 (0.8465)	-12.0744*** (-3.3235)
<i>AuditFee</i>	-0.0366 (-0.1854)	-0.0772 (-0.4061)	-0.0836 (-0.4343)	-0.0567 (-0.2843)
<i>AuditFee*Act</i>	-0.0391 (-0.2536)	0.0862 (0.5694)	0.1561 (1.0012)	0.0282 (0.1836)
<i>CSR</i>	-0.0537*** (-4.2104)	-0.0484*** (-4.2630)	-0.0516 (-4.3634)	-0.0518*** (-4.0280)
<i>Age</i>	-0.0198 (-0.1046)	-0.0326 (-0.8042)	-0.0379 (-0.9508)	-0.0467 (-0.2426)
<i>Growth</i>	0.0045 (0.6710)	0.0008 (0.1271)	0.0027 (0.4066)	0.0060 (0.8880)
<i>Leverage</i>	0.0333** (1.7930)	0.0098 (0.5568)	0.0166 (0.9551)	0.0440*** (2.3406)

Table IX cont'd

	(1)	(2)	(3)	(4)
<i>Size</i>	-7.7825*** (-8.0737)	-5.3675*** (-6.6155)	-5.5698 (-6.8912)	-8.0728*** (-8.2245)
<i>c</i>	112.0294*** (8.1431)	74.9658*** (9.6282)	54.7715 (5.8860)	98.2570*** (7.9698)
F-statistic	47.9646	20.7112	19.5255	47.2477
<i>p value</i>	0.0000	0.0000	0.0000	0.0000

***, **, and * denote significance at the 5%, 10% and 15% levels, respectively.

Table X Long-term impact of the new Indian Companies Act 2013 on the sample of non-compliant firms

This table gives the regression results for equation (8), (9), (10), and (11) in column (1), (2), (3), and (4), respectively for the sample of non-compliant firms. The dependent variable is Tobin's Q. *TobinQ* is the proxy for firm performance, measured as (market value of common stock + book value of preferred stock + book value of total liabilities)/(book value of total assets). *CGS* is the corporate governance score. *CGS_c1*, *CGS_c2*, and *CGS_c3* are the 3 components of the governance score. *Act* is a dummy variable equal to one for the years after the introduction of the act or zero otherwise. *AuditFee* is the amount a company spent on audit for the year. *CSR* measures the amount a firm spends on corporate social responsibility in a year. *Age* is the number of years since a firm's date of incorporation. *Growth* is the year-on-year change in revenue. *Leverage* is the firm's total debt scaled by its total assets. *Size* is the natural log of the firm's total sales at the end of each financial year.

	(1)	(2)	(3)	(4)
<i>CGS</i>	0.0051 (0.0780)			
<i>CGS*Act</i>	-0.0208 (-0.2928)			
<i>CGS_c1</i>		-0.0127 (-1.4308)		
<i>CGS_c1*Act</i>		0.0242** (2.1863)		
<i>CGS_c2</i>			0.0066 (0.2569)	
<i>CGS_c2*Act</i>			-0.0347 (-1.1768)	
<i>CGS_c3</i>				0.0826** (1.8420)
<i>CGS_c3*Act</i>				-0.0571 (-1.2654)
<i>Act</i>	-1.2095 (-0.2899)	-2.3323*** (-2.7296)	-0.1185 (-0.0681)	1.3144 (0.5763)
<i>AuditFee</i>	-0.0728 (-0.5040)	-0.0932* (-1.6814)	-0.0816 (-0.9383)	-0.0258 (-0.1716)
<i>AuditFee*Act</i>	0.2224*** (2.1456)	0.1440*** (3.1666)	0.2420*** (3.5337)	0.2161*** (2.0873)
<i>CSR</i>	-0.0051 (-0.8355)	-0.0037** (-2.3027)	-0.0042 (-1.2903)	0.0004 (0.0689)
<i>Age</i>	-0.0905* (-1.5267)	-0.1998*** (-5.9911)	-0.0927*** (-3.7619)	-0.5171*** (-3.9954)
<i>Growth</i>	0.0010 (0.0429)	0.0019*** (4.9203)	0.0000 (0.0257)	-0.0007 (-0.2884)
<i>Leverage</i>	-0.0167*** (-2.2501)	-0.0075*** (-4.6413)	-0.0171*** (-3.4043)	-0.0160*** (-2.1109)

Table X cont'd

	(1)	(2)	(3)	(4)
<i>Size</i>	-0.6120*	-0.9222***	-0.6126	-0.5590
	(-1.4444)	(-7.5276)	(-1.3090)	(-1.1981)
<i>c</i>	15.5253***	22.3440***	15.5392***	25.7846***
	(2.9000)	(15.6249)	(5.7849)	(4.0028)
F-statistic	5.8868	69.7921	6.0788	41.8127
<i>p value</i>	0.0000	0.0000	0.0000	0.0000

***, **, and * denote significance at the 5%, 10% and 15% levels, respectively.

Figure I AAR and CAAR values for the sample of compliant firms

This graph shows the AAR and CAAR values for compliant firms over a 10-day period i.e. 5 days before the announcement, the announcement day (Day 0), and 5 days post announcement.

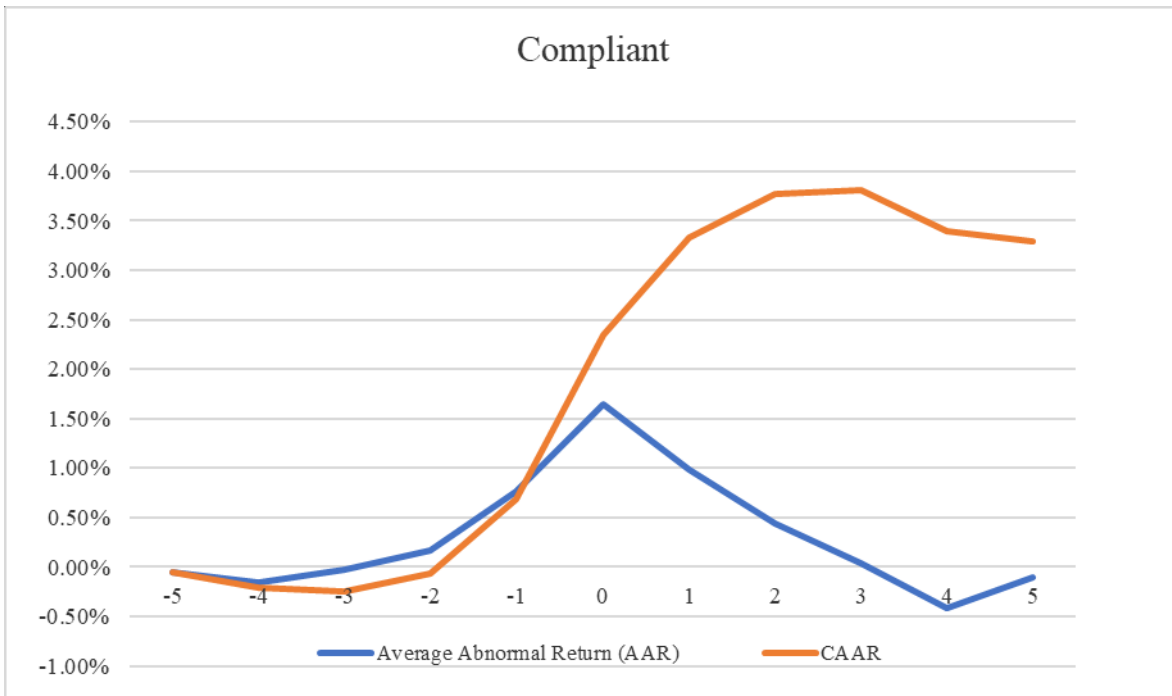
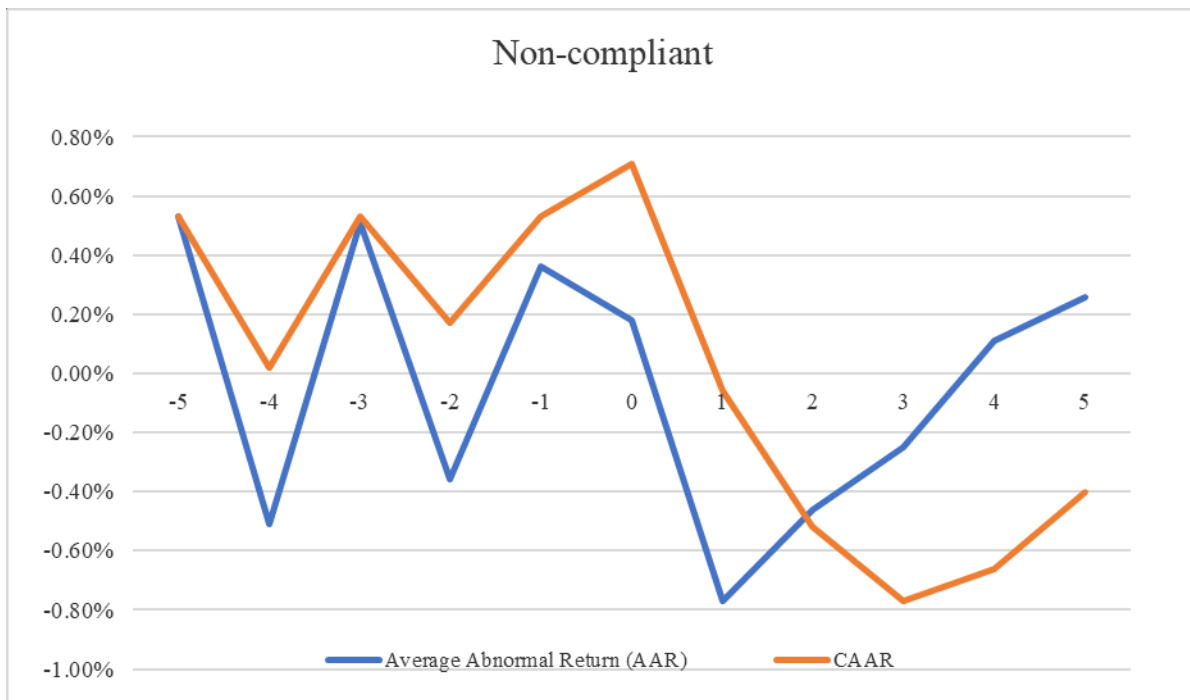


Figure II AAR and CAAR values for the sample of non-compliant firms

This graph shows the AAR and CAAR values for non-compliant firms over a 10-day period i.e. 5 days before the announcement, the announcement day (Day 0), and 5 days post announcement.



APPENDIX A

Table A.1 AAR and CAAR values for the sample and their significance (Market Adjusted Returns model)

This table shows the Average Abnormal Returns (AAR) and Cumulate Average Abnormal Returns (CAAR) for the whole sample and sub-samples. Day 0 is taken as the day the Act was introduced, i.e., 12th September, 2013. The abnormal returns are measured using the market adjusted returns model. The monthly yield on 91-day Treasury bills has been used as the risk-free rate, and NIFTY Smallcap 100 Index is used as a proxy for market returns. The ARs are calculated based on the estimation window (-270, -21). Below the AAR and CAAR values, two significance tests, Patell Z and adjusted Patell Z, are taken to test the significance of these abnormal returns.

	AAR(-1)	AAR(0)	AAR(1)	CAAR (-1, +1)
<i>Panel A: Full Sample</i>				
AAR/CAAR value	0.51%	0.90%	0.03%	1.44%
Patell Z	1.1555	3.0092***	0.8443	2.892***
Adjusted Patell Z	1.0972	2.8574***	0.8017	2.7461***
<i>Panel B: Compliant Firms</i>				
AAR/CAAR value	0.66%	1.39%	0.79%	2.85%
Patell Z	0.8612	3.0754***	1.3037	3.0254***
Adjusted Patell Z	0.8522	3.0432***	1.2901	2.9938***
<i>Panel C: Non-compliant Firms</i>				
AAR/CAAR value	0.19%	0.12%	-0.28%	-0.03%
Patell Z	-0.6546	0.6921	-0.412	-0.2162
Adjusted Patell Z	-0.6098	0.6448	-0.3838	-0.2014

***, **, and * denote significance at the 5%, 10% and 15% levels, respectively.

Table A.2 Long-term impact of the new Indian Companies Act 2013 with winsorized Tobin's Q

This table gives the regression results for equation (8) for the full sample, compliant sample, and the non-compliant sample in column (1), (2), and (3), respectively. The dependent variable is winsorized Tobin's Q. *TobinQ_W* is the proxy for firm performance, measured as (market value of common stock + book value of preferred stock + book value of total liabilities)/(book value of total assets) which is winsorized at 0.5% level. *CGS* is the corporate governance score. *Act* is a dummy variable equal to one for the years after the introduction of the act or zero otherwise. *AuditFee* is the amount a company spent on audit for the year. *CSR* measures the amount a firm spends on corporate social responsibility in a year. *Age* is the number of years since a firm's date of incorporation. *Growth* is the year-on-year change in revenue. *Leverage* is the firm's total debt scaled by its total assets. *Size* is the natural log of the firm's total sales at the end of each financial year.

	(1)	(2)	(3)
<i>CGS</i>	0.0257 (0.8207)	-0.0680* (-1.6288)	0.0006 (0.0457)
<i>CGS*Act</i>	-0.0452 (-1.3652)	0.0696* (1.6206)	0.023 (1.5105)
<i>Act</i>	1.8011 (0.8675)	-4.6267** (-1.9824)	-1.8387** (-2.0778)
<i>AuditFee</i>	0.0183 (0.2441)	0.0622 (0.9210)	-0.0294 (-0.7117)
<i>AuditFee*Act</i>	0.0242 (0.4235)	-0.0819 (-1.3368)	0.0863*** (2.9839)
<i>CSR</i>	-0.0238*** (-6.1475)	-0.0561*** (-5.2710)	-0.0026 (-1.3262)
<i>Age</i>	-0.0451** (-1.7254)	-0.0323*** (-2.4836)	-0.2021*** (-5.5137)
<i>Growth</i>	0.0024* (1.4573)	0.0076* (1.7327)	0.0022*** (7.5304)
<i>Leverage</i>	-0.0150*** (-2.901)	-0.0051 (-0.4542)	-0.0056*** (-4.1835)
<i>Size</i>	-1.5217*** (-5.491)	-3.0771*** (-4.8620)	-1.0273*** (-10.6205)
<i>c</i>	22.3550*** (6.7441)	44.1931*** (5.7527)	21.7688*** (13.3852)
F-statistic	27.7070	28.7446	89.9301
<i>p value</i>	0.0000	0.0000	0.0000

***, **, and * denote significance at the 5%, 10% and 15% levels, respectively.