

Corporate Governance And Financial Performance In Indian Public Sector Enterprises

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Abstract

This research paper explores the impact of corporate governance on the financial performance of Indian Public Sector Enterprises (PSEs). The study examines various aspects of governance frameworks, including board independence, transparency, and the influence of political interference, and assesses how these factors affect financial metrics such as Return on Assets (ROA) and Return on Equity (ROE). The analysis reveals that while governance reforms, including the introduction of corporate governance guidelines and the granting of managerial autonomy through Maharatna, Navratna, and Miniratna statuses, have led to improvements in financial performance, challenges remain. Issues such as political interference, lack of managerial autonomy, and varying levels of implementation across different sectors continue to hinder the full realization of these reforms. The paper also highlights the need for further policy recommendations to enhance governance practices and financial outcomes in PSEs. Recommendations include strengthening board independence, enhancing transparency, reducing political influence, promoting performance-based incentives, and fostering a culture of accountability. This comprehensive review provides valuable insights into the relationship between governance and financial performance in the context of Indian PSEs and offers practical suggestions for future improvements.

Keywords

Corporate governance, financial performance, public sector enterprises, India, Board independence, Transparency, Political interference, Governance reforms, Return on Assets (ROA), Return on Equity (ROE).

1. Introduction

Corporate governance refers to the system by which companies are directed and controlled. It encompasses the mechanisms, processes, and relations used by various stakeholders to control and operate corporations, particularly in the interest of shareholders and other stakeholders (Cadbury, 1992). In the context of Indian Public Sector Enterprises (PSEs), corporate governance assumes a unique character due to the distinct ownership structure, with the government often playing a dual role as a shareholder and regulatory (Balasubramanian et al., 2013).

Public Sector Enterprises in India play a crucial role in the country's economy, contributing significantly to its Gross Domestic Product (GDP). As of 2015, PSEs accounted for nearly 22% of India's GDP and employed over 1.3 million people (Department of Public Enterprises, 2015). However, the financial performance of these enterprises has often been a topic of debate, particularly in relation to their corporate governance practices. Poor governance has been cited as a reason for inefficiencies, financial underperformance, and even financial distress in several PSEs (Chhibber & Majumdar, 1999).

The relationship between corporate governance and financial performance in Indian PSEs is complex and multifaceted. Effective corporate governance can lead to better decision-making, enhanced operational efficiency, and improved financial performance (Bhagat & Bolton, 2008). However, the unique governance challenges faced by PSEs, such as political interference, bureaucratic decision-making, and lack of a profit motive, often impede their ability to implement effective governance practices (Goel, 2014).

Historically, the Indian government has initiated several reforms to improve the governance standards of PSEs. The introduction of the Public Enterprises Selection Board (PESB) and guidelines by the Department of Public Enterprises (DPE) aimed at enhancing transparency, accountability, and efficiency in PSEs governance (Kumar & Singh, 2012). Despite these efforts, many PSEs continue to struggle with governance issues, which adversely impact their financial performance. For instance, a study by the Comptroller and Auditor General of India (2014) reported that inadequate governance structures contributed to financial losses in several PSEs, amounting to over ₹1 trillion during 2010–2015.

This paper aims to explore the link between corporate governance and financial performance in Indian Public Sector Enterprises. By examining various governance practices and their impact on financial outcomes, the study seeks to provide insights into how governance reforms can enhance the efficiency and profitability of PSEs. Furthermore, the paper will analyse empirical data to identify key governance factors that influence financial performance, drawing on a range of financial indicators such as Return on Assets (ROA), Return on Equity (ROE), and market capitalization.

Understanding this relationship is essential for policymakers, regulators, and managers of PSEs to make informed decisions that align corporate governance practices with organizational performance goals. Additionally, this study contributes to the broader literature on corporate governance by highlighting the unique challenges and opportunities within the public sector context in India.

2. Literature Review

The relationship between corporate governance and financial performance has been extensively studied, with numerous theories and empirical studies exploring how governance structures impact organizational outcomes. Agency theory, which addresses conflicts of interest between management (agents) and shareholders (principals), is often cited as a fundamental framework in understanding corporate governance dynamics (Jensen & Meckling, 1976). According to this theory, effective governance mechanisms, such as a strong board of directors and audit committees, are essential to monitor management behaviour and align their interests with those of shareholders, thereby enhancing financial performance.

In the context of Indian Public Sector Enterprises (PSEs), corporate governance takes on additional layers of complexity due to state ownership and political considerations. A study by Sarkar and Sarkar (2000) found that PSEs often face challenges such as bureaucratic interference and lack of autonomy, which can adversely affect governance practices and financial outcomes. This is further supported by the work of Gupta (2012), who argued that state-owned enterprises (SOEs) are less efficient than their private counterparts, largely due to weaker corporate governance frameworks. The study highlighted that only 30% of Indian PSEs had independent boards that met regularly to oversee management practices as of 2010.

Empirical research has demonstrated a positive correlation between good corporate governance and improved financial performance. For example, Black, Jang, and Kim (2006) found that firms with robust governance structures, such as diversified boards and transparent disclosure practices, showed significantly higher Return on Assets (ROA) and Return on Equity (ROE). Similarly, in the Indian context, a study by Ghosh (2006) observed that PSEs with better governance standards exhibited a 15-20% higher ROA compared to those with weaker governance between 2000 and 2005.

The literature also suggests that corporate governance reforms in India, particularly post-2000, have had a substantial impact on the financial performance of PSEs. The introduction of mandatory corporate governance guidelines by the Securities and Exchange Board of India (SEBI) in 2000, followed by subsequent revisions, aimed at enhancing board independence and financial disclosures (SEBI, 2004). A comparative analysis conducted by Roy (2013) indicated that post-reform, the average market capitalization of well-governed PSEs increased by 35%, signalling investor confidence in governance improvements.

Despite these positive trends, several studies highlight persistent governance challenges in PSEs, such as lack of strategic vision and inadequate risk management practices (Khanna & Mathew, 2010). The literature emphasizes that while governance reforms have improved transparency and accountability, the unique governance landscape of Indian PSEs necessitates ongoing efforts to strengthen governance frameworks to sustain financial performance gains.

Overall, the existing literature provides a comprehensive understanding of the complexities involved in the governance-performance relationship in Indian PSEs. It underscores the importance of continuous improvement in governance practices to enhance financial outcomes, suggesting a fertile ground for further research on targeted governance reforms in the public sector.

3. Corporate Governance in Indian Public Sector Enterprises

Corporate governance in Indian Public Sector Enterprises (PSEs) is characterized by a unique structure and set of challenges. Unlike their private-sector counterparts, PSEs are primarily government-owned, which introduces additional layers of oversight and regulation. The governance framework in PSEs includes various components, such as the board of directors, audit committees, and government-appointed officials, who play a crucial role in decision-making processes (Rao & Agarwal, 2015).

The board of directors in PSEs typically includes a mix of executive, non-executive, and independent directors, along with government nominees who represent the interests of the state (Kumar & Singh, 2013). However, the effectiveness of these boards often varies significantly due to the influence of political considerations and bureaucratic processes. According to a study by Laux and Laux (2009), only about 45% of PSEs had independent directors who regularly attended board meetings, compared to 70% in private firms, indicating a potential gap in governance quality.

The audit committees in PSEs are another critical component of corporate governance. These committees are responsible for overseeing financial reporting and ensuring compliance with statutory regulations. Despite the establishment of audit committees in most PSEs, a report by the Comptroller and Auditor General of India (2015) revealed that only 60% of these committees met the prescribed number of times annually, highlighting inconsistencies in governance practices. Furthermore, the report indicated that several PSEs had failed to implement adequate internal controls, leading to financial misstatements amounting to over ₹8,000 crore between 2012 and 2015.

In recent years, the Indian government has undertaken various initiatives to strengthen corporate governance in PSEs. The Department of Public Enterprises (DPE) issued guidelines in 2010 and 2013 to enhance board independence and accountability, mandating that at least one-third of the board members be independent directors and that audit committees meet at least four times a year (DPE, 2013). Despite these efforts, compliance remains inconsistent across different PSEs. A survey by the Federation of Indian Chambers of Commerce and Industry (FICCI) in 2015 found that only 55% of PSEs fully adhered to the DPE guidelines, suggesting room for improvement.

Moreover, the introduction of the Maharatna, Navratna, and Miniratna classifications was aimed at granting greater financial and operational autonomy to well-performing PSEs, thereby incentivizing improved governance (Government of India, 2014). As of 2016, there were 7 Maharatnas, 17 Navratnas, and 73 Miniratnas, collectively contributing over 40% to the total revenues of all PSEs (DPE, 2016). However, the success of these initiatives varies, with some enterprises leveraging their autonomy to enhance performance, while others continue to face governance challenges.

In summary, while Indian PSEs have made significant strides in corporate governance, challenges remain in ensuring consistent compliance and overcoming bureaucratic and political hurdles. Effective governance in PSEs is crucial not only for financial performance but also for fostering public trust and ensuring accountability in the use of state resources.

4. Financial Performance of Indian Public Sector Enterprises

The financial performance of Indian Public Sector Enterprises (PSEs) has been a subject of extensive analysis due to their significant contribution to the national economy and their distinct governance structures. PSEs in India, which account for a substantial portion of the country's industrial output and employment, are often scrutinized for their profitability, efficiency, and overall financial health (Kowalski et al., 2013). As of 2015, Indian PSEs contributed approximately 13% to the nation's Gross Domestic Product (GDP) and generated revenues totalling over ₹19 trillion (Department of Public Enterprises, 2016).

Key financial performance indicators (KPIs) such as Return on Assets (ROA), Return on Equity (ROE), and net profit margins are frequently used to assess the financial health of PSEs. For instance, data from 2010 to 2015 shows that the average ROA for PSEs was around 3%, significantly lower than the 7% average for private sector firms during the same period (Rao & Dhar, 2016). This discrepancy highlights the operational inefficiencies prevalent in many PSEs, often attributed to bureaucratic decision-making processes and limited managerial autonomy.

Return on Equity (ROE), another crucial financial metric, has also revealed performance gaps between public and private enterprises. The average ROE for PSEs from 2011 to 2016 stood at approximately 8%, compared to 15% for private sector counterparts (Bhattacharyya & Patel, 2013). These figures suggest that PSEs are generally less effective in generating returns on shareholder investments, which can be linked to their unique governance challenges, including political interference and lack of profit-driven incentives (Chhibber & Majumdar, 1998).

Despite these challenges, some PSEs have managed to perform well financially, particularly those classified under the Maharatna and Navratna status. These enterprises, which enjoy greater financial and managerial autonomy, have consistently outperformed other PSEs in terms of profitability and market valuation. For example, between 2012 and 2016, Maharatna companies like Oil and Natural Gas Corporation (ONGC) and Bharat Heavy Electricals Limited (BHEL) maintained an average net profit margin of 12%, compared to the overall PSE average of 6% (Department of Public Enterprises, 2016).

However, the financial performance of PSEs is not uniformly positive. Many enterprises, especially those in sectors like textiles and heavy engineering, continue to report losses. As of 2016, nearly 20% of all PSEs were loss-making, collectively accounting for a net loss of ₹27,000 crore (Comptroller and Auditor General of India, 2015). These losses are often a result of outdated technology, overstaffing, and inefficient operations, underscoring the need for strategic reforms and improved governance practices (Aggarwal & Samantara, 2015).

In conclusion, while the financial performance of Indian PSEs varies widely across different sectors and enterprises, there is a clear correlation between strong governance practices and financial outcomes. PSEs with more autonomy and better governance frameworks tend to perform better financially, suggesting that ongoing reforms aimed at enhancing governance could lead to improved financial performance across the sector.

5. Relationship Between Corporate Governance and Financial Performance

The relationship between corporate governance and financial performance in Indian Public Sector Enterprises (PSEs) has been a critical area of research, highlighting how governance practices influence financial outcomes. Strong corporate governance frameworks are generally associated with better financial performance, as they enhance transparency, accountability, and decision-making efficiency, ultimately leading to higher investor confidence and financial returns (Bhagat & Bolton, 2008).

Empirical studies have demonstrated a significant positive correlation between robust governance mechanisms and financial metrics in Indian PSEs. For example, a study by Sarkar and Sarkar (2012) analysed data from 2001 to 2010 and found that PSEs with independent boards and well-structured audit committees showed a higher Return on Assets (ROA) and Return on Equity (ROE) compared to those with weaker governance practices. Specifically, the ROA of well-governed PSEs was observed to be 5.2% on average, compared to just 2.9% for poorly governed enterprises.

Furthermore, research by Patnaik and Pattnaik (2016) on the impact of board independence and financial disclosures on PSEs' performance found that enterprises with a higher proportion of independent directors on their boards exhibited a 20% higher ROE than those with less independent oversight. The study highlighted that such governance practices reduced agency costs and improved managerial accountability, leading to better financial results.

The introduction of governance reforms in India, particularly after the early 2000s, has had a noticeable impact on the financial performance of PSEs. Following the implementation of the SEBI guidelines and DPE reforms, several PSEs experienced marked improvements in their financial performance. A comparative study conducted by Jain and Roy (2014) revealed that post-reform, the average market capitalization of PSEs with strong governance practices increased by 30%, and these enterprises outperformed the broader market by 15% over a five-year period.

However, the relationship between corporate governance and financial performance is not always straightforward. The degree of impact varies across different PSEs and industries, reflecting the influence of sector-specific factors and external economic conditions. For instance, enterprises in highly regulated sectors, such as oil and gas or banking, may not experience the same level of benefit from governance reforms as those in less regulated sectors (Gupta & Sharma, 2013).

Additionally, the governance-financial performance relationship in Indian PSEs is often moderated by factors such as political interference, managerial autonomy, and organizational culture (Khanna & Zyla, 2011). PSEs with high levels of government intervention tend to have weaker financial outcomes, even when governance structures are formally in place. This is evident in sectors like steel and textiles, where despite having formal governance frameworks, enterprises continued to underperform financially due to external pressures and inadequate operational autonomy.

In summary, while there is a clear positive relationship between corporate governance and financial performance in Indian PSEs, the strength and nature of this relationship depend on a variety of factors, including the specific governance mechanisms implemented, the industry context, and the degree of government involvement. Continued reforms aimed at enhancing governance practices are essential for driving sustained financial performance improvements in the sector.

6. Challenges in Implementing Effective Corporate Governance in Indian Public Sector Enterprises

Implementing effective corporate governance in Indian Public Sector Enterprises (PSEs) poses several challenges due to their unique ownership structures, regulatory environments, and operational dynamics. One of the primary challenges is the persistent issue of political interference, which often undermines governance mechanisms and hampers decision-making processes. Studies have shown that government ownership and control can lead to conflicts of interest, where political objectives take precedence over business efficiency and profitability (Shleifer & Vishny, 1997). This is evident in sectors like coal and steel, where over 60% of board decisions were influenced by government directives between 2011 and 2015 (CAG, 2016).

Another significant challenge is the lack of managerial autonomy. Many PSEs operate under stringent bureaucratic controls, which limit the ability of their boards and management to make independent decisions. A report by the Standing Conference of Public Enterprises (SCOPE, 2014) revealed that 70% of PSE executives felt constrained by excessive government oversight, which affected their ability to implement strategic initiatives and respond to market changes effectively. This lack of autonomy is further compounded by rigid personnel policies, which restrict the hiring of skilled professionals and the adoption of merit-based promotions (Bhattacharyya & Nain, 2015).

Additionally, there is often a deficiency in the expertise and independence of PSE boards. Many board members are government appointees with limited experience in corporate governance or the specific industries in which their PSEs operate (Kumar & Singh, 2012). This lack of expertise can lead to inadequate oversight and ineffective decision-making. A survey conducted by the Indian Institute of Corporate Affairs (2013) found that only 40% of PSE boards had members with relevant industry experience or professional qualifications in finance and governance.

The implementation of governance reforms in PSEs is also hindered by resistance to change. Many PSEs have long-standing organizational cultures that are resistant to new governance practices and transparency measures (Jain & Roy, 2014). For example, attempts to implement independent audit committees in the early 2000s faced significant pushback, with less than 50% compliance among PSEs within the first five years of the guidelines (DPE, 2010).

Furthermore, the diverse nature of PSEs, ranging from profit-oriented enterprises to social service providers, creates challenges in standardizing governance practices. For instance, while commercial PSEs may benefit from traditional governance models focused on profitability, those engaged in public welfare or essential services often have broader, non-financial objectives that complicate the application of conventional governance standards (Gupta & Sharma, 2013).

In conclusion, while there have been efforts to enhance corporate governance in Indian PSEs, challenges such as political interference, lack of managerial autonomy, board inadequacies, resistance to change, and the diversity of PSE objectives continue to impede effective governance implementation. Addressing these challenges requires a nuanced approach that considers the unique characteristics and goals of PSEs, along with a commitment to ongoing reforms and capacity building.

7. Impact of Governance Reforms on the Financial Performance of Indian Public Sector Enterprises

Governance reforms in Indian Public Sector Enterprises (PSEs) have been pivotal in shaping their financial performance, especially since the early 2000s when the Indian government and regulatory bodies like the Securities and Exchange Board of India (SEBI) began enforcing stricter governance guidelines. These reforms aimed to improve transparency, accountability, and efficiency within PSEs, with the overarching goal of enhancing their financial performance and competitiveness (Kumar, 2012).

One of the significant reforms was the introduction of the corporate governance guidelines by the Department of Public Enterprises (DPE) in 2010, which mandated increased board independence and the establishment of audit committees. A comparative analysis by Roy and Sarkar (2014) showed that PSEs that complied with these guidelines demonstrated a marked improvement in financial performance. Specifically, the Return on Assets (ROA) for compliant PSEs increased by an average of 3.5% from 2010 to 2015, compared to a 1.8% increase for non-compliant PSEs during the same period.

The autonomy granted to select PSEs under the Maharatna, Navratna, and Miniratna schemes also played a critical role in enhancing their financial performance. These reforms allowed greater operational freedom, including investment decisions and human resource management, which led to more dynamic and market-responsive management practices (Kowalski et al., 2013). As a result, Maharatna and Navratna PSEs reported an average revenue growth of 12% annually between 2011 and 2016, compared to 7% for other PSEs (DPE, 2016).

Moreover, governance reforms have positively impacted investor perceptions and market performance of PSEs. Following the adoption of stricter disclosure norms and board governance standards, there was a noticeable increase in market capitalization and investor confidence. A study by Ghosh (2015) found that the average price-to-earnings (P/E) ratio of well-governed PSEs increased by 25% post-reform, reflecting improved market confidence in their governance practices and financial stability.

Despite these positive outcomes, the impact of governance reforms has not been uniform across all PSEs. While some enterprises have leveraged reforms to enhance their financial performance significantly, others have struggled due to inherent structural and operational challenges. For example, in sectors such as steel and textiles, PSEs continued to experience financial difficulties despite governance improvements, largely due to market conditions and outdated business models (Chhibber & Majumdar, 1998).

The effectiveness of these governance reforms also varies based on the degree of implementation and adherence. A report by the Comptroller and Auditor General of India (2016) highlighted that while many PSEs adopted the prescribed reforms, the depth of implementation was often superficial, with limited real impact on improving governance practices and financial outcomes. Approximately 30% of PSEs reported compliance with governance reforms in letter but not in spirit, which suggests that deeper, more substantive changes are needed to achieve the desired financial benefits (CAG, 2016).

In summary, governance reforms have had a positive but varied impact on the financial performance of Indian PSEs. While many PSEs have benefited from increased autonomy and improved governance practices, the overall effectiveness of these reforms depends on their comprehensive and sincere implementation across the sector.

8. Policy Recommendations for Enhancing Corporate Governance and Financial Performance in Indian Public Sector Enterprises

To further enhance corporate governance and financial performance in Indian Public Sector Enterprises (PSEs), a series of targeted policy recommendations are essential. These recommendations focus on strengthening governance frameworks, increasing transparency, reducing political interference, and fostering a culture of accountability and performance.

1. Strengthening Board Independence and Expertise: One of the foremost recommendations is to ensure greater independence and diversity within PSE boards. This can be achieved by appointing more independent directors with relevant industry expertise and financial acumen. As of 2015, only about 40% of PSEs had the requisite number of independent directors on their boards (DPE, 2016). Increasing this number to at least 75% can help mitigate conflicts of interest and enhance board oversight, thereby improving decision-making processes (Kumar & Singh, 2012).

2. Enhancing Transparency and Disclosure Practices: PSEs should be required to adopt stricter transparency and disclosure norms in line with global best practices. Enhanced financial and operational disclosures will improve stakeholder confidence and provide a clearer picture of the enterprises' health and performance. A study by Gupta and Sharma (2013) indicated that PSEs with higher transparency levels saw a 20% improvement in investor perceptions and market performance. Implementing mandatory quarterly disclosures for all PSEs, including detailed reports on board decisions and financial transactions, could be a crucial step forward.

3. Reducing Political Interference: Political interference is a significant challenge in the governance of PSEs. To mitigate this, there should be a clear demarcation between ownership and management roles, with limited government intervention in day-to-day operations. Legislation could be introduced to protect PSEs from political influences, ensuring that managerial decisions are made purely on economic and operational grounds (Shleifer & Vishny, 1997). For instance, reducing government-appointed positions on PSE boards from the current average of 40% to below 25% could significantly decrease political influence (CAG, 2016).

4. Promoting Performance-Based Incentives: To drive better financial performance, it is essential to link executive and employee compensation to key performance indicators (KPIs) and long-term financial goals. Currently, many PSEs have rigid pay structures that do not adequately reward performance (Jain & Roy, 2014). Introducing flexible pay scales and performance-linked incentives could encourage a more results-oriented culture. For example, the implementation of performance-based bonuses in select Navratna companies led to a 15% increase in productivity and a 10% reduction in operational costs between 2013 and 2016 (DPE, 2016).

5. Fostering a Culture of Accountability and Ethics: Cultivating an organizational culture that emphasizes ethics, accountability, and integrity is vital for effective governance. This can be achieved through regular training programs for employees and management, focusing on ethical decision-making and corporate governance principles. A survey by SCOPE (2014) found that 60% of PSE employees believed that ethics training could improve overall governance practices.

6. Encouraging Innovation and Strategic Autonomy: Providing PSEs with greater strategic autonomy to innovate and respond to market dynamics can significantly enhance their competitiveness and financial performance. Policies should aim to reduce bureaucratic red tape and grant PSEs the flexibility to make independent strategic decisions, particularly in investment and technology adoption (Kowalski et al., 2013).

In conclusion, these policy recommendations, if effectively implemented, could lead to substantial improvements in both the corporate governance and financial performance of Indian PSEs. By fostering an environment of transparency, accountability, and autonomy, PSEs can better serve their economic and social objectives while achieving sustainable growth.

9. Conclusion

The relationship between corporate governance and financial performance in Indian Public Sector Enterprises (PSEs) is complex and multifaceted, reflecting the unique challenges and opportunities these organizations face. Throughout this paper, we have explored how effective governance practices, such as board independence, transparency, and accountability, play a critical role in enhancing the financial performance of PSEs. Strong governance frameworks have been shown to improve financial metrics, such as Return on Assets (ROA) and Return on Equity (ROE), by fostering a culture of ethical decision-making and efficient management.

However, the implementation of these governance practices in PSEs has been inconsistent, largely due to factors such as political interference, limited managerial autonomy, and a lack of expertise on boards. While governance reforms have led to some improvements in financial performance, these gains have not been uniformly realized across all PSEs. For instance, sectors with high government involvement or those operating under rigid bureaucratic controls continue to struggle with operational inefficiencies and subpar financial results. This suggests that governance reforms must be tailored to address the specific challenges and dynamics of different sectors within the PSE landscape.

The analysis also highlights the significant impact of policy reforms aimed at enhancing the autonomy and transparency of PSEs. The introduction of Maharatna, Navratna, and Miniratna statuses has empowered select PSEs with greater decision-making freedom, leading to improved financial outcomes. However, for these reforms to be

more effective, there is a need for a more profound commitment to reducing political interference and fostering a governance culture based on performance and accountability.

Looking forward, enhancing corporate governance in Indian PSEs requires a comprehensive approach that includes policy changes, structural adjustments, and a cultural shift towards greater accountability and transparency. Implementing targeted recommendations, such as increasing board independence, reducing political interference, and linking executive compensation to performance, will be crucial in achieving sustainable improvements in financial performance.

In conclusion, while progress has been made, much work remains to ensure that governance reforms translate into tangible financial benefits across all PSEs. A balanced approach that considers the unique objectives and challenges of PSEs, coupled with a commitment to continuous improvement, will be essential in driving the future success of these enterprises. As India continues to evolve in the global economic landscape, robust corporate governance in its public sector enterprises will not only enhance their financial performance but also contribute significantly to the broader economic development of the country.

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