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Corporate governance and firm performance in Indian listed IT companies”

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Abstract: *This paper examines the relationship between corporate governance and firm performance in Indian listed IT companies. The study includes the variables board independence and board diversity of corporate governance and return on assets (ROA) as measure of firm performance. The study used the panel data of Indian IT companies from 2008 to 2011.Fixed effect method of panel data is used to examine the relationship. The study found a positive relationship for both the variables. The study suggests that number of women on board should be increased which may lead to improved firm performance.*

Keywords: *Board Independence, Board diversity, Corporate governance, Firm performance*

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I. 1.Introduction

In India concept of corporate governance has been an area of interest after the scam of satyam. Corporate governance refers to the set of systems, principles and process by which a company is governed. Corporate governance is “the system by which companies are directed and controlled.” (Cadbury Committee, 1992). It includes the regulatory mechanism and roles and responsibilities among management, board of directors, shareholders and stakeholders. It provides the guidelines in a manner that enhance the value of firm and also beneficial for its stakeholders. Good corporate governance means better allocation of corporate resources by firm which leads to a better firm performance. Suppliers and employees will want to be associated with such firm and want to maintain a longer relationship with these firms with a view of fair and transparency in their system and investors will be more interested in investing their money in these firms. In this study, two key variables of corporate governance are of main interest which are board independence and board diversity. In this study, impact of board independence and board diversity on firm performance is discussed. A board functions effectively if it is composed of the "right people" and has "the right chairman". Furthermore, the board should be supported by the "right" attitude and approach from the company's management, external auditors and other staff. Comparisons of male and female staff on board members also affect the performance of the board. Some studies found positive relationship between board independence and firm performance and some found negative relationship. Same case is found in the relationship of board diversity and firm performance. firm performance is measured by the tool return on assets (ROA).now the question is to be answered is that board independence and board diversity impact the firm performance or not. This study makes an attempt to examine this relationship of listed IT companies of Bombay stock exchange. The study used the fixed effect of panel data in the analysis.

The paper is organized as follows: in the next section, we discuss objectives of the study and review the theoretical literature on board independence and board diversity and firm performance. In Section 3, we discuss the hypothesis development. in section 4,we discuss the research methodology , We present the results and discussions in section 5 and conclusion in section 6.

II. Objectives Of The Study

1. To determine the relationship between board independence and firm performance.
2. To determine the relationship between board diversity and firm performance.
3. To give some suggestions to the companies under study so that they can improve their performance.

2.1 Importance of the study: The study is a pioneering attempt to examine the relationship between corporate governance and firm performance in Indian IT companies. This study will provide suggestions to the companies under study so that they can improve their performance by adopting and implementing a suitable governance system. Therefore, this study will provide useful information to policymakers, academics, corporate executives and other stakeholders.

2.2 THEORETICAL LITERATURE

2.2(a) Board independence and firm performance

Board independence represents number of outside directors as compared to the inside directors. This is the proportion of inside directors to the outside directors. Outside directors are the people who are not members of top management, their associates or family, employees of the firm or members of the past management of the firm. Inside directors play an important role in day to day working of the firm while outside directors provide check on the activities and ensure that interests of shareholders are protected. Outside director is an independent director who has no affiliation with firm other than affiliation with firm's board of directors. Independent directors are viewed as people who bring transparency, better quality and better control to the firm. The board monitoring and control function becomes difficult with insider dominated board since they cannot provide appropriate monitoring against itself (Fama, 1980). The independent director brings neutrality and objectivity in the board. Some researchers found positive relationship (Shleifer and Vishny, 1997; Perry and Shivdasani, 2005; Rhoades et al., 2000), others report either negative or no relationship between the board structure and firm performance (Bhagat and Black,2000; Heracleous, 2001; Daily and Dalton, 1992**)**. Abdullah (2004) examined no relationship of board independence with firm performance while further studies show a positive relation with firm performance (Chakrabarti et al., 2010; Reddy et al.,2010). Bhagat and Black (2000) examined 934 US firms and found increase proportion of independent directors have no relation with improved performance.

2.2(b) Board diversity and firm performance

Board diversity denotes a well balanced board which is made of individuals from different professional fields. Board diversity includes factors like age, gender, education and experience (Kang et al., 2007; Erhardt et al., 2003). The empirical evidence on the relationship between proportion of women on board and firm performance is quite controversial while some studies found a positive relationship between women on board and firm performance while some found a negative relationship some do not find any relationship. Some of the differences may be due to different time period of study, different countries data, different performance measures and different tools used.

Some reported that board diversity is positively associated with improved firm performance (Erhardt et al., 2003; Carter et al., 2003; Richard, 2000) while others found negative (Shrader et al., 1997; wellalage and locke,2010) and even no relationship in several instances (Zahra and Stanton, 1988; Dalton et al., 1998). Board diversity has a positive relation with firm performance (Carter et al., 2002; Carter et al., 2007). Rose (2007) found no relationship, while Ararat et al., (2010) reported a positive relationship between women on board and firm performance.

III. Hypothesis Development

On the basis of above literature following hypothesis are proposed

3.1 Hypothesis 1: The percentage of independent directors on the board is positively related with firm performance.

3.2 Hypothesis 2: The percentage of women directors on the board is positively related with firm performance.

To test these hypotheses, following regression model is used

$$\mathbf{ROA = \beta1 + \beta2Bsize + \beta3Bind + \beta4Bdiv + \mu}$$

Where ROA (return on assets) is dependent variable to measure the financial performance, Bsize is the board size, Bind is the board independence, Bdiv is the board diversity and μ is the error term. $\beta1$ is the intercept term and $\beta2$, $\beta3$, $\beta4$ are the slope coefficients.

Variable descriptions

ROA(return on assets)	It is measured as net income divide by total assets
Board size	It is measured as total number of directors on the board
Board independence	It is measured as % of independent directors on the board
Board diversity	It is measured as % of women on the board

Here ROA is the dependent variable to measure the financial performance and others are corporate governance variables.

IV. Research Methodology

The proposed study will adopt the following methodology:

4.1 Research Design: The proposed study will be both descriptive and exploratory in nature.

4.2 Selection of sample: The sample would be all Indian IT companies listed on Bombay Stock Exchange of India

4.3 Data collection: The source of data would be secondary in nature which includes quantitative data and it would be collected using company annual reports and financial database from Prowess

4.4 Analysis of data: Data will be entered and processed using statistical package for social sciences (SPSS) and fixed effect of panel data will be used.

4.5 Scope of the study: This study will make an endeavor to examine the relationship of corporate governance with firm performance in Indian IT companies. The study shall be over the period 2008 to 2011. The variables of corporate governance are board composition, board size, board diversity and Firm performance variable is Return on assets (ROA) .

V. Results And Discussions

Table 1.1 : Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	28	6	51	25.46	11.455
Board size	28	6	16	11.07	2.595
Women on board	28	0	20	6.07	6.722
Independent director	28	6	60	45.75	11.809
Valid N (listwise)	28				

Table1.2
Type III Tests of Fixed Effects[a]

Source	Numerator df	Denominator df	F	Sig.
Intercept	1	28.000	29.705	.000
Women on board	4	28.000	18.526	.000
Independent director	6	28.000	8.815	.000
Board size	7	28.000	9.146	.000

a. Dependent Variable: ROA.

Table1.3
Model Dimension[b]

		Number of Levels	Covariance Structure	Number of Parameters
Fixed Effects	Intercept	1		1
	Wboard	6		5
	Inddir	10		9
	Bsize	11		7
Random Effects	wboard + inddir + Bsize[a]	27	Variance Components	3
Residual				1
Total		55		26

a. As of version 11.5, the syntax rules for the RANDOM subcommand have changed. Your command syntax may yield results that differ from those produced by prior versions. If you are using SPSS 11 syntax, please consult the current syntax reference guide for more information.

b. Dependent Variable: ROA.

Table 1.1 presents the descriptive statistics for board size, board independence, board diversity and return on assets (ROA).The average board size 11.07.the average percent of independent directors is 45.75 and average percent of women on board is very low that is board diversity is on the lower side in Indian IT companies. According to Table1.2, significant value of F-test shows that it has a significant value and there is some relationship between firm performance and corporate governance variables that is board independence and board diversity and significant value accept the null hypothesis and there is positive relationship in both the cases.

5.2 Limitations and Future directions

The study used the return on assets (ROA) as a measure of firm performance. By using, other ratios of firm performance measurement such as return on equity (ROE), Tobin’q, share price etc, interesting results may obtain. Also the results may be affected by Satyam fiasco 2009, so time period of study could be taken for a longer period.

VI. Conclusion

This study attempts to examine the relationship between corporate governance and firm performance in Indian listed IT companies. Two key variables are of main interest board diversity and board independence, these variable are main variables responsible for the board effectiveness and hence for the firm value and shareholder value. The empirical results for the period 2008-2011 show a positive relationship for both the variables. The study suggests that number of women on board should be increased which may lead to improved firm performance.

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