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Corporate Governance Principles And Its Relationship With Executive Compensation In The Service Sector of India

Arindam Ghosh, Amir Jafar, Anjan Kumar Ghosh and Rashid Usman Ansari

Abstract

Hefty Executive Compensation seems to have impact on financial health of an organisation. Exorbitant amount of remuneration drawn by the executives often raises the question on balance of compensation between executive and non-executive groups of employees. This imbalance leads to the issue of inappropriate maintenance of corporate governance in an organisation. In order to comprehend the relationship between these two aspects i.e. executive compensation and corporate governance, an empirical study has been designed and performed involving four major service industries of India e.g Information Technology (IT), Telecommunication, Banking, as well as Healthcare. Ten top-ranked companies from each of these service sectors have been chosen to construct the sample group of 40 through quota sampling method. This ranking is based on their position as on the end of second quarter in 2015 in Bombay Stock Exchange (BSE) measured in terms of total annual turnover. Annual reports have been explored to obtain data of executive compensation for a period of 5 years i.e. 2010-11 to 2014-15. The measurement of corporate governance has been performed on the basis of recommended set of corporate governance principles by Organisation for Economic Co-operation and Development or OECD. The dataset has been constructed over the aforementioned 5 years' period. Finally, linear regression has been performed to comprehend the relationship between the corporate governance principles and executive compensation in Indian service sector.

Keywords: *Executive Compensation, OECD Principles of Corporate Governance, Indian Service Sector*

Indian service sector is primarily constituted with industries like information technology, telecommunication, healthcare, and banking.

Indian information technology sector had experienced two significant disasters - one in the year of 2009 when Satyam Scam shattered the root of Indian corporate ethics by falsification

Arindam Ghosh, Assistant Professor, Department of Business Administration, Supreme Knowledge Foundation Group of Institutions, Mankundu, (Affiliated to MAKAUT, West Bengal, India

Dr Amir Jafar, Associate Professor, Department of Business Administration, Aligarh Muslim University, Murshidabad Centre, West Bengal, India

Anjan Kumar Ghosh, Research Scholar, Department of Business Administration (Human Resource), The University of Burdwan, West Bengal, India

Dr Rashid Usman Ansari, Assistant Professor, Department of Business Administration, Aligarh Muslim University, Murshidabad Centre, West Bengal, India

of company's accounts, and another in 2017 when Mr. Vishal Sikka resigned as a result of an allegation of inappropriate corporate governance characterized by unrestrained and irrational quantum of executive remuneration.

Executive compensation in Indian industries has been allegedly erratic in nature and exorbitantly high. As this is a significant component of corporate governance as well, a need is identified to comprehend a relationship between the various corporate governance attributes and compensation offered to executives of Indian service sector.

Objective of the Study

This research is focused to understand relationship between the various principles governing the corporate affairs (as described by Organisation for Economic Co-operation and Development or OECD) and executive compensation in Indian service sector. The primary objective of this study is to see if the maintenance of corporate governance principles ensures a judicious amount of executive remuneration or not.

Theoretical Background

Based on OECD Council Meeting held in April 1998, a set of principles was designed in collaboration with various pertinent international organisations and governments of member countries (Organistaion for Economic Co-operation and Development, 1999). India being the member of OECD since May 16, 2007, and in response to the requirement of Indian corporate houses to maintain corporate governance compliance as per Companies Act, 2013 and SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015, Bombay Stock Exchange (BSE) in collaboration with International Finance Corporation (IFC), a World Bank Group member, has attempted to measure quantitatively the corporate governance attributes (known as OECD Principles). The OECD Principles are namely - Enforcing Rights and Equitable Treatment of Shareholders, Role of Stakeholders, Disclosures and Transparency, Responsibilities of the Board (Bombay Stock Exchange, 2018). The variables representing corporate governance practices in this research are based on these OECD Principles. A detail discussion has been performed in the following sections of this article.

Review of Literature

The aforementioned OECD principles are attributes in nature and it is necessary to assign quantitative values to those attributes. The first principle "Enforcing Rights and Equitable Treatment of Shareholders" interprets the rights of shareholders to receive relevant information about the company that will facilitate their investment decisions. The next three principles respectively interpret assurance of stakeholders' rights to receive performance-development initiatives, revelation of financial and operating results, as well as supervising the capital expenditure, divestiture, and acquisition practices of the firms (Organistaion for Economic Co-operation and Development, 1999).

Although the earning information are less informative for investors (Francis, Schipper, & Vincent, 2005), governance practices and firm valuation parameters (Earnings before Taxes, Earnings before Interest and Tax, Earnings before Interest, Taxes, Depreciation, and Amortization, Net Profit after Tax etc.) are found to be positively correlated (Drobetz, Schillhofer, & Zimmermann, 2004).

Career satisfaction which is a manifestation of employees' (one of the stakeholders of the organisations) performance-development opportunities is empirically found to be inversely related to employee turnover scenario of the organisations (Liu & Lin, 2016).

Transparency of information for the corporations are maintained through disclosure of financial efficiency indicators like Return on Assets (ROA) and Return on Equity (ROE) (Newell, Hiang, Ooi, & Haihong, 2005).

The optimum utilization of resources and maintenance of balance between liquidity and profitability objectives ensure an efficient working capital management by the Board of Directors of an organisation. Working Capital Turnover Ratio, therefore, reflects the extent of exercising of board responsibilities (Dash & Ravipati, 2009).

Scope of the Study

All necessary data have been collected from secondary data source i.e. published annual reports of Bombay Stock Exchange (BSE)-listed companies. Four prominent industrial segments representing the service sector of the country have been identified for this study. Such industries are Banking, Healthcare, Information Technology, and Telecommunication.

The selection of the sample organisations for this study has been done on the basis of the list published by Bombay Stock Exchange (BSE) at the end of second quarter of 2015.

Quota sampling (top 10 from each abovementioned industrial sector) has been performed to construct the sample group on the basis of Total Turnover measured in crore. Therefore, the total sample size comes to 40 for this research.

As few companies have presence in multiple sectors, repeated presence has been ignored and the sample size has further consolidated to 35.

Executives are defined as top-level managers with an obvious exclusion of bottom and middle-level managers (Balsam, Fernando, & Tripathy, 2011). Compensation of the top brass is predominantly referable to CEO remuneration (Conyon & He, 2013). Top executives are placed under three categories - CEO, President, and Executive/Senior Vice President (Rajagopalan & Prescott, 1990). However, top executive is referred as CEO only in majoriy of cases (Shimko & Tucker, 1993; Longnecker, 1995; Gomez-Mejia, 1997).

Methodology of the Study

The 3-yearly moving average of 5-yearly (2010-11 to 2014-15) data of Gross Executive Remuneration (i.e. Average Gross Executive Remuneration) for all organisations has been used in this study.

The following organisational performance indicators (including financial and human resource parameters) over the abovementioned 5-yearly period have been used in this study in accordance with aforementioned OECD principles of corporate governance:

1. Earnings before Interest, Taxes, Depreciation, and Amortization - representing Shareholders' Rights
2. Employee Turnover Ratio - representing Role of Stakeholders
3. Return on Owner's Equity - representing Disclosure and Transparency

4. Working Capital Turnover Ratio - representing Responsibilities of Board

These two sets of variables to draw the aforementioned relationships between OECD principles of corporate governance and executive compensation have been used. The first set i.e. Average Gross Executive Remuneration (AGER) acts as the dependent variable and the organisational performance indicators reflecting such principles act as independent variables or predictors. Linear regression method has been used to determine the relationship between the two sets of variables.

Presentation of Data

The sample organisations along with their respective values of AGER and organisational performance indicators (representing OECD principles of corporate governance) have been tabulated in Table 1 below:

Table 1: Executive Compensation and Organisational Performance Indicators of Indian Service Sector

Sl.	*Company Name*	*Average Gross Executive Remuneration (Crore)*	*Employee Turnover Index*	*EBITDA*	*Return on Owners' Equity (ROE)*	*Working Capital Turnover Ratio (WCTR)*
1	Axis Bank Ltd.	6.8284	-0.14	5283.32	0.17	3.43
2	Bank of Baroda	0.8021	-0.04	4755.38	0.00	-2.18
3	The Federal Bank Ltd.	2.1471	-0.06	810.20	0.00	30.78
4	HDFC Bank Ltd.	11.6567	-0.07	7054.93	0.00	1.70
5	ICICI Bank Ltd.	19.9285	-0.06	9875.52	0.00	2.01
6	IndusInd Bank Ltd.	3.2056	0.12	1108.43	0.00	-1.79
7	Kotak-Mahindra Bank Ltd.	7.6953	-0.09	2219.01	0.00	-5.90
8	Punjab National Bank	0.8450	-0.04	4406.40	0.00	-5.76
9	State Bank of India	0.8740	0.00	16033.90	0.00	-11.90
10	Yes Bank Ltd.	2.7326	-0.26	1311.46	0.21	1.95
11	Apollo Hospitals Enterprise Limited	34.2571	-0.05	382.35	0.10	0.94
12	Aurobindo Pharma Ltd.	6.7940	-0.06	818.91	0.15	7.93
13	Cipla	32.0330	0.04	1737.69	0.15	2.40
14	Dishman Pharmaceuticals and Chemicals Ltd.	6.8862	0.01	130.65	0.09	-122.39
15	Divi's Laboratories Ltd.	51.8685	0.00	803.47	0.25	2.07
16	Jubilant Life Sciences Ltd.	10.9817	0.01	423.41	0.04	-0.48
17	Lupin Ltd.	42.7612	-0.02	2345.47	0.25	2.80
18	SPARC	2.1154	0.15	-21.26	-0.35	0.03
19	Sun Pharmaceutical Industries Ltd.	6.2390	-0.08	4922.40	0.19	1.33
20	Wockhardt Ltd.	3.7169	0.00	1166.68	0.32	4.16
21	Dish TV India Ltd.	1.465	0.00	-101.10	0.33	-1.71

Sl.	Company Name	*Average Gross Executive Remuneration (Crore)*	*Employee Turnover Index*	*EBITDA*	*Return on Owners' Equity (ROE)*	*Working Capital Turnover Ratio (WCTR)*
22	HCL Technologies Ltd.	13.570	-0.06	5479.57	0.29	-4.86
23	Idea Cellular Ltd.	9.113	-0.12	6700.89	0.09	-5.52
24	Infosys Ltd.	16.146	-0.09	13095.56	0.25	1.52
25	TATA Consultancy Services	13.094	-0.12	18860.99	0.37	3.25
26	Tech Mahindra Ltd.	36.957	0.15	1836.60	0.26	9.81
27	Wipro Ltd.	14.297	0.01	8361.86	0.23	3.71
28	Bharti Infratel Ltd.	15.764	0.00	3895.24	0.06	7.23
29	Reliance Communications Ltd.	0.571	0.22	1620.06	0.03	-3.54
30	Sun TV Network Ltd.	117.922	0.01	1301.78	0.26	1.97
31	Intellect Design Arena Ltd	0.179	0.00	-8.07	-0.01	0.26
32	Mindtree Ltd.	6.376	-0.09	424.47	0.24	3.32
33	NIIT Ltd.	3.551	0.09	-20.38	-0.01	5.89
34	Take Solutions Ltd.	0.509	0.00	96.93	0.19	3.93
35	Tata Elxsi Ltd.	1.840	0.00	74.44	0.20	12.60

[Source: Computed]

Data Analysis and Interpretation

Null Hypothesis (H0): Maintenance of corporate governance principles does not impact executive compensation in Indian service sector.

Alternative Hypothesis (H1): Maintenance of corporate governance principles affects executive compensation in Indian service sector.

Table 2 below indicates the descriptive statistics of the dataset. The maximum mean value and standard deviation have been observed for the organisational performance indicator EBITDA. On the other hand, the minimum mean value is observed for Working Capital Turnover Ratio. The minimum standard deviation has been observed for Employee Turnover Index across the dataset.

Table 2: Descriptive Statistics

	Mean	*Std. Deviation*	*N*
Average Gross Executive Remuneration	14.4492	22.24796	35
Employee Turnover Index	-.0183	.09047	35
EBITDA	3633.9189	4701.65684	35
Return on Owners Equity	.1243	.14451	35
Working Capital Turnover Ratio	-1.4574	22.13724	35

[Source: Computed]

Table 3 represents correlation matrix for predictors of linear regression model. However, no correlation has been observed between AGER, Employee Turnover Index, EBITDA, and Working Capital Turnover Ratio. Weak, however, significant correlation exists between AGER and Return on Owners' Equity.

Table 3: Correlations Matrix for Predictors

		Average Gross Executive Remuneration	*Employee Turnover Index*	*EBITDA*	*Return on Owners Equity*	*Working Capital Turnover Ratio*
Pearson Correlation	Average Gross Executive Remuneration	1.000	.076	-.061	.321	.070
	Employee Turnover Index	.076	1.000	-.321	-.327	-.055
	EBITDA	-.061	-.321	1.000	.151	.037
	Return on Owners Equity	.321	-.327	.151	1.000	.074
	Working Capital Turnover Ratio	.070	-.055	.037	.074	1.000
Sig. (1-tailed)	Average Gross Executive Remuneration	.	.333	.363	.030	.346
	Employee Turnover Index	.333	.	.030	.028	.376
	EBITDA	.363	.030	.	.193	.417
	Return on Owners Equity	.030	.028	.193	.	.336
	Working Capital Turnover Ratio	.346	.376	.417	.336	.
N	Average Gross Executive Remuneration	35	35	35	35	35
	Employee Turnover Index	35	35	35	35	35
	EBITDA	35	35	35	35	35
	Return on Owners Equity	35	35	35	35	35
	Working Capital Turnover Ratio	35	35	35	35	35

[Source: Computed]

Although in this study, no linear regression model has been proposed to be constructed and only the relationship between multiple independent variables and single dependent variable has been tested through linear regression only, Table 4 presents Model Summary which is of utmost importance as adjusted R2 indicates the fitness of regression model. As the value of adjusted R2 is 0.032, it indicates 3.2% variance in the dependent variable (a value range of 0.1 to 0.2 is accepted in social science research) (Gaur & Gaur, 2009). Therefore, a suitable regression model is not recommended on the basis of these two sets of variables.

Table 4: Model Summary

Model	*R*	*R Square*	*Adjusted R Square*	*Std. Error of the Estimate*	*Change Statistics*				
					R Square Change	*F Change*	*df1*	*df2*	*Sig. F Change*
1	.382a	.146	.032	21.89179	.146	1.279	4	30	.300

a. Predictors: (Constant), Working Capital Turnover Ratio, EBITDA, Return on Owners Equity, Employee Turnover Index
[Source: Computed]

In the study of Analysis of Variance (Table 5), the non-significant F value at 95% significance level indicates the absence of any significant relationship between the predictors and criterion variables.

Table 5: ANOVAa

Model		*Sum of Squares*	*df*	*Mean Square*	*F*	*Sig.*
1	Regression	2451.531	4	612.883	1.279	.300b
	Residual	14377.515	30	479.250		
	Total	16829.046	34			

a. Dependent Variable: Average Gross Executive Remuneration
b. Predictors: (Constant), Working Capital Turnover Ratio, EBITDA, Return on Owners Equity, Employee Turnover Index
[Source: Computed]

In the following Coefficient table (Table 6), the Collinearity Statistics section tells us about the multicollinearity among the variables. If multicollinearity is identified, the regression analysis does not provide accurate result (Gaur & Gaur, 2009). Therefore, it is essential to look at the VIF (variance inflation factor) and Tolerance values and a VIF value of more than 5 (and Tolerance value of less than 0.2) indicates multicollinearity. In this research, the problem of multicollinearity does not exist and an interpretation of relationship between variables through linear regression is accepted.

Table 6: Coefficientsa

Model		*Unstandardized Coefficients*		*Standardized Coefficients*			*Correlations*			*Collinearity Statistics*	
		B	*Std. Error*	*Beta*	*t*	*Sig.*	*Zero-order*	*Partial*	*Part*	*Tolerance*	*VIF*
1	(Constant)	9.030	5.613		1.609	.118					
	Employee Turnover Index	45.499	45.915	.185	.991	.330	.076	.178	.167	.817	1.224
	EBITDA	.000	.001	-.062	-.349	.729	-.061	-.064	-.059	.894	1.118
	Return on Owners Equity	59.556	27.575	.387	2.160	.039	.321	.367	.364	.888	1.127
	Working Capital Turnover Ratio	.054	.170	.053	.315	.755	.070	.057	.053	.993	1.007

a. Dependent Variable: Average Gross Executive Remuneration
[Source: Computed]

Conclusion and Scope of Future Research

From this empirical study, it has been observed that the null hypothesis i.e. maintenance of corporate governance principles does not impact executive compensation in Indian service sector has been accepted. Therefore, it can be further concluded that although executive compensation is a manifestation of corporate governance, still it cannot be stated that maintenance of good governance will ensure the restrained and logical quantum of executive remuneration in Indian service sector.

Although the quantitative organisational performance indicators have been used as independent variables in this study as representatives of OECD principles, future research can be conducted following the BSE-IFC recommended corporate governance scorecard (Bombay Stock Exchange, 2018).

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