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Impact of Corporate Governance on Financial Performance of Information Technology Companies

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Abstract: Corporate Governance is a broad term in today's competitive world. It is a series of processes, policies, rules, and regulations by which companies are managed and governed. In this perspective, the study attempts to analyze the impact of corporate governance on the financial performance of Information Technology (IT) Companies in India. Specifically, the study analyzed the impact of Board size, Board Composition, and Audit Committee Independence on Return on Assets and Return on Equity, which are considered as measures of financial performance. The findings of the study revealed that there is a significant and positive impact of Corporate Governance on Financial performance of IT companies, and Audit Committee Independence shows the most significant effect on Financial performance. The finding of the study endeavors to contribute to the limited literature available in the context of corporate governance in IT companies in India.

Keywords: Corporate Governance, Financial performance, IT companies.

I. INTRODUCTION

In the long-run economic growth of any company is the combination of a reliable corporate governance mechanism, virtuous management, continuous research and development, and consumer confidence. The concept of corporate governance can be defined " as a set of relationships between a company's management, its board, its shareholders, and its stakeholders" [12]. The OECD Principles of Corporate Governance states that "Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are formulated,and the means of attaining those objectives and monitoring performance are determined"[22]

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Corporate Governance precisely deals with resolving the issues related to conflict of interest of different stakeholders by following ethical practices. Effective corporate governance acts as a catalyzer for the progress of any company. It helps the companies to perform better through qualitative decision making.

Although there are various models of corporate governance which have been adopted by different regions of the world such as Anglo-American model, Japanese model, German Model, and Indian model but the essence of every model lies in transparency, fairness and full disclosure of business operations for safeguarding the interest of different stakeholders like employees, shareholders, customers, financial institutions, government and society as whole. The concept of corporate governance has been existing for a long time. Initially, it was developed for protecting the interest of shareholders, and gradually it started gaining importance among other stakeholders [9]. But it gains momentum after the major business failures like Enron, World com, AIG, and Bear Stearns. Some research works reported that noncompliance of corporate governance practices, absence of transparency, and lack of full disclosures were the primary reasons for these failures. These falls gave birth to the formalization of corporate governance by appointment of different committees such as Cadbury committee, Greenbury committee, Hampel committee, Blue ribbon committee and Turnbull committee in western countries. Keeping pace with the developments taking place at global level similar developments were started in Asian countries also. In India, various committees were appointed by regulators to analyze the status of corporate governance and to recommend guidelines related to corporate governance, and financial statement disclosure such as Clause 49 of SEBI Listing Agreement is recommended by Kumaramangalam Birla committee (1999) [23]. From the above discussion, it can be said that Corporate governance primarily aims at safeguarding the interest of stakeholders which generates a sense of belongingness among them consequently it results in effective financial performance. Many empirical studies have been conducted to analyze the impact of corporate governance on the financial performance, but surprisingly very few research studies have studied the impact of corporate governance on the financial performance of Information Technology (IT) companies [15]. Therefore, this paper seeks to analyze the impact of corporate governance on the financial performance of IT companies in India.The paper is organized into eight sections: Introduction of the study is discussed in section one, section two deals with objective of the study.

Section three reviews the literature followed by the research gap and the significance of the study in section four. Section five deals with research methodology and section six discuss results of statistical analysis. Section seven deals with conclusion followed by limitation and future scope of the study in last section.

II. OBJECTIVE OF THE STUDY

The aim of the study is to analyze the impact of corporate governance on the financial performance of IT companies in India.

III. REVIEW OF LITERATURE

In the 19th century, due to long series of financial scandals and failure of major corporate houses regulators, shareholders, investors and society at large were forced to realize the fact that corporate governance is the best remedy for such economic fallouts. This realization drags the special attention of researcher towards finding out the relationship between corporate governance and performance of companies worldwide. Many were motivated to undertake the research on finding out the different ways of implementing the effective corporate governance mechanism in companies and further to analyze its impact on specifically firm's financial performance. Zahra and Pearce [21] reported unique linkages among different board attributes and critical board roles and presented them in the form of a combined model. Beasley [3] conducted an empirical test to access the impact of number of outside directors in Board of Directors on financial frauds and reported that probability of frauds in financial statements reduces significantly with large number of outside directors in Board of Directors. Dalton, Daily, Ellstrand, and Johnson [5] stated importance of Independent directors over dependent directors. According to their findings Independent directors have more accessibility of external resources and information than dependent directors.In general, better governance results in improvement of financial performance as it reduces investors' risk and helps in enticing more investors [17]. The firms with effective corporate governance practices are expected to have strong financial performance as these firms can use the resources efficiently. [4],[11]. Bae and Goyal [1] analyzed the corporate governance practices followed in Korean companies and reported that equity market performance has direct and positive relationship with adoption of good corporate governance practices.Dua and Dua [6] documented that appropriate disclosure of corporate governance efforts leads to improvement in the market value of Indian companies. Goel [7] found that better Corporate governance results in improvement in financial performance of Indian companies. Contrary to the above research findings, few studies reported no correlation between corporate governance and financial performance of companies. Roodposhti and Chashmi [16] reported negative correlation exists between financial earnings of Irani companies and ownership and independent board. Tata and Sharma [18] found that corporate governance disclosures have no significant relationship with corporate performance concerning board structure,ownership, and other disclosures

IV. RESEARCH GAP AND SIGNIFICANCE

It is astonishing to note that although there is an extensive amount of literature available on corporate governance however very few studies have been undertaken to investigate the impact of corporate governance on the financial performance of IT companies in India despite the fact that IT industry is one of the crucial players in India's economy. It contributes around 7.7% in India's GDP. So, the findings of the study contribute to the existing literature for researchers and readers by bridging the above-mentioned research gap. Moreover, the findings of the study will be beneficial in making the investors more aware of the relevance of corporate governance, particularly in the IT sector.

V. RESEARCH METHODOLOGY

A. Research Design

For the study, a descriptive research design has been adopted to study the impact of corporate governance on the financial performance of IT companies in India. Descriptive research is a process which includes the collection of data for testing the research hypothesis or answering the questions related to the existing state of affairs of the subject under study without manipulating any variables under study [13].

B. Sample and Data collection

The sample of the study consist of Top 10 IT companies of India based on revenue (2019) as depicted in Table 1.

Table1: List of Sampled IT companies

TCS	L&T Infotech
Infosys	Mindtree
Tech Mahindra	Mphasis
Wipro	Oracle Financial Services
HCL Technologies	Rolta India

The study has used secondary data as it provides a reliable source of information required by the researcher to analyze the phenomena of the study [19]. Data related to corporate governance and financial performance for five years 2015-2019 has been gathered from annual reports published on companies websites.

C.Assessing Corporate governance

For assessing corporate governance, the study focuses on the following three characteristics of corporate governance depicted in Table 2.

Table 2: Characteristics of Corporate Governance

1. Board Size (BOS)	Total number of Directors in the Board
2.Composition of Board (BODCOM)	Number of Executive and Non-executive Directors
3. Audit Committees Independence (AUDI)	Number of Independent directors present in audit Committees

D. Assessing Financial Performance

Different researchers have used different approaches to assess the financial performance of firms, i.e., Accounting Ratios [8],[2] or Market Valuation Ratios [10] or Mixed ratios [14],[7]. The study has used the first approach, i.e., Accounting Ratios and has taken Return on asset (ROA), and Return on Equity(ROE) as measures for assessing the financial performance of IT companies as these are profitability accounting ratios which are strategically crucial for all business undertakings.

E.Statistical Tools

The study has used Correlation Analysis and Regression analysis for analyzing the impact of corporate governance on the financial performance of IT companies in India.

F.Regression Model:

$ROA_{it} = f(BOS_t, BODCOM_t, AUDI_t)$ (1)

$ROA_{it} = \beta_o + \beta_1 BOS_t + \beta_2 BODCOM_t + \beta_3 AUDI_t + e_t$ (2)

$ROE_{it} = f(BOS_t, BODCOM_t, AUDI_t)$ (3)

$ROE_{it} = \beta_o + \beta_1 BOS_t + \beta_2 BODCOM_t + \beta_3 AUDI_t + e_t$ (4)

Where;

ROA_{it} and ROE_{it} represent the financial performance of the IT companies at time t and are dependent variables.

BOS, BODCOM, and AUDI represent the independent variables and used as measures of Corporate governance of the IT companies at time t.

e_t is an error term which represents other possible factors that may affect the financial performance of companies.

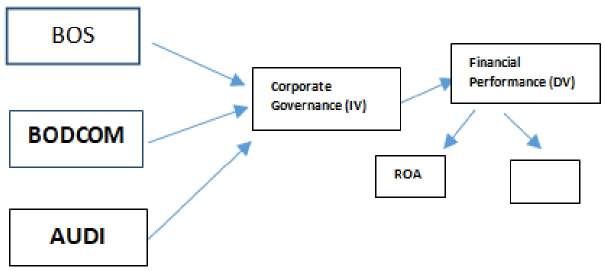

Fig1. Study Model

VI. STATISTICAL ANALYSIS, RESULTS, AND DISCUSSION

A.Correlation Analysis

Before performing the multiple regression analysis, correlation analysis has been carried out to check multicollinearity and examine the relationship between dependent and independent variables. The results of the correlation analysis are depicted in Table 3.

Table 3: Correlation matrix

	ROA	ROE	BOS	BOD COMP	AUDI
ROA	1				
ROE	0.628	1			
BOS	0.125	0.148	1		
BOD COM	0.276	0.374	0.164	1	
AUDI	0.376	0.491	0.354	0.594	1

The analysis present that there is no problem of multicollinearity as the values of the coefficient of correlation are relatively small; therefore in regression analysis all variables can equally participate. Overall there is positive correlation among all explanatory variables. The highest correlation is observed between ROA and ROE (0.628) followed by the correlation between Audit committee independence and Board Composition (0.594).

B.Regression Analysis

Impact of corporate governance on ROA

Table 4: ROA Model Summary

R	0.869
R Square	0.831
Adjusted R Square	0.816
F	3.689
Significance F	0.022

Table 5: Regression of ROA & Corporate Governance

	Unstandardized Coefficients		Std. Coefficients	t	Sig.
	B	Std.Error	Beta		
(Constant)	0.485	0.251		1.953	0.111
BOS	0.064	0.01	0.456	1.186	0.013
BODCOM	0.178	0.061	1.371	2.617	0.021
AUDI	0.192	0.015	1.068	2.816	0.045

Analysis of Table 4 presents that value of adjusted R^2 is 0.816, which indicates that 81.6% of the variations in ROA of IT companies is due to variations in corporate governance variables. As F value is 3.689, and Significance level is 0.022; therefore, it shows that this model is strong and statistically significant at α=0.05. The findings of Table 5 depicts that at α=0.05 Audit committee independence has the most significant impact on the ROA with 0.045 level of significance. Moreover, a unit increase in BOS, BODCOM, and AUDI will lead to increase in ROA by a factor of 0.064, 0.178, 0.192 respectively.

Impact of corporate governance on ROA

Table 6: ROE Model Summary

R	0.948
R Square	0.789
Adjusted R Square	0.852
F	3.317
Significance F	0.031

Table 7 : Regression of ROE & Corporate Governance

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std.Error	Beta		
(Constant)	1.753	0.786		2.689	0.041
BOS	0.618	0.281	0.516	2.103	0.012
BODCOM	1.454	0.594	1.119	3.16	0.025
AUDI	3.142	1.481	0.816	2.014	0.031

Analysis of Table 6 presents that value of adjusted R^2 is 0.852, which indicates that 85.2% of the variations in ROE of IT companies is due to variations in corporate governance variables. As F value is 3.317, and Significance level is 0.031; therefore, it shows that this model is strong and statistically significant at α=0.05. The findings of Table 7 depicts that at α=0.05 Audit committee independence has the most significant impact on the ROE with 0.031 level of significance. Moreover, a unit increase in BOS, BODCOM, and AUDI will lead to an increase in ROA by a factor of 0.618, 1.454,3.142 respectively. To sum up, all the variables under study are statistically significant as ($p < 0.05$).

VII. CONCLUSION

The study concludes that Corporate Governance has a positive and significant impact on Financial Performance of IT companies in India. Out of all the characteristics (BOS, BODCOM, and AUDI) considered for measuring corporate governance, AUDI shows the most significant and positive impact on both ROE and ROA. From the findings of the study it is implied that by having independent members in Audit committee, the committee feels free from the pressure of the management of the company and enjoys full freedom in giving its independent advice and consequently which leads to the transparent evaluation of the financial performance of the companies. Furthermore, by having the assurance that all financial matters are being scrutinized accurately by the independent members of the audit committee, sense of protection gets generated in stakeholders which allures them to invest more in the company and leads to improvement in the financial performance of the companies. Hence, it implies that stakeholders give more value to those companies which follow effective corporate governance mechanism; therefore, it is highly recommended that companies should comply with all corporate governance rules and regulations as it has a direct and significant relationship with company's financial performance.

VIII. LIMITATION AND FUTURE SCOPE

This study has considered data related to financial performance and corporate governance of top 10 Indian IT companies for 5 years (2015-2019) based on revenue to study the impact of Corporate Governance on Financial performance of IT companies. Future researchers can consider more than 10 companies and can extend the period of the study also. Furthermore, three characteristics of Corporate governance have been taken into consideration for analysis; future studies can consider other characteristics such as CEO duality, number of board's meetings, number of audit committee's meeting, ownership and size of company for analysis.

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