

Women Directors' Compensation and Firm Performance of an Emerging Economy: India

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Abstract

This probably maiden study for Indian financial market on executive compensation uses novel approach by using data of women director's compensation of firm listed at Bombay stock exchange (BSE)India. The methodology adopted for this study is multivariate regression method; this method is common for the research on compensation, on the basis of the survey of literature which treats total compensation paid to the director as dependent variable and firm performance as independent variable. This study adds to the literature one more equation that is impact of firm performance (dependent variable) on compensation (independent variable). Further by using the holistic combination which is rare in the literature of executive compensation, both measures of firm performance mainly accounting measures (EPS, ROCE and RONW) and market measures (P/E, P/BV) gives comprehensive view of firm performance in relation to compensation. The control variables mainly net sales, R and D and total assets are drawn from literature often known as instrumental variable approach in econometrics. The boundary condition for the sample is BSE-500 firms listed at Bombay stock exchange out of this BSE-500 firms sample of 407 firms are used for study.

Keywords: Corporate governance, emerging economy, executive compensation, firm performance, India, Indian firms, women director.

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1. Introduction

Early studies in this area focused on an effort to understand the true nature of the pay performance link by considering the unexplored factors which are sufficient enough to cause the variation in the results. A variation in results has caused and thereby provides recommendations for future research aimed at developing a more integrated research agenda (Sousa & Voss, 2002). This study is to further investigate the relationship between executive compensation and firm performance and identify the future research agenda. Accordingly, the study strives to reexamine the relationship between executive compensation and firm performance using extant literature so as to remove fundamental confusion about the pay-performance link.

The extant literature on women directors to performance of firm argue, uncontrolled top management pay cries out for action by government Mackenzie, H. (2017), Rouault, S. (2017), argues renewed pro-quota discourse among conservative parties proves that a symbolic instrument does have the power to provoke genuine institutional change in gender equality policy making. Glass, C., & Cook, A. (2017). find that the appointment of Asian directors is strongly predicted by the ethnic composition of the community where the firm is located. Lending, C. C., & Vähämaa, E. (2017). examines the relationship between the presence of female board members and measures of board independence and director expertise in Europe. They provide empirical evidence that the composition of the board varies based on the gender of directors, but not to a great extent. This paper also reveals that pending and required quotas affect board structure. Tahir, R. (2017), analyse the issue of gender diversity on corporate boards in New Zealand companies, their results indicate that women are severely underrepresented.

Chen et al. (2017) in their study find board gender composition significantly increases the dividend payout only for firms with weak governance, suggesting that female directors use dividend payouts as a governance device. Niccolo Gordini et al (2017), argue the presence of women director on Italian firms is not just number game, their presence does not destroy shareholder value. Xiang, R., & Qin, M. (2017). paper empirically tests the effect of female audit committee member's characteristics on high quality external audit demand. They conclude female director's education level is positively significantly related to high quality external audit demand. Lückerath-Rovers, M. (2013), study investigates the financial performance of Dutch companies both with and without women on their boards. Their results show that firms with women directors perform better than those without women on their boards. Liu et al. (2014), find that the impact of female directors on firm performance is significant in legal person-controlled firms but insignificant in state-controlled firms in china. Lam et al. (2013), find female CEOs receive less favourable compensation terms than their male counterparts. Terjesen et al. (2015), findings provide evidence that the female directors enhance boards of directors' effectiveness. They also report that firms that are concerned with board independence, and that firms in more complex environments are more likely to have gender-balanced boards.

Thus, the extant literature presents diverse view of female board member presence in the board of firm.

1.1. Indian Studies on compensation and performance

Kakani & Ray (2002) opined that through the board of directors, shareholders retain the services of a CEO/MD to maximise the shareholder as well firm value. One might guess that there can be relation in CEO/MD compensation and a firm's performance. The argument for the regular increase in pay was to attract and retain talent at the senior managerial level.

Additionally, it has been argued that the risk and responsibility at the senior level needs to be compensated by a sufficient increase in the pay packet. Ghosh, A. (2003) studied the relationship for board structure, CEO/MD compensation and performance of Indian firms. These authors have examined how the level and different components of executive compensation have an effect on the performance. The relation in compensation and performances has to be non-linear. Ghosh (2003) findings were — There are effects of the compensation of the CEO on the performance; there is a non-linear relation between pay and performance of the firm; and pay-performance sensitivity is higher for the smaller firms in comparison to the larger firms. Ghosh (2003) have shown performance is very sensitive to the pay of the CEO/MD in comparison to the compensation of the entire board and the structure of the compensation also has an important role in determining the performance. Parthasarathy, Menon and Bhattacharjee (2006) in their study investigated the determinants of executive compensation using data on performance, governance and compensation for a large sample of Indian firms. The results show that no profitability measures is important determinant of total CEO/MD pay. Firm size is a significant variable in explaining both total CEO/MD pay and the proportion of variable or incentive pay that a CEO/MD receives. They also proposed that CEO/MD compensation was a function of three distinct sets of parameters: (a) firm performance and shareholder wealth, (b) firm specific characteristics and (c) corporate governance parameters because the issue of compensation is complex as number of factors playing a crucial role in the determination of compensation. The main contribution of the Ghosh (2003) study was their study on compensation as very limited literature available on the determinants of top executive compensation in Indian firms. Ghosh (2006) in this studies shows, determination of Board and CEO Compensation and he examines the effect of governance, performance and diversification on board as well as CEO compensation and its components in Indian firm. This paper found that board compensation largely depends on current and past year firm performance and compensation depends on present year firm performances. Other point mentioned on CEO compensation, was that size of the firm is more significant important pay to performance relation. However, majority of studies show a positively related pay to performance relation but it seems low in most of the cases.

1.2. Objectives

The main objective of this study are:

(With change in the legal system that is, introduction of Companies act, 2013 and modification in Clause-49-)

- 1: How much is the sensitivity of firm performance to women director compensation post-reform.
- 2: What is the effect of the women directors' compensation on firm performance

1.3. Theories

Agency theory states that an agency problem exists when an agent, such as a Director or a top executive, acts in a manner that is not necessarily in line with the interest of the shareholders which needless to say, is to maximize share value, but instead aims at maximizing personal wealth (Attaway, 2000).

Due to that the relationship between executive compensation and firm performance exhibits varying degrees of relation depending on the context, and sometimes even a negative relationship, the subject has been widely researched over the years.

Institutional theory by Dimaggio (1983) portrays- Coercive, Normative and Mimetic as the Guiding force that anchors the other constructs. Since the organization compensation

practices and policy is responsible for the overall compensation of the firm director compensation, and the Development and direction of the firm. Therefore, the institutional norms have important role to play in setting up the director's compensation of the firm.

According to Institution Theory, Coercive, Normative and Mimetic pressure independently monitor strategic compensation challenges facing a firm and evaluate director performance. However, a noticeable gap in the research in the failure to examine the application of this Coercive, Normative and Mimetic pressure in the design of director's compensation skills or the processes to maximize the firm compensation strategy.

2. Literature

There is relationship between presence of compensation of women directors and firm performance: Although, the constitution of India grants equal rights to both Men's and Women's of India, the average representation of women in corporate India in the year 2009 was 4.1% in comparison to global average of 9.1 % (See annexure-I). It might be reason that, the section 149(1) of the India's Companies Act, 2013, was introduced which states that:

“Such class or classes of company as may be prescribed shall have at least one woman director” having paid up share capital in excess of Rs.100 crores (16 million US \$; @ Rs. 62 per US \$ on 29th December'2014) or turnover of Rs.300 crores (48 million US \$; @ Rs. 62 per US \$ on 29th December'2014) or more shall appoint a woman director within 3 years from the commencement of the 2nd proviso as above”

SEBI, Capital market regulator in India, on 16th September'2014, relaxed provision for appointing at least one woman director by April 1, 2015.

Some studies suggest female managers have eleven points higher mean total emotional intelligence scores than their male colleagues as reported by Mandell and Pherwani's study (2003), using Bar-On Emotional Quotient Inventory.

This report link mentioned below that there is a correlation between performance and the proportion of women on executive board. Available at: http://www.europeanpwn.net/files/mckinsey_2007_gender_matters.pdf

There is evidence to suggest that Female directors bring more fairness and transparency as well as improve overall efficiency of the company they lead, Catalyst (1993), non-profit research firm in US, notes 82% of the 50 most valuable Fortune 500 firms were found to include at least one-woman director on the board.

Two years later, Catalyst (1995) reports that of the top 100 US companies in terms of revenue, 97 had at least one-woman board member.

Based on the 1993 Ashridge survey of the Top 200 UK companies, it was found that 49 companies (25%) have women on their boards: an increase from 21 companies (11%) in 1989. The results also indicate that women are much more likely to be non-executive directors, she noted that women might have a slight edge over men in strategic planning.

Shrader et al. (1997) who examined firm financial performance with gender diversity at the middle-and upper-management, and at the board of director levels for large firms, find in general, a positive link between women in management positions with firm financial performance. They explained the positive performance relationship by suggesting that these companies were recruiting from a relatively larger talent pool, and subsequently recruited more qualified applicants regardless of gender.

Due to the under representation of women, there has been relatively little research conducted on women directors to performance (Burke, 1997).

Erhardt (2003), results support the hypothesis, that executive board of director diversity was positively associated with both ROA and ROE.

Thus, diversity with boards of directors appeared to have an impact on overall organizational performance.

3. Hypothesis

The alignment hypothesis (Jensen,1993) takes the following form;

Firm performance= f (compensation + control variable)

Total compensation=f (firm performance + control variable)

Here,

Firm performance = Accounting firm performance = ROCE is the ratio which measure the performance of a company as a whole in using all sources of long-term finance for the financial year 2015-2016.

Firm performance =Accounting firm performance = RONW is a ratio that shows the extent to which companies manage their own capital (net worth) to effectively and measure the profitability of the investments made by its own capital owners or shareholders of the company for the financial year 2015-2016.

Firm performance = Accounting firm performance = EPS is a measurement of the company's per-share performance for the financial year 2015-2016.

Firm performance = market measure of firm performance = P/BV calculated by dividing the stock price by book value. Book value is calculated by subtracting intangible assets and liabilities from total assets for the financial year 2015-2016.

Firm performance = market measure of firm performance = P/E ratio measures the number of times a stock quotes as a multiple of its earnings per share for the financial year 2015-2016.

Compensation = total compensation paid to the women directors for the financial year 2015-2016.

Control variable = Net sales, Advertising expenditure and R and D expenses for the financial year 2015-2016.

4. Research Methodology

In order to determine how well the regression model explains the relationship between the included variables, there are a number of econometrics tests at the researcher's disposal.

4.1. The method of choice

Given the discussion about the common practice for researching the pay performance relationship, this study adopts a regression model where total compensation for top-management will be held as the dependent variable and a combination of accounting- and market based variables are the independent variables. The study spans over a period for one year, 2016, the year when the one women director per firm was introduced. The sample is constructed using BSE- 500 companies listed on the Bombay stock exchange. The methodology largely follows that of Jensen, 1990; Murphy, 1985, who by studying the American stock market which arguably can be said to hold some resemblance to this study.

4.2. Pooled Ordinary Least Squares Models

Much of the early research (Bhagat et al. (1999), Hambrick et al (2000), Bhagat and Black (2002)) on the relation between compensation and performance has employed the common practice of collecting data on subjects in a population at a single point in time using ordinary least square (OLS).

The pooled ordinary least square (OLS), (Verbeek, M. (2012), Bates, D., Maechler, M., Bolker, B., and S. Walker (2015)) estimates are considered efficient, or of minimum variance. Therefore, inferences drawn on the significance of parameter estimates can be considered accurate. As noted earlier, many of the early studies documenting, relation between compensation and performance have employed OLS estimators. Thus, when attempting to replicate the results of previous studies using OLS, robust standard errors was employed to control for potential problems with OLS estimator. In such cases, researchers correct for this problem using White's (1980) robust standard errors.

4.3. Sample selection

The sample includes 547 observations of 407 firms drawn from BSE-500 firm for the financial year 2015-2016. Information on women director compensation and firm compensation as well as other variables for each of these firms has been hand-collected from the annual company/report statement of the firm.

4.4. Descriptive statistics:

From the table 1 the return on capital employed (ROCE) for the year 2016 of the 407 firms drawn from the BSE-500 has mean of 15 and standard deviation of 16. The return on net worth (RONW) of these firms has mean 13 and standard deviation 23. P/E ratio is with mean 76 and the standard deviation of 433. P/BV is with mean 123 and standard deviation of 4.79. Net sales mean of these firms are Rs.13015 crores, standard deviation is Rs.37291 crores. Advertisement expenditure is Rs.94 crores (mean with standard deviation of Rs. 474 crore. Research and development expenditure (R & D) is Rs 7.21 crores(mean) and standard deviation of Rs 51.02 crores. The Earning per share(EPS) is mean 37 and standard deviation of 253. The total compensation paid to the women directors of these firms are Rs.42.93 lakhs(mean) with standard deviation of Rs. 2.87 crore.

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROCE (%) [Latest]	499	-28.12	172.89	15.9384	16.64094
RONW (%) [Latest]	499	-206.05	313.51	13.9846	23.11142
Price Earning (P/E) [Latest]	498	.00	5950.00	76.6151	433.48282
Price to Book Value (P/BV)[Latest]	498	-27.77	123.11	4.7971	9.71012
Net Sales[Latest] (RS.)	499	12.59	455891.63	13015.5654	37291.67526
Advertisement[Latest] (RS.)	499	.00	8847.93	94.6612	474.86465
R & D Expenses [Latest] (RS.)	499	0	923	7.21	51.029
EPS (Adj) (Unit Curr.)[Latest]	500	-84.6	5578.7	37.802	253.0671
[Remuneration - Unit Curr. (Latest)] (Rs.)	547	0	612600000	4293185.01	28778075.520
Valid N (listwise)	498				

Data source: Annual statement of BSE-500 Indian traded firms

Note-Net sales, advertisement, total remuneration and R and d is in crores of Indian rupees' 1crore =100 lakhs, 1crores=10 millions.1 US \$ = Rs. (Indian) 67

5. Results and Discussion

The regression analysis, see the table-2, the model no I to V of the regression analysis looks at the impact of the compensation on firm performance by using accounting measure (EPS, RONW & ROCE) and Market measure (P/E, P/BV). The model no. VI is to measure pay - performance sensitivity (Jensen, 1990). The model no vii includes the market measure to test the sensitivity. The model VIII and IX includes the dummy to measure the impact of promoter directors (controlling shareholder) and independent directors.

Table 2. Regression of firm performance on compensation of women directors for the year 2016

Independent Variable	YEAR 2016 EPS I	YEAR 2016 ROCE II	YEAR 2016 RONW III	YEAR 2016 P/E ratio IV	YEAR 2016 P/BV V	Year 2016 Tot.Comp. VI	Year 2016 Tot.Comp. VII	Year 2016 Tot.Comp. VIII	Year 2016 Tot.Comp IX
Intercept	36.485** (2.958)	16.196*** (20.389)	14.025*** (12.543)	79.711*** (3.776)	4.917*** (10.17)	6156994** (3.132)	6386221.18** (3.152)	4966722.4**	10132782.1***
Corporate governance variable									
Total compensation	-0.011 (-0.234)	-0.047 (-1.058)	-0.034 (-0.764)	-0.014 (-0.305)	-0.025 (-0.570)	-	-	-	-
Control Variable									
Net sales	0.012 (0.255)	-0.144** (-3.100)	-0.066 (-1.411)	-0.033 (-0.691)	-0.114** (-2.435)	-0.012 (-0.259)	-0.013 (-0.280)	-0.008 (-0.179)	-0.026 (-0.566)
R & D expenses	0.007 (0.166)	0.055 (1.242)	0.051 (1.136)	-0.015 (-0.333)	-0.003 (-0.058)	-	-	-	-
Advertisement Exp.	0.009 (0.194)	0.171*** (3.685)	0.097** (2.076)	0.043 (0.900)	0.158** (3.389)	-	-	-	-
EPS	-	-	-	-	-	-0.007 (-0.155)	-0.007 (-0.155)	-0.005 (-0.103)	-0.011 (-0.239)
ROCE	-	-	-	-	-	-0.043 (-0.757)	-0.043 (-0.757)	-0.042 (-0.726)	-0.046 (-0.789)
RONW	-	-	-	-	-	-0.009 (-0.167)	-0.010 (-0.167)	-0.010 (-0.171)	-0.001 (-0.013)
P/E	-	-	-	-	-	-	-0.017 (-0.367)	-0.027 (-0.589)	-0.017 (-0.374)
P/BV	-	-	-	-	-	-	-0.012 (-0.250)	-0.013 (-0.284)	-0.008 (-0.169)
Dummy women controlling shareholder (promoter) director	-	-	-	-	-	-	-	0.151** (3.381)	-
Dummy women Independent director	-	-	-	-	-	-	-	-	-0.122** (-2.706)
R ²	0.02	0.19	0.11	0.05	0.16	0.05	0.05	0.02	0.01
F	0.058***	5.086***	1.69	0.30	3.51***	0.31	0.24	1.84**	1.26
Obsevation	547	547	547	547	547	547	547	547	547
N(firms)	407	407	407	407	407	407	407	407	407

As this study uses both market and accounting measure of firm performance, by using multi factor regression model. Whereas, the model VIII of the regression indicates that the presence of women director –Promoter (controlling shareholder) is positively related to total compensation of women directors, it indicates that it may lead to higher compensation of women directors. The model IX finds, the dummy regression result of women independent director presents evidence that presence of women independent Directors lowers the pay.

The two objectives of this study were:

1. To see the sensitivity of compensation in relation to firm performance.

This study indicates very low- pay to performance relationship, the model VI (see table-2) of the regression is replicated from the highly-cited study of Jensen, 1990 and Murphy, 1985, they find positive but very low pay to performance relationship, but the model VI of this study indicates negative relationship. However, the study find results in alignment with Duffheus and Kabir (2008) who also reports a negative relation. Murphy Kevin et. al., (1998)-the pay-performance relation (including pay, options, stockholdings, and dismissal) for chief executive officers indicate that CEO wealth changes \$3.25 for every \$1,000 change in shareholder wealth. Although the incentives generated by stock ownership are large relative to pay and dismissal incentives, most CEOs hold trivial fractions of their firms' stock, and ownership levels have declined over the past 50 years.

The model VI and VII (see table-2) indicates very low pay-to- performance relationship in this study.

This low pay-performance sensitivity which is also in aligned with the literature (Jensen, 1990; Murphy, 1985,)

Although no hypothesis was made on the control variable R & D expenditure which is very low and in some regression model negatively co-related to R & D expenditure of firm performance can be expressed in words of (Jensen, 1993, P.854-855),

“In this case the firm's shareholders suffered an opportunity loss equal to the value that could have been created if the firm had paid the funds out to them and they had invested it in equivalently risky projects. The opportunity cost of R&D and capital expenditures thus can be thought of as the returns that would have been earned by an investment in equivalent-risk assets over the same time period.”

2. The effect of compensation and firm performance

There is a negative relationship between the total women director compensation and firm performance It is in alignment with the earlier literation and study, based on Dutch firms by Duffheus and Kabir (2008) who also reports a negative relation.

From the table -2, to test this the regression model 1 to 5 was constructed, the result show negative relation between compensation and firm performance on both the accounting measure, (EPS, ROCE and RONW) as well as market measure (P/BV and P/E)

The model –I, II, III, IV, V and VI of the regression (see table-2) indicates that the total compensation of women directors is negatively correlated to the both accounting measure and market measure of firm performance.

See model VIII and IX in table -2, the regression result indicates the compensation is in non-alignment with the firm performance, the dummy variable for women promoter directors indicates that it may lead to higher compensation of directors, Sonja Fagernis (2006), also reports that CEOs related to founding members or directors are paid more than other CEOs. Sarkar and Sarkar (2009), reveals in India marked level of concentration is in the hand of the

“Promoters” (i.e. Founding and controlling/Dominant shareholders). Ghosh A. (2006), notes compensation was higher on an average Rs.69 lakhs (6.9 millions) when the CEO was related to the founding family. The dummy regression result (model IX) of women independent director presents evidence that presence of women independent Directors lowers the pay.

The implication of this study is that the compensation committee (clause 49 of listing agreement) should Linearly aligned compensation to firm performance, by making stock option mandatory in compensation (Jensen and Murphy,2004). Sarkar et al., (1996), showed in late 1990's, Over 40% of Indian companies had promoter (controlling shareholder) on the board and in over 30 % of the companies the promoter served as chairman of the board. Therefore, Agency Power-Promoters (controlling shareholder) presence affecting over compensation of directors, it needs for dilution of powers of promoters, also indicated in model VIII of regression analysis. There is a need that the Compensation committee responsible for design of directors' compensation should be free from the influence of promoter's, and the directors' compensation must be economically efficiently which effects firm performance.

To summarize the result the replication of the earlier model of (Jensen, 1990; Murphy, 1985) shows negative relationship of firm performance to total compensation of women directors' data of the Indian firms.

Further, adding one more dimension through this study is the addition of impact of total compensation on firm performance shows negative and low sensitivity of total compensation on firm performance.

6. Conclusion

This probably the maiden study on women directors' compensation of Indian financial market was designed with the objective to test alignment hypothesis of the firm performance in relation to women directors' compensation. By using both the measure accounting and market measure of firm performance this study uses comprehensive view to test the relationship of firm performance which research believes is the addition to the Jensen, 1990; Murphy,1985, as both the accounting measure and market measure of firm performance have advantages and disadvantages, accounting measure is most stable measure whereas, market measure is considered volatile measure.

Thus, by using the data for the year 2015-2016 it test the institution theory, the recent companies act, 2013 for Indian firm forbids paying directed of joint stock firm through stock option whereas the clause-49 of listing agreement permits stock option, there by confusing the Indian firms to pay through the stock option.

The agency theorist, Jensen (1993), alignment hypothesis of compensation in relation to the firm performance, argues that the sensitivity of the firm performance can be improved by making stock option mandatory in compensation (Jensen and Murphy, 2004).

The result of this study indicates that the negative relation of compensation of the woman's directors to firm performance is economically inefficient because the compensation setting of the women directors are based on ratchets effect, which tries to beat the industry standard for paying the women's director rather economically efficient and objectively setting the compensation in relation to firm performance.

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APPENDIX A

Table 3: International comparison of women on boards

Country	% of Women on Boards	Country	% of Women on Boards
Australia	9.9%	China	6.6%
Hong Kong	7.6%	India	4.1%
Japan	0.9%	Indonesia	4.1%
New Zealand	11.4%	Malaysia	4.2%
Singapore	5.7%	Pakistan	4.6%
Industrialised Asia-Pacific	3.6%	Philippines	23%
		South Korea	1%
Austria	6.7%	Taiwan	6.4%
Belgium	6.5%	Thailand	6.7%
Denmark	12.1%	Emerging Markets – Asia	4.7%
Finland	21%		
France	8.2%	Czech Republic	4.4%
Germany	9%	Hungary	10.2%
Greece	9.5%	Poland	10.2%
Iceland	14.3%	Russia	5.8%
Ireland	7.1%	Turkey	9.7%
Italy	3.6%	Emerging Markets – Europe	7.8%
The Netherlands	10.3%		
Norway	35.9%	Egypt	7.1%
Portugal	0.4%	Israel	12.5%
Spain	6.6%	Morocco	0%
Sweden	23%	South Africa	14.6%
Switzerland	8.4%	Emerging Markets – Middle East and Africa	12.4%
UK	7.8%		
Industrialised Europe	9.6%	Argentina	4.1%
		Brazil	3.9%
Canada	11.3%	Chile	2.4%
US	11.4%	Colombia	11.3%
North America	11.4%	Mexico	6.5%
		Peru	3.6%
		Emerging Markets – Latin America	4.7%
		Total Emerging Markets	6%
		Total	8.9%

Source:
 Women on Boards: A
 Statistical Review by Country,
 Region, Sector and Market
 Index; Governance Metrics
 International; March 2009