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Comparative Analysis of Corporate Governance Practices between IT and Real Estate Sector of India

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Abstract: The purpose of this paper is to compare corporate governance practices between IT sector and Real estate sector in India.

Design/methodology/approach – Panel data covering the ten-year period between 2001 to 2010 for both IT sector and Real estate sector which are compared using T-test.

Findings – The corporate governance score of sampled IT firms is found to be insignificantly different from the sampled Real Estate firms on the basis of CGI method. Whereas in case of Scorecard method the corporate governance score is found to be significantly high for IT sector firms than Real estate sector firms.

Practical implications – IT sector have voluntarily adopted international corporate governance practices whereas Real estate sector employ only mandatory provisions. In addition to a number of other reasons, the most significant reasons behind relatively less transparency in real estate sector is the opacity leading to discretion in government rules and regulation pertaining to this sector forcing the firms to use various means which may not be entirely within the domain of legal/ ethical behaviour? This has clear implications for governance, regulation and legislation.

Originality/value – IT and real estate sectors are perceived to be the two extreme as far as government regulation is concerned. As a consequence their corporate governance practices should also reflect the difference. The study compares the status of corporate governance practices between IT and Real estate sector of India.

Paper type – Research paper.

Keywords: Corporate governance, India, Comparative analysis, Scorecard, Corporate Governance Index, Information Technology, Real estate.

I. INTRODUCTION

In India after independence the tendency of the government policy towards business was the gradual increase in government control and influence over various dimensions of business including setting of the business operation, expansion, broad banding, downsizing, hiring of workers, etc. This trend started reversal in early 1980s under the compulsion from IMF and subsequently liberalisation gain momentum after Narsimha Rao government took over in 1991 (Lalita, 2006). However, the strategy of the government of India regarding liberalisation was calibrated and sector specific. As a result at present we find various industries confronted with different level of government control and influence on business. On the one side of spectrum we have knowledge based industries including IT, biotech and media where skilled professionals started the business and emerged successfully as there were very few barriers to entry. Tarun and Krishna, (2004) rated the software firms best on corporate governance practices in comparison to other Indian firms. Indian Software firms are more likely to be listed on the NYSE. The listing reflects that the software firms follow globally best governance practices. India's former IT minister Late Shri Pramod Mahajan, once quipped that India is a leader in "IT and beauty contest, two areas that the government has stayed out of" (Devesh, 2007). Indian IT biggies such as Infosys technology and Wipro are consistently rated amongst the best managed companies in the country. Nasscom (organization representing the IT industry) governance and ethics committee has further strengthened the corporate governance practices in IT sector (Deccan Herald April 28, 2010). Similarly "NASSCOM Perspective 2020: Transform business, Transform India" report has asserted that IT industry has been a champion for Corporate Social Responsibility over the last decade.

On the another extreme of the spectrum we have industries based on natural resources where complex law and rules of the government make it extremely difficult for business to run its even day to day operations without government regulations. Real estate sector is considered as industry based on natural resources because its prime input i.e. land is a natural resource and regulated by government. Commenting on the corporate governance practices of Real Estate sector Colin Dyer, global CEO of international property consultancy Jones Lang LaSalle (2012) said that major challenge for the real estate sector is lack of transparency in business activities. The "Global real estate transparency index 2012" report ranked India at 50th place out of 97 economies worldwide surveyed. According to "Global real estate transparency index 2011" government policy and regulation regarding use of land is highly opaque leading to lot of discretion in the hand of government, which act as a root cause of corruption in real estate sector. The Jones Lang Lasalle in 2011 found in a survey that 68% respondents felt that real estate sector should adopt "Single Window Clearance" model as adopted by IT sector to reduce corruption.

The businesses are supposed to respond to the given business conditions in order to remain competitive. And in case of relatively less transparent business environment the corporate may resort to various actions which may fall in the grey area of legality and morality so that they are on the right side of the government rules and regulation. Therefore it can be hypothesized that other things being equal, the more transparent business environment shall lead to better corporate governance practices.

Keeping all these views in mind, out of Knowledge based sectors we have chosen IT sector which is contributing 9% to Indian GDP in FY2013. Exports dominate the IT industry and constitute about 77% of the total industry revenue. The industry's share of total Indian exports is about 25% in FY2013. Out of natural resources based sectors we have chosen Real estate sector because its contribution to India's GDP has been estimated at 13.5 per cent in 2013, and the segment is expected to generate 7.6 million jobs in the same period. Both seem at extreme ends as far as corporate governance practices are concerned.

The remainder of the paper is organized as follows: section 2 reviews the relevant literature, Section 3 describes the empirical model and the sample, section 4 presents the main results and finally some conclusions is outlined in section 5.

II. Review of Literature

Corporate governance can be explained with narrow and wider view. Corporate governance's narrow view focuses on creation of an environment of trust at firm level. Here corporate governance is a set of relationships amongst all the stakeholders like shareholder, BOD, auditor and management. And broader view focuses on creation of confidence at economic level. This means good corporate governance leads to efficient resource allocation, overall excellent market confidence, and good industrial growth of that country.

An extensive literature is reviewed and it is observed that the use of two or three corporate governance indicators is prevalent. Firm's ownership structure is the most researched indicator of corporate governance (Sidney and Bertrand, 2010; Michael and Karl, 2003; Ekta, 2005; Neeraj and Arun, 2005; Allan, 2004; Jenifer et al., 2007). As boards are considered to be decision-making groups, its size can affect the decision-making process and effectiveness of the board, so board size is another frequently used dummy of corporate governance (Neeraj and Arun, 2005; Ahmadu and Tukur, 2005). There is large number of researches who focused on CEO duality (Ahmadu and Tukur, 2005; Michael, 1993; Eugene and Michael, 1983). Another well documented corporate governance indicator is board composition (David et al., 2003; Khurram et al., 2011; Anthony and Nicholas, 2006; Steen, 2005)

In contrast, few papers used composite score of these corporate governance indicators, to determine the impact of corporate governance practices on firm financial performance, by preparing Corporate Governance Index and Scorecard (Prashant and Tara Prasad 2011; (Jayati et al. 2012). A number of empirical studies used Scorecard for a comparative analysis of corporate governance practices within a sector (Swati and Rashesh, 2012; Swati and Rashesh, 2012; Mamta et al., 2012).

(Qadir and Ramiz, 2010) did a comparative analysis between chemical and pharmaceutical sector of Pakistan in order to determine which sector is having more influence of corporate governance on firm financial performance using regression method. However, (Palanisamy, 2012) did a comparative study of corporate governance practices between manufacturing and non manufacturing sector of India using differences of means test method. (Adenike, 2013) did a comparative study of the corporate governance codes of a developing economy with developed economies using case study method.

After reviewing extensive literature it is observed that there is no rigorous and scientific exercise available to substantiate a difference in corporate governance practices between IT and Real estate sector in India. Therefore we decided to undertake a rigorous and in-depth exercise to do a comparative analysis of corporate governance practices between IT sector and Real estate sector.

III. Research Design and Sample

3.1 Research design

In order to do comparative study of corporate governance practices between IT and Real estate sector, Corporate Governance Index method and Scorecard method are used.

3.1.1 CGI (Corporate Governance Index method)

In order to determine the Corporate Governance status of the firm, a composite Corporate Governance Index is better than individual indicators. The available Corporate Governance Indices which are notable could be the index developed by (Nasha, 2008; Jang et al., 2003; Tarun et al., 2001; Leora F. and Inessa, 2002; Prashant and Tara Prasad, 2011).

Firm's ownership structure, Board Size, Board composition are the most researched indicator of corporate governance (Sidney and Bertrand, 2010; David et al., 2003; Ekta, 2005; Neeraj and Arun, 2005; Allan , 2004; Jenifer et al., 2007; Ahmadu and Tukur, 2005; David et al., 2003; Khurram et al., 2011; Anthony and Nicholas, 2006; Steen, 2005). Whereas (Prashant and Tara Prasad, 2011) used Board Responsibilities, Board structure, Shareholders Rights, Transparency & disclosure and Audit Committee as corporate governance indicator to formulate Corporate Governance Index. Out of these indicators eleven most frequently used have been taken these are Board size, Board independence, Non Executive Director in board, annual board meetings, Independent Director attended board meeting, Audit committee size, Independent Director in audit committee, Non Executive Director in audit committee, annual audit committee meeting, number of Directorship and Promoter holding. And then to compare Corporate Governance Index value of both sectors, differences of mean test is used.

$$H0: \text{Mean (IT)} = \text{Mean (RE)}$$

3.1.2 Scorecard Method

The Signalling theory is the idea that one party (termed the agent) credibly conveys some information about itself to another party (the principal). Likewise if a company is fair in all aspects then it will maintain transparency, which leads to voluntarily adoption of non mandatory provisions of corporate governance practices. CGI capture only mandatory provisions, whereas scorecard is more rigorous standardised method which cover almost all the Statutory and Non mandatory requirements stipulated by Clause 49 of the listing agreement. This method is proposed by Das S.C. 2007 and subsequently used by various studies (Swati and Rashesh, 2012; Swati and Rashesh, 2012; Mamta et al., 2012).In order to compare Scorecard values of both sectors the differences of mean test is used:

H0: Mean (IT) = Mean (RE)

3.2 Sample

In India the process of corporate governance reforms was initiated by industry's leaders. Then SEBI appointed the committee on corporate governance in 1999 under the chairmanship of Shri Kumar Mangalam Birla. In 2000, SEBI incorporated all its recommendations in clause 49, a new section of listing agreement, which took effect from 2000 to 2003. Further for improvement in exiting clause 49 SEBI setup a committee under the chairmanship of Mr. Narayana Murthy in 2003. Keeping these reforms in mind a time period of 2001 to 2010 have been chosen. The sample used in this study is composed of all IT and Real estate sector Indian companies listed in the stock exchange for which annual corporate governance reports from 2001 to 2010, were available on the prowess database. In all, 62 firms met these criteria, but for convenience 30 from each sector have been chosen, for a total of 600 observations.

IV. RESULTS

4.1 Descriptive Statistics

Table 1 provides a summary of the descriptive statistics for the data used in Corporate Governance Index method. The mean Value of corporate governance score for IT and Real estate sector are 66.86 and 66.75 respectively.

Table 1		**Group Statistics**: **Corporate Governance Index Method**				
Sector		N	Mean	Standard deviation	Maximum	Minimum
Score	IT	30	66.87	7.924	87	54
	RE	30	66.76	7.312	79.81	53.81

In case of IT sector maximum score is 87 and minimum is 54, whereas in case of Real estate sector maximum is 79.81 and minimum is 53.81, which reflects that data in both the sectors are less dispersed and value of standard deviation is more or less same.

Table 2 provides a summary of the descriptive statistics for the data used in scorecard method. The mean Value of corporate governance score for IT and Real estate sector are 55.77 and 49.04 respectively.

Table2		**Group Statistics : Scorecard Method**				
Sector		N	Mean	Standard deviation	Maximum	Minimum
Score	IT	30	55.77	9.11	92	36.4
	RE	30	49.04	6.29	68	33.9

In case of IT sector maximum score is 92 and minimum is 36.4, which reflects that data is highly dispersed. Whereas in case of Real estate sector maximum is 68 and minimum is 33.9, which reflects that data is comparatively less dispersed and concentrated towards the mean value.

4.2Differences of Mean Test results and discussions

Now the first question is whether there is significant difference between IT and Real estate sector as far as corporate governance practices are concerned? This paper addresses the above question by analysing Table3 and Table4.

Table3	**Differences of Mean Test : Corporate Governance Index Method**		
Sector	Mean	Mean difference	Sig. (2-tailed)
Score IT	66.87	0.10750	0.957
RE	66.76	0.10750	0.957

As shown in Table 3, the corporate governance score is found to be insignificantly different for IT sector firms and Real estate sector firms. As the P value (.957>.10) it reflects that results are insignificant even at 10% level of significance. It means as far as mandatory provisions of listing agreement are concerned both the sectors scored more or less same. Kumar Mangalam Birla committee report (2000) asserted that in Indian conditions a statutory rather than a voluntary code would be far more purposive and meaningful, at least in respect of essential features of corporate governance.

Therefore for the purpose of probing the issue further we employed the Scorecard method. The results are presented in table 4.

Table4	**Differences of Mean Test : Scorecard Method**		
Sector	Mean	Mean difference	Sig. (2-tailed)
Score IT	55.7737	6.73033	.002
RE	49.0433	6.73033	.002

As shown in Table 4, the corporate governance score is found to be significantly different for IT sector firms and Real estate sector firms. As the P value (.002<.01) it reflects that results are significant at 1% level of significance. The results show that the IT firms have been following superior corporate governance practices as hypothesized.

V. CONCLUSION

Our findings substantiate the conclusion of the Kumar Mangalam Birla committee report (2000) that in a developing country like provision of more strict norms for corporate governance is urgently required. As far as mandatory provisions of listing agreement are concerned both IT and Real estate sector scored more or less same. But when both statutory and non-mandatory practices have taken into consideration then IT sector scored well as compare to Real estate sector. In short IT sector have voluntarily adopted international corporate governance practices where as Real estate sector adopted mandatory provisions because they were bound to do so. The financial market being not sufficiently sophisticated there are not enough incentives for the companies to disclose more than mandated information. The finding also indicates the requirement of further investigation related to the relationship between disclosure of information and market value of a firm in countries like India. Moreover, the findings present a compelling case for both the CREDAI as well as the government to make efforts to simplify the rules and regulation related to real estate sector so that companies are not compelled to resort to means that are otherwise avoidable.

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