Corporate Governance and Investment Decision of Small Business Firms: Special reference to India

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Abstract

This study is basically examines the relationships between corporate governance and the investment decision of small business firms in India. Owners and the members of the board of directors of small firms from India were survey to discover their perceptions, feelings, and beliefs on the relationship between corporate governance and the investment decision of small business firms to invest in the real estate market. This study has utilized survey research. Overall results show that the CEO tenure, the CEO duality, board size, total assets of the firm, and small business performance positively impact on the investment decision of the small business firms in India. The CEO duality, total assets, and firm performance positively impact on the investment decision of small business firms in the Indian service industry. The board size and the firm performance positively impact on the investment decision of small business firms in the Indian manufacturing industry. This study contributes to the literature on the relationship between corporate governance and the investment decision of small business firms. The study can be useful for real estate investors and investment advisors.

1. Introduction

This study examines the relationship between corporate governance and the investment decision of small business firms in India. The growth of small business firms depends on the investments and good corporate governance is required to make sound investment decisions. Kajola [2, p.16] defines corporate governance as the system by which business corporations are directed and controlled.

According to Ruiz-Porras and Lopez-Mateo [1] corporate governance theory contributes to explain firms' behavior and their decisions, like investment ones.

Grabowski and Mueller [3] also suggest that the degree of the separation between ownership and control explains investment decisions. In addition, Gugler *et al.* [4] explain ownership structures systematically affect investment decisions of the firm.

The potential growth of the firm cannot be achieved without investments. One of the investment areas is real estate investment. The real estate investment is necessary to operate and to expand small business firms. Some economists believe that good corporate governance practices contribute to firm growth [5]. They also argue that good practices increase returns on equity and promote efficiency of the firm which is in the favor of all stakeholders. Thus, good corporate governance leads to economic growth by enhancing corporate decisions [1, p.19].

The improvement in the investment of the firm is necessary to achieve the overall corporate objectives, to keep the organizations in business, and to create a greater prospect for future opportunities. Modern firms are run by professional managers [agents] [6] who

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may not work in the favor of shareholders (principals). The principal-agent problem has a negative impact on future investment of the firm. Corporate governance plays an important role in minimizing i) an agency problem and ii) agency costs. The board of directors minimizes agency problems and the agency costs by aligning managers' and shareholders' interests. The minimization of agency problems and the agency costs helps corporations to maximize the shareholders' wealth by exploring future investment opportunities.

This study examines the relationship between corporate governance and the investment decision of small business firms in India. Ruiz-Porras and Lopez-Mateo [1] has examined the relationship between the corporate governance and investment decision of the firm in Mexican manufacturing firms. This study seeks to extend the above study by analyzing data from Indian small business firms.

The literature cites a number of variables that are potentially associated with the investment decision of the firm. In this study, the selection of exploratory variables is based on the previous empirical work. The choice of proxy variables can be limited, however, due to data limitations. As a result, the set of proxy variables includes seven factors: The CEO tenure, the CEO duality, board size, total assets, small business performance, industry dummy, and investment decision.

This study contributes to the literature on the relationship between corporate governance and investment decision the firm in at least two ways. First, it focuses on Indian small business firms while a very limited research has been conducted on such firms recently. Second, this study validates some of the findings of previous authors by testing the relationship between the CEO tenure, the CEO duality, board size, total assets, small business performance, industry dummy, and investment decision. Thus, this study adds substance to the existing theory developed by previous authors.

2. Literature Review

Corporate governance deals with the rights and responsibilities of a company's management, its board, shareholders and various stakeholders such as employees and customers. The corporate governance affects the investment decisions of the company. Therefore, good corporate governance is necessary to make sound investment decisions which, in turn, help firms to prosper in the domestic as well as in the global market.

Modern firms are managed under the direction of a board of directors. According to [2, p.17] the board of director's delegates responsibilities to the CEO and other management staff who manages day-to-day affairs of the firm. The directors, with their wealth of experience, provide leadership and direct the affairs of the business with high sense of integrity, commitment to the firm, its business plans, and long-term shareholder value.

The CEO supervises the operations of the firm in effective and ethical manners, and prepares the strategic plans, annual operating plans, and budgets for the board's approval [2]. Thus, the CEO plays an important role in the investment decision of the firm. The CEO tenure has a positive impact on the investment decision of the firm. The investment decisions of the firm also improve when the CEO serves as a director of the board. In the small business firms, the larger board size (large number of directors) is in the favor of the firm because they provide i) help to make investment decisions and ii) financial support.

According to Kyereboah-Coleman [6] the nature of ownership of the firm constitutes a dimension of its governance structure. Therefore, institutional ownership influences the investment decision of the firm. The empirical studies on the relationship between corporate governance and the investment decision of the firm are as follows:

Bohren *et al.* [7] collected data from US manufacturing firms and found that i) good governance improves the efficiency of capital allocation within firms and ii) lax governance produces underinvestment rather than overinvestment.

Chang *et al.* [8] collected data from Taiwan and found that corporate governance mechanisms affect investment decisions of the firm.

Ruiz-Porras and Lopez-Mateo [1] collected data from Mexican manufacturing firms and found that the separation of ownership encourage investment decisions among the Mexican manufacturing firms. They also found a positive relationship between cash flows and the investment.

Aldrighi *et al.* [9] collected data from Brazil and found that ownership and control structures significantly affect the firm's investment decisions.

In summary, limited availability of literature review shows that the corporate governance positively impact on the investment decision of the firm.

3 Methods

3.1 Measurement

To remain consistent with previous studies, measures pertaining to:

1. The CEO tenure, the CEO duality, and board size were taken from Kyereboah-Coleman [6],

2. Small business performance were taken from Zehir et al. [10],

3. Total assets were taken from Michaelas et al. [11], and

4. Investment decision of small business firms were taken from Gill and Biger[12].

All the scale items were reworded and the reliability of these re-worded items was retested for construct validity. Respondents were asked to indicate their agreement with each item, using a five-point Likert scale ranging from "Strongly Disagree" to "Strongly Agree," related to small business performance variable.

Respondents were asked to indicate their agreement with each item, using a five-point Likert scale ranging from "0%-5%%" to "76%-100%." related to "investment decision small business firms" variable. The measurements of the independent and dependent variables are as follows:

The CEO tenure (Tenure) independent variable was measured by a single item that asked respondents to indicate the number of years they have been involved as a CEO of the company. Categorized alternative responses were: 0-4 Years, 5-9 Years, 10-30 Years, and 31 Years and Over.

The CEO duality (CD) independent variable was measured by a single item that asked respondents to indicate if he or she serves chairperson of the board in the company. Categorized alternative responses were: 1) Yes and 0) No.

Board size (BS) independent variable was measured by a single item that asked respondents to describe number of directors (decision makers) they have in their companies. Categorized alternative responses were: i) 1-3 directors and ii) 4 and more directors.

Total assets (TA) independent variable was measured by a single item that asked respondents to describe if total assets of their companies increased within last three years. Categorized alternative responses were: 1) Yes and 0) No.

Small business performance (SBP) independent variable is operationalized as the extent to which owners/the members of board of directors of the small business firms perceive that the net profit margin and return on assets have improved over the last three years. Zehir et al. [10] used the seven-item tolerance-of-freedom scale which measures the "small business growth" variable. In the present study only two items were selected to measure the "SBP" variable. Scale items were reworded and the reliability of these re-worded items was retested.

The Cronbach alpha on the responses of the 29 small business owners who participated in the pre-test of the above scale items was 0.84. All three items were included in the final questionnaire.

Investment decision of small business firms (ID) is operationalized as "the proportion of small business firms' total portfolio" that is allocated in the real estate market to earn higher rate of return and to diversify risk. Gill and Biger [12] used three items to measure "investment decision of investors" variable. Based on that study, two items were selected to measure the "ID" variable. Scale items were reworded and the reliability of these re-worded items was re-tested.

We calculated a Cronbach's alpha of .84 on the responses of the 29 respondents who participated in the pre-test of the above scale items. These two items were included in the final questionnaire.

3.2 Sampling Frame, Questionnaire Distribution, and Collection

The current study consisted of the population of Indian owners/the members of board of directors of small business firms. Indian owners/the members of board of directors of small business firms in India were chosen as a sampling frame.

Analysis and Results 4

Measures of central tendency, variance, skewness, and kurtosis were calculated on responses to all of the items. Skewness measures for all of the items were within the range of: +0.995 to +1.067, which is considered to be a good range for most research that requires using statistics appropriate to normal distributions. Therefore, we used statistics that assume scalar values and symmetric distributions to test our hypotheses.

able 1 provides the Pearson correlation for the variables used in the regression model. As s wn in Table 4, investment decision of small business firms (ID) is positively corrected with tenure (the CEO tenure), the CEO duality (CD), total assets (TA), and small business performance (SBP) in the service and manufacturing industries of India.

	Entire Sample ($N = 207$)									
	ID	Tenure	CD	BS	TA	SBP	Industry			
ID Tenure	1	0.211** 1	0.240** -0.045	0.123 0.127	0.283** 0.166*	0.386** 0.170*	0.056 0.063			
CD BS TA SBP			1	-0.149* 1	0.225** 0.087 1	0.268** -0.047 0.326** 1	0.025 0.230** -0.048 0.048			

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Set vice multiplity $(N = 140)$								
	ID	Tenure	CD	BS	TA SBP			
ID Tenure	1	0.176* 1	0.227** -0.080	0.094 0.111	0.279** 0.365** 0.202* 0.118			
CD				1-0.108	0.128 0.172*			
BS				1	0.003 -0.012			
ТА					1 0.184*			
SBP					1			

Service industry $(IN = 140)$	Industry (N = 140	(N =	Industry	Service
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Manufacturing Industry $(N = 67)$									
	ID	Tenure	CD	BS	ТА	SBP 0.444*			
ID	1	0.298*	0.276*	0.164	0.316**	*			
Tenure		1	0.032	0.134	0.107	0.301* 0.521*			
CD			1	-0.239	0.423**	*			
BS				1	-0.169	-0.139 0.669*			
TA SBP					1	*			

**Correlation is significant at the 0.01 level (2-tailed) *Correlation is significant at the 0.05 level (2-tailed) ID = Investment decision of small business firms Tenure = The CEO tenure

CD = The CEO duality BS = Board size

TA = Total assets

SBP = Small business performance

4.1 Testing of Hypotheses

Overall, positive relationships between i) tenure and ID, ii) CD and ID, iii) BS and ID, iv) TA and ID, v) SBP and ID were found (see Table 2); that is, the CEO tenure, the CEO duality, board size, total assets, and small business performance are the predictors of investment decision of small business firms in India.

A non-significant relationship between industry and ID were found.

In the service industry, positive relationships between i) CD and ID, ii) TA and ID, and iii) SBP and ID were found (see Table 2); that is, the CEO duality, total assets, and small business performance are the predictors of investment decision of small business firms in the Indian service industry.

Non-significant relationships between i) Tenure and ID and ii) BS and ID were found (see Table 2); that is, the CEO tenure and the board size are not the predictor of investment decision of small business firms in the Indian service industry.

In the manufacturing industry, positive relationships between i) BS and ID and ii) SBP and ID were found (see Table 2); that is, the board size and small business performance are the predictors of investment decision of small business firms in the Indian manufacturing industry.

Non-significant relationships between i) Tenure and ID, ii) CD and ID, iii) and TA and ID were found (see Table 2); that is, the CEO tenure, the CEO duality, and total assets are not the predictors of investment decision of small business firms in the Indian manufacturing industry.

Table 2: Regression Coefficients a, b, c

Entire Sample (N = 207)

R2 = 0.234; SEE = 0.888; F = 10.21; ANOVA's Test Sig. = 0.000

0.280 SBP + 0.002 Industry Unstandardized Standardized Collinearity Coefficient Coefficients c **Statistics** S В Std. Error Beta Tolerance VIF Sig. t (Constan) -1.342 0.292 0.000 -4.605

Regression Equation: ID = -1.342 + 0.016 Tenure + 0.405 CD + 0.169 BS + 0.426 TA + 0.016 Tenure + 0.405 CD + 0.016 Tenure +

0.052 0.926 Tenure 0.016 0.008 0.1261.956 1.079 CD 0.405 0.1602.430 0.016 0.879 0.167 1.137 BS 0.169 0.070 0.1572.415 0.017 0.907 1.102 TA 0.426 0.193 0.1482.210 0.028 0.849 1.177 SBP 0.280 0.068 0.2804.136 0.000 0.833 1.200 0.002 0.136 0.0010.017 0.986 0.937 Industry 1.068

Service Industry Sample (N = 140)

R2 = 0.225; SEE = 0.954; F = 7.76; ANOVA's Test Sig. = 0.000

Regression Equation: ID = -1.463 + 0.014 Tenure + 0.459 CD + 0.158 BS + 0.573 TA + 0.293 SBP

					Collinearit		
Unstandardiz	zed	Standardize	Standardized				
Coefficients		Coefficient	Coefficients c			Statistics	
			t	Sig.			
В	Std. Error	Beta			Tolerance	VIF	
(Constan)	-1.463	0.397	-3.687	0.000			
Tenure	0.014	0.010 0.108	1.369	0.173	0.928	1.077	
CD	0.459	0.208 0.173	2.206	0.029	0.937	1.067	

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BS	0.158	0.117 0.104	1.351	0.179	0.978	1.023
TA	0.573	0.251 0.181	2.282	0.024	0.920	1.087
SBP	0.293	0.079 0.290	3.689	0.000	0.934	1.071

Manufacturing Industry Sample (N = 140)

R2 = 0.283; SEE = 0.752; F = 4.81; ANOVA's Test Sig. = 0.000

<u>Regression Equation: ID = -1.052 + 0.018 Tenure + 0.295 CD + 0.159 BS</u> +

0.170 TA + 0.300 SBP

Unstandardized			Standardized			Collinearity		
Coefficients		Coefficients c			Statistics			
В	Std. Error		Beta		t	VIF	olerance	
(Constant)	-1.052	0.504			-2.089	0.041		
Tenure	0.018	0.013		0.162	1.384	0.171	0.855	1.170
CD	0.295	0.289		0.134	1.020	0.312	0.685	1.459
BS	0.159	0.079		0.229	2.020	0.048	0.914	1.094
TA	0.170	0.339		0.075	0.502	0.617	0.535	1.871
SBP	0.300	0.162		0.307	1.854	0.069	0.428	2.336

aDependent Variable: ID

b Independent Variables: Tenure, CD, BS, TA, SBP, and Industry c Linear Regression through the Origin

SEE = Standard Error of the Estimate

ID = Investment decision of small business firms Tenure = The CEO tenure

CD = The CEO duality BS = Board size

TA = Total assets

SBP = Small business performance

1. A test for multicollinearity was performed. All the variance inflation factor (VIF) coefficients are less than 3 and tolerance coefficients are greater than 0.40.

2. 23.4% (R2 = 0.134) of the variance in the degree of ID can be explained by the degree of Industry, CD, Tenure, TA, BS, and SBP in India.

3. 22.5% (R2 = 0.225) of the variance in the degree of ID can be explained by the degree of SBP, BS, Tenure, CD, and TA in the Indian service industry.

4. 28.3% (R2 = 0.283) of the variance in the degree of ID can be explained by the degree of SBP, BS, Tenure, CD, and TA in the Indian manufacturing industry.

As shown in Table 5, analysis of variance (ANOVA) tests are also significant at 0.000.

5 Discussion, Implications, and Future Research

5.1 Discussion

The main purpose of this study was to examine the perceived relationships between corporate governance and the investment decision of small business firms in India. This was done by surveying a sample of owners/the members of board of directors of small business firms from the Punjab area of India.

The overall results show that investment decision of small business firms is positively related to the CEO tenure, the CEO duality, board size, total assets, and firm performance. In the service industry, investment decision of small business firms is positively related to the CEO duality, total assets, and firm performance. In the manufacturing industry, investment decision of small business firms is positively related to the board size and firm performance. The findings of this study support the findings of:

1. Bohren *et al.* [7] who found that good governance mechanisms improve the efficiency of capital allocation within firms and that lax governance produces underinvestment rather than overinvestment.

2. Chang *et al.* [8] who found that corporate governance mechanisms affect investment decisions of the firm.

3. Ruiz-Porras and Lopez-Mateo [1] who found that the separation of ownership encourages investment decisions and cash flows positively impact on the investment of the firm.

4. Aldrighi *et al.* [9] who found that ownership and control structures significantly affect the firm's investment decisions.

In conclusion, the CEO tenure, the CEO duality, board size, total assets, and small business performance positively influence the investment decision of small business firms in India.

5.2 Limitations

The present study asks for responses from fixed format, set-questions survey tools, which could direct questions to the exclusion of providing additional input. Maturation of participants can also affect the survey response rate. Maturation of participants, in the context of this research, means that some of the research participants may be on holidays. However, a short study period (four weeks) limited any negative effects from maturation.

5.3 Future Research

The present study is limited to perceptions. The relations found may suffer from common factor bias, as the questions were parts of the same data collection instrument. Future research is needed to test the relation of perceived investment decision of small business firms to actual investment in the real estate market through longitudinal data. Other variables such as firm age, ECO age, number meetings, etc., should also be used in the future study.

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