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RESEARCH IN FINANCE VOLUME 37

CONTEMPORARY ISSUES IN FINANCIAL ECONOMICS: EVIDENCE FROM EMERGING ECONOMIES

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Emerald Publishing Limited
Howard House, Wagon Lane, Bingley BD16 1WA, UK

First edition 2023

Editorial matter and selection © 2023 Rita Biswas and Michael Michaelides.
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British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library

ISBN: 978-1-80117-839-6 (Print)
ISBN: 978-1-80117-838-9 (Online)
ISBN: 978-1-80117-840-2 (Epub)

ISSN: 0196-3821 (Series)

INVESTOR IN PEOPLE

CONTENTS

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INTRODUCTION

This volume focuses on contemporary issues in financial economics spanning from board diversity to sustainable finance. The first chapter focuses on the impact of board gender diversity on dividend payout decisions in India. This is followed by a study examining the benefits of early adoption of sustainable finance by government-owned banks in Indonesia. Next, a cross-country study analyzes the influences of country-level as well as firm-level governance quality on the adoption of sustainable finance in the banking sector. Following this, we present a chapter that examines the relation between financial market freedom and economic growth in India followed by another cross-country study examining the relation between labor rights and equity market performance. The final chapters are related to Indonesia – one study examines the impact of adopting eXtensible Business Reporting Language (XBRL) on earnings management while the final chapter explores the relation between financial slack and green banking activities.

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CHAPTER 1

CORPORATE BOARD GENDER DIVERSITY AND DIVIDEND DECISIONS: EVIDENCE FROM INDIA

Rama Sastry Vinjamury

ABSTRACT

The Indian Companies Act (2013) mandates the appointment of at least one woman director for large publicly listed companies in India in order to increase gender diversity on corporate boards. The study analyzes the relationship between corporate governance mechanisms, board gender diversity, and ownership structure on dividend payout decisions in an emerging economy like India. The study uses data collected for nonfinancial firms listed on NSE (National Stock Exchange) 500 in India from the period 2008 to 2020. Contrary to the evidence from developed economies, the study finds that increased female representation and greater proportion of female independent directors on the board are associated with lower dividend payout decisions in the Indian context. As it stands, the female representation on corporate boards in India is woefully low and appears to be mere tokenism. The study explores the role of regulation in increasing gender diversity on corporate boards and offers insights from an emerging economy where such a regulation is in place.

Keywords: Corporate governance; gender diversity; ownership structure; dividend decisions; India; board of directors

Contemporary Issues in Financial Economics: Evidence from Emerging Economies
Research in Finance, Volume 37, 1–13
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ISSN: 0196-3821/doi:10.1108/S0196-382120230000037001

1. INTRODUCTION

Corporate governance can be viewed as a set of mechanisms by which the "suppliers of finance to corporations assure themselves of getting a return on their investment" (Shlifer & Vishny, 1997). Corporate governance encompasses mechanisms that allow stakeholders of a corporation to exercise control over firm insiders and management so that their interests are protected (John & Senbet, 1998). In other words, corporate governance mechanisms may help address the issue of separation of ownership and control, which can often lead to agency problems. In this context, dividend policy can be viewed as a corporate governance device. Specifically, dividend policy can be viewed as a means to mitigate Jensen's (1986) free cash flow problem. In a similar vein, prior studies posit that dividends reduce the free cash within the firm, thereby reducing the agency costs (e.g., Easterbrook, 1984; Rozeff, 1982).

Given the importance of corporate governance, developing economies such as India have introduced regulatory changes to strengthen corporate governance mechanisms. For example, the Companies Act (2013) enacted by the Parliament of India seeks for a major overhaul of corporate governance norms to be adopted by firms in India. Also, Securities and Exchange Board of India (SEBI) introduced revised Clause 49, where requirements for firms have been changed to bring it in line with the Companies Act (2013). Not surprisingly, the key provisions of the Act pertain to board composition. For example, Section 149 (1) of the Indian Companies Act (2013) provides for compulsory appointment of at least one woman director for large publicly listed companies in India. Introduction of such a provision may be viewed in light of the emerging literature, which analyzes the impact of female directors and managers on corporate decision-making. This literature suggests that female directors and managers have a significant impact on these decisions. For example, Matsa and Miller (2013) show that female directors are less likely to downsize the workforce. Similarly, female directors are less likely to make acquisition bids and are more likely to make acquisitions with lower bid premiums (Levi, Li, & Zhang, 2014). Also, female directors take on less debt and are more likely to make less risky financing and investment choices (Faccio, Marchica, & Mura, 2016).

Firm's dividend policy is an important corporate decision deliberated by the board. In this context, recent studies have analyzed the role of female board members on dividend decisions in developed economies (e.g., Chen, Leung, & Goergen, 2017). Adams and Ferreira (2009) and Chen et al. (2017) provide empirical evidence that female directors focus more on monitoring than their male counterparts on corporate boards. In this context, dividend decisions can be viewed in terms of the monitoring role performed by female board members. Specifically, dividend policy can be viewed as a mechanism to mitigate Jensen's (1986) free cash flow problem. Dividends may reduce the free cash within the firm and may contribute toward reducing the agency costs (e.g., Easterbrook, 1984; Rozeff, 1982). This argument assumes that a high dividend payout might compel the firm to return to the capital markets frequently to meet their funding needs and attracts greater scrutiny from the market participants. However,

most of these studies are focused on developed economies and there is a gap in analyzing the role of female directors on dividend decisions for firms in emerging economies.

Given this background, this chapter attempts to analyze the role of female directors on corporate boards as monitors in mitigating agency problems. Prior studies (e.g., Chen et al., 2017) argue that dividend payouts can be viewed as a monitoring device and larger payouts can be viewed as a means to reduce free cash flow and related agency problems. In view of such a link between monitoring and dividend payouts, the study analyzes the relationship between presence of female directors on the board and the propensity to pay dividends. Contrary to the evidence provided by Chen et al. (2017), this study finds that the presence of female directors on boards in an emerging economy such as India is associated with lower dividend payouts to its shareholders. This result is statistically significant and holds true for the presence of independent female directors on the board. Consistent with previous studies (e.g., Chen et al., 2017; Hu & Kumar, 2004), the study finds that propensity to pay dividends is positively associated with increase in board size and board independence. Also, greater audit committee independence is positively associated with dividend payouts. In addition, the study finds that the propensity to pay dividends is negatively associated with greater promoter ownership. On the other hand, dividend payouts are positively associated with the increase in *pressure-sensitive* institutional investors.

The rest of the chapter is organized as follows: Section 2 discusses Companies Act (2013) enacted by the Indian Parliament and the role of women directors as per the Act. Section 3 provides a literature review and lists objectives of the study. Section 4 discusses data and methodology adopted for the study. Section 5 discusses empirical results. Section 6 discusses policy implications and conclusions.

2. THE COMPANIES ACT (2013) AND WOMEN DIRECTORS

The Companies Act (2013) is an Act[1] of the Parliament of India. The Act among other things regulates the incorporation, responsibilities, and dissolution of a company in its jurisdiction. Among other provisions, the Act aims to introduce major corporate governance reforms to be adopted by firms in India. Many provisions of the Act pertain to corporate board composition. For example, the Act stipulates that:

> every company shall have a Board of Directors consisting of individuals as directors and shall have
>
> (a) a minimum number of three directors in the case of a public company, two directors in the case of a private company, and one director in the case of a one-person company; and
> (b) a maximum of fifteen directors.[2]

Also, "every listed public company shall have at least one-third of the total number of directors as independent directors." Of special interest to this study is Section 149 (1) of the Act, which provides for compulsory appointment of at least one woman director for large publicly listed companies in India. As per the Act,

the following class of companies shall appoint at least one-woman director

(i) every listed company;
(ii) every other public company having—
  (a) paid-up share capital of one hundred crore rupees or more; or
  (b) turnover of three hundred crore rupees or more.

Given that the appointment of at least one woman director on a listed company board is mandatory (the study is focusing on listed companies), the study attempts to analyze the impact of such a regulation on corporate decision in terms of dividend payouts.

3. LITERATURE REVIEW AND OBJECTIVES OF THE STUDY

Many studies in the recent past in developed economies have focused their attention on analyzing the impact of female board members on firm value, performance, and risk-taking behavior (e.g., Ahern & Dittmar, 2012; Dezso & Ross, 2012; Faccio et al., 2016; Matsa & Miller, 2013). Specifically, Faccio et al. (2016) show that female directors are less likely to take on debt and are more likely to make less risky financing and investment choices. In addition, other studies have analyzed the role of female directors in influencing corporate decisions. For example, Levi et al. (2014) show that female directors are less likely to make acquisition bids. In case of an acquisition bid, female directors tend to make acquisitions with lower bid premiums. In a similar vein, Miller and Triana (2009) report that propensity to spend more on research and development increases with female directors on the board.

There is a growing body of literature that suggests that the discussions of complex decision problems improve when female directors are part of the decision-making processes (e.g., Gul, Srinidhi, & Ng, 2011). In addition, Adams and Ferreira (2009) and Chen et al. (2017) find that female directors are more likely to engage in monitoring and provide empirical evidence that female directors focus more on monitoring than their male counterparts on corporate boards.

To analyze the monitoring role of female directors on the board, prior studies have looked at firm's dividend policy (e.g., Chen et al., 2017). In this context, dividend policy can be viewed as a mechanism to mitigate Jensen's (1986) free cash flow problem. Prior studies argue that dividends reduce the free cash within the firm which helps in reducing the agency costs (e.g., Easterbrook, 1984; Rozeff, 1982). Specifically, Easterbrook (1984) argues that dividend plays a corporate governance role. This argument assumes that a high dividend payout might compel the firm to return to the capital markets frequently to meet their funding needs and attracts greater scrutiny from the market participants.

Brickley, Lease, and Smith (1988) provide a model where they categorize institutional investors as pressure-sensitive or pressure-insensitive institutional investors. They posit that pressure-insensitive institutional investors are more likely to monitor and discipline the managers. On the other hand, pressure-sensitive institutional investors are likely to have existing business relationships with the firm and are less likely to be effective monitors. Consistent with this view, studies (e.g., Almazan, Hartzell, & Starks, 2005) show that institutional ownership

is negatively associated with the level of executive compensation and the relationship is stronger for pressure-sensitive institutional investors. Also, Cornett, Marcus, Saunders, and Tehranian (2007) document a positive relationship between pressure-insensitive institutional investors and corporate operating performance. At the same time, the presence of pressure-sensitive institutional investors has no impact on a firm's operating cash flow returns.

Given this background, the objective of the study is to understand the role of corporate governance mechanisms, board gender diversity, and ownership structure on dividend payout decisions in an emerging economy like India. Specifically,

(1) to analyze the relationship between board gender diversity and firm's propensity to pay dividends in an emerging economy like India; and
(2) to analyze the role of firm ownership structure on dividend decisions. Specifically, how increased promoter ownership and presence of pressure-sensitive and pressure-resistant institutional investors impacts dividend decisions.

4. DATA AND METHODOLOGY

The data for the study are from the Centre for Monitoring Indian Economy (CMIE) Prowess database. Data were collected for nonfinancial firms listed on the National Stock Exchange (NSE) 500 in India for the period 2008–2020.

The dependent variable used for the analysis is dividend payout (DIV_PAYOUT), which is a binary variable. DIV_PAYOUT takes on a value of "1" in the event of a dividend payment and "0" otherwise. Logit models are used given the nature of the data used for the analysis. To determine the role of female directors, other corporate governance variables and ownership structure on dividend payout decisions, the following baseline model is considered.

$$\begin{aligned} \text{DIV\_PAYOUT}_{it} &= \alpha_0 + \beta \textit{Board gender diversity}_{it} \\ &\quad + \delta \textit{Other governance variables}_{it} \\ &\quad + \gamma \textit{Ownership variables}_{it} + \theta \textit{Control variables}_{it} \\ &\quad + \textit{Industry}_i + \textit{Year}_t + \varepsilon_{it} \end{aligned} \tag{1}$$

In addition to the logit model described above, a panel tobit regression model with year and industry fixed effects is also employed. $\text{Tobit\_DIV\_PAYOUT}_{it}$ is used as a dependent variable for the tobit model. This variable represents the ratio of dividends to total net income. Since dividends cannot be negative, the dependent variable is left censored. Therefore, the tobit model is specified as follows:

$$\begin{aligned} \text{Tobit\_DIV\_PAYOUT}_{it} &= \alpha_0 + \beta \textit{Board gender diversity}_{it} \\ &\quad + \delta \textit{Other governance variables}_{it} \\ &\quad + \gamma \textit{Ownership variables}_{it} + \theta \textit{Control variables}_{it} \\ &\quad + \textit{Industry}_i + \textit{Year}_t + \varepsilon_{it} \end{aligned} \tag{2a}$$

where $\text{Tobit\_DIV\_PAYOUT}_{it} > 0$

$$\text{Tobit\_DIV\_PAYOUT}_{it} = 0, \text{where Tobit\_DIV\_PAYOUT}_{it} \leq 0 \quad (2b)$$

The models (logit and tobit) specified above do not lend themselves to causal inference, but allow us to analyze the associations between dependent and independent variables. For more detailed analysis, four models each for logit and tobit models are considered in this study (i.e., a total of eight models). In the first and fifth models, the impact of female directors on dividend payout decisions is analyzed. In the second and sixth models, proportion of independent female directors is included for the analysis. In the third, fourth, seventh, and eighth models, in addition to the role of gender diversity, the role of pressure-sensitive and pressure-resistant institutional shareholders on dividend payout decisions is analyzed.

In terms of board gender diversity, the proportion of female directors on the board (B_FEMALE) and independent female directors on the board (FEMALE_IND) are considered. Other corporate governance variables used in the analysis are board size (BSIZE), board independence (BIND), audit committee independence (AIND), number of board meetings (BMEETINGS) (e.g., see Vinjamury, 2020). In terms of ownership variables, promoter ownership (PROMOTERS), pressure-sensitive institutional investor ownership (P_SENSITIVE) and pressure-resistant institutional investor ownership (P_RESISTANT) are considered for the analysis along with other control variables.

LOG_TA represents natural logarithm of firm total assets and is used as a proxy for firm size. Leverage (LEVERAGE) is defined as the ratio of total borrowings to total assets. Adjusted Tobin's Q (TQ) is used as a proxy for growth opportunities. TQ was obtained using similar calculations as in Gompers, Ishii, and Metrick (2003). Following Chen et al. (2017), ratio of cash holding to net fixed assets is used as a measure of liquidity (LIQUIDITY). Return on Assets (ROA) is used as a measure for profitability. Other factors constant, more profitable companies may have a propensity to pay higher dividends. Again following Chen et al. (2017), ratio of net fixed assets to total assets (ASSET_TANGIBILITY) and ratio of research and development to sales (RD_SALES) are used as a proxy for asset tangibility and financial distress costs.

In terms of other governance characteristics, board size (BSIZE) and percentage of independent directors (BIND) are used as control variables. Audit committee independence (AIND) and frequency of board meetings (BMEETINGS) are used to capture the extent of monitoring by the board members. Finally, FAGE is used to control for the age of the firm. The construction of these variables for empirical analysis is described in Table 1.1. Both industry fixed effects and year fixed effects are accounted for in the analysis.

Table 1.2 reports summary statistics of the variables used in the study. The median dividend payout ratio (DIV_PAYOUT) for the sample firms is close to 22%. The median board size (BSIZE) of the firms used in the analysis is 11. The median board independence (BIND) is 50%. The mean and median promoter institutional shareholdings (PROMOTER) are 55.57% and 55.44%, respectively. Of the total institutional ownership, the mean pressure-sensitive (P_SENSITIVE) and pressure-insensitive (P_RESISTANT) institutional ownership represents 4.078% and 10.816%, respectively. The median audit committee independence (AIND) for the sample firms is 75%. The mean proportion of female board

Table 1.1. Description of the Variables Used in the Study.

Variable	Description	How Is it Measured
TQ	Adjusted Tobin's *Q*	(Total assets + market capitalization – book value of equity – deferred tax liability)/total assets
ROA	Return on assets	Net income/total assets
DIV_PAYOUT	Dividend payouts	Ratio of dividends to net income. Is a binary variable, Defined as "1" in case of dividend payment and "0" otherwise
BSIZE	Board size	Number of directors on the board
BIND	Board independence	Number of independent directors on board/ number of directors on board
BMEETINGS	Board meetings	Frequency of annual board meetings
AIND	Audit committee independence	Percentage of independent directors on the audit committee
B_FEMALE	Female directors	Number of female directors on the board
FEMALE_IND	Female independent directors	Number of female independent directors on the board
PROMOTERS	Promoter shareholdings	Percentage of shares held by the promoters
P_INSENSITIVE	Pressure insensitive institutional investors	Percentage of shares held by nonpromoter mutual funds and foreign institutional investors
P_SENSITIVE	Pressure sensitive institutional investors	Percentage of shares held by nonpromoter banks and financial institutions
FAGE	Firm's age	Age of the firm since its incorporation (in years)
LEVERAGE	Leverage	Ratio of total borrowings to total assets
RD_SALES	R&D expenses to sales	Ratio of research and development to sales
LIQUIDITY	Liquid assets	Ratio of cash to net fixed assets
TANGIBLE_ASSETS	Tangible assets	Ratio of net fixed assets to total assets
LOG_TA	Logarithm of total assets	Natural log of total assets

Note: The table describes the variables used in the study.

Table 1.2. Descriptive Statistics.

Variable	*N*	Mean	Median
DIV_PAYOUT	3,919	0.214	0.219
BSIZE	3,919	11.742	11.000
BIND	3,919	0.502	0.500
B_FEMALE	3,919	0.044	0.000
FEMALE_IND	3,919	0.026	0.000
AIND	3,919	0.720	0.750
BMEETINGS	3,919	4.377	4.000
FAGE	3,919	40.730	33.000
LOG_ASSETS	3,919	10.223	10.152
TANGIBLE_ASSETS	3,919	0.276	0.260
LIQUIDITY	3,919	0.013	0.001
RD_SALES	3,919	0.017	0.001
LEVERAGE	3,919	0.177	0.134
ROA	3,919	0.088	0.080
TQ	3,919	2.833	1.998
P_SENSITIVE	3,919	4.078	1.690
P_RESISTANT	3,919	10.816	8.570
PROMOTERS	3,919	55.570	55.440

Note: The table reports the number of observations (*N*), mean (Mean), and median (Median) of the variables used in the study. Refer to Table 1.1 for a detailed description of the variables.

Table 1.3. Correlation Matrix.

	DIV_PAYOUT	BSIZE	BIND	B_FEMALE	FEMALE_IND	AIND	BMEETINGS	FAGE	LOG_ASSETS	TANGIBLE_ASSETS	LIQUIDITY	RD_SALES	LEVERAGE	ROA	TQ	P_SENSITIVE	P_RESISTANT	PROMOTERS
DIV_PAYOUT	1																	
BSIZE	−0.02	1																
BIND	0	−0.11	1															
B_FEMALE	0.01	0.04	0.03	1														
FEMALE_IND	0.01	0.04	0.11	0.72	1													
AIND	−0.01	−0.02	0.27	−0.08	−0.08	1												
BMEETINGS	0.01	−0.42	0.01	−0.1	−0.09	0.07	1											
FAGE	−0.02	0.13	0.02	0	−0.01	0.17	−0.04	1										
LOG_ASSETS	−0.01	0.4	−0.02	0.08	0.09	0.04	0	0.18	1									
TANGIBLE_ASSETS	0.01	0.05	0.06	−0.02	−0.03	0.04	0.02	−0.05	0.04	1								
LIQUIDITY	0	−0.01	−0.01	0	0.02	0	0.02	0.01	0.01	−0.09	1							
RD_SALES	0	−0.03	0.02	0.02	0.05	0.03	−0.03	−0.06	−0.07	0.02	−0.01	1						
LEVERAGE	−0.02	0.01	0.05	−0.07	−0.08	0.04	0.07	−0.05	0.13	0.44	−0.05	−0.01	1					
ROA	0.02	−0.04	0.01	−0.04	−0.04	0	−0.01	−0.01	−0.13	−0.17	0.03	−0.31	−0.46	1				
TQ	0.01	−0.05	−0.03	0.07	0.08	−0.01	−0.01	−0.04	−0.1	−0.15	0.03	0.31	−0.32	0.25	1			
P_SENSITIVE	0.02	0.17	−0.08	−0.05	−0.05	0.07	0.05	0.28	0.39	−0.02	0.03	−0.03	−0.02	−0.03	−0.12	1		
P_RESISTANT	0.01	0.1	0.15	0.14	0.12	0.05	0.02	−0.07	0.36	−0.1	0.03	−0.01	−0.12	0.11	0.16	0.07	1	
PROMOTERS	−0.01	−0.05	−0.19	−0.05	−0.03	−0.13	0	−0.1	−0.08	−0.06	0.01	0.03	−0.06	0.03	0.16	−0.34	−0.47	1

Note: The table reports the Pearson correlation coefficients for the variables used in the study. Refer to Table 1.1 for a detailed description of the variables.