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Sukhjinder Kaur
Assistant Professor,
Department of Commerce,
Guru Nanak Dev University
College, Sujanpur, Punjab,
India

Dr. Gurpreet Kaur
Assistant Professor,
Department of Commerce,
Bebe Nanaki Guru Nanak Dev
University College, Mithra
Kapurthala, Punjab, India

Corresponding Author:
Dr. Gurpreet Kaur
Assistant Professor,
Department of Commerce,
Bebe Nanaki Guru Nanak Dev
University College, Mithra
Kapurthala, Punjab, India

The role of board remuneration in driving firm performance: Evidence from Indian IT sector

Sukhjinder Kaur and Dr. Gurpreet Kaur

Abstract
Financial analysts and academics are very interested in board compensation since it is thought to be a deterrent to financial crises that have rocked corporations in the 21st century. This study sought to determine the effect of board remuneration on financial performance of Indian IT companies. The sample of this study comprised of BSE (IT) index listed companies which comprised of 53 IT companies listed on Bombay stock exchange for the financial year 2017-2018. Focussing on Grounding the study on the agency theory, the study assumed that board remuneration will positively influence financial performance. Secondary data was obtained from annual reports and from Ace Equity Database. Board remuneration was measured by Executive and non-executive remuneration while financial performance was measured using the variable return on assets (ROA) and board size, NED proportion and firm size as control variables. Multiple linear Regression technique was used on cross-sectional data for 2017-18 to draw the inferences of the study. The study found statistically significant relationship of board remuneration with firm performance of BSE (IT) index listed companies and insignificant relation with control variables.

Keywords: Executive remuneration, non-executive remuneration, firm performance, ROA

Introduction

The Board of Directors is responsible for strategically supervising corporate operations as well as honouring and rewarding executives on an individual level. Through appropriate and timely disclosures, the Board must simultaneously assure adherence to the legal framework, the integrity of financial accounting and reporting systems, and credibility in the eyes of stakeholders. Executive directors and non-executive directors are the two main categories of directors. For the benefit of the company's shareholders, the executive directors are held in high regard for the management of the business, which includes formulating and carrying out strategic plans to build long-term value for companies in terms of firm performance.

Contrarily, the non-executive directors have a duty in supervising the executive directors as well as offering advice and recommendations on how to run the company. In this article, the compensation information for both executive and non-executive directors is referred to as "directors' compensation." In order to recognise individual excellence, the total compensation earned by directors may include both fixed pay and variable short-term incentives. Only cash-based compensation is covered in this study. Directors are seen as a scarce asset; therefore, compensation not only affects how they behave but also helps to retain talent by offering appealing compensation. The financial success of an entity is significant to stakeholders in general and to shareholders in particular since it boosts the company's value, provides the foundation for dividend payments, and can be utilised to draw in new investors (Muller, 2014).

In light of empirical studies showing a favourable relationship between executive and board compensation and risk-taking behaviours, the 2008–2009 financial crisis brought up significant issues regarding the significance of corporate governance tools in deciding on compensation and incentive structures (Fahlenbrach and Stulz, 2011; Chesneye *et al*.,2012) [10]. Critics have essentially asserted that high compensation levels may force directors to ignore irregularities, as was demonstrated after the collapse of World Com, the Enron scandal, and the Lehman Brothers Holdings case, where independent directors were accused of selling significant amounts of shares prior to the company's collapse in order to increase returns on stock options (Aebi *et al*., 2011) [3]. Numerous attempts to control board compensation have been made as a result of its significance. For instance, the UK's 1995 Greenbury report aimed to regulate compensation.

Similar to this, the Sarbanes-Oxley Act of 2002 was introduced in the United States to address corporate remuneration in reaction to significant scandals like Enron and World Com.

In February 2000, SEBI added Clause 49 to the listing agreement for businesses seeking to list on Indian stock markets. This provision is comparable to the U.S. Sarbanes-Oxley Act of 2002 in terms of corporate governance and board member composition. Concerns regarding effective corporate governance have skyrocketed since Satyam Computer Services Limited was found to have committed India's largest-ever corporate fraud and breach of governance. A significant piece of legislation in this area is the new Companies Act of 2013, which correctly and thoroughly defines, expands, and specifies the roles and obligations of directors. These recently added provisions of the Companies Act of 2013 regarding the obligations and liabilities of the directors, including the independent directors, not only give the directors more clarity regarding their conducts and obligations, but they also ensure better and error-free corporate management and governance. Corporate governance and director compensation are given significant attention under both the new Companies Act, 2013, and the Securities and Exchange Board of India (SEBI) rules. The managerial people of a company are defined with reference to executive salary in Section 2 (51) of the Indian Companies Act. To safeguard the interests of all stakeholders, the Indian Companies Act also specifies the upper limit on director compensation as well as other transparency requirements.

Theoretical Review Agency theory

The relationship between the benefit of the principal (shareholders) and the compensation of the agent (director), as it relates to business success, has been extensively studied using principal agent theory. The positive relationship between executive compensation and firm performance can be explained by the principal-agent theory. The relationship between director compensation and company performance ought to give the company a strong incentive to succeed. These studies provide light on the murky relationship between executive compensation, business performance, and corporate governance efficiency.

In this relationship, the principal hires the agent to deliver a service under the terms of a contract. Although the principal expects the agent to act in their best interests, the agent may not always act in the principal's best interest owing to opportunistic behaviour. In order to maximise company returns, shareholders (Principals) have hired the executive management as agents. Since the agents do not own the resources, they may engage in morally dubious behaviour, such as neglect their responsibilities to pursue leisure activities or conceal their inefficiency to avoid losing incentives, or, to put it another way, operate in ways that increase their own personal wealth at the expense of the principals. When the principal's and the agent's goals or desires diverge, the agency problem occurs. It also occurs when the principle finds it difficult or expensive to confirm the agent's actions.

The scholars noted two key requirements that must be met in order to minimise the possibility of such agency issues: First, an efficient principal-agent risk-bearing machinery must be created; next, the design must be closely followed by the network of organisations and contracts. (Mukaila *et al*., 2005). The first step, which is examined in the formal agency literature, looks at the amount of risk that each party should take on in exchange for their individual gains. The agent must accept to fulfil the obligations outlined in the rights when the principal transfers some rights to them. The second step illustrates how businesses employ contractual monitoring and bonding to influence the first step's designed structure and generate viable remedies to the agency problems. The costs associated with supervising contracts and connecting, as well as the inevitable decline in brand value brought on by agency problems, are referred to as agency costs.

According to Fama (1980) [11], there are several ways that businesses might structure their corporate governance to manage the agency problem that has been brought on by the separation of ownership and control. Decision management ensures that situations where the agent who has no ownership of the firm's resources and may enhance self-interest by making decisions that are unfavourable to the principal are avoided because decision management is typically separated from decision control rights both at the top (board and managers) and lower levels (managers and workers). So, as a corporate governance measure to mitigate the agency issue that can develop from management actions, the corporation's shareholders elect the board of directors. As a result, the board has decision control authority and managers have decision management rights.

The structure and salary of the board is another method that corporate governance addresses the agency issue. It is ensured that judgements made by internal directors are objective by the nomination of external directors. As a result, the shareholders may give stock grants or options as share-based incentives if a director fulfils their tasks and obligations effectively. Such incentive agreements are anticipated to assist in balancing the interests of management and shareholders, hence resolving agency issues (Cullen *et al*., 2012) [8]. As a result, the agency theory offers a thorough analytical framework that can be used to investigate how corporate governance systems can effectively curtail opportunistic managerial behaviour and, in the process, provide an equitable return on investment for the suppliers of capital.

Review of literature

The agency theory, which discusses how top directors' compensation policies should be meant to lower agency cost, is the basis for earlier studies on the directors' compensation. Numerous studies have shown a favourable pay-performance link, including (Conyon and He 2011; Fernandes 2008; Canyon and lerong, 2011; Müller, V 2014; Parthasarathy, A *et al*., 2006) [17, 9, 20, 21] However, other research (Shamsul *et al*., 2001; Ghosh, A, 2003; Amess *et al*., 2003; Miyienda *et al*., 2012) [1, 12, 19]. Aggarwal. R and Ghosh. A (2015) [4] were unable to find any conclusive evidence of pay-performance relationships. In this work, concise reviews of pertinent studies have been covered.

In his 2001 study, Shamsul Nahar Abdulla examined the relationship between Malaysian company directors' compensation and lagged ROA. In terms of corporate governance, it has been discovered that board independence and the scope of non-executive directors' interests have a detrimental effect on the compensation of directors. In context of UK, Kevin Amessa and Leigh Drakeb (2003) [1] discovered that there is frequently no relationship between changes in TFP for all three variables and executive compensation. Size and executive remuneration indicators have a strong link, especially for the Director.

In a sample of 51 companies listed on Euronext Lisbon between 2002 and 2004, Nuno Fernandes (2007) discovered that companies with more nonexecutive board members pay their executives higher salaries, while companies with no nonexecutive board members actually experience fewer agency issues and better align the interests of shareholders and managers. Chinese companies that were publicly traded and listed between 2001 and 2005 on the Shanghai and Shenzhen Stock Exchanges were the subject of an analysis by Martin J. Conyon and Lerong He in 2011 [17]. According to the study, corporations under state control and those with concentrated ownership structures have lower executive compensation and CEO incentives, while those with more independent members on the board have a stronger pay-for-performance relationship. The likelihood that the CEO will be replaced for poor performance is higher in non-State (private) managed businesses and in businesses with more independent directors on the board. Last but not least, evidence shows that executive pay in the US (including bonuses and salaries) is around 17 times greater than in China.

Cliff *et al*. (2013) In a sample of 57 companies listed on the Nairobi Securities Exchange, found that directors' compensation among Kenyan listed companies has a poor link with ROE and Tobin's Q but a relatively substantial positive relationship with EAT.A sample of sizable groups listed on the London Stock Exchange between 2010 and 2011 were used by Muller V (2014). The findings showed a substantial correlation between the basic fee for non-executive directors, fees paid in shares, and additional compensation for board committee membership (as corporate board compensation characteristics) and both immediate and long-term financial firm success. Rita Ruparelia and Amos Njuguna (2016) [24] In a sample of 20 financial service companies from 2003 to 2013, there was a significant correlation between board compensation and DY, but not ROA, ROE, or EPS.

There is a growing body of literature in India that explores the relationship between executive pay and corporate success. Nevertheless, the outcomes are uneven. An early study by Ramaswamy *et al*. (2000) [22] that looked at the compensation of CEOs of the top 150 companies listed on the Bombay Stock Exchange (BSE) found an inverse correlation between executive pay and ownership levels in family-controlled businesses between 1992 and 1993. According to Arijit Ghosh's 2003 [12] study, which included 462 manufacturing companies from the Indian corporate sector for the years 1997 to 2002, the size of the board and the percentage of non-executive directors have a non-linear relationship with firm performance. Executive compensation and firm performance are also found to have a non-linear relationship.

The return on assets as a proxy for business performance was discovered by Ghosh (2006) [13] to positively and marginally effect CEO compensation using a panel data approach on a sample of Indian manufacturing enterprises. On the other hand, executive compensation was not associated with the company's performance (Parthasarathy *et al*., 2006) [21]. Chakrabarti *et al*. (2012) [6] analysed companies listed on the Bombay Stock Exchange for seven years (2004–2010) and found a correlation between CEO compensation and firm size (measured by market capitalization, assets, and revenue) and the percentage of promoter holding.

Aggarwal and Ghosh (2015) [4] have investigated the relationship between directors' compensation and a firm's value using both accounting and market-based measurements, and they give evidence of a significant positive relationship between accounting performance and directors' compensation. Saravanan. P., Srikanth, and Avabruth. M (2006) examined a sample of 316 firms with regard to executive compensation and 256 firms with regard to non-executive compensation between 2011 and 2014. They discovered that corporate governance variables, such as board size, CEO duality, and the proportion of NEDs on the board, have a significant impact on the non-executive compensation.

Weak evidence of a pay-performance link is discovered among the sample firms by Raithatha and Komera (2016) [23]. On the other side, Kaur and Singh (2018) [14] discover a stronger and more favourable association between CEO compensation and firm performance.

Research Problem

The majority of empirical articles exclusively discussed executive directors' compensation, ignoring that of non-executive directors (NEDs). NEDs often keep an eye on the senior managers, provide the company with a valuable array of skills and experience, and aid the board in making strategic decisions. Although South and East Asia's economies are expanding quickly, there is little research on CEO salary (Firth *et al*., 2006). Contrary to the fact that not much is known regarding directors' salaries in underdeveloped countries developing and rising economies have not overlooked the significance of the problem of how executive compensation and board structure affect company performance (Ramaswamy *et al*., 2000) [22]. The Companies Act of 2013 recommended that various corporate governance committees be established to reform the current governance systems in Indian corporations. These committees have emphasised the significance of designing board structures and executive compensation to the highest possible standard in order to reduce agency issues and enhance firm performance. Generally speaking, there isn't much research on emerging nations (Ghosh, 2003) [12]. The current study focuses on the connection between the company performance of BSE IT index companies and the compensation of the board, which includes executive and non-executive members.

Objective of the study

The main objective of the study is to determine whether there is a relationship between Board remuneration and firm performance for BSE (IT) index listed companies. The specific objective is to determine the relationship between Board remuneration and firm Performance.

Research Methodology

Sample

In terms of sample selection, this research was carried out by obtaining secondary data and information from annual reports of companies and Ace equity databases. The sample of this study comprised of BSE (IT) index listed companies drawn from Ace Equity database which comprised of 53 IT companies listed on Bombay stock exchange for the financial year 2017-2018. The remuneration information for executive and non-executive directors is collected manually from annual reports available online from respected website of the companies. The sampled return on asset (ROA) data was obtained from Ace Equity, a publicly accessible, standardised financial database. Besides, the director board size and the Proportion of non-executive directors' data were extracted manually from the annual reports of the respective companies. While, other firm level data total sales which represents size of the firm also draw from Ace Equity database.

Regression Model

Since this is a cross sectional study of Board Remuneration and firm performance the Remuneration data and other independent/control variables covers a single time period i.e. for financial year 2017-18. The association between firm performance, board compensation, and other control factors was investigated using multiple regression analysis in this study. Regression analysis able to provide not only the relationship between two or more variables (whether positive or negative), but also information on the strength of the relationship. The strength of the association was determined by the coefficient of determination, and the relative explanatory power, direction, and significance of the explanatory variables in the Regression model were determined by standardised coefficients.

The Model of this study is expressed as follow

Firm Performance (FP) = f (Board remuneration, Board size, NED proportion, firm size)

Dependent variable

Firm Performance

Out of the number of financial performance measures available, profitability measure Return on asset ROA is used in this study to measure firm performance. Being ratio, this measure is normalised for any size effects among different firms.

Independent Variable

Board Remuneration

a. Executive Remuneration

Executive remuneration means salary, bonus, perquisites, stock options, pension and commission (linked to a firm's net profit) according to the Section 2 (51) of the Indian Companies Act, 2013. Present Study covers the executive remuneration as total remuneration consisting of all the above.

b. Non-executive remuneration

The listing agreement's Clause 49 (II) (C) states that the board of directors determines the NEDs' compensation, and that decision must be approved by the shareholders at the annual general meeting. Additionally, the article permits the commission due to NEDs.

Control Variables

Board size

The performance of the business is jointly and severally owned by the board of directors. The board often establishes the company's strategic goals and makes sure that the necessary tools, processes, and resources are available to meet those goals; as part of its governance mechanism, the board also periodically evaluates the senior managers' and executives' performance. Core, Holthausen, and Larcker (1999) also advocate the use of board size as a control variable.

NED Proportion

Over the past two decades, non-executive directors have drawn a lot of attention from regulators and academics since they are thought to be a tool for improving the governance practises of corporations. When it comes to monitoring and advising senior management, adding experience to the company, and assisting the board in making strategic decisions, NEDs play a crucial role in corporate governance. The Companies Act of 2013's corporate governance standards in India highlighted the obligations and roles of NEDs, enhancing their independence. Sheu and Yang (2005) support using the proportion of NEDs on the board as a control variable.

Size of the Firm

Mishra *et al*. (2001) the size of the company is a reflection of how well-equipped the larger companies are to finance their investment initiatives both internally and externally through the issuance of new common stock. Sales, revenues, profits, the number of staff, and other factors can all be used to gauge the size of an organisation. The total sales of a company from its operations for the fiscal year 2017–18 are included in the current study as a control variable to indicate firm size.

Board Remuneration and Firm Performance

Studies have been conducted to determine the connection between corporate governance, business performance, and director compensation. According to Lee *et al*. (2008) [15], there is a positive correlation between corporate governance and business performance, with better performance being observed in the organisations with more effective corporate governance structures than those with less effective structures. The theoretical foundations of the agency theory have been validated throughout time by a number of empirical research (Core, Holthausen and Larcker, 1999; Brick *et al*., 2002). Research works on Indian corporations (Ghosh, 2006; Tomar and Korla, 2011; Balasubramanian *et al*., 2013) [13] similarly support the agency theory and draw the conclusion that CEO remuneration is significantly correlated with business success.

In contrast, Tee and Hooy (2009) looked at a sample of government-linked firms (GLCs) between 2001 and 2006 and discovered a negative correlation between directors' compensation and company performance (as determined by lagging return on equity). Abdullah (2006) [2], however, found no proof that director compensation affects company performance. In light of the explanation above, testable hypotheses are as follows:

H_0: There is no significant relationship between Board remuneration and performance of the firm.

H_1: There is significant relationship between Board remuneration and performance of the firm.

Results and Discussion

Due to the cross sectional nature of this study, the financial year 2017–18 is the only time period for which the remuneration data and other independent/control variables are available. For the purpose of comparing Board compensation to the dependent variables, the data is submitted to multiple linear regression. To determine the precise effects of different independent variables on the dependent variables, regression analysis is used. It indicates that if the percentage of independent variables changes and the dependent variable changes as a result, it is important for the researcher to look at the variations in the dependent variable caused by each independent variable separately. It aids in coming to more accurate conclusions about how various explanatory variables affect the dependent variable.

Table 1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.475[a]	.225	.161	12.18672
a. Predictors: (Constant), FsizeSales, NEDproportion, Board Size, BRDREM				

Table 1 above, the Adjusted R square for the present study is .161 indicating that 16.1% of the variation in the firm performance (ROA) is explained by Board Remuneration.

Table 2: ANOVA[a]

Model		Sum of Squares	DF	Mean Square	F	Sig.
1	Regression	2074.315	4	518.579	3.492	.014[b]
	Residual	7128.770	48	148.516		
	Total	9203.085	52			
a. Dependent Variable: FR_ROA						
b. Predictors: (Constant), Fsize Sales, NE Dproportion, Board Size, BRDREM						

The term "sig. F" refers to the P-value that measures the significance of the overall model; A sig. value less than 0.05 indicates that the explanatory variables as a whole has statistically significant relationship with the dependent variable. Model for the present study is fit for the Regression model as its P-value is .014, therefore model is significant at 1% level of signify

Table 3: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
	(Constant)	11.565	13.321		.868	.390
	BRDREM	.031	.011	.559	2.756	.008
	BoardSize	.415	.691	.088	.601	.551
	NEDproportion	-.141	.161	-.120	-.871	.388
	FsizeSales	.000	.000	-.205	-1.148	.257
a. Dependent Variable: FR_ROA						

From table 3 above, the coefficient for BRDREM with ROA is .031 and P- value .008 indicating a positive relationship between board remuneration and Return on Asset (ROA), rejecting the null hypothesis at 1% level of significant? Directors' remuneration being significantly related to ROA have been supported by Yatim (2012) [28] Martin J. Conyon and Lerong He (2011) [17].

The coefficient for control variable Board size with ROA is .415 and P-value. 551 indicating positive insignificant relationship with ROA. (Topak, 2011) exhibits in his study that there is no relationship between board size and firm performance for Turkey The coefficient for control variable non-executive director proportion with ROA is -.141 and P-value .388 indicating negative insignificant relation with ROA. Mangel and Singh (1993) [16] find a negative relationship in the US-based firms. Hempel and Fay (1994) could not find any association between the NEDs' Proportion and the firm performance supported the present study. The coefficient for control variable firm size with ROA is .000 indicating positive insignificant relation with ROA. Mohd W Mohd *et al*. (2018) in their study for ROA and ROE as proxy for firm performance show there is positive insignificant relationship between firm size and firm performance supported the present study.

Conclusion and Limitations

This study shows a strong and positive correlation between director compensation and firm ROA performance. High compensation may be able to retain directors by motivating them to carry out their responsibilities and put more effort into serving the interests of shareholders. The findings also demonstrate a positive insignificant association between board size and firm size and business performance. NED Proportion, meanwhile, exhibits a weakly negative association with firm performance. Results are inconclusive due to the limited sample size. The cross section research sample size is insufficient to adequately reflect the secondary market. The size of the represented companies in the index varies widely as well. The public, investors, and employees will be better protected and treated fairly with effective corporate governance, which will eventually lead to the development of a transparent capital market. As evidence suggests there has been little study on the subject in the Indian context, future research may involve a larger sample of IT companies listed and traded on Indian stock exchanges. A cross sectional study needs a fairly large data set to establish the correlations between the various parameters put forth in the model. Hence, the data set will be limited to the universe of all listed IT companies that are traded on stock exchanges. The sample of this study comprised of BSE(IT) index listed companies which comprised of 53 IT companies listed on Bombay stock exchange for the financial year 2017-2018.The sample size for cross section study is too small to represent the secondary market. The index also has considerable variation in the size of the representative companies.

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