CHAPTER - I

INTRODUCTION

Accounting system is the dominant source of business information since no other system of a business entity has the ability to combine the performance of all functions of a business into one set of measures which has led accounting to be known as “language of business” (Michael Porter, 2005).

The aim of accounting is to communicate economic message on the result of business decision to the users from time to time. Thus corporate reporting is a total communication system between a company and its users. This is the most direct, least expensive, most timely and fair method of reaching all shareholders and others, present and potential users. Financial reporting includes not only financial statements but also other means of communicating information that relates, directly or indirectly to the information provided by the accounting system.

The major objective of financial statements is to provide information which is useful to the present and prospective investors, creditors and other user groups to make rational investments, credit and other pertinent economic decision making (Ashok Chandak, 2003).

Today’s business environment is highly competitive and it is very difficult to withstand the competition unless they develop themselves into large entities with diversified activities. The economic reforms adopted by India since 1991 have changed the total scenario of the Indian corporate sector. As a consequence of accepting Liberalisation, Privatisation and Globalisation (LPG) policy, the Indian economy is further wide opened for free movement of capital into the country and as a result of this, many MNCs have been established in India and the competition is further intensified.
With the globalization and liberalization of economy, firms have diversified their operations in different products and services as well as in different geographical areas. Rates of profitability, opportunity for growth and risks vary significantly from one industrial sector to other and from one geographical area to another (Iyer N.V, 2003).

Investors’ information needs are vast, dynamic and complex. They need comprehensive information on all aspects of the business unit. The decision to invest or divest is guided by investors’ perspective on entire or total working of the business unit. Mere profit and asset data are not enough for investors. The sources of profit and the avenues of investments are also required to be provided. In order to meet these demanding needs of investors for complete information, accounting standards have been promulgated by various accounting bodies and organisations both in formal and informal way. Increased information is to be provided on segments, earnings per share, consolidation of financial statements, impairment of assets, related party transactions, deferred taxes, lease accounting, financial instruments, discontinuing operations, intangibles, etc.

Segment reporting is one such requirement imposed on business in recent years. It is reporting by business or geographical segments. It is an attempt of providing a disaggregated data rather than the traditional method of providing aggregated data. The reporting assumes importance in the present context because of growing dimensions of business activities. Businesses are generally large and highly diversified. The diversified activities may be different on risk and return lines. Each line of activity may have its own product market characteristics. Aggregated data may be deceptive as it reports total or on aggregated basis. The final profit figures may be an inclusive of
profits and losses of all products. One product may be cross-subsidising other products. Such reporting may force investors to err in their judgments.

In the light of the above developments, the risks associated with the product line as well as geographical line of business have been increased. The questions that arise in the mind that, are the financial statements disclosed by the companies provide sufficient information and meet the expected requirements of the shareholders and stakeholders in making better informed judgments? Or more disaggregated information is needed? To facilitate accurate and profitable decision-making by investors, the segment reporting has been made mandatory. In India, the ICAI has issued a separate accounting standard dealing with segment reporting. AS-17 on “Segment reporting” is a mandatory accounting standard dealing with the segmental reporting practices. The inclusion of AS-17 “Segment Reporting” issued by Institute of Chartered Accountants of India (ICAI) as a part of overall reporting gives scope for disclosure of such detailed information based on the segments under which firms are operating. The companies operating under business line or geographical line or both have to disclose information under AS-17 on such reportable segments.

Need of the study:

The Indian IT industry is playing a vital role in the Indian economy. IT sector is much talked about in its contribution to the economy. The origin of IT industry can be traced to mid 1970s and 1980’s where very few numbers of companies were established. The Indian IT industry took pace only after the adoption of New Economic Policy in 1991 where the Government took the initiatives to give boost to the Indian IT industry by establishing STPs (Software Technology Parks), passing NCP (New Computer Policy-1984) and establishment of SEZ scheme(Special Economic Zone), etc.
India is home to a large number of IT professionals, who have the necessary skill and expertise to meet the demands and expectations of the global IT industry. India is called as IT hub of the world. The cost of skilled Indian workforce is reasonably low compared to the developed nations. This makes the Indian IT services highly cost efficient and also the IT enabled services like business process outsourcing (BPO) and knowledge process outsourcing (KPO) have expanded significantly in the Indian job market. Further, India has a huge pool of English-speaking IT professionals and the English-speaking countries, like US and UK, depend on the Indian IT industry for outsourcing their business processes.

The emergence of Indian IT sector has brought about sea changes in the Indian job market. The IT sector of India offers a host of opportunities of employment. With IT giants like Infosys, Cognizant, Wipro, Tata Consultancy Services, Accenture and several other IT firms operating in some of the major Indian cities, there is no dearth of job opportunities for the Indian software professionals. The IT enabled sector of India absorbs a large number of graduates from general stream in the BPO and KPO firms. All these have solved the unemployment problem of India to a great extent. The average purchasing power of the common people of India has improved substantially. The consumption spending of the people has increased; in turn there is an increase in the demand. All these have improved the gross production of goods and services in the Indian economy and standard of living of the people.

The information technology industry of India has been attracting considerable amount of foreign direct investment in the recent years. Investments are being made in the four principal sectors of the Indian information technology industry - online businesses, information technology services, information technology based services and software merchandise.
Newer investment opportunities are opening up every now and then in the sector.

As per the findings of the NASSCOM-McKinsey report the Indian information technology is supposed to receive between 4 and 5 billion United States dollars by way of foreign direct investment in the year 2009.

Indian IT sector has shown consistent increase in revenues and exports. Software and services are exported to about 95 companies from India. North America accounts for 61% of the software exports from India. The annual survey of NASSCOM for the year 2008-09 highlights that Industry recorded a revenue of gross USD 58.8 billion; export revenues of US$46.3 billion as against domestic revenue of USD 12.5 billion (INR 570 billion). It recorded a growth of 16.3% in exports compared to domestic market growth of 21%.

Within the export segment, IT services have grown by 14.7% to clock revenues of USD 26.5 billion; BPO exports are up by 16.5% registering revenues of USD 12.7 billion. Engineering services and product exports clocked revenues of USD 7.1 billion, growing at 11%. New markets for software exports from India have opened up in the Middle East, South and Southeast Asia, Africa, and Eastern Europe.

Thus, it can be said that the growth of India's IT industry has been instrumental in facilitating the economic progress of India.

This phenomenal growth in IT industry in India is one reason why it was felt to undertake the present study. The industry has grown both intensively and extensively. There is organic and inorganic growth. The sector offers multi-faceted services both in domestic and off-shore markets. The widening
services mix and customers profile are the two cornerstones of IT sector development in India.

How far do these IT companies consider those growth matrices in their financial reporting? Do IT companies report based on the service mix and customer profile? How far investors in general and capital market in particular are benefited by this growth? The present study answers some of these research queries. It aims at integrating segment reporting requirements in the growth of IT companies and evaluates the reporting practices followed by companies.

The investors need widen when business widens or expands both in products and areas. The clarity in reporting reduces the extent of risk assumed by users in their decision-making process. IT companies, since are expanding by leaps and bonds, are required to satisfy the increased need for information. The segment reporting is one such practice which improves both quantum and quality of information available in the hands of users.

REVIEW OF LITERATURE:

Several research works have been conducted with regard to Segment reporting practices both in Western world and India. A brief review of the works is attempted here:

C.R.Emmanuel and N.W.Garrod (1999) ¹

The study evaluates the relevance of the concept of “management approach” adopted in identification, relevance and comparability of reportable segments in USA and Canada shifting from the previous concept of “risks and returns” or industry approach to segment identification. A comparison of UK firms was done on segment identification as UK firms have maintained the risk return or industry approach in identification of segments. The author concludes that, reporting practices lack comparability and relevance became of
identification of reportable segments by means of their internal organizational structure.

Neil Garrod (2000)²

The author conducts a study on competitive disadvantage arising from segment reporting. An empirical study was conducted on a sample size of 135 large size listed companies in UK and non-UK companies. The study reveals that disadvantage suffered by companies from disclosing segment information is very limited. The author felt that the competitive disadvantage is restricted only to geographical segment disclosures than line of business disclosures. He also opines, that neither the size of companies nor the jurisdiction under which companies report has any influence on this relationship.

Michael Ettredge (2000)³

The study evaluates the effects of implementation of US Standard on segment reporting SFAS 131, *Disclosure about Segments of an Enterprise and Related Information* as against the earlier SAFS 14 on numbers of Reported Business Segments. It was felt that under SAFS 14, many large and complex firms ‘under-reported’ their segments to avoid competitive threat that arise from disclosing sensitive segment profits to competitors, customers and suppliers. The author contends that the change in the number of segments should be positively associated with firm size, and with the complexity and diversity of firm operations. The study uses a sample of 3,735 publicly listed companies. The author finds that, by adoption of new standard SFAS 131 on segment reporting has increased the number of reported segments which were previously recognized less in number by these companies under the previous standard SAFS 14.
Low Lock Teng, Kevin and Mazlina Mat Zain (2001) 

The study was conducted to test the disclosure practices under IAS 14 Reporting Financial Information by Segments by Malaysian companies. The authors tested empirically by selecting a sample size of 168 Public companies listed on Kuala Lumpur Stock Exchange. 

The authors examine the influence of variables like firm size, financial leverage and total assets on segmental reporting disclosure practices. The study reveals that firm size has positive influence on the level of segmental disclosure, larger firm tend to disclose more segmental information than smaller firms. The authors conclude that there is no relationship between the proportion of assets in place and level of segment disclosure.

Annalisa Prencipe (2002) 

The author conducts a survey based study on determinants of the quality of voluntary segment disclosures by using the theoretical framework of Proprietary Costs Theory by selecting a sample size of 67 Italian listed companies. The variables such as size, ownership diffusion, financial leverage and profitability are employed in the study. The findings show that proprietary costs are particularly relevant for segment reporting, thus limiting the incentive for the companies to provide such information to the market.

Dr. Manoj Kumar (2004) 

The author conducts a survey based study on factors influencing foreign listing decisions by Indian firms. The study includes managers of foreign-listed Indian firms and finds that Indian firms list their shares in foreign stock exchanges to achieve a fair valuation of firm, increase credibility of firms and financial statements, increase firms prestige and visibility and facilitate mergers and acquisitions in foreign markets.

The study examines segment reporting practices followed by German listed companies and the influence of proprietary cost in voluntary business segment disclosure. He finds that German firms voluntarily provide business segment data when the proprietary costs are low. He also finds that firms with lower ownership concentration and higher foreign sales are more likely to disclose voluntarily and that German firms that are cross-listed at London Stock Exchange or in US OTC market voluntarily provide both cash flow statements and segment reports.

Mishra V. (2004) 8

Vishal Mishra undertakes a survey based research work on “Strategy” perspective of five top players in Indian software industry. He selects Infosys Technologies Limited, Wipro (Technologies) Limited, HCL Technologies Limited, Satyam Computer Services Limited, and I-Flex Solutions Limited as sample units for study. The author conducts SWOT analysis of these companies and finds that the IT sector adopts Intensive Strategies and Diversification Strategies and there is a threat from the economies like China, especially in the field of outsourcing in the years to come.

Chandana Chakraborty and Dilip Dutta (2006) 9

The present study takes up analytical review of the organization and size of the Indian software industry. It also throws light on its future outlook together with the opportunities, challenges and National Policy of Indian software industry. The study includes a survey of 68 software developers and it reveals that foreign participation in terms of joint venture corporation or subsidiary organization still remains limited in the Indian software industry and
it is represented mainly by the private domestic limited companies. It is opined that Indian software industry has larger potentiality towards employment opportunity but study reveals that the employment contributions towards national employment is very poor which stood at 0.01%.

M.S. Narasimhan and S. Vijaylakshmi (2006)¹⁰

The authors study the disclosure levels of the 50 large size sample Indian companies and find that T&D (Transparency and Disclosure) score has considerably improved after 2003 compared with level of disclosure in 2000. The present study examines, whether size, management holding, institutional holding, leverage, profitability, liquidity industry and size of the audit firm have any impact on behavior of firms in disclosing information. The results of the study reveal that the size, ownership and leverage have positive influence on disclosure.

Anna-Karin Hessling & Johanna Jaakola (2007)¹¹

The study was conducted on segment reporting practices under (International Accounting Standard 14 Revised) IAS 14R by 46 large-cap Swedish companies which were listed on Stockholm Stock Exchange. The study also evaluated possible implications on Swedish companies of introducing new International Standard on Segment reporting IFRS 8 (International Financial Reporting Standard) Operating Segment which is enforced from 1 Jan 2009. The study shows that 78% sample units report line of business as primary segment where as 17% report geography as primary segments. The consistency of reporting between segment information and information in other parts of the annual report is 80%. The researcher finds that the number of one-segment companies may decrease and some companies may
need to change structure of reportable segments with the introduction of new Standard IFRS 8.

**Poonam Mahajan and Subhash Chander (2007)**

The author empirically examines the quantum of corporate disclosure in Indian Software Companies with attributes such as age, size, profitability, leverage, listing status, shareholding pattern, audit firm and residential status of a company. The study finds that, the extent of disclosure varies from 32.2% to 71.1% in the software industry. The study also reveals that a large number of software companies provide more information voluntarily along with mandatory information. The study finds a significant association between disclosure level and size, profitability, and audit firm. However, no significant association exist between age, listing status, leverage, shareholding pattern, and residential status of companies.

**Isabelle MOERMAN and Ignace DE BEELDE (2007)**

The authors conduct an empirical study to explore segmental reporting practices in a sample companies listed on the German Neuer Markt. The authors investigate whether company size, type of auditor and the reporting frame work have any impact on segmental disclosures and also examine whether companies reporting under IAS disclose more or companies reporting under US GAAP. The findings suggest that company size has an impact on reporting and that IAS companies report more information on primary segments than US GAAP companies. It is also found that, the type of auditor (Big Four Vs non-Big Four) does not have an impact on segment reporting.

**Kanogporn Narktabtee and Manatip Chankitisakul (2007)**

The study covers segment reporting by listed companies in Thailand. The present study examines segment reporting practices by focusing on how
firms define their segments and also the accounting information items, particularly, segment sales, income and assets. The study was conducted on a sample size of 3944 companies listed during 1994-2005. The result of the study shows that Thai companies do not fully comply with the standard. The study concludes that the standard should provide clearer guidelines to identify segment. However, it finds that number of firms disclosing segment information has grown remarkably after the implementation of standard since 1994 and most of the firms disclose segment sales but are not likely to disclose segment profits and assets.


The study was undertaken to examine the level of corporate governance disclosures of 155 listed public limited sample companies in Bangladesh. The researcher finds that DSE (Dhaka Stock Exchange) listed companies comply with the regulatory requirements. It also finds that corporate governance disclosures in Bangladesh are significantly influenced by local ownership, the SEC notification, and size of the company. Age of the firm and size of the board of directors do not have significant impact on corporate governance disclosures.

**Diana Petrova (2007)**

The author conducts a study on the requirements and problems relating to the financial reporting for segments in Bulgarian enterprises. The study pays special attention to the significance of segmental financial information and benefits of segmental reporting. The author contends that external users can understand the past performance better and assess the future prospects if adequate segmental information is provided. Such information is essential for
the successful decision making. The author also opinions that the benefits from segmental information should exceed the costs of getting such information.

**Christine Botosan, Susan McMahon & Mary Stanford (2009)**

The authors conduct a study on the quality of segment information and level of disclosure between two U.S Standards on segment reporting SFAS No.14 (Statement of Financial Accounting Standard) and SFAS No.131.

The authors contend that the firms take advantage of greater flexibility in SFAS 14 to combine different operations into single segment and 'hide' certain operations. They also highlight difference between SFAS No. 131 and SFAS No. 14 on the adoption of the management approach in grouping operations into reportable segments and identifying reportable segments based on the way management organises business activities within the firm for the purposes of operating decisions and assessing performance. The authors investigate whether SFAS No. 131 is more successful than SFAS No. 14 in compelling managers to delineate segments for external reporting purposes in a manner that faithfully represents their firms’ internal organizational structure. They conclude that firms reporting a single segment under SFAS No. 14, but multiple segments under SFAS No. 131 tended to take greater advantage of the flexibility in SFAS No. 14 to “hide” certain operations.

**Statement of the problem :**

The review reveals a gap in segments reporting practices of Indian companies in general and IT firms in particular. The present study aims to fill this gap. IT firms have grown by leaps and bounds in recent years and are listed in India and foreign stock exchanges. There is an adoption of segmental reporting practices by these firms out of compulsion and voluntary basis. However, there has been no attempt to understand the motivations and effects
of such reporting practices. The Indian is pervaded by small and big; profitable
and non-profitable firms in the domestic and non-domestic customer base. It
becomes incumbent to know the influence of these variables on reporting
practices. The present study aims to achieve all these. Hence, the statement of
the problem: “Segment Reporting in India; A Comparative Study of
Information Technology Companies”.

Objectives of the study

The study aims to:

- identify segmental reporting requirements as per Indian GAAPs.
- identify the gaps in segmental reporting requirements between Indian
  GAAPs and US GAAPs.
- examine segmental reporting practices of sample IT companies.
- examine the extent and quality of segmental reporting practices of
  Indian and foreign listed IT firms in India.
- analyse the segmental reporting practices based on profitability and size
  of software firms.

Hypotheses

The study tests the following hypotheses:

1. There are more business segments in IT companies than geographical
   segments.

2. Business segments are primary segments in sample IT companies.
3. Companies listed in multiple stock exchanges adopt better segmental reporting practices than companies listed on only one stock exchange (Indian).

4. Big firms have better reporting practices than small firms.

5. Profitable firms report more than non-profitable firms

**Selection of Sample Units & Research Methodology:**

The study uses both Primary and Secondary sources of data. The primary data is collected from administration of questionnaire, among sample IT firms. The questionnaire has two parts- A and B. Part A consists of 7 questions regarding profile of sample units and part B consists 22 closed ended questions related to segment reporting practices and disclosure. Initially, a sample of 150 Indian IT companies listed on BSE/NSE was selected. The list of these names is collected from the web site, http://www.myiris.com. Table 1.01 shows the details relating to questionnaire sent and received.

**Table-1.01 No. of attempts made and responses received.**

<table>
<thead>
<tr>
<th>No of Attempts</th>
<th>Questionnaire sent</th>
<th>Questionnaire received</th>
<th>% of response</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>150 -24*=126</td>
<td>09</td>
<td>7.14</td>
</tr>
<tr>
<td>II</td>
<td>110</td>
<td>11</td>
<td>10</td>
</tr>
<tr>
<td>III</td>
<td>60</td>
<td>05</td>
<td>8.33</td>
</tr>
<tr>
<td>IV</td>
<td>45 (sent through e-mail)</td>
<td>20</td>
<td>44.44</td>
</tr>
<tr>
<td>Total</td>
<td>126</td>
<td>45</td>
<td>35.71</td>
</tr>
</tbody>
</table>

* Letters returned as addresses not found.
Table 1.01 shows, in all 4 attempts were made to get the responses from the selected sample units. The questionnaires were sent to CFOs of the respective companies through courier. In the first attempt, after waiting for 2 months, only 7% of the sample units replied and 7 companies returned the questionnaire by filling Part A information (profile of company) only, stating that they operate on single segment and don't have segment reporting. In the second attempt, questionnaires were mailed to 110 companies and there is 10% response rate in a period of one month. Another attempt was made and this time questionnaires were sent to 60 companies. We received 05 filled questionnaires, a response rate of 8.33%. Due to poor response and delay, researcher thought of sending the questionnaires through e-mail and were sent to 45 sample units. 20 sample units responded through e-mail. In all 45 sample units responded out of 126 companies, a response rate 36%.

The required secondary data is collected from the Annual Reports of sample units. The data collected through the questionnaire has been tabulated, analyzed and interpreted to arrive at conclusions. The researcher uses "percentage method" in analyzing the tabulated data. The hypotheses developed were tested using percentage, mean, median, standard deviation, correlation and regression techniques.

Univariate Models:

The study employs univariate regression models to test the significance of relationship between the score and its determinants separately. The score is calculated by taking the following nine points:

I. Segmental Ratio Analysis
II. Segmental Cash Flow Analysis
III. Segment-wise product profile
IV. Segment-wise customer profile

V. Segment-wise Opportunities, threats and risks

VI. Segment-wise capital expenditure plans

VII. Pie-charts, bar diagrams and other statistical information segment-wise

VIII. Age of segments

IX. Relative contribution of each segment to total performance

A score of ‘1’ is given if a firm discloses and ‘0’ if not disclosed. We run univariate model by taking size and profitability as determinants. The size of firm is considered by taking the total assets employed by the IT firms and profitability is defined as a ratio of EBIT to total assets.

**Multivariate Regression Model:**

In order to study the impact of various corporate attributes, Multiple Regression Analysis has been used. The model is employed to test the relationship between the score (dependent variable) and determinants. We calculate score by taking type of information provided by sample companies. A score of ‘1’ is given if item is shown and ‘0’ if not disclosed. We consider totally nine items of financial disclosures. The total score obtained is compared with various determinants. The study considers the following as determinants of the extent of segment reporting:

I. Profitability

II. Assets

III. Equity capital

IV. Listing status

V. Shareholding pattern

VI. Independent Directors
The following regression line is used to test the relationship between the score and its determinants.

\[ Score = \beta_1 + \beta_2 \text{Profitability} + \beta_3 \text{Assets} + \beta_4 \text{Equity capital} + \beta_5 \text{Listing (Listed both in India and foreign=1 and listed in India=2)} + \beta_6 \text{Shareholding pattern} + \beta_7 \text{Independent Directors} + \mu \]

Where \( \beta_1 \) is constant and \( \beta_2, \beta_3, \ldots, \beta_7 \) are beta coefficients of independent variables. \( \mu \) is a statistical error term, normally distributed about a mean of 0.

We exclude equity capital in running the model and rerun the model as shown below:

\[ Score = \beta_1 + \beta_2 \text{Profitability} + \beta_3 \text{Assets} + \beta_4 \text{Listing (Listed both in India and foreign=1 and listed in India=2)} + \beta_5 \text{Shareholding pattern} + \beta_6 \text{Independent Directors} + \mu \]

**Chapter Scheme:**

The present study has been organised in to 7 chapters:

**Chapter-I:** First chapter is devoted to Introduction, need of the study, objectives of the study, hypotheses and methodology used for the study, etc.

**Chapter-II:** Second chapter highlights on the necessity and importance of financial reporting, concept of financial reporting. AS-17 and key concepts in segment reporting are explained. Analysis of primary and secondary reporting format is done in this chapter.

**Chapter-III:** Third chapter provides the information about growth and development of IT sector in India and also gives a brief profile of sample units.

**Chapter-IV:** This chapter throws light on the Segmental Practices followed by the sample units.
Chapter-V: The fifth chapter provides a comparative analysis of listing status and reporting practices of sample IT firms.

Chapter-VI: The sixth chapter explains the determinants of segmental reporting practices. It provides an account of segmental reporting practices followed by sample units based on size and profitability. It highlights the impact of size and profitability on segmental reporting practices. Further various hypotheses formed under the study have been tested by the use of statistical tools in this chapter.

Chapter-VII: The seventh chapter is used to outline the major findings of the study. It also provides suggestions to improve segmental reporting practices by Indian IT companies.
REFERENCES:

1) C.R. Emmanuel and N.W. Garrod “On Segment Identification, Relevance And Comparability” Working Paper Series, Published in 1999 by the Dept. of Accounting and Finance, University of Glasgow, Glasgow.


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