CORPORATE DISCLOSURE PRACTICES IN INDIAN COMPANIES: CLAUSE 49 OF THE LISTING AGREEMENT

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Abstract: In the wake of recent financial scandal (the Satyam scam case) in India and in the context of the global financial crisis, the term corporate disclosure practice has become a hot topic of debate. Inequality, glorification of greed, lack of concern for society, feudal mindset and manifold regulations are some reasons responsible for increase in the rate of scams. India has one of the best disclosure laws but poor implementation together with socialistic policies of the pre- reform era has affected corporate governance. Concentrated ownership of shares, pyramiding and tunneling of funds among group companies mark the Indian corporate landscape. Since liberalization, however, serious efforts have been made at overhauling the system with the Securities & Exchange Board of India (SEBI) instituting the Clause 49 of the Listing Agreements dealing with corporate disclosure practices. In India, it is mandatory for all the listed companies to comply with the revised Clause 49 of listing agreement, which came into operation on January 1, 2006 to protect the interests of investors through enhanced governance practices.

This study seeks to determine the extent to which Indian listed companies disclose their corporate practices. Also, the determinants of disclosures have been looked into. The paper concludes that there is a substantial scope for improvement in the corporate governance/ disclosure practices.

Keywords: Corporate Disclosure Practices, Clause 49, Listed Companies, Scope of improvement.

INTRODUCTION

In January 2000 SEBI has accepted the recommendations and directed Stock exchanges to implement all mandatory recommendations on corporate governance by making necessary amendments in their listing agreements. A new clause 49 was incorporated in the listing agreement about corporate governance.

The term 'Clause 49' refers to clause number 49 of the Listing Agreement between a company and the Stock Exchanges on which it is listed. The Listing Agreement is identical for all Indian Stock Exchanges, including the NSE and BSE. This clause is a recent addition to the Listing Agreement and was inserted as late as 2000 consequent to the recommendations of the Kumar Mangalam Birla Committee on Corporate Disclosure and Governance constituted by SEBI in 1999.

Clause 49, when it was first added, was intended to introduce some basic Corporate Disclosure practices in Indian companies and brought in a number of key changes in governance (many of which we take for granted today). In late 2002, the SEBI constituted the Narayan Murthy Committee to "assess the adequacy of current corporate governance practices and to suggest improvements." Based on the recommendations of this committee, SEBI issued a modified Clause 49 on October 29, 2004 (the 'revised Clause 49') which came into operation on January 1, 2006.

Revised Clause 49 of the Listing Agreement in India requires all listed companies to file every quarter a Corporate Disclosure report. According to SEBI guidelines (visit www.sebi.gov.in), "The key mandatory features of Clause 49 regulations deal with the followings: composition of the board of directors, the composition and functioning of the audit committee, governance and disclosures regarding subsidiary companies, disclosures by the company, CEO/ CFO certification of financial results, and reporting on Corporate Disclosure and Governance as part of the Annual Report." Moreover, Clause 49 also requires companies to provide "specific" corporate disclosures of the followings: related-party transactions, disclosure of accounting treatment, if deviating from Accounting Standards, risk management procedures, proceeds from various kinds of share issues, remuneration of directors, a management discussion and analysis section in the annual report discussing general business conditions and outlook, and background and committee memberships of new directors, as well as, presentations to analysts. In addition, a board committee, with a non-executive chair, is required to address shareholder or investor grievances. Finally, share transfer,

a long-standing problem in India, must be done expeditiously (Patel, 2006).

The revised Clause 49 has suitably pushed forward the original intent of protecting the interests of investors through enhanced governance practices and disclosures. The revised Clause 49 moves further into the realm of global best practices (and sometimes, even beyond). This Clause 49 has clearly been a milestone in the evolution of Corporate Governance practices in India." It is now mandatory for the Indian listed companies to file with the SEBI, the Corporate Disclosure and Governance compliance report, shareholding pattern along with the financial statements. The SEBI has created a separate link, known as "Edifar," to post the relevant information submitted by the company. No doubt, the quality and quantity of disclosures have improved; with an enhancement in transparency in the disclosure practices. Transparency in corporate financial reporting enhances discipline in management, facilitates appropriate valuation of the company, and reduces the opportunity for a few to benefit by using sensitive information not available to the capital market. Appropriate valuation of companies in the capital market exposes under-performing companies to the risk of takeover. The fear of losing control acts as a stimulus to perform at the optimum level from owners' perspective. The quality of corporate financial reports is an essential determinant of the quality of corporate governance.

Moreover, transparency in corporate financial report is essential to enforce accountability of executive management to the board of directors and accountability of the board of directors to shareholders. Therefore, regulators protect the right of the capital market to receive timely and complete information necessary to evaluate the performance and financial position of the company and to forecast its ability to generate adequate cash flows in future (Bhattacharyya (2003)). Thus, one of the objectives of any disclosure regulation is to increase the transparency and accountability by providing timely and 'true and fair' information to the stakeholders.

LITERATURE REVIEW

The business-corporation is an increasingly important engine for wealth creation worldwide, and how companies are run will influence welfare in society as a whole. In order to serve this wealth creating function, companies must operate within a framework that keeps them focused on their objectives and accountable for their actions.

That is to say, they need to establish adequate and credible corporate governance arrangements. To remain competitive in a changing world, corporations must innovate and adapt their corporate governance practices so that they can meet new demands and grasp new opportunities. Better corporate governance increases the likelihood that the enterprises will satisfy the legitimate claims of all stakeholders and fulfill their economic, environmental and social responsibilities and contribute to sustainable growth.

Gupta et. al (2003) studied the corporate governance reporting practices of 30 listed Companies in Bombay Stock Exchange (BSE), Sensex by extracting corporate governance section from the annual report. According to them although the companies provided information related to all dimensions there was considerable variance in the extent & quality of disclosure made by the companies in the annual report. Even Holder Webb et al (2009) examined a sample of 50 US firms & their public disclosure packages from 2004. They found that smaller firms provided fewer disclosures pertaining to board selection procedure, oversight of management & independence as compared to larger firms who provided more disclosures relating to audit committee matters, board selection procedure, independence standards & whistle blowing procedure. They also found that boards that were of lesser independence provided less information relating to management oversight & independence matters.

Earlier, Ramsay & Hoad (1997) had analyzed the extent to which Australian companies disclose their corporate practices by examining the annual reports of 268 listed companies. They used content analysis method for the study. They found that the extent & quality of disclosure are typically better for larger companies as compared to small companies. Arcot & Bruno (2006) also examined the effectiveness of 'comply or explain' with respect to corporate governance in the U.K. For the study, they used database of non financial companies. They made a detailed analysis of both the degree of compliance with the provisions of corporate governance code of best practices as well as explanations given in case of noncompliance. The study revealed an increase in the trend for compliance as well as use of uninformative explanations in case of non-compliance.

Javed & Iqbal (2007) analyzed as to whether difference in the quality of firm-level corporate disclosure has an effect on the firm-level performance of the companies listed in the Karachi Stock Exchange. They used Tobin's Q & total Corporate Governance Index (CGI) for the study. They analyzed 50 firms for their study. They found that ownership, shareholding & board composition enhanced firm performance while transparency & disclosure have no significant effect on firm performance.

The literature review reveals that relatively less attention has been paid to the concept of corporate disclosure in India as compared to the rest of the world & this created the need for this study.

METHODOLOGY

The websites of the world's major listed companies were visited, and the text in the transparency policies as stated on these websites copied, and then pasted into a word processing package. This served as the input data for this analysis.

FINDINGS/ OBSERVATIONS

Securities Exchange Board of India (SEBI) also making continuous efforts to protect the interest investors by way of strengthening the corporate governance guidance by asking companies for more and more disclosure of information on corporate working in financial statements. To safe guard the investment, now investor has to be very careful and alert before investing in any company, for that matter investor has to check the who are the promoters of the company and also see the corporate governance practices existing in that company and see that the disclosure practices are us per mandated by clause 49 of listing agreement.

SENSEX is one of the major index wildly watched by investors in India as well as oversees to track the direction of Indian stock market, it consist of top 30 companies with large market capitalization from different sectors and these are the top performing companies in India. In this paper an attempt has been made to identify the disclosure practices followed by these companies and to see the disclosure is in line clause 49 of listing agreement. Later, Securities Exchange Board of Indian made revised Clause 49 of listing agreement mandatory for all the listed companies India from first January 2006, to protect the interest of various stake holders in the company. Clause 49 mandates that all listed companies have to disclose in its annual report a detail report on corporate governance disclosure practices they have followed. This study evaluates the corporate governance and disclosure practices followed by 30 SENSEX companies by examining the annual reports for financial year ended 31st march 2009.

Many developing and emerging market nations like ours have not yet fully developed the legal and regulatory systems, enforcement capacities and private sector institutions required to support effective corporate disclosure. Therefore, disclosure practice reform efforts in these nations often need to focus on the fundamental framework.

Reform needs vary, but often include basic stock exchange development, the creation of systems for registering share ownership, the enactment of laws for basic minority shareholder protection from potential self-dealing by corporate insiders and controlling shareholders, the education and empowerment of a financial press, the improvement of audit and accounting standards, and a change in culture and laws against bribery and corruption as an accepted way of doing business.

In addition to differences in the development of legal and regulatory systems and private institutional capacity, nations differ widely in the cultural values that mould the development of their financial infrastructure and corporate governance. These differences in culture may make certain concepts difficult to accept.

ANALYSIS & DISCUSSION

Our study makes several valuable contributions to the literature. First, we outline a clear channel where disclosure methods are discussed through which corporate governance affects its investors and about various operating bodies that helped in the incorporation of listing agreement for better disclosure practices by the corporations. We provide evidence suggesting that corporate disclosure practice affects market information asymmetry. Second, we examine how an absence of complete information restricts the effectiveness of voluntary disclosure that corporate may practice for misleading its investors. We find that Regulation formed by various bodies successfully changes the disclosure methods adopted by firms, and equalizes the impact of corporate disclosure. In addition, our research substantially expands the growing literature on the corporate by mentioning the role of different reports and justifying that complete participation within corporate will prevent any fraudulent activities at the management levels.

As markets become more open and global, and business becomes more complex, societies around the world are placing greater reliance on the private sector as the engine of economic growth. In both developed and developing nations, a growing proportion of economic activity takes place in firms organized as corporations. Corporations are creatures of law; societies allow corporations to be created by law because they recognize that incorporation provides an efficient form of organization, and society benefits as a result.

Transparency in corporate disclosure is important because the quality of it impacts:

§ the efficiency with which a corporation employs assets;
§ its ability to attract low-cost capital;
§ its ability to meet societal expectations; and
§ its overall performance.

SUGGESTIONS

Several key factors as given below are behind the increased emphasis on good and qualified disclosure practices:

A. Collapses of prominent businesses (Enron, WorldCom, Lehman Brothers etc.) both in the financial and non financial sectors, have led to more emphasis on controls (e.g. to safeguard assets etc). Finally, the prominent examples of recent corporate collapses give reasons to believe that a firm's valuation does not only depend on the profitability or the growth prospects embedded in its business model, but also on the effectiveness of control mechanisms ensuring that investors' funds are not expropriated or wasted in value decreasing projects.

B. Changing patterns of share ownership, particularly in the United States and United Kingdom, have led to a greater concentration of share ownership in the hands of institutional investors, such as pension funds and insurance companies.

C. The institutionalization of shareholdings, i.e., the process of accumulation and managing of capital by professional asset gatherers, is a worldwide trend. Institutional investors are increasingly seeking to diversify their portfolios and invest overseas. They then look for reassurances that their investment will be protected.

D. With technological advances in communications and markets generally, ideas can be disseminated more widely and more quickly, and institutional investors globally are talking to each other more and forming common views on key aspects of investment such as corporate governance.

E. With businesses as diverse as family-owned firms and state-owned enterprises increasingly seeking external funds, whether from domestic or international sources, corporate governance assumes a greater role in helping to provide confidence in those companies and hence to obtain external funding at the lowest possible cost.

CONCLUSION

There is substantial scope for improvement in the corporate governance disclosure practices. Many companies did not disclose a number of important issues. The compliance level with respect to remuneration committee, board of directors, statement of philosophy, general body meetings, general shareholder information & miscellaneous is high whereas with respect to shareholder committee, audit committee, MDA, the means of communication is not very high.

The purpose of corporate governance is to achieve a responsible, value-oriented management and control of companies. Sound corporate governance practices enhance the trust and confidence of present and future stockholders viz., lenders, suppliers, customers, employees and general public in domestic and global market place. By striving for better governance, firms are able to reduce their cost of capital, mitigate risk, enhance investors' confidence and enhance corporate valuation.

Thus, the study of transparent corporate governance in the present environment, as the standards are viewed as a technical response to call for better financial accounting and reporting; or as a reflection of a society's changing expectations of corporate behavior and a vehicle in social and political monitoring and control of the enterprise.
Good Corporate disclosure plays very vital role in protecting the interest of various stake holders in capital market. Corporate frauds like of Enron, World Com at global level and frauds done by promoters of Satyam computers is a blot on India's corporate image and It is a collective failure of directors, auditors and regulatory agencies in ensuring transparency and accountability.
Lastly, it should be noted that although SEBI had issued various guidelines for improving corporate governance norms in India, the onus to follow the same lies with the companies to compete in the global economy.

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