ABSTRACT

I. Introduction

This research is a comprehensive study to analyse the interrelated aspects of financial disclosures and corporate governance with the help of empirical methods. Studies related to corporate governance and financial disclosures around the world started as early as 1961 but developments in India on this score have been particularly slow. This is due to the fact that till 1991, India followed a closed system of economic development where foreign players were not encouraged to participate in the market. The situation changed after liberalization as corporate governance came to be then seen in an international context. Resultantly, the focus on corporate governance increased and related rules and regulations started to be framed.

This research examines existing corporate governance mechanisms of listed Indian firms, both large and medium scale, from the year 2002 to the year 2009. It provides a complete picture about what determines corporate governance disclosures of listed Indian companies. The study investigates the determinants of firm-level corporate governance disclosure among listed Indian companies, aiming to identify firm characteristics associated with high corporate governance disclosures. By addressing itself to understanding firm attributes which impact corporate governance and examining those attributes that have a direct linkage with corporate governance disclosures in India, the study aims to suggest how to augment corporate governance disclosures in listed Indian companies. By examining corporate governance disclosures over a period of eight financial years, the study documents evidence that it is possible that firms change their disclosure behaviour over time.

The study is motivated by the need to understand one element of corporate governance i.e. disclosure, in the context of the Indian environment. This line of research helps to
understand what can lead companies to improve their governance practices as regards financial disclosure.

There is a large variation in the quality of corporate governance practices adopted by firms even when they are subject to the same contractual environment. Therefore, it is possible that firms within the same country have widely divergent standards of overall corporate governance. This implies that different Indian firms could have varying standards of corporate governance disclosure. The importance of financial disclosures is driven by the fact that they are an important source of communication between the principal and agent. The study by providing an understanding of disclosure levels of Indian companies is expected to provide useful insights into reducing information asymmetry between principal and agent across firms with varying standards of disclosure.

A fundamental objective of corporate governance research in disclosure is to provide evidence of the extent to which information provided in financial accounting systems can reduce agency problems. Research in the field of corporate governance disclosure during recent years has mainly focused on the disclosure practices in the annual reports of the firms. In conducting this research also, annual reports have been used as a main source of information. As attempted by various other researchers, this study also aims to establish determinants of corporate governance.

This thesis has been presented in five chapters. The first chapter provides an introduction to the topic and elaborates upon the existing landscape of financial disclosures and corporate governance in India. The second chapter reviews theoretical constructs and empirical literature on the nature and consequences of corporate governance problem and role of financial disclosure therein. The third chapter is devoted to presenting the research methodology undertaken to conduct this work. Chapter four is devoted to analysing the data collected and drawing inferences from the same while findings and recommendations of the study are presented in chapter five.
The first generation corporate governance research, primarily US research, focuses on firm specific governance mechanisms such as board composition and equity ownership. The second generation of corporate governance research focuses on impact of institutional infrastructure of different countries on corporate governance. It considers the impact of differing legal systems on the structure and effectiveness of corporate governance and compares systems across countries.

Extensive review of literature shows that divergence in interest between insiders and outsiders over the apportioning of wealth generated by the firm is the seminal cause of the corporate governance problem. The issue can be tackled by setting up monitoring devices to check the self aggrandizing behaviour of managers. External and internal mechanisms for controlling agency costs are available. Due to practical limitations, external disciplining devices including takeover threat, managerial labour market, mutual monitoring by managers, reputation and product market competition, cannot alone be successful in solving the corporate governance issue. Firms therefore adopt internal disciplining devices simultaneously. These internal devices include composition of board of directors, insider ownership or existence of large shareholders.

Disclosure of accounting information plays a key role in most governance mechanisms stated above. Cadbury Committee (1992) was the first to emphasize that improved disclosures are one of the essential elements of healthy corporate governance practices. Hampel Committee (1998) regarded disclosures as an important element of accountability and a means to assess a company’s performance and governance practices. OECD and securities regulators in different countries also suggested the joint use of a variety of corporate governance mechanisms by firms. Corporate governance and full disclosure have been regarded as intrinsic for investor protection (Blue Ribbon Report-USA, 2000). The OECD (2006) Guidance on ‘Good Practices in Corporate Governance Disclosure' states that all material issues related to the corporate governance of a company should be disclosed in a timely manner. Disclosures should be clear, concise and precise and governed by the ‘substance over form’ principle. Financial disclosures can be used by managers and investors to identify economically attractive investment
opportunities. Financial disclosures can also be used in corporate control mechanisms that discipline managers and to reduce information asymmetries among investors.

**II. Research Methodology**

The present study examines annual reports of 114 listed Indian companies over a period of eight years, 2002 – 2009. The sample has been selected on the basis of random sampling from the Economic Times ranking of 2009. The companies in the sample have been categorized as large companies and medium sized companies on the basis of their net worth. The sample has also been divided into eight industry sectors in order to analyse the difference in corporate governance disclosures among diverse sectors. The study draws a full picture about the determinants of a firm's disclosure decision. The independent variables considered in the study are size of the company, profitability, leverage, sales in foreign exchange, whether company is internationally listed or not, whether the company belongs to financial sector or non financial sector or whether the company belongs to public or private sector.

**Corporate Size:** The size of the company has been a major variable in many studies examining disclosure practices. Gathering, preparing and disclosing information in the form of an annual report is a costly process. The publication of an annual report would place a financial burden on small firms. Large firms find it easier to meet such expenditure and hence are likely to disclose more.

**Listing Status:** Firms whose shares are listed internationally face additional pressures for the disclosure of information compared to companies whose shares are only listed domestically. Hence such firms are expected to have higher levels of corporate governance disclosures.

**Leverage:** Although there is no consistent finding in literature about the relationship between leverage and disclosure, higher leverage levels seem to be associated with lower levels of disclosure. This is so because debt holders do not demand the same level of disclosure of public information as shareholders. Thus, companies with higher leverage are expected to disclose less.
**Sales in Foreign Currency:** As firms go global, they interact with investors and regulators globally. They have to adhere to the standards set by their countries of operation. Thus, companies with high levels of sales in foreign currency are likely to disclose more.

**Industry:** Industry membership may exert an influence on what a firm discloses. There is a positive relationship between disclosure and diversity of the company represented by number of industries.

**Profitability:** Well-run firms have incentives to distinguish themselves from less profitable firms in order to raise capital on the best available terms. Thus, firms with higher profits are expected to disclose more.

This study uses a mix of primary and secondary sources for collecting data about the independent and dependent variables. The dependent variable i.e. the corporate governance disclosure score is based on information provided by firms in their annual reports to shareholders. It has been constructed by using 88 questions in all to measure corporate governance disclosure in India. These questions have been drawn from the Standard and Poors’ (S&P) transparency and disclosure instrument. This disclosure instrument has items based on three categories i.e. ownership structure and investor relations disclosure, financial transparency and operational information disclosure and board management structure and processes disclosure.

A dichotomous procedure has been followed to score each of the disclosure issue. The contents of the annual reports have been examined and scoring has been done in the form of 0 or 1. This procedure has been repeated for all companies. Each company has been awarded a score of “1” if the company appears to have disclosed the concerned issue and “0” otherwise. The score of each company has been aggregated to find out the net score of the company. The subsection scores have also been derived in the same way as the overall scores. A similar approach has been adopted by previous studies on disclosure and corporate governance such as Patel et al. (2002). The scores, however, are a
quantitative assessment of the disclosure practices of a company. They are not a qualitative indicator of the value of that information.

The disclosure score in this study uses the unweighted scoring approach. The underlying assumption is that all disclosure items are of equal importance to corporate information users. Also, there is a degree of arbitrariness inherent in the use of a weighted index, both in the selection of items and the size of the weight.

Primary data have been collected by personal interaction with concerned managers for those items of the survey for which detailed information was not available on the company’s website. These attributes included contents of the code of business conduct and ethics, policy on information disclosure, discussion on corporate strategy, plans for investment, output forecast information, a detailed earnings forecast and details of the type of business the company is in. The concerned managers were at various designations such as Chief Manager – Public Relations, Company Secretary and Legal Counsel, Vice President – Corporate Communication and Media Relations, President – Corporate Affairs or General Managers.

Secondary data have been collected from the company websites. Two databases – Capitaline and Prowess, the financial database maintained by the Centre for Monitoring of Indian Economy have also been used extensively to obtain data pertaining to market capitalisation, profits, financial leverage and revenues in foreign exchange.

To provide primary evidence of the impact of corporate attributes on corporate governance disclosures of different companies in India, this study uses the multiple regression technique. Regression analysis is the most widely and versatile dependence modeling technique applicable to business decision making. It establishes a predictive relationship between the dependent and the independent or the explanatory variables. The regression model used in this study to explain the level of Corporate Governance Disclosure Score is as follows:

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\text{CGDS} = C + \beta_1 \text{SIZE} + \beta_2 \text{PAT} + \beta_3 \text{LEV} + \beta_4 \text{FER} + \beta_5 \text{INTLIST} + \beta_6 \text{IND} + \beta_7 \text{MC} + \text{et}
\]
Where, \( C \): Constant; \( \beta_1 \ldots \beta_7 \): Coefficients;

a. \( \text{CGDS} \) is the Corporate Governance Disclosure Score
b. \( \text{SIZE} \) is the Firm size measured by market capitalisation
c. \( \text{PAT} \) is the Profits after tax of a company
d. \( \text{LEV} \) is the Debt-equity Ratio
e. \( \text{FER} \) is the: Net earnings in foreign exchange
f. \( \text{INTLIS} \) is the International listing status of a company; A dichotomous variable which is equal to 1 if the company is listed on an international exchange; is equal to 0 if the company is not listed on any international exchange.
g. \( \text{IND} \) is the Type of sector (financial or non-financial); A dummy variable, 1 if company is in the Financial Industry, 0 if the company i is in the Non Financial Industry.
h. \( \text{MC} \) is the Type of ownership, 1 if the company i is a Public Sector Company, 0 if the company is a Private Sector company.
i. \( \epsilon \) is the stochastic disturbance term

The hypotheses formulated for this study have been tested using univariate and multivariate statistical analysis. All null hypotheses have been tested at the value of alpha \( = 0.05 \) level of significance, which assures 95 percent confidence about the statistical inferences drawn from the results of the tests of hypotheses (Larson & Farber, 2003). The statistical data analysis has been performed using the software Statistical Package for Social Sciences-Graduate Pack Version 13.0 (SPSS-Grad Pack 13.0).

Statistical tests examine the difference in disclosure practices of firms based on firm characteristics namely size, proxied by market capitalization, profits, leverage, revenues in foreign exchange, listing status, and belonging to financial/ non-financial sector, public/ private sector. Results of the study show that corporate governance disclosure is
significantly influenced (at 5 per cent level) by size of the company (represented by market capitalization) and whether the company is internationally listed or not.

The multiple regression model output also brings out that in India, profitability, leverage, foreign exchange revenues, whether the company belongs to financial or non-financial sector, public or private sector are not significant contributors towards ensuring better corporate governance. Results of Multiple Regression of the years 2009 to 2002 revealed that international listing status has a positive and statistically significant relation with corporate governance disclosure. This is consistent with theory. Results across all years except 2008 indicate that size has a positive and significant relation with disclosure. Profitability which is statistically non-significant in 2007 and 2008 was significant until 2006 but in the negative direction. Other variables i.e. leverage, revenues in foreign exchange, whether financial or non-financial firm are not significant across years of study in the case of listed Indian firms.

The study also employs the technique of Discriminant Analysis (DA) to identify those observable firm characteristics which are associated with high or low disclosure. DA provided a parsimonious way to distinguish between the two groups based on independent variables. Examination of the structure matrix in DA revealed only two significant predictors namely international listing and size. This complements the results of the Multiple Regression.

III. Conclusion & Findings

- Listed Indian companies have a moderate level of disclosure with companies scoring an average score of 42.82 out of 88. The study has been able to identify top five Indian companies as regards corporate governance disclosures. These companies are Infosys with the highest score of 57 followed by WIPRO Ltd and ITC Ltd, both with a score of 56. These companies are followed by Tata Motors Ltd at 55 and Chennai Petroleum Corporation with a score of 54.

- The extent of disclosure of the Indian companies was found to vary among the sample, disclosure scores ranging between 31 and 57. This finding is consistent
with previous studies on disclosure in other developing countries (La Porta et al., 1999, Shleifer & Vishny, 1997).

- Infotech & telecom sector is found to have the highest disclosure score of 46.09 followed by automobiles sector at 45.28 and banking at 44.71. Fertilisers and chemicals sector ranked the lowest with an average disclosure score of 38.88. This can be explained by the fact that infotech & telecom sector in India has seen great expansion in the last few years. As a result, there is increased need for capital. To meet this requirement of capital, the sector has increasingly approached global capital markets. As a consequence, the companies in this sector have had to meet disclosure requirements of two countries - the host country and new country of listing.

- Financial sector is found to have a higher disclosure score of 43.47 than that of non-financial sector which has a disclosure score of 42.47. This could be explained by the fact that financial sector is more regulated than the non-financial sector.

- Public sector companies are found to have a slightly higher disclosure of 42.83 than that of private sector companies which have disclosure score of 42.55. The difference is marginal although public sector companies should be leading by example, given their size and nature of industries. The public sector in India is dominated by banking and companies in the fuel, power and steel sectors. There is an immediate need for public sector Indian companies to adopt global best practices and to undertake financial reporting with better quality information. They should view corporate governance as a tool for enhancing competitiveness rather than viewing it as cumbersome burden of regulation to be merely complied with.

- There is greater variation between scores in financial & operating information disclosure where companies, theoretically have a greater choice with respect to levels disclosure. There are 40 questions available for financial information
disclosure as opposed to 26 for ownership related disclosure and 22 for board and management related disclosure.

- Within the three main components of the corporate governance disclosure scores, disclosures for financial and operating information are highest among the sample companies. This result was along the expected lines since the regulations related to financial information were also most stringent and wide in coverage.

- Based on data analysed in the previous chapter, corporate governance disclosure in India is significantly influenced by the size of the company. Most studies such as Ahmed & Nicholls (1994); Wallace & Naser (1995); Gray et al. (1995) indicate the presence of a significant positive relationship between firm size and disclosure. This may be so because large firms may have the resources and logistics to provide more informative disclosures on corporate governance practices. A plausible explanation of the same could be differences in attitudes, efforts, and resources of medium versus large companies towards corporate governance disclosure.

- Corporate governance disclosure in India is also significantly influenced by its listing status. The results of the present research match those of previous studies such as Meek et al. (1995); Archambault & Archambault (2003) as regards impact of listing on international exchanges and disclosure. All studies have reported a positive relationship.

- Studies on relationship between leverage and disclosure have yielded mixed results. While Ahmed & Courtis (1999) have found a positive relationship, Zarzeski (1996) has found a negative relationship between leverage and corporate governance disclosure. Studies which have not found a significant relationship between leverage and disclosure include Wallace & Naser (1995) and Archambault & Archambault (2003). The present study also does not find a significant relationship between leverage and disclosure.

- Results of studies on relationship between profits and disclosure are divided.
While some studies such as Verrecchia (1983, 1990) find a positive relationship between firm performance and disclosure, some other studies such as Wallace & Naser (1995) find a negative relationship. The present study also finds a negative impact of profits on disclosure.

- All independent variables possess similar degree of significance when they are regressed individually and jointly with the dependent variable.

- Another finding is that companies do not have a consistent disclosure policy. The corporate governance disclosure scores as of March 2002 for the sample are significantly different from the score as of March 2009.

- The corporate governance disclosure score for the period of the study (2002 to 2009) indicates that financial disclosures of the sample companies have shown a continuous growth. There has been a steady improvement of overall disclosure scores through the sample during the period of the study. This is indicative of a clear movement towards better governance practices, albeit slowly. The corporate governance disclosure score increased from an average of 27 in the year 2002 to 42.82 in the year 2009. The overall pace of improvement, year on year has been the highest for the year 2005 over the year 2006. Despite the overall corporate governance improvement, the level of disclosure is still moderate. The main challenge, thus, lies in mainstreaming the process of corporate governance disclosures across firm sizes and industries.

- The standard deviation of the corporate governance disclosure score decreases steadily from 7.49 in the year 2002 to 5.39 in the year 2009. This suggests greater convergence of corporate governance disclosures in 2009 than in 2002. The convergence can be a result of the governance wave which swept Indian firms in the latter period of the study.

- There is a differential reaction of large and medium companies to Clause 49. Disclosure in annual reports has increased with increase in size of companies. Larger firms have reacted more positively to Clause 49 than medium sized firms. Given that most of Clause 49 reforms were present in the CII voluntary code also,
it can be surmised that it is the threat of enforcement of the law via Clause 49 that has led companies to enhance disclosure.

**Areas for Further Research**

- This research studies only one element of corporate governance namely financial disclosure. The study sheds light on the level of disclosure among listed Indian companies. Financial disclosures are related to a single aspect of corporate governance namely regulatory discipline. However, for further research, corporate governance practices of listed Indian companies can be studied over a number of years with a focus on self discipline and market discipline. Increased understanding of the inter linkages between regulatory discipline, self discipline and market discipline in the Indian context can serve as an input for policy makers.

- This study attaches equal weight to all disclosure items. Doing so helps reduce subjectivity, but in reality, some aspects of disclosure are more important for corporate governance than some others. The same study can be further extended by developing a score which attaches different weights to individual items contributing to the score. Alternatively, analysts’ ratings of firm level corporate governance may be used. Comparisons may be made between the scores developed by this study and those developed by the other study.

- Eight industrial sectors have been covered in this study. There are many more industrial sectors which have not been included for purpose of this research. Further research may be carried out by examining more industrial sectors based on the same method of analysis. This could result in comprehensive and conclusive ideas being developed in the Indian context.

- The study uses the traditional regression analysis to establish the impact of firm characteristics on firm disclosures. The study also uses discriminant analysis to identify those firm characteristics which are associated with higher disclosures. For further research, the robust statistical procedure of panel data analysis may be used to develop deeper insights into the issue.