Comparative Study of Corporate Governance Disclosure practices adopted by Listed Companies in Manufacturing and Software sectors in India

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Abstract

The article discusses the importance of Corporate Governance disclosure in enhancing firm value. It has been observed that even though the disclosures are made mandatory, there is a large variation in the quality of corporate governance disclosure practices adopted by companies listed in different countries. Empirical research done earlier has also proved that good corporate governance practices followed enhances the firm value. There is large variation in disclosure practices across industries and across companies listed in different countries. The article does a comparative analysis of disclosures across companies listed in India in Manufacturing and Software sectors. It has been found that software sector being more advanced an modern, they are scoring better in their disclosure scores as well.

Keywords:

Investor Protection, Corporate Governance Disclosures, Governance Scoring

Introduction

Cadbury committee (1992) defines corporate governance as a system by which companies are directed and controlled. In India, Narayana Murthy Report (2003) defined corporate governance as “Corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company. 'Corporate governance deals with the mechanisms that ensure investors in corporations get a return on their investments (Shleifer and Vishny, 1997). Better governance not only gives protection to the investors but also enable the companies to have better access to capital markets thus leading to a win win situation both to the investors and companies.

Corporate governance, though an age old phenomenon needed a relook with the occurrence of corporate scandals like WorldCom , Enron ,Barclays ,GlaxoSmithKline, and closer to home the recent Satyam scandal in India. Scams have become a regular feature in India as well, Harshad Mehta scam, Ketan Parikh scam, UTI (United Trust of India) scam, Bhansali scam, recent Satyam Scam to name a few.

Recognizing the need for good corporate practices SEC (Securities Exchange Commission) introduced Sarbanes Oxley Act in United States. Following the path, SEBI (Securities and Exchange Board of India) introduced clause 49 to the listing agreement to enhance transparency and integrity to financial statements. Corporate governance reforms paved way to noteworthy disclosures which reduce information asymmetries and to ensure investor protection.SEBI introduced clause 49 of the listing agreement. Following Satyam Scandal Industry groups and Indian regulators advocated a number of reforms which led to MCAs (Ministry of Company Affairs) Corporate Governance Voluntary guidelines 2009. Little attention is given to this concept by corporate till recently. Transparency is reflected by the disclosures made by the firm. It is mentioned in the Cadbury Committee Report (1992), that improved disclosure results in improved transparency, which is one of the most essential elements of healthy corporate governance practices. Around the world corporate governance regulations were made. Disclosure norms were made more stringent which creates a pressure of accountability on the part of the management. Governance issues related to boards of directors, responsibilities of directors, independence of directors, independence of financial auditors, audit and remuneration committee and relations between boards and executives gained importance This lead to better financial transparency, firm performance and ensure investor confidence.

The Need and Importance of the Problem

Though the disclosures are made mandatory, there is a large variation in the quality of corporate governance disclosure practices adopted by companies listed in different countries. Empirical research done earlier has also proved that good corporate governance practices followed enhance the firm value. This in turn shows the importance of implementation of good corporate governance practices.

In our study in the Indian context, we found that the disclosure norms adopted by companies is heterogeneous in nature and varies from industry to industry. So we have taken Indian listed companies in manufacturing and software sectors to make a comparative study of the disclosure practices adopted by the companies in these two sectors.

The reason for choosing these sectors is that they stand in two diagonally opposite directions. Manufacturing sector being a traditional old timer, companies in this sector comparatively have more average age than software sector which is a new entry. In addition the organizational structure of manufacturing sector have more hierarchal levels and that of software firms is relatively flat. Most software firms of India have a global spread and are listed across the world, whereas most manufacturing firms are listed only in India either in BSE or NSE or both. Apart from this, the shareholding pattern is different for both sectors .In manufacturing sector the concentration of promoters holding is more and in software sector it is fragmented. These differences in the sectors prompted us to study the corporate governance disclosures followed by companies in these two sectors by constructing corporate governance index

Literature Review

Corporate disclosure to stakeholders is the principal means by which companies canbecome transparent (Solomon and Solomon 2004). Investors get attracted by the relevant and reliable disclosure of the company's performance (Diamond and Verrecchia, 1991 and Kim and Verrecchia, 1994). Regulated disclosure provides new and relevant information for investors which ultimately reflects the transparent system of the organization (Kothari, 2001 and Bushman and Smith, 2003).Karim (1996) argued that disclosures made by companies in their annual report should be considered as the most important source of information about a company.Holder-Webb et al. (2009) found a high degree of variability in the presentation of and reporting format choices.

Bhuiyan and Biswas (2007) examined the actual corporate governance practices in thelisted public limited companies in Bangladesh by considering 45 disclosure items by developing a corporategovernance disclosure index and found a significant difference in the governance index of companies in different sectors.They found that financial sector firms have better disclosure index than non-financial sector firms.Regulated disclosure provides new and relevant information for investors which ultimately reflects the transparent system of the organization (Kothari, 2001 and Bushman and Smith, 2003).

But disclosures are like a double-edged sword in the management's hands. Certain disclosure like human resources, director's information, shareholders information, related party transactions can reduce the asymmetry of information between the shareholders and management. But providing information is costly. On the other hand disclosures about the marketing, R&D, and technology might jeopardize the firm's competitive advantage. Researchers have concluded that too much disclosure of confidential information may lead investors to believe that extensive specific information may harm the firm's value (Chahine and Filatotchev, 2008).

Objectives

1. To study the existing corporate governance disclosure practices followed by companies in manufacturing and software sectors.

2. To create corporate governance disclosure score.

3. To make a comparative study of the corporate disclosure practices followed by companies in manufacturing and software sectors.

Methodology

As SEBI regulations relating to clause 49 of the listing agreement are applicable to the listed companies in India, we have selected some listed companies in software and manufacturing sectors. Corporate governance disclosure practices adopted by these companies are to be examined from the CG section of annual reports of the companies.Since Confederation of Indian Industry Code recommendations; Birla Committee recommendations; Narayana Murthy committee recommendations have emphasized the roleand responsibilities of independent directors we have taken board of directors as one of the important constituent of our corporate governance index score.We have also considered CEO Chairman duality as a constituent of governance score as Fama and Jensen (1983) claim that if board is controlled by the CEO, this implies or signals absence of separation of decision management and decision controlA list of 35 items from the CG section of the annual reports and divided into various dimensions like statement of philosophy n ,ECO chairman duality, board of directors, various committees like audit committee, remuneration committee, shareholders committee, meetings, shareholder information and committee's compliance and the like. A list of the main and sub dimensions are shown inn annexure I. A dichotomous procedure is followed to score each of the disclosure items comparing with the parameter selected basing on the suggested list of items by SEBI. A score of 1 is awarded to the company if the company has disclosed and a score of 0 given if it has not disclosed that particular parameter. All the 40 parameters are given equal weight as they are considered to be equally important.

A corporate governance disclosure index will be calculated using the formulae followed by Bhuiyan and Biswas (2007) which is stated below.

Corporate governance disclosure Index (CGDI)=Total Score of individual company*100/ maximum possible score.Hence the maximum score attainable by the company is 100 and minimum is zero. In the next step we perform industry wise classification of the score through mean, standard deviation and coefficient of variation.

Analysis of Data

Corporate governance disclosure index (CGDI) was calculated for five software companies and eleven manufacturing companies. The descriptive statistics of their CGDI is given in the table 1 below:

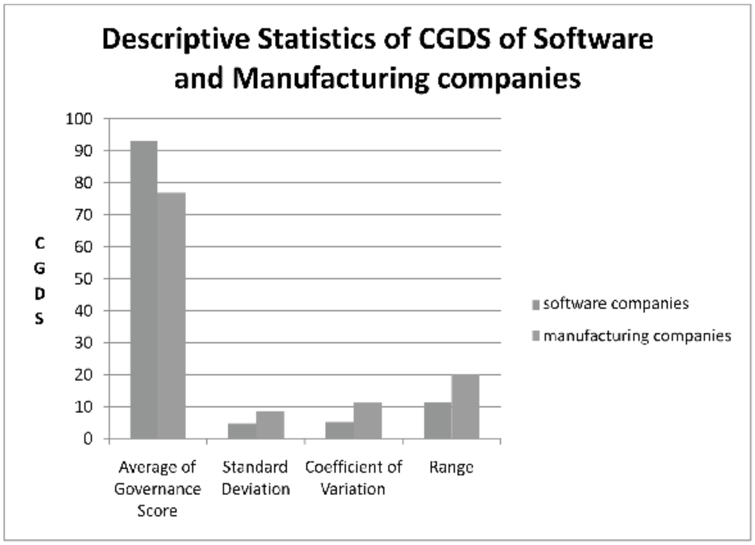
Table1: **Descriptives of the disclosure scores of two sectors**

	software companies	manufacturing companies
Average of Governance Score	93.14285714	76.88311688
Standard Deviation	4.780914437	8.543243704
Coefficient of Variation	5.132883598	11.11198928
Range	11.42857143	20

Source: Compiled and computed from company annual reports and Corporate Governance reports downloaded from their official websites and CMIE data base

It is clear from the table that the average disclosure of software companies is much higher than the disclosure of manufacturing companies. The standard deviation and coefficient of variation is also higher for these companies which implies that that some of the companies are lagging much behind and they need to improve a lot in governance. The range is very wide in case of manufacturing companies. The descriptive statistics given in table 1 is shown in the diagram 1 below:

Diagram 1



The table and the diagram clearly reveal that software companies are performing better than the manufacturing companies in CGDS. Not only the average of software companies is high their standard deviation, coefficient of variation and rang is also less. It implies there is less of variation amongst these companies.

Findings

It is observed that the corporate governance index of manufacturing sector are less than that of software sector. If we look at the areas where they are lagging behind, we find that CEO chairman duality is still existing in most companies in manufacturing sector .Major differences are also observed in the dimensions of board of directors and audit committees. Tenure and age limit of the directors not well disclosed in manufacturing sector .In addition, the roles and responsibilities of the audit committee are not well defined and in most cases chairman of the audit committee is not and independent director. The reason for the low scores of manufacturing sector to a certain could be high percentage of shareholding held by promoters of the companies.It is estimated that nearly 50 percent of equity ownership in 200 large Indian companies are held by promoters or shareowners who also participate in management and have control over operations (Zafft, 2002).In contrast to this, promoters shareholding of major software companies like TCS, Infosys, Wipro, and HCL Technologies have come down.

Though we find that the firms provided information related to the significant dimensions selected we observed a variance inn the quality of the disclosures made by them as it is evident from the disclosures in the sub dimensions.

Despite of the costs associated in better disclosures, most software firms choose to have better governance practices which is a welcome sign.

Conclusions

Though Satyam has followed the corporate governance disclosures as per clause 49 of the listing agreement of SEBI and Sarbanes Oxley Act, this scandal puts a question mark on the implementation of the governance norms in India. The mechanism need to be more stringent to avoid the occurrence of such scams.

Limitations

1 The analysis is based on the sample of companies

2. Only two sectors are taken for the purpose of analysis and comparison

3. The data is secondary in nature

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Annexure: Item wise Disclosure Observed

	ITEMWISE DISCLOSURES	
	Main Dimension	Sub dimension
1	Statement of Philosophy	Philosophy of code of governance
2	Board of directors	Independent directors=1/3 of board size
3		Attendance of each director for board meetings
4		CEO CHAIRMAN DUALITY-SHOULD NOT BE THERE
5		Membership in other companies
6		tenure and age limit of each director

7		compliance with code of conduct
8	Audit committee	Are there min 3 members
9		Are 2/3 members independent directors
10		Details of financial expert member
11		chairman of audit committee-is he independent director
12		details of audit committee meetings
13		Are the roles and responsibilities of the committee spoecified
14	Remuneration committee	Details of companies remuneration policy
15		Are all the members non executive directors
16		Is the chairman of remuneration committee an independent director
17		breakup of remunation given
18		details of fixed component and performancelinked incentive along with criteria of performance
19		stock option details
20	shareholder committee	is a non executive director heading-his name
21		number of complaints received during the year
22	General Shareholder information	Date, time and venue of AGM
23		Financial year
24		Date of book closure
25		Dividend payment date
26		Listing on stock exchange
27		Stock code
28		Market price data for each month of last financial year
29		Performance in comparison to broad-based indices
30		Registrar and Transfer Agent (RTA)
31		Share transfer system
32		Distribution of shareholding
33		Address for correspondence
34	Miscellaneous	Certificate of compliance by the auditors
35		Name and address of compliance officer