

Chapter 7

Summary and Conclusion

7.1 Introduction

Information is central to the efficient functioning of any market and lack of information will lead to information asymmetry problem. If markets have to function efficiently, companies must make relevant, reliable, comparable and timely disclosures to the market participants. Information is provided to the market participants through mandatory disclosures governed by regulations and also voluntary disclosures by companies.

This research work examines the mandatory disclosure regulations and its enforcement. This study also examines the levels of voluntary disclosure practices and factors affecting them. The standards of disclosures cover both mandatory and voluntary disclosures. The corporate disclosure environment consists of disclosures made by the firm, which are a result of several factors like market forces, industry forces and the institutional environment encompassing the standard setting, enforcement, auditors and other institutions.

Mandatory disclosures are the minimum required by law, and covers reporting and accounting standards. Mandatory disclosures are enforced through an enforcement system. Enforcement of regulations through the legal system is essential for the proper functioning of the markets. Voluntary disclosures are made at the discretion of the management and are governed by market forces. Increased disclosures will reduce information asymmetry and lower the cost of transaction for the investor.

A high standard of disclosure can be achieved through a combined process of regulation, professional standards, voluntary codes and market mechanisms. It is the appropriate combination of these elements, which determines the effectiveness of disclosures and thereby corporate governance. The objectives of the study are as follows:

- To analyze the disclosure regulation relating to reporting and accounting standards and compare them with those of the United Kingdom, Germany, the United States of America and the International Accounting standards. Select disclosure practices are also studied.
- To examine the level of voluntary disclosures by Indian companies and examine the factors affecting the same. The study also examines the overall effectiveness of the annual report.
- To compare the role and functioning of the various institutions that set and enforces laws and regulations relating to disclosures

The rest of the conclusion chapter is organised as follows: The second section discusses the methodology and summarises the findings. The third section suggests some policy recommendations for the regulators. The fourth section gives the limitations of the study and suggests areas for future research.

7.2 Summary of findings

The reporting and accounting regulations vary in different countries. These differences will create a problem for investors in terms of interpreting and comparability of the financial statements. The purpose of this study was to compare the accounting and reporting disclosure regulations between those of UK, USA, Germany and the IAS with India. Further, this study examined the level of harmonisation of accounting regulations between these countries. The gaps in the standards were identified.

Reporting Standards

The reporting standards were compared to those of US GAAP, IAS, UK GAAP and German GAAP. The result of the study indicates, that the reporting regulations in India are comparable in terms of number of disclosures (raw form) with those of other countries. However, the format for reporting certain items like 'profit from continuing operations' and 'prior period items' have to be reflected properly in the profit and loss statement. The balance sheet does not reflect the 'current', 'non-current classification' as required by the International Accounting standards. Giving the current non-current breakup is more useful to the investors for analysis. Presentation of 'Reserves and Surplus' also needs improvement.

An additional statement like the Comprehensive Income Statement needs to be mandated to reflect the new accounting standards properly. Differences are observed in reporting of profits for the current period or continuing operations and prior period items. Recently issued reporting standards are in line with IAS barring minor differences.

The US reporting regulations is quite elaborate because of the integrated disclosure system and has more disclosures in the form 10 K regulations, which are filed within sixty days of the close of the accounting year. UK reporting standards are modest as the viewpoint is to regulate less giving more discretion to the managers, while the German reporting reflects a conservative bias towards disclosure. Segment reporting in US is also different from IAS as well as India accounting standards. Other differences are discussed in Chapter 3.

With the raising of disclosure standards, Indian reporting standards are now comparable with the requirements of international accounting standards. While the regulations are adequate, companies do not strictly adhere to the standards and report the bare minimum only. Reporting standards relating to Segment Reporting- AS17 were examined to explore the levels of disclosures by companies. Out of the eighty-six companies examined, 23% of the companies have claimed to be in single segment. Out of these, at least thirteen companies could have given segment reporting. Automotive, Petroleum and pharmaceutical companies are weak in segment reporting. Some diversified companies could have given additional segment. Geographical segment reporting is provided by 50 % of the companies. Overall conclusion is that segment reporting is still weak for Indian companies.

With high concentration of ownership (Average 49 % for the sample companies) transactions with subsidiary and other related parties become important. Given the importance of a related party transaction, the reporting practices of companies under 'Related Party Transactions' AS-18 were studied. The results showed that companies have generally used the aggregate format for reporting. Here the related party transaction gets clubbed under a generic head as in 'Associates' or ' subsidiaries' etc. Only 8 companies in the study have given party wise details. In the present format, much of the information gets combined.

Shareholding information given in the annual report as mandated in the listing agreement was examined. In the absence of a format for reporting in the annual report, companies have used their own formats and are opaque in disclosures especially with respect to the block holding or the promoter's holdings. Disclosures under the Management Discussion and analysis indicate that information is vague and general in nature. It is suggested that certain minimum disclosure or standard disclosure be formulated as guidelines to companies.

Accounting Standards

The comparison of the Indian Accounting Standards with US GAAP and IAS indicates that the mandatory accounting standards have attained some level of comparability with the IAS, especially, with the recently issued accounting standards. However, accounting standards issued earlier like Amalgamation AS-14, Revenue Recognition AS-9, Fixed Assets AS-10, needs considerable revision to fall in line with IAS. Measurement and accounting investments (financial instruments) also needs considerable revision to fall in line with the IAS. AS does not use discounting concepts also. Recent standards use the 'fair value' as the basis of measuring many transactions. ICAI should come out with comprehensive guidelines for both the preparers and the auditors of the financial statements on the use of fair value. Corporate disclosure of companies indicates a wide variation in practices followed, indicating a problem area both in terms of interpretation and lack of enforcement.

The accounting harmonisation study for certain accounting standards was also examined. The result of the study indicates that recent accounting standards are substantially in harmonisation with IAS and are less harmonised with US GAAP. The standard setter must also issue standards on emerging areas like financial instruments, off balance sheet items and industry specific standards.

Voluntary Disclosures

This study also looked into the corporate voluntary disclosure environment of 86 companies that are part of the BSE 100 by constructing an index. The result indicates that non-financial and financial information

disclosures are weak. The average disclosure scores were 19.4% and 24.7% respectively. The average strategic information score was highest at 43.6%, which can be attributed to the mandating of the MDA and other disclosures in the Directors report to improve transparency and disclosure. Some companies disclose more information than mandated but most of the others disclose only the minimum mandated or very give general information without giving any additional information. Overall the results show that the voluntary disclosures are weak for Indian companies. The relatively poorer disclosure levels can be partly attributed to the merit-based philosophy to regulation that was practiced. Under this philosophy, regulators rather than shareholders largely determine the merit of transactions, and hence the role of disclosure is limited.

To explore further, factors affecting the voluntary disclosure levels of the companies were examined through a regression analysis. Ownership structure, size of the company, industry and size of the audit firm were independent variables. The ownership structure was further classified into multinational ownership, government ownership, and foreign investor ownership.

The results of the study indicated that the voluntary disclosure practices of companies were significantly influenced by the ownership structures, indicating that with higher ownership concentration, companies will tend to disclose less information. The study on size of a company proxied by market capitalisation indicates that big companies disclose more information.

Foreign investors had a positive impact on the company's disclosure environment, indicating that the companies have to meet high standards of disclosures if they want foreign investors investing in their companies. Multinational companies show significant negative association with only financial information and weak association with non-financial information. There are no significant results for government companies where the overall disclosures are also low.

The impact of industry on the disclosures indicate that service industry comprising mainly of the Software and Telecommunication services company have a positive association with the overall disclosures scores, indicating that disclosure levels are high in this industry.

The study on auditors' size indicated that big auditors have no significant influence on the voluntary disclosures made by the companies. The results are not significant for both the big Indian as well as big foreign affiliated auditors. The results have two sets of implications. One that big auditors provide credibility to the accounting information and hence companies may perceive no additional benefits for more voluntary disclosures. The other is the need for auditors to play an active role in disclosures, specially relating to mandatory disclosures where there is an element of management discretion like in segment reporting.

With a high ownership concentration, there is very little incentive for the management to disclose information voluntarily. Hence, mandatory disclosures attain great importance.

To analyse the needs of the investors and the effectiveness of the annual report, a primary questionnaire survey was undertaken. The result of the survey indicated that the annual report and the quarterly results were the most important source of information for the investor for decision making. The relative rankings also indicate that for investing, the quarterly information is most important followed by the annual report, especially as the quarterly information was timelier. When it came to decision-making television media was also found to be important. Computer databases were not ranked high, as the technology is yet to take off in this country.

The survey of usage of annual report showed that 5 % of the respondents never read the annual report while 54.5 % sometimes briefly read the annual report. The Profit and loss statement was the most read statement followed by the balance sheet with a mean score of 2.6 and 2.58. Other sections of the report like the earnings per share, MDA and Directors report were also widely read. This finding suggests that shareholders are also interested in getting an overview of the company and its performance along with pure financial data. The result also indicated that many individual do not read the recent additional information given in the annual report.

The findings suggest that some parts of the annual report are largely ignored by shareholders, or at best, are read only briefly. The relatively low usage of much of the annual report may be a reflection of the passive nature of

many retail investors and their lack of interest in much of the detailed disclosure. This could also mean that all information needed by the investors is not available in the annual report/or in the format they need. This study developed a summary reporting for the individual investor in a simple format.

The last research question addressed in the thesis is the role of regulatory and other institutions on the disclosure environment of the companies. Until the setting up of the National Advisory Council on Accounting Standards, the standard setting and enforcement was left to a professional accounting body that did not face close scrutiny from a regulatory agency, as the FASB does from the SEC in the U.S.⁴³⁷ Moreover as compared to the US and IAS the standard setting process is less transparent. The comparative study indicated that enforcement of regulations related to disclosures were weak in India as compared to USA and UK, indicating the need for improvement in the disclosure practices and developing an institutional framework for enforcing disclosures. Policy recommendations are discussed next.

7.3 Policy Recommendations

This research examined the disclosure environment and explored its inadequacies. The study shows that disclosure regulations are moving towards international standards however the disclosure practices of companies are not adequate. Voluntary disclosures are greatly influenced by ownership structures. Enforcement of disclosure regulations is also weak. These findings have relevance for policy making at different levels. Though the market mechanisms have a way of penalising companies for non-disclosures regulatory and other institutions must initiate measures to make the market more efficient. The following recommendations are as a result of the above examination. The detailed recommendations are given in the respective chapters and a few are discussed below. Certain changes are also suggested to improve the overall disclosure environment based on literature and best practices.

1. Reporting Standards

⁴³⁷ This position has slightly changed with the setting up of the National Advisory council under the Companies Act, 1956.

The balance sheet must give more specific the current non-current break up of assets and liabilities. The statement of changes in owner's equity/comprehensive income statement needs to be prepared, especially, when fair value accounting is adopted. The profit and loss account must be formatted to include certain minimum items on the face of the statement and proper presentation of results from operations.

While the information required by the annual report is adequate, the quality of reporting by Indian is deficient in many ways. There seems to be a gap in the accounting standards and the reporting actually disclosed by the firms. Thus indicating an urgent need for an institutional set up that will review the quality of disclosures.

In order to encourage better corporate communication, regulators, standard setters and professional bodies in some countries have issued guidelines relating to the explanatory material, which accompany the figures in annual reports. These guidelines amplify the requirements of company law, helping companies to meet the expectations of the market. In a few countries, compliance with these guidelines is mandatory, while in others it is an encouraged practice. The regulators or even the professional bodies can come out with guidelines for disclosures. Specific guidelines need to be formulated for the Management Discussion and Analysis section without forgoing the company's' competitive position as it is now a weak area of disclosure. Price sensitive information is required to be disclosed to the stock exchanges. Many companies report very vague information. However, due to slack enforcement, companies escape punishment. In such cases, a follow-up by the regulators will force companies to provide better answers, especially if they are quick to punish. In this regard, SEBI and the stock exchanges need to work with the corporate sector to have more meaningful continuous disclosures. Otherwise, corporate governance and disclosure will be mere reporting requirements that penalise the better managed companies and are simply ignored by many others. Disclosures would be opaque and companies will pressurise the regulators for exemption or will aggregate information in many ways. In order to avoid this, the accounting standards must be stringent to insist on full disclosure. Segment reporting and related party transactions disclosures must be strictly enforced.

The Naresh Chandra Committee stated that a company's 'contingent liability' and 'significant risk factors' could adversely affect the corporation's future health and hence it is important to disclose the same. The Committee therefore recommended that management should provide a clear description in plain English of each material liability and its risks, which should be followed by the auditor's comments on the management's view. This section should be highlighted in the significant accounting policies and notes to accounts, as well as, in the auditor's report, where necessary.

Timeliness is the essence of any good disclosure system. The reporting time for the annual report should be reduced to three months instead of the present 6 months in a phased manner for the listed companies. The US has recently reduced it to 60 days.

2. Accounting Standards

Indian accounting standards are in the process of harmonisation with the International Accounting Standards. Differences between the two standards need to be addressed. Some of these are, accounting for business combinations, financial assets like derivatives and trading liabilities like derivative liabilities. There is also a need for revising the accounting standards issued earlier where there are inconsistencies with the IAS as discussed in chapter 4. Conflicts between the accounting standards and the Companies Act must also be eliminated.

3. Additional Disclosures to be Mandated in Reporting

Several measures have been taken in the recent years to improve transparency and disclosure levels in Indian companies. These measures are reflected in the higher disclosures scores mainly in the 'strategic information' that are directly related to some of the mandatory items. This implies that mandatory disclosures have played a greater role in the disclosure environment. The results also show that the overall voluntary disclosures are very poor (the average being 29%) and combined with a high ownership concentration, many companies may not give voluntary disclosures and there will be a further distortion in the disclosure levels of the companies. To reduce the differences in levels of disclosures, the regulators must mandate certain additional disclosures by

companies as discussed in Chapter 5. A few of the important ones are discussed below.

Strategic Information

Strategic information disclosure is included in the annual reports like the corporate objectives and mission statements. These are normally qualitative in nature and incorporate business and strategic ambitions. However, company aspirations are not always linked to targets that may be measured and assessed by investors. To be useful and credible, objectives should be specific to the industry concerned. They should also be measurable and realistic and may be set for a range of areas, for instance, unit sales, market share, productivity or unit operating cost. Further, additional more forward looking perspectives including future plans and measurement of uncertainties and risks should also be mandated. General information on the background of the company i.e. a brief history of the company along with details about the products and the operations would make the understating of the annual report lot easier for the non-professional reader. Some companies do not discuss their product lines or the nature of their business in the Directors' report. The company's product information was available only in the additional information section, which discusses the production capacities of the various products and their sales details. If it is a service company, even this information is not available. Hence, the general information must mandate additional details about their services.

Corporate Non-financial Information disclosure

Non-financial information is a relatively poor area of disclosure (average 19.5%). In the researchers view, this is partly attributed to the merit-based philosophy to regulation that is practiced for many years. These disclosures can be improved only through regulation if they are to be included in the annual report. Information about the Directors, the safety policy and the safety of the product should be mandatory. Environmental issues have become very important in recent years and hence conservation of energy and those related to safety of products or the impact of a process or products on the environment should be mandated in the annual report. Some of the other non-financial information should be at least displayed in the company website.

Corporate Financial Information

The Management Discussion and Analysis report have improved the Directors' report by including specific items of information. Yet, managements have great discretion in disclosing information. A review of operating results should give the significant features of operating performance for the financial period. It should discuss the performance of the main business segments and their impact on overall group results, with comment on both successes and failures. Investors seeking to understand future results are particularly interested in the trends from year to year.

The review of financial information ideally must include: the impact of acquisitions and disposals on the current and future results, changes in the business environment including any governmental, economic, and other factors that materially affect the operations. Significant components of revenues or expenses affecting the operating results should be explained. Specifically, results of operations can be analysed with respect to changes in prices, new products, services and markets and marketing strategies. Some companies merely give the numerical changes from year to year, which are readily computable from the financial statements. Some companies use pictorial representation along with the review while others also give the ratio analysis. Annual report of government companies have the review of the Comptroller and Auditor General in a standard format.

Naresh Chandra Committee recommended that management should provide clear description of risk factors and material liability that should be followed by the comments of the auditors.⁴³⁸

Discussion of resources and the cash flow statement is very valuable information for the investors for future forecasts. However, not many Indian firms discuss the cash situation. The existence of excess cash and bank balances nor the deficit from operations is explained. Hence, these are required to be mandated.

The legal environment in countries like US discourages companies from disclosing forward-looking information because of litigation. At the same time,

⁴³⁸ In Germany the Management report by the company requires to be audited.

companies are constantly threatened by the short-term repercussions on the stock prices. Good corporate governance calls for an un-biased but balanced reporting of the forward-looking financial information.

Instead of merely mandating the structure, regulators can prescribe some additional guidelines for disclosures and also give the best practices. Corporate disclosure guidelines that are voluntary, but which requires disclosure and explanations of non-compliance, are generally preferable to a detailed listing rule, laws and regulations that mandate a uniform approach to disclosures. Too many detailed prescriptions will also go against the spirit of a disclosure-based philosophy to regulation, and will take us back to the merit-based philosophy.

4. Integrated Disclosure System

Companies are now filing information with different authorities, such as the Registrar of Companies, Stock Exchanges and SEBI. Integrated disclosures at one place will be highly useful to the user for getting information about a company as in the SEC and its filings in EDGAR (Electronic Data Gathering, Analysis, and Retrieval system). EDGAR performs automated collection, validation, indexing, acceptance, and forwarding of submissions by companies. Such a system would help the market participants in accelerating the receipt, acceptance, dissemination, and analysis of time-sensitive corporate information filed. At present SEBI has developed an Electronic Data Information Filing and Retrieval system (EDIFAR) for listed companies to file certain documents and statements.⁴³⁹ The stock exchanges also have an electronic system for disseminating information. The DCA also gives certain information through its website. These have to be further improved.

An integrated disclosure system would increase the efficiency of the information dissemination. It is recommended that a centralised information disclosure system be established which integrates the information given to the Stock Exchange, ROC and SEBI. DCA and SEBI should design a full and comprehensive set of returns to be filed by listed companies for such display on their web sites or any other web sites specifically designated for this purpose

⁴³⁹ See website at www.sebiedifar.nic.in(Dec 03,04)

and make available all such filings to the public for information and downloading, free of charge.

5. Electronic Disclosure system

The electronic media specially the Internet is gaining more importance for dissemination of information. More meaningful and transparent disclosures and improved annual reports with more detailed filings with regulatory authorities can be achieved with latest technologies. Company's websites must be encouraged to give certain basic information including three years annual reports.

While these information are given by the company the ultimate reporting standard will be achieved through the Extensible Business Reporting Language (XBRL). The XBRL allows for the "tagging" of information at all levels which makes data self-describing to a computer. Investors can retrieve information in the format and the content the user wants. Data retrieval in this system would be fast and the user can retrieve both financial and non-financial information.⁴⁴⁰ In addition, the integrity and credibility of the company's financial information is ensured, the process is streamlined and costs associated with disclosure are greatly reduced. Duplication of information is eliminated. Thus, with XBRL investors need not retrieve opaque electronic paper documents from individual companies. Timely, relevant, accurate and complete information is made available simultaneously to all for immediate use. The key participants such as the companies and SEBI must take the lead in encouraging and adoption of XBRL as the standards in business reporting.

6. Regulatory and Institutional System

The existence of quality disclosure regulations and standards would only amount to paper regulations unless accompanied by a suitable infrastructure or regulatory environment for enforcement. Having new standards and reporting regulations may not result in better-quality financial reporting, especially with concentrated ownership, cross holdings, weak auditors (not independent) who have little positive incentive to produce objective evaluations, and lack of

⁴⁴⁰ Company websites that are transparent, complete and responsive of information given to investors are ranked and is found in <http://www.irwebreport.com/> Bayer AG, Unisys, Microsoft corporation are amongst the top 20 companies which are investor friendly.

litigation-induced pressure. A good enforcement environment is necessary for the efficient functioning of the market. These include i) enforcement authority that oversee the reporting of companies and will penalise companies that flout the accounting standards and other disclosures ii) effective independent auditors iii) legal environment that will penalise fraud and manipulation of the markets and iv) simple mechanisms for private litigation that will compensate the investors or through class action suits. The disclosure environment is complete only with the strong institutional set-up.

Standard Setting

The standard setting process is less transparent in India as compared to the IAS or the US. The standard setting process including publishing of comment letters and basis for conclusion must be made public. These are not followed now. Since the Accounting standards predominantly are in line with IAS, the present set up could continue under the supervision of the NACAS and the standard setter can look into implementation and practice related issues.

Monitoring of Financial Reporting

At present, except in a limited way, no regulatory agency is monitoring the financial reporting of the companies. There is an urgent need for having an institution that can monitor the reporting and accounting practices of companies on the lines of the Financial Reporting Review Panel in the UK. This regulatory institution must monitor the accounting and reporting practices of companies through disclosures made and also investigate instances of fraudulent financial reporting through investor grievances, whistle blowers and qualification in the audit report can trigger investigation on the fraudulent financial reporting. Adequate protection must be given to the whistle blowers. The monitoring of financial reporting can also be done through a division in the DCA. A system of categorisation of listed Companies based on capitalisation or such criteria as sales, Z Category companies or any suitable criteria can be taken up for scrutiny. Periodic scrutiny and investigation into the affairs of companies should be taken on selective basis.

A powerful and competent authority should be able to reject a filing of financial statement if not prepared as per the required accounting and reporting

standards or having material audit qualifications. This could be a deterrent and a proactive approach to ensure proper reporting. Suitable changes would also have to be made in law at a later stage when the overall institutional set up is geared to take this monitoring role.

Auditors and Audit report

Annual audit is the main instrument through which the financial statement attains credibility. Auditors play an important role in the overall disclosure environment. Various committees have recommended the strengthening of the role of auditors.

The results of this study indicated that neither the big audit firms with foreign affiliations nor big Indian audit firms have any significant role in voluntary disclosures. The auditor's involvement in disclosure of financial information is inadequate. As indicated in the Special Committee Report the users of financial information preferred a higher involvement of auditors in different types of information in reporting which includes voluntary disclosures. The role of auditor must be expanded for a limited review of the MDA along with the financial statements.

The qualification in an audit report directly reflects on the management of the company and the infringement of the accounting rules or other breaches. The audit qualification though given in 'italics' tends to get lost in the myriad of information given in the audit report. The Naresh Chandra Committee requires that qualifications to accounts must form a distinct section of the auditor's report. They must be listed in plain English giving the nature and reasons for qualification. The Directors report must contain the reply to the qualifications (Although it is mandatory even now, the reply to the qualifications were usually found in the Directors report only as a reference to the explanations given in the 'Notes to accounts')

When an audit report contains qualification, it should be made mandatory for the audit firm to send a copy of the qualified report to the Registrar of Companies, SEBI and the Stock Exchange, about the qualifications made, with a copy of this letter being sent to the management of the company. This will enable the regulators to investigate and question the companies regarding such

qualifications.⁴⁴¹ The regulators may also examine the possibility of rotation of auditors at least once in 5 years.

Legal Enforcement

Laws must enforce strict legal penalties for attempts to defraud the investors through false and misleading statement and deliberate overstatement of facts or omitting to state material facts. Financial statements must be rejected if they are not prepared as per the accounting standards.

The penalties for non-compliance of financial disclosures specified in the Companies Act are low and non-deterrent. In most cases, the maximum penalty is either imprisonment for a year, or a fine of no more than Rs.50000 or both. In practice, there has hardly been any instance of imprisonment. If an auditor has signed the audit reports that are not in conformity with the law, the maximum penalty is Rs.10000. In all such cases, the fines are so small that it will hardly deter the defaulting companies and in any case judicial delays will diminish the deterrence that such penalties are supposed to inflict. It is recommended that penalties under the Companies Act be steep especially for listed companies and swift action be taken on erring companies.⁴⁴²

The auditor's liability in the case of fraudulent reporting is very limited. The examination of the disciplinary cases instituted by ICAI has very few instances of disciplining the erring auditor for accounting and misreporting. It is recommended that high penalties be levied for the auditor and strict disciplinary action be taken against the erring auditors.

Many companies have not complied with the requirement of the Clause 49 of the listing agreements as indicated in the Narayanamurthy Committee Report. The stock exchange and SEBI must now bring such non-compliance to the notice of the investing public so that the markets can then discipline the poorly disclosing companies. Penalty must also be levied for such non-compliance.

Stock exchanges penalise non-compliance with temporary trading suspensions, classification and separate trading under the 'Z' category indicating 'investor beware' and delisting. De-listing of shares in most cases usually

⁴⁴¹ This was also proposed in the Companies Amendment Bill, 2003.

causes hardship to small investors. The Stock exchange must take stringent action against the erring companies through levy of steep fines. It is suggested that exchanges install a signalling or a rating system that can identify the type of violators like those relating to non-compliance of the listing agreement, companies with poor performance on certain criteria or those under government investigations or other irregularities.

Stock exchanges can also play an active role in educating the investors. The SEC for instance, provides a variety of services to address the problems and questions of an investor through its website, so that investors can invest wisely and avoid fraud.

Penalty system for brokers and analysts, underwriters and bankers must also be introduced specially in cases where companies come into market and disappear with the funds of the investors. This will act as a deterrent and will ensure that in future they will be careful to check the antecedents of the promoters who come to the stock market.

System of Private Litigation and Class Action Suits

When an investor relies on the incorrect information in the annual report of the company and purchases its shares and incurs a loss, they must get succour through the legal system. At present, the statute does not specifically cover compensating an investor for acting on fraudulent information. A general law can at best cover it. There is no provision under the Companies Act that enables an investor to claim compensation from the erring management.

Compensation under the Indian Contract Act (Sections 73 and 74), deals with breach of contract and its consequences. The investor can claim only losses or damages to the extent arising from a breach. It is recommended that the judicial system/consumer forum/ National Company Law tribunal have powers to award compensation to investors who invest relying on fraudulent financial reporting and have suffered consequent damages.

According to Ball, private litigation rights and class action suits are essential to enforce an efficient disclosure system. Without a system for

⁴⁴² SEBI (Amendment) Act,2002 has raised the fines steeply.

penalising inadequate financial disclosure and reporting, other institutional changes are doomed to fail.⁴⁴³

An important legal deterrent is the existence of class action suits that can be filed. A class action is a lawsuit filed by one or more plaintiffs (who are known as the "named plaintiffs") on behalf of others who have a similar legal claim. Because they allow people to join together as a group in one lawsuit against common defendants, class actions are important for consumers. In the Indian context as the legal system involves huge cost and time for the individual investor a class action suit may be the answer to claims of the minority shareholders. More importantly, class actions encourage more responsible behaviour on the part of corporate defendants. The present public interest litigation has not really taken of in India. The old adage "power in numbers" holds true in class action cases. By spreading the costs of litigation among many people, each individual can achieve justice with reasonable cost. Class actions, comprised of groups of consumers working together to stand up for their rights, demand the attention of corporations and other wrongdoers. For an effective class action suit, the judicial system has to be efficient.

Investor Education

SEBI and a few stock exchanges have taken a step in pushing forward investor education. SEBI's website is very informative and periodical press clippings on this issue are also useful. (SEBI; 2003) A separate website for investor education was inaugurated at <http://investor.sebi.gov.in> the information given through this website must be made timely and user friendly. Reports that are made out by SEBI to Parliament and Government that are not price-sensitive need to be posted on the SEBI website and made available to the market participants. It is suggested that investor complaints are routed through the SEBI website so that SEBI can monitor the satisfaction of these complaints. As recommended an integrated disclosure system is the need of the day and electronic application for investor grievance must be introduced.

Monitoring Role of Financial Institutional Investors

Traditionally the domestic financial institutions have played a passive role

⁴⁴³ R. Ball, "Infrastructure requirements for an economically efficient system of public financial

in the governance of the firms. Indian Financial Institutions have been weak in monitoring companies in which they have shareholding⁴⁴⁴ as compared to the US financial institutions like CalPERS (the California State Employees' Retirement Fund) and Hermes (the British fund for postal and telecommunications workers). Such active investors expect annual reports to provide clear and credible explanations and signposts to business performance. It is hoped that, just like in the US, Indian institutional investors will also actively monitor companies they invest in and demand that better disclosure and accountability from the management.⁴⁴⁵ Some of the agency related problems can be alleviated when the institutional investor actively monitor the management of the company.

7.4 Limitations of the study and areas for further research

The following discussion analyses the limitations of this research. Substantial efforts have been taken in order to limit the influence of these limitations on the result of the study and the only objective of giving the limitations is to be aware of some of the restrictions in interpreting the results.

7.4.1 Limitations of the study

One of the limitations in the study is the sample size of the study. The number of companies taken in the sample was eighty six.

The second limitation of the research is the composition of companies in the sample. The sample consists of all listed companies of the BSE 100 index except the banking and finance companies. By taking this sample the study would be limited to the top hundred companies in terms of market capitalisation, which is also the justification for such a sample.

reporting and disclosure", *Brookings- Wharton Papers on Financial services* 127-182 (2001)

⁴⁴⁴ T. Khanna and K.G. Palepu " Emerging market business, Groups, Foreign Investors and Corporate Governance", 1999 Working Paper www.nber.org/papers/W6955 (Mar 24, 2002)

⁴⁴⁵ In the U.S., for example, pension funds as the California Public Employees Retirement System (CalPERS) are widely known to be active monitors of investee companies. They develop yearly list of under-performing companies, hold closed door meetings with boards to encourage a shareholder friendly business agenda, organise shareholder revolts through the proxy system, and employ the heavy leverage of public opinion and the popular media to pressure companies to conform to best practices standards for corporate governance.

7.4.2 Areas for future research

This study can be extended in several ways. A similar study could be done to examine the disclosure standards with respect to an industry for instance - banks and the specific regulations related to banks. Further study can be under taken by including loss making or non-index companies or companies that have low market capitalisation.

The emphasis in disclosure index studies is on annual reports. Although Annual reports are very important in a firm's business communication, there are several other channels firms employ in their communication. In order to better understand communication issues, these other modes can also be examined. Disclosure regulation and practices for initial public issue can also be examined.

To conclude, In an ideal world with efficient capital markets, role of regulators and regulations are not important, because the markets would recognize which companies are well governed and which are not, and reward and punish accordingly. Unfortunately, ideal capital markets exist only in theory. Moreover, India has followed a merit based disclosure system, which means, that under the merit-based philosophy to regulation, the emphasis was on compliance with rules and regulations set by regulatory and quasi-regulatory agencies. Under this environment, companies are conditioned to disclose the bare minimum as required by rules and regulations, and no more.

As we move from a merit based system to a disclosure-based system, legally mandated rules are minimum but supported by a larger body of self-regulation and voluntary compliance. This has to be supported by a high level of shareholder activism that takes the place of the regulators. If the disclosure-based system has to succeed, then regulators, shareholders as well as companies must change to bring the disclosure to international standards.