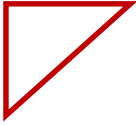


Disclosure and Shareholder Voting: Evidence from India

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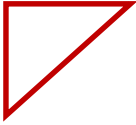




Motivation

- Evidence that higher shareholder participation leads to better governance outcomes.
- Using data from China, in weak investor protection countries granting minority shareholders increased control helps to reduce value-decreasing corporate decisions (Chen, Ke, and Yang (2013), *The Accounting Review*).
- Using data from U.K. on imposition of shareholder approval for corporate acquisitions, shareholders gain 8 cents per dollar at announcement with mandatory voting, or \$13.6 billion over 1992-2010 in aggregate and without voting, U.K. shareholders lost \$3 billion. (Becht , Polo, and Rossi (2016), *Review of Financial Studies*).
- Thus regulators have an interest in promoting shareholder participation in voting.

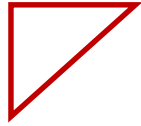




Research questions

- However, it is unclear if requiring voting is enough because voting assumes information processing and decision making.
 - Disclosure transparency can have a first order effect on expropriating corporate decisions (Djankov, LaPorta, Silanes, and Shleifer (2008), Journal of Financial Economics).
- We examine two related questions:
 - Does more transparent information disclosure lead to informed voting outcomes by minority shareholders?
 - Are there cross-section differences, retail investors versus institutional investors, on the effect of disclosure transparency on voting decisions?
 - How does the disclosure impact voting advisory services?





Setting

Unique setting in India:

- Companies Act (2013): Requires material related party transactions (RPTs) to be approved by disinterested shareholders.
- Material RPT as per SEBI: Total amount of RPTs with an individual party in a financial year is expected to exceed 10% of the most recent total revenue.
- Only “disinterested” shareholders who are not connected to the related party can vote.
- Early evidence show that there is significant reduction in volume of such transactions, especially on financial transactions (Li (Working paper), 2018).

We measure information transparency by measuring qualitative attributes of text in postal ballot notices and announcements of RPT resolutions

- Tone (Sentiment of disclosures)
- Linguistic complexity (Fog)





Overview of results

- Disclosure attributes don't have substantial effects on the participation or direction of voting.
- Participation seems to be impacted by IIAS positive recommendation and presence of independent directors - lower voting participation!
- Seems to suggest that more than the disclosure per se, the independent mechanisms of oversight have a important effect.
- Univariate trends show that after 2013, vetos has increased and IIAS's negative recommendations have substantially gone up.
- Seems to suggest a more indirect effect of disclosure on voting outcomes of RPT transactions.





Institutional background about RPTs

- RPTs could be structured to tunnel firms' assets.
- Before 2013:
 - Clause 49 of the Listing Agreement issued by SEBI: audit committee for review and approval .
 - Accounting standard AS-18: Disclosure on nature of relationship and the amount of transactions with each related party.
- Srinivasan (2013): RPTs are widespread in India and firms with high RPTs have lower performance.
- Satyam scandal: Transfer of USD 1.6 billion.





Institutional background

Companies Act, 2013

- RPTs that are not an arm's length basis to be approved by the board of directors
- If the amount of RPTs exceed a prescribed amount, then shareholders' approval is required

Regulation 23, SEBI Listing Obligations and Disclosure Requirements (LODR):

- All RPTs require prior approval of audit committees
- All material RPTs required approval of shareholders through resolution
 - Material RPT as per SEBI: Total amount of RPTs with an individual party in a financial year is expected to exceed 10% of the most recent total revenue
- Related parties shall abstain from voting on such resolutions





Sample and data

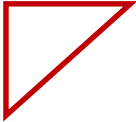
- Using IIAS’s “Adrian” product we hand-collect resolution related information
 - Postal ballot notices and voting outcome
 - Information on total number of shares held, number of votes polled, number of votes in favor, number of votes against, separately for institutional shareholders and non-institutional (retail) shareholders.
- Using the text of ballot notices we measure:
 - Linguistic complexity: Fog index (Li 2008), number of words, and sentences
 - Tone of disclosures: Loughran and McDonald (2011) financial dictionary
 - number of optimistic words minus the number of pessimistic words, scaled by the total number of words in the disclosure
- Accounting and stock price data: Prowessdx
- Final sample: 663 unique resolutions from 491 unique firms during 2014-2018



Statistics of Key Variables by Year

YEAR	2014	2015	2016	2017	2018
<i>NUMBER OF RESOLUTIONS</i>	32	169	144	152	166
<i>NUMBER OF FIRMS</i>	25	115	103	105	118
<i>% RESOLUTIONS VETOED</i>	0.00%	1.18%	0.00%	1.32%	1.81%
<i>TOTAL PARTICIPATION (%)</i>	41.26	41.05	45.83	46.3	44.57
<i>% INVESTORS IN FAVOUR</i>	96.93	94.29	97.04	95.05	93.03
<i>PARTICIPATION BY INSTITUTIONS (%)</i>	63.05	64.85	74.65	71.62	68.78
<i>% INSTITUTIONS IN FAVOUR</i>	96.54	92.31	93.86	91.90	87.45
<i>PARTICIPATION BY RETAIL INVESTORS (%)</i>	21.68	16.46	23.60	22.46	21.82
<i>% RETAIL INVESTORS IN FAVOUR</i>	95.78	96.42	99.03	96.84	94.95
<i>IIAS RECOMMENDATION</i>	0.94	0.85	0.85	0.80	0.74
<i>FOG</i>	20.94	23.59	23.83	28.75	30.71
<i>TOTAL SENTENCES</i>	17.10	14.55	15.13	13.51	13.57
<i>TOTAL WORDS</i>	412.50	376.71	404.49	382.88	394.48
<i>TONE</i>	-0.23	-0.11	-0.23	-0.25	-0.24





Disclosure and Investors' Participation in Voting

	TOTAL PARTICIPATION	PARTICIPATION BY RETAIL INVESTORS	PARTICIPATION BY INSTITUTIONAL INVESTORS
	(1)	(2)	(3)
<i>FOG</i>	-0.036	-0.086	0.037
	[-0.539]	[-1.031]	[0.511]
<i>TONE</i>	3.393*	-2.089	1.394
	[1.837]	[-0.916]	[0.687]
<i>RPT</i>	0.149	-0.324	0.297
	[0.300]	[-0.524]	[0.539]
<i>PROMOTERS HOLDING</i>	-0.138*	-0.204**	-0.142*
	[-1.830]	[-2.183]	[-1.713]
<i>SPECIAL RESOLUTION</i>	1.960	1.356	-3.125
	[0.644]	[0.373]	[-0.936]
<i>POSTAL BALLOT</i>	6.841**	-1.799	4.303
	[1.990]	[-0.421]	[1.139]
<i>IIAS RECOMMENDATION</i>	-4.249	-0.552	-10.419***
	[-1.382]	[-0.144]	[-3.087]
<i>ROA</i>	58.343***	11.579	40.886*
	[3.021]	[0.484]	[1.928]
<i>LOG (ASSETS)</i>	4.533***	0.296	-1.028
	[5.532]	[0.295]	[-1.142]
<i>MB</i>	0.196	-0.719**	0.204
	[0.745]	[-2.206]	[0.705]
<i>ANNUAL RETURNS</i>	-1.965	-4.139	-4.581
	[-0.604]	[-1.044]	[-1.282]
<i>STD DEV RETURNS</i>	-49.630	37.480	-13.302
	[-1.344]	[0.822]	[-0.328]
<i>% INDEPENDENT DIRECTORS</i>	-21.312**	-3.639	-43.826***
	[-2.233]	[-0.309]	[-4.172]

No substantial effect of disclosure transparency

- Decrease in participation
- Higher promoter holding
- IIAS certification
- Director independence

Year FE Observations YES 346



YES Eller College of Management 346

Disclosure and Investor Support of Resolutions

	<i>% INVESTORS IN FAVOUR</i>	<i>% RETAIL INVESTORS IN FAVOUR</i>	<i>% INSTITUTIONAL INVESTORS IN FAVOUR</i>
	(1)	(2)	(3)
<i>FOG</i>	0.065 [1.639]	-0.036 [-0.900]	0.123 [1.223]
<i>TONE</i>	2.406* [1.966]	-0.238 [-0.189]	7.063** [2.104]
<i>RPT</i>	0.186 [0.558]	-0.082 [-0.242]	0.564 [0.512]
<i>PROMOTERS HOLDING</i>	-0.024 [-0.477]	-0.029 [-0.556]	-0.107 [-0.789]
<i>IAS RECOMMENDATION</i>	11.403*** [5.586]	-0.786 [-0.361]	32.823*** [6.232]
<i>SPECIAL RESOLUTION</i>	-1.611 [-0.802]	2.654 [1.298]	-1.551 [-0.270]
<i>ROA</i>	13.467 [1.038]	14.799 [1.111]	8.543 [0.233]
<i>LOG (ASSETS)</i>	-1.282** [-2.364]	1.009* [1.837]	-5.674*** [-3.651]
<i>MB</i>	0.023 [0.130]	0.152 [0.842]	-0.473 [-1.005]
<i>ANNUAL RETURNS</i>	-0.060 [-0.028]	1.822 [0.821]	4.174 [0.692]
<i>STD DEV RETURNS</i>	35.183 [1.426]	23.629 [0.923]	92.187 [1.263]
<i>% INDEPENDENT DIRECTORS</i>	-14.264** [-2.261]	8.999 [1.368]	-60.074*** [-3.453]
Year FE	YES	YES	YES
Observations	345	355	346

With low percentage of vetos the test is less reliable



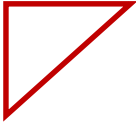
Market Reaction to Voting Outcomes

	<i>CAR</i> [-3, +3]			<i>CAR</i> [-3, +5]		
	(1)	(2)	(3)	(4)	(5)	(6)
<i>FOG</i>	-0.000* [-2.285]		-0.000 [-1.933]	-0.000 [-0.236]		-0.000 [-0.167]
<i>TONE</i>		-0.014*** [-5.040]	-0.015*** [-4.848]		-0.013*** [-4.680]	-0.013*** [-5.953]
<i>RPT</i>	0.002 [1.322]	0.003 [1.492]	0.003 [1.585]	0.002 [0.931]	0.002 [1.104]	0.002 [1.139]
<i>% INDEPENDENT DIRECTORS</i>	-0.053 [-0.667]	-0.062 [-0.769]	-0.055 [-0.676]	-0.029 [-0.321]	-0.033 [-0.358]	-0.032 [-0.343]
<i>PROMOTERS HOLDING</i>	0.000 [0.573]	0.000 [0.708]	0.000 [0.758]	0.000 [0.426]	0.000 [0.520]	0.000 [0.499]
<i>SIZE</i>	-0.000 [-0.035]	-0.002 [-0.374]	-0.001 [-0.168]	-0.002 [-0.312]	-0.002 [-0.454]	-0.002 [-0.463]
<i>MB</i>	0.004*** [5.313]	0.004*** [5.405]	0.004*** [5.314]	0.004** [3.153]	0.004** [3.251]	0.004** [3.222]
<i>ANNUAL RETURNS</i>	0.023 [1.147]	0.022 [1.148]	0.021 [1.123]	0.036 [1.873]	0.034 [1.865]	0.034 [1.830]
<i>STD DEV RETURNS</i>	-0.557*** [-7.160]	-0.587*** [-8.443]	-0.583*** [-8.458]	-0.491** [-3.240]	-0.518** [-3.486]	-0.517** [-3.393]
<i>IIAS RECOMMENDATION</i>	0.009 [0.481]	0.009 [0.447]	0.010 [0.488]	0.018 [0.871]	0.018 [0.841]	0.018 [0.843]
Industry FE	YES	YES	YES	YES	YES	YES
Year FE	YES	YES	YES	YES	YES	YES
Observations	214	213	213	214	213	213
R-squared	0.259	0.267	0.271	0.271	0.278	0.278

Disclosure transparency variables were expected to have a positive coefficient!

Too small a sample to have confidence.

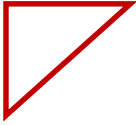




Conclusion

- Shareholder voting is an important mechanism for shareholder engagement in corporate governance.
- We examine whether information disclosure affects investors' voting decisions -
 - Broadly the direct effect of disclosure transparency does not appear to be influence participation in voting.
 - However, the requirement of disclosure and voting requirement seems to increase the percentage of vetos and impact of IIAS recommendations.
- Our evidence should not be interpreted as disclosure transparency as not being important - it makes for a independence and oversight from IIAS.





Contribution

- Shareholder voting:
 - ❑ Shareholder voting power deters value-destroying corporate actions and improves firm value (Chen, Ke and Yang 2013; Becht, Polo and Rossi 2016; Li 2018)
 - ❑ The first study to examine the effect of information disclosure in shareholders' voting decisions.
- Effect of regulation on RPT
 - ❑ U. S. SEC: Disclosure of the approval process of RPTs (Hope and Lu 2019)
 - ❑ China: joint enforcement actions by eight ministries to constrain rampant RPTs (Jiang et al. 2010)
 - ❑ India: the 2013 Companies Act and SEBI listing requirements





Related Studies

- Effect of corporate disclosure on investors' decision making:
 - ❑ Readability and investors' reaction (Miller 2010; Rennekamp 2012)
 - ❑ Obfuscation of information (Li 2008; Kim et al. 2019)
 - ❑ Tone management (Huang et al. 2014)
- Shareholder voting and corporate decisions:
 - ❑ Mandatory shareholder voting improves the quality of decisions and firm value (Chen et al. 2013; Becht et al. 2016)
 - ❑ Li (2008): A significant decrease in material RPTs after 2013 in India; mandatory voting may deter expropriating RPTs
- RPTs can reduce transaction costs or expropriate outside investors:
 - ❑ Misuse of RPTs in countries with weak investor protection (Bertrand et al. 2002; Jiang et al. 2010)
 - ❑ Expropriate RPTs in developed market (Kohlbeck and Mayhew 2017)

