
UNIT 15 INVESTORS RELATIONS

Objectives

The objectives of this unit are to:

- explain the corporate form of business organization and the need for maintaining investor relations
- highlight the importance of investor relationship for the corporate form of business organization.
- pinpoint the different forces that demand for information from the companies and varying purposes for which it is demanded by the stakeholders
- bring out the rationale for corporate governance in building by good investor relations
- explain the advantages achieved from being a good governance company

Structure

- 15.1 Introduction
- 15.2 Corporate form of Business Organization
- 15.3 Demand for Information
- 15.4 Transparency and Disclosure
- 15.5 Corporate Governance
- 15.6 Investor Service
- 15.7 Summary
- 15.8 Self-Assessment Questions
- 15.9 Further Readings

15.1 INTRODUCTION

Savings and investment determine the growth, be it the economy or the company. Business units require funds for acquiring assets for manufacturing and investing in good projects and thereby achieving economies of scale. The company form of business organization facilitates the creation of such large firms with large capital base. This is made possible by collecting money from millions of investors. Investors provide capital at the time of starting the venture as well as for the growth of the firm. While the funds provided by the equity holders make them the owners of the company, the funds provided by the debt holders make them the lenders.

Hence, the company form of business mostly has a financial structure with a mix of debt and equity. In case of publicly listed company the equity holders

are the promoters, the directors and their relatives, Government, sometimes the institutional investors, the banks and the general public (or small investors) and they all jointly own the company. The debt holders are basically financial institutions, banks and general public who lend money against a mortgage or by getting bonds or debentures issued from the company. In some cases, the debt holders are issued convertible bonds, as per which they can submit their bonds and get them converted to equity at later stage. So in this case they become owners from lenders.

The existing companies diversifying & growing at rapid pace and new business ventures with unconventional ideas and products require funds to execute their ideas into products and services. These funds are provided by investors in the form of equity and debt by investors. These investors require information regarding the use of their funds and likely returns associated with the investment. The **Investor Relation Team** has the primary responsibility of providing information and interacting with investors. Table 15.1 presents the different kind of investors who invest in the equity of the company. This classification is as per the SEBI regulations

Table 15.1 : Category of Investors/ Shareholders

		Institutional Investor
A Promoters and promoter group		
	(1) Indian promoters	
	(a) Indian individuals / Hindu undivided Family	
	(b) Central and state governments as promoters	
	(c) Indian corporate bodies as promoters	
	(d) Financial institutions and banks as promoters	X (D) *
	(e) Other promoters	
	(2) Foreign promoters	
	(a) Foreign individuals as promoters	
	(b) Foreign corporate bodies as promoters	
	(c) Foreign institutions as promoters	X (F) *
	(d) Qualified Foreign Investors	X (F) *
	(e) Other foreign promoters	
	(3) Promoter groups	
B Non-promoters (public shareholdings)		
	(1) Institutions as non-promoters	
	(a) Mutual funds as non-promoter	X (D) *
	(b) Financial institutions and banks as non-promoters	X (D) *
	(c) Venture capital funds as non-promoters	X (D) *
	(d) Insurance companies as non-promoters	X (D) *
	(e) Foreign institutional investors as non-promoters	X (F) *
	(f) Foreign venture capital investors as non-promoters	X (F) *
	(g) Qualified Foreign Institutional Investors	X (F) *
	(h) Other institutions as non-promoters	X (D) *
	(2) Central and state governments as non-promoters	
	(3) Non-institutional investors	

	(a) Corporate bodies as investors	
	(b) Individual investors	
	(c) Qualified foreign non-institutional investors	
	(d) Other investors	
C	Custodians	

Table 15.2 furnishes the details of the equity share capital and the number of equity shares held by the investors of large Indian companies forming part of NSE 50 index. The table shows that the paid up share capital of these firms. The paid up capital of these companies range from Rs. 24 crores to 9696 crores. The number of equity shares issued run into millions and in some cases in billions. Table 15.2 also depicts the equity share capital and the number of equity shares outstanding. The last two columns of the table shows free float market capitalization and ratio of free float market capitalization to total market capitalization. Free float market capitalization is a proxy measure to determine the diversification of investor base. Free float market capitalization is calculated by considering only those outstanding shares that are or can be actively traded in the open market. To compute free float market capitalization the shares held by the following are excluded but are not limited to:

- Shareholding of promoter/founders/directors
- Shares held by hedge funds/private equity funds etc.
- Locked in shares
- Cross holding by related companies in a group company
- Shares held by various trusts which are not actively traded

A company having a diversified investor base will have higher proportion of free float market capitalization in its total market capitalization. The last column in table 15.2 calculates this proportion and it can be observed that for most of the companies free float market capitalization ranges from 40% to 60%, implying a large and diversified investor base. When the company has large and diversified investor base the investor relation has to be designed so as to meet the information requirements of each category of investors

Table 15.2 Equity Share Capital of NSE (NIFTY 50) Companies

Company Name	Face Value	Number of shares (in lakhs)	Equity Capital (in crores)	Total Market Capitalisation (in crores)	Free Float Market Capitalisation (in crores)	FFMC/TMC
Adani enterprises ltd.	1	11400.01	114.00	379463.17	90556.21	23.86429
Adani Port and Special Economic Zone	2	21123.73	422.47	171007.17	57851.56	33.8299
Apollo Hospital	5	1437.85	71.89	63560	45021.94	70.83376
Asian Paints	1	9591.98	95.92	298396.84	140731.14	47.16241
Axis Bank	2	30724.01	614.48	275824.75	240263.64	87.10735
Bajaj Auto	10	2836.55	283.65	105031.68	47432.53	45.16021
Bajaj Finserv Ltd.	1	9556.89	95.57	161129.21	103004.82	63.92684
Bajaj Finance	2	6054.29	121.09	432285.55	191973.13	44.40887

Bharti Airtel	5	55632.32	2781.62	446810.95	196339.79	43.94247
BPCL	10	21692.53	2169.25	65196.89	28705.72	44.02928
Britannia	1	2408.68	24.09	89964.3	44871.51	49.87702
Cipla	2	8070.02	161.40	93265.17	62011.85	66.48983
Coal India	10	61627.28	6162.73	147689.78	50392.62	34.12059
Divis Lab	2	2654.69	53.09	94808.12	46031.61	48.55239
Dr. Reddy's Lab	5	1664.97	83.25	74090.5	53189.84	71.79036
Eicher Motors	1	2734.56	27.35	100356.88	50781.05	50.60047
Grasim Industries	2	6583.80	131.68	112977.99	63755.11	56.43144
HCL Technologies	2	27136.65	542.73	279643.18	109177.25	39.04163
HDFC Ltd.	2	18145.95	362.92	433452.3	433452.3	100
HDFC Bank Ltd.	1	556999.59	5570.00	814328	642901.1	78.94867
HDFC Life Insurance	10	21491.05	2149.10	115750.77	51208.1	44.23996
Hero Motrocorp	2	1998.22	39.96	51461.21	33534.86	65.16532
Hindalco Industries	1	22471.75	224.72	89999.36	57776.55	64.19662
Hindustan Unilever	1	23495.91	234.96	590076.34	229737.86	38.93358
ICICI Bank	2	69702.31	1394.05	646279.85	645392.51	99.8627
Indusind Bank	10	7752.43	775.24	88575.44	74616.49	84.24061
Infosys Ltd.	5	42078.28	2103.91	641988.24	555646.25	86.55085
ITC	1	123991.79	1239.92	427895.65	306094.8	71.53492
JSW Steel	1	24172.20	241.72	155439.36	59353.39	38.18427
Kotak Mahindra Bank	5	19857.38	992.87	368443.81	278564.07	75.60558
Larsen Toubro	2	14051.91	281.04	271222.97	230786.49	85.09106
Mahindra & Mahindra	5	12431.93	621.60	157823.29	121662.73	77.08794
Maruti Suzuki	5	3020.80	151.04	269677.44	116506.17	43.20205
Nestle India	10	964.16	96.42	195069.24	74469.26	38.17581
NTPC	10	96966.66	9696.67	162855.5	79324.06	48.70825
ONGC	5	125802.79	6290.14	164550.05	51790.49	31.474
Power Grid Corporation	10	69754.53	6975.45	152832.17	74802.31	48.94409
Reliance	10	67653.70	6765.37	1665228.13	855630.46	51.38218
SBI Life Insurance	10	10007.14	1000.71	124924.08	56632.38	45.33344
State Bank of India	1	89246.12	892.46	515307.08	218934.11	42.48614
Sun Pharma	1	23993.35	239.93	236886.34	106566.46	44.98633
Tata Consumer Products	1	9215.52	92.16	71097.71	46180.56	64.95365
Tata Motors	2	33212.67	664.25	135441.25	72024.33	53.17754
Tata Steel	1	122212.10	1222.12	123984.17	81627.9	65.83736
Tata Consultancy Services	1	36590.51	365.91	1160285.19	323927.03	27.91788
Tech Mahindra	5	9731.59	486.58	105076.88	66301.1	63.09771
Titan	1	8877.86	88.78	236337.55	111988.27	47.38488
Ultratech Cement	10	2886.72	288.67	185988.43	73837.66	39.70014
UPL Ltd.	2	7506.08	150.12	52167.23	37736.87	72.33827
Wipro Ltd.	2	54856.40	1097.13	211142.27	56976.99	26.98512

Table 15.3 shows the outstanding corporate bonds as of end of June,2022 quarter ,which is the most important source of funding for companies. As of June 2022 quarter outstanding corporate bonds were to the tune of Rs.39,57,796 crore. Investor relation team has to work effectively to raise funds through debt at minimum cost. Here we shall understand that the information requirements of debt holders is different from that of equity holders. The debt holders are concerned with liquidity and debt coverage

during the tenure of the debt whereas equity holders are concerned with long term growth prospects of the company.

Table 15.3 Outstanding Corporate bonds – From Sep 2020 Quarter

Quarter	Type of Instruments	Number of Issuers	Opening No. of instruments Outstanding	Opening Outstanding Amount (Rs. In crores)	Number of Issuers	No. of Issues	(Amount in Rs. Crores)	Number of Issuers	Number of Redemptions	(Amount in Rs. Crores)	Number of Issuers	No. of Instruments outstanding	Net Outstanding Amount (Rs. In Crores)
Sept-20	Fixed Rate	2400	17948	3036883	499	1337	181464.1	359	843	114062.1	2470	18514	3103564
	Floating Rate	519	2889	128711.5	67	286	17428.11	74	209	7003.288	523	3000	138861
	Structured Notes	102	859	36818.57	19	116	2105.99	24	186	3455.335	105	841	35371.99
	Others	554	2845	126888.7	191	722	5365.949	214	848	6372.166	563	2770	127978.4
	Total	3575	24541	3329302	776	2461	206364.1	671	2086	130892.9	3661	25125	3405776
Jun-22	Fixed Rate	3502.00	21398.00	3546658.56	556.00	1496.00	116164.00	423.00	969.00	177001.48	3558.00	21606.00	3479398.39
	Floating Rate	786.00	3682.00	243284.59	121.00	348.00	16085.92	50.00	104.00	12636.97	810.00	3729.00	249868.84
	Structured Notes	158.00	1089.00	45678.98	37.00	128.00	5624.85	36.00	198.00	4953.49	166.00	1120.00	46449.86
	Others	843.00	3189.00	181403.10	234.00	847.00	16986.28	69.00	117.00	16549.85	860.00	3290.00	182079.25
	Total	5289.00	29358.00	4017025.23	948.00	2819.00	154861.05	578.00	1388.00	211141.79	5394.00	29745.00	3957796.34

Source : NSDL& CDSL

To get better understanding of who actually controls the company, we need to look into the shareholding pattern data of these companies. Table 15.4 presents the percentage of equity holding by different categories of equity shareholders of nifty 500 companies which account for nearly 95% of the total market capitalisation of Indian companies.. The promoters holding represent the equity holding of those who had promoted the company and they basically control the management. The foreign promoters' holding arises if there is joint venture between an Indian company and a foreign company. Such investment can also arise if the foreign firm sets up its own company in India, which are often called as multinationals and also when foreign investors invest in Indian Companies through Foreign Portfolio Investment (FPI) route. Hence promoters could comprise of either Indian or foreign based on how they originated. The institutional investors' holding represents the equity holding of the financial institutions, the banks and mutual funds. The other private corporate body equity holding implies the holdings of other companies. For instance if Britannia industries invests in the shares of the ABB Ltd, it would be classified into other company holdings. Companies at times do this form of investing, when excess cash is available and it lies idle in the company. The others equity shareholding represent the holdings of small investors, who are also owners of the company. But these small investors mostly invest for the sake of investment or speculation. They sell their shares if they feel that the company's share is performing badly in the capital market.

These two tables thus highlight the fact that number of investors are large typically in large companies and also the categories of the investors are of different kinds. While the average promoters' holding of these companies is around 43%, non-promoters contribution is 57%. In such a scenario a formal investor relationship arrangement assumes importance. Many companies today have a full fledged investor relations department headed by an investor relationship officer. The present unit is dedicated to discuss why the companies need to have a good relationship with investors and what exactly should the companies do to maintain such good relationships.

		2013	2014	2015	2016	2017	2018
A. Promoters and promoter group		49.0	49.1	49.0	49.2	49.5	50.8
	1) Indian promoters	45.1	45.2	45.3	45.6	46.1	47.3
	a) Indian individuals	22.0	22.1	22.6	23.8	24.5	25.7
	b) Central and state governments promoters	1.3	1.2	1.3	1.2	1.2	1.4
	c) Indian corporate bodies as promoters	19.4	19.4	19.0	19.2	18.8	18.5
	d) Financial institutions and banks as promoters	0.2	0.2	0.2	0.2	0.1	0.1
	e) Other promoters	2.2	2.2	2.2	1.3	1.4	1.6
	2) Foreign promoters	3.9	3.9	3.7	3.6	3.5	3.5
	a) Foreign individuals as promoters	0.6	0.5	0.6	0.6	0.6	0.6
	b) Foreign corporate bodies as promoters	3.3	3.3	3.0	2.9	2.7	2.8
	c) Foreign institutions as promoters	0.0	0.0	0.0	0.0	0.0	0.0
	d) Qualified Foreign Investors	0.0	0.0	0.0	0.0	0.0	0.0
	e) Other foreign promoters	0.1	0.1	0.1	0.0	0.1	0.0
	3) Promoter groups	0.0	0.0	0.0	0.0	0.0	0.0
B. Non-promoter (public shareholding)		50.6	50.6	50.8	50.7	50.4	49.2
(1) Institutions as non-promoters		5.1	5.0	4.9	4.9	5.1	5.1
	a) Mutual funds as non-promoter	0.8	0.9	1.0	1.1	1.2	1.3
	b) Financial institutions and banks as non-promoters	0.8	0.8	0.7	0.7	0.8	0.7
	c) Venture capital funds as non-promoters	0.0	0.0	0.0	0.0	0.0	0.0
	d) Insurance companies as non-promoters	0.6	0.6	0.5	0.5	0.5	0.5
	e) Foreign institutional investors as non-promoters	2.4	2.5	2.2	2.3	2.3	2.4
	f) Foreign venture capital investors as non-promoters	0.1	0.1	0.1	0.0	0.0	0.0
	g) Qualified Foreign Institutional Investors	0.0	0.0	0.0	0.0	0.0	0.0
	h) Other institutions as non-promoters	0.1	0.1	0.2	0.2	0.2	0.2

Table 15.4 : Percentage Equity Holdings of Various Investor Classes

	2) Central and state governments as non-promoters	0.1	0.1	0.1	0.1	0.1	0.1
(3) Non-institutional investors		45.5	45.6	45.9	45.6	45.2	44.0
	a) Corporate bodies as investors	10.9	11.0	10.9	9.8	9.8	9.2
	b) Individual investors	31.7	31.6	31.8	31.6	31.5	30.7
	c) Qualified foreign non-institutional investors	0.0	0.0	0.0	0.0	0.0	0.0
	d) Other investors	2.9	2.9	3.1	4.2	4.0	4.0
C. Custodians		0.4	0.3	0.2	0.1	0.1	0.1

In order to understand the growing importance of investor relations and its evolving role as strategic enabler let us discuss the findings of a KPMG survey published in 2019, in which 91 companies were surveyed to understand the role of investor relation function as strategic enabler. The main findings of the survey are as follows.

The top three goals for IR functions were

- Enhance shareholders engagement
- Improve financial disclosure and overall creditability
- Enable better compliance and corporate governance

Other findings of the survey were

- 68% of CFO's and 51% of CEO's actively participated in IR activities
- 40% companies outsourced their IR activities mainly for backend processing activities
- Perception studies were mainly outsourced and annual report preparation involved both in-house and outsourced effort
- In terms of challenges with reference to IR function, top three challenges faced by the companies were
- Successful articulation of intrinsic equity value and potential equity value
- Since IR function is not perceived as a hardcore management function the positioning of IR function as a strategic function in the company
- Communicate the guidance/expectations of top level management to managers down the line

15.2 CORPORATE FORM OF BUSINESS ORGANIZATION

The company form of organization is governed by the Companies Act. In India, the Companies Act was passed during 1956 and subsequently amended

and revised and eventually replaced by Companies Act,2013. The Companies Act of most countries allow a group of people to start a company and approach public to raise large capital in the form of debt or equity. Generally, the small investors buy the shares and become the owners of the company. Institutional investors, as explained earlier, not only buy the shares, they also lend money to these companies against bonds or mortgage. Hence it can be found that the owners of a company could be any number of small investors. The investor range increases with the size of the company. So the ownership is spread across the world or countries. Figure 15.1 provides an overview of the links between the company, the shareholders, the institutions and the market.

While ownership is widely spread, the control is retained by a few. In the sense that the management of the company is handed over to few Board of Directors elected by the shareholders. This is because not all owners can manage the company with a very small stake. This separation of ownership and control leads to agency problem. Since agents behave with self-interest, it might harm other investors who are not directly involved in management of the company. For instance, managers may invest the capital in not so good projects, and the result being the shareholders bear the loss of such bad investment. The managers may also use the shareholders money in different possible ways to serve their own interest.

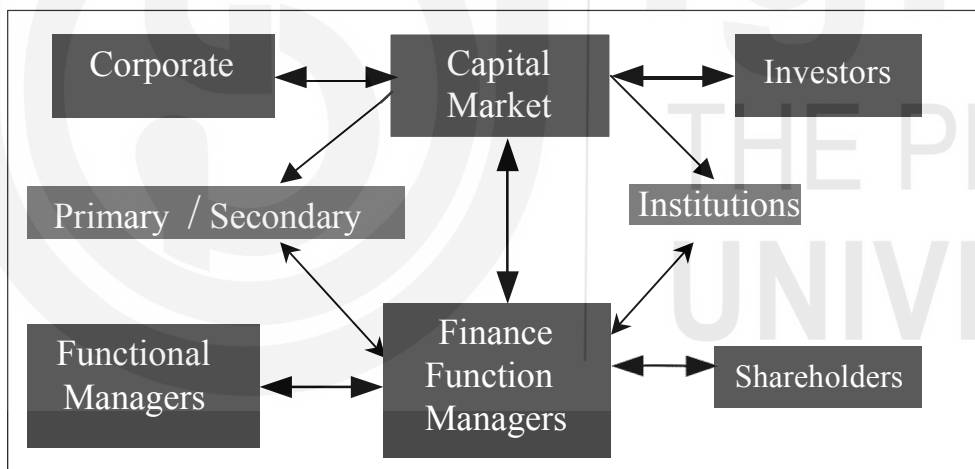


Figure 15.1: The Functioning of Corporate Form of Business

These managers may also get involved with creative accounting, with the help of the auditors. We have seen many instances of scams of this nature. In all these cases, every stakeholder is affected. The equity holders, on learning such frauds, start selling the shares and this pulls down the prices of the stock in the market. Not only will the small investors do such act, this could happen with the institutional investors as well. The matter is even worse with the institutional investors. This is because the institutional investors are both lenders as well owners in many companies. They not only cause damage by selling the shares, they will avoid lending to these companies in future. So the growth of the firm gets affected and finally the company might get liquidated.

There are several ways in which the management or promoters can assure the managers manage the firm efficiently. Investor relationship in a broader sense includes all such efforts taken by the agents to ensure that investors are not affected by the agency problem. Investors expect management to run the firm efficiently in a most transparent manner and take all decisions that maximize the investors return. The next section would explain in detail the expectations of the investors from the management of the company. If these expectations are not met, then the company would be heading towards serious trouble.

In the corporate form of business the stakeholders who put their resources based on trust, reputation and risk reward profile of the investment. In order to create and consequently enhance trust and reputation and provide information to investors to decide on risk return profile IR function plays an important role.

Key Considerations for investor relation function

Investor relation function is an evolving corporate function. In order to maximise the output of this vital activity the IR team shall keep the following considerations in mind.

Secure Board Commitment:

The contents and the direction of IR is generally guided by the higher management. It is always a better idea to seek the commitment of the Board of Directors regarding long term and open two way communication with various existing and potential stakeholders. The stakeholders may be domestic or foreign entities and may be long term or short term stake holders one thing of importance here is that different categories of stakeholders will have need for different kind of information therefore IR function shall design the communication meeting the expectation of different stake holders. In addition there should also be a broad policy regarding communication with analysts, brokerage houses and media.

Form the investor relation team and assign responsibilities:

In normal circumstances CEO and CFO of the company are assigned with the responsibility of investor relation, . but when the company is venturing into new business line or developing new product it is better to associate key personnel handling these activities to be part of IR team. Another aspect of IR team is the role of external advisers. If the team consist of them then specify clearly the role and responsibilities of external members/advisors. Also decide beforehand the activities to be handled in house and the activities to be out sourced.

Identify current and future investors:

The investment climate is a dynamic one and there is always a probability of investors shifting from one company to another in search of better yields and future potential benefits. In order to avoid this; regularly analyse the share holders register and bond holders register and benchmark that against peer

companies. Another aspect is the composition of investors viz. retail or institutional. In case of opaqueness in company's operations retail investors can be targeted as they are less demanding as compared to institutional investors. Similarly in case of foreign investors the level of disclosures requirement is high as compared to domestic investors. The segmentation of investors profile is important in order to target specific investors suited to company's profile.

Determine the investment proposition:

The IR team should clearly articulate why an investor should invest in their company. This requires a thorough analysis of the finances and operations of the company. This would translate into specifying the current and future ability of company to provide investors with capital growth/capital returns including their size and timing

Select appropriate mix of communication tools:

Communication is one of the most vital aspect of investor relation. Apart from the mandatory communication of price sensitive information to the stock exchanges where the company's share are listed, the IR team should choose communication tools which are capable of transmitting information to large number of present and future investors. Apart from investors also design your communication strategy so as to result in wider media coverage and analyst attention.

Set the financial reporting calendar:

Timely reporting of financial results (quarterly/half yearly/yearly) is an important aspect of IR. In between the results if any price sensitive information evolves then communicate the same to the investors.

15.3 DEMAND FOR INFORMATION

Basically, the demand for corporate information comes from the shareholders and investors, managers, employees, customers, lenders and other suppliers, security analysts, policy makers, regulators and government. Purpose of soliciting information by different stakeholders of the organization varies to a great extent. For instance, the Government seeks financial information of the company mainly to check if it pays the right amount of taxes as also to check if it does not violate licenses granted, export-import policies etc.

The suppliers would be demanding the financial information basically to ensure that the company would be in business for sufficiently long period of time and it would be worthwhile to have business with them. They would like to know if the company would be able to pay their dues. Likewise, the lenders would use information to verify the creditability of the company.

The managers call upon information of various types for planning and control purposes. Of course, the information supplied to the managers within the firm

may be much more in detail and confidential compared to the information provided to the outsiders. The customers, particularly the consumers of durable goods or vehicles or IT products, would be interested in knowing whether the company would exist in near future to provide them the service for the product they purchased. So they would be constantly watching the company's performance for the same. The employees would be interested in the company information because they would want to know if they would get better wages or salaries for the coming years. Because if the firm is not doing well, the chances are that they might lose their jobs and also lose wages. So they keep a watch on the performance of the company.

The analyst demand information to publish reports on the performance of the company and to rate its debt payment capacity. He continuously tracks the company for information and analyzes the company accordingly and informs the public on buy and hold strategies. On the other hand, the demand for information by small and retail investors differs from that of the experienced analysts. The small investors simply do not have the time to keep track of the company's latest information. This is because small investors invest in a number of companies and it is difficult for them to keep track of the information of all these companies. Moreover they would not be able to analyze the information as usefully as the experienced analysts do. Hence, they require much more detailed information and mainly in a processed format so that they can evaluate the risk and return characteristic of the company. This is for the fact that the risk and return of a firm are dependent on the following:

- i) the social, political and macroeconomic factors which are common to all companies belonging to different industries, such as social harmony, relations with other countries, political stability, growth rate of gross domestic product (GDP), inflation rate, money supply, and policies of the government;
- ii) the industry factors which are common to all companies in a particular industry, such as labour conditions in the industry, policies of government which have influence on the industry, and demand and supply factors and;
- iii) company-specific factors which are important to any company, such as financial performance, changes in the top management, decisions relating to financing, investment and dividend. With the knowledge of these factors, investors would be able to calculate the expected returns of securities of different firms, the risk associated with their returns and accordingly take their investment or portfolio decision.

Once the investment decision is made, shareholders and investors demand information for the purpose of safeguarding their interest in the corporate firm. This involves control of managerial behaviour so as to guide managerial activities towards the maximisation of shareholders' wealth. Thus, shareholders and potential investors require information so as to help them to make the investment decision, as also to design contracts and mechanisms for controlling the behaviour of managers, and orient the managerial behaviour

towards realizing the objectives of a firm. Accordingly, they demand all information that is non-proprietary, i.e. information whose disclosure does not affect the firm's future cash flows.

We know that the objective of existing shareholders is to maximise their expected utility or wealth, even if it is at the expense of other parties involved in the activities of a concern. First, they wish to safeguard their interest and want to limit the possibilities for expropriation by all other parties. Second, they will try to achieve the goal of maximisation of the wealth of the firm or alternatively the expected utility or wealth of shareholders by expropriating the other parties involved. Towards this end, they would like the management to take decisions which would increase their wealth either through achieving higher sales, higher incomes and higher profits or through transfer of wealth from other parties involved in the corporate activity such as creditors, managers, employees, customers and government. They also demand the management of the company to disclose information that maximizes the value of the firm.

However, we should also note that the demand for disclosure of corporate information of prospective shareholders differs from that of existing investors. Whereas the former wants the firm to reveal both value enhancing as well as value diminishing information, the latter, expects the firm to reveal only the value enhancing information and not to reveal the value diminishing information. Such conflicts can be seen as amount existing groups of promoters, institutional shareholders and public shareholders.

There are several agencies engaged in protecting the interest of small investors and other stakeholders. The requirement that the company form of organization has to be registered under the companies Act, 1956 is the first protection to investors and others. The Registrar of companies makes sure that the company that is formed is genuine and has been formed for the purpose of being in the business. The investors' interests are protected by the Securities Exchange and Board of India (SEBI). SEBI had laid down some listing requirements for the companies seeking to raise money from the small investors or public. Once the company accepts the listing agreements, the company's shares get listed in the stock exchange. SEBI has also brought several regulations and guidelines for market participants and intermediaries to protect the interest of investors. The Institute of Chartered Accountants of India lays down the necessary accounting standards based on which the companies need to prepare the financial statements and get it audited by the chartered accountants. This is done to ensure that the financial statements represent true and fair view of the financial position of the company.

Basically the investor demands can be classified into three basic categories.

- 1) Transparency and Disclosure
- 2) Good corporate governance
- 3) Investors Service

Each of these are discussed in detail in the following sections.

Activity 1

Check with some of your friends who invest in stocks on the information that they require/use while selecting the stocks for investments. Identify whether companies disclose such information in the annual report.

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Activity 2

Check with your friend whether he/she is happy with the information supplied by the company in disclosing such information. Also, find out whether they are satisfied with the role of SEBI and Stock Exchanges in improving disclosure standards.

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15.5 TRANSPARENCY AND DISCLOSURE

Companies typically do not make available information on a day to day basis because of strategic reasons, and huge costs involved in collection and dissemination of such information to all the users. At the same time, the companies disclose summary of information periodically for various purposes. Corporate disclosure of information is determined by the market forces, costs associated with corporate disclosures and the regulatory forces (Refer Figure 15.2)

Market forces which influence the decision of corporate firms may relate to the capital, labour and corporate control market. Corporate firms compete with each other in the capital market for resources. They may issue different instruments which meet the requirements of investors. The various forms of raising finance have been discussed in the earlier sections. Under these circumstances, capital market forces exert pressure on firms to provide information relating to the instruments offered, terms of instruments, the distribution of expected returns and importantly, on the projects for which the capital is being raised. This is necessary because the investors have no foresight about returns and the quality of the product. And firms may be apprehensive, that in the absence of the authentic information, they may be perceived by investors as 'lemon'. In the instance of non-disclosure by corporate firms, the investors may not be able to assess the risk and returns on the projects undertaken by the firms, as they would have no idea as to which firm's projects are good or bad. Investors, under such circumstances,

require on average a high return. This higher required return may force the issuers of capital to withdraw from the market as the net present value of the project would be negative, if the projects are implemented with resources mobilised at a higher cost. When 'good' issues are withdrawn from the market, investors revise their required return upwards, which force some firms to withdraw from the market. In this process, the capital market ends up in a situation where there are only high risk offers, and there would be no investors ready to supply the resources. Given the uncertainty about the product quality, success of the projects and the cost of being perceived as a 'lemon', corporate firms have an incentive to supply the information that they believe will enable them to raise capital on the best available terms.

Some firms may make overly optimistic forecasts about the future cash flows associated with a project. However, checks such as (i) reputation of the firm, (ii) reputation of the management, (iii) third-party assessment and clarification, and (iv) legal penalties, act as deterrents for firms to make these overly optimistic forecasts.

The labour market forces also exert pressure on the management to disclose information to the public. This can be due to either external or internal forces. For example, reputation of a management plays a vital role in determining the managers' prospects of promotion and other incentives structure within the firm as well as outside the firm. Hence, managers would not be willing to take steps that damage their reputation of competence. Further, professional managers are governed by a set of standards of behaviour or a code of conduct which are determined by professional bodies, and non-adherence to standards may lead to disciplinary action against them by the professional bodies. Thus, forces in the labour market prompt the managers to disclose information which improves their prospects, as well as their reputation.

The corporate control market forces also influence the firms' decision of disclosure, and the timing of information release to the public. The efficient working of a concern depends on the soundness of the policies determined by the board of directors, and their effective implementation by the managing director and his team of managers. If investors perceive that a company is not run efficiently and identify ways in which its functioning can be improved, they may attempt to take over the controlling stake of the company. This perception of non-controlling stakeholders is influenced by their private information. Such private information gives them an advantage, as they can acquire the stocks of the company at the existing prices. Under such circumstances, managers are forced to improve not only their working but also the level of information disclosure. At times, even when the investors do not have information about its good future prospects, the prices of a company's securities may be under priced. However, the corporate predators and raiders, under such circumstances, make attempts to take over the company by actively buying the securities of the company in the secondary market. This forces the managers to reveal the information about the prospects of the company to the outsiders. Thus, the market forces influence the supply of information in two ways: first by prompting the existing management of firms to disclose information to the public and

secondly, through the threat of actions of corporate predators and raiders, who continuously explore the opportunities for takeovers.

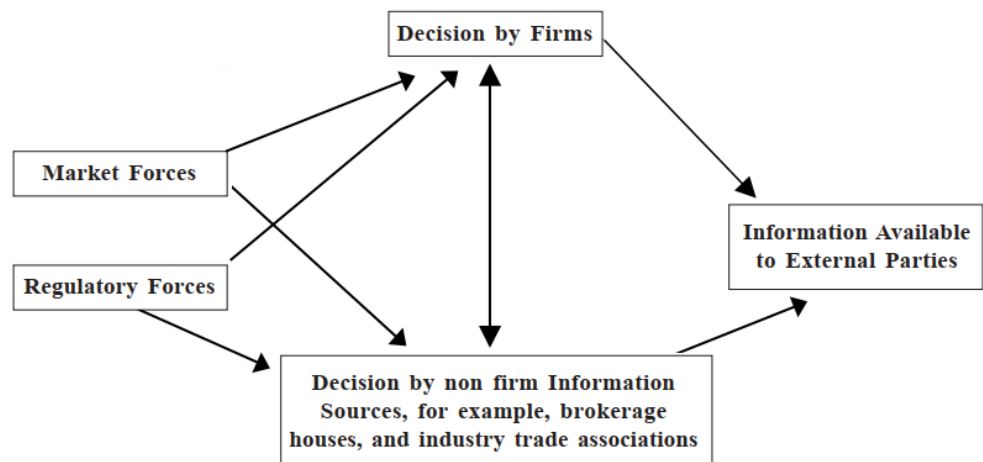


Fig. 15.2: Factors Influencing the Information Set Available to External Parties

Source: Foster, George, *Financial Statement Information*, p.24, Prentice-Hall International, Englewoodcliffs, New Jersey, 1986.

The costs associated with corporate disclosures also influence the time and extent of disclosure of information. These costs include: (i) collection and processing costs, (ii) litigation costs, (iii) political costs, (iv) competitive disadvantage costs, and (v) additional constraints on management decisions.

Collection and processing costs include the costs borne by both the suppliers and users of financial information. Corporate firms as well as users of information incur the costs of collection of information. The corporate management has to make decisions on what information is to be collected and at what frequency. It is not possible for firms to collect all the information on a continuous basis, as it involves unlimited resources, both human and financial.

The decision on information collection is often based on the assessment of costs and benefits associated with such information. Firms, while computing the costs of collecting and processing information, have to bear in mind the costs incurred by the firm as well as the costs borne by investors in performing such task. Similarly, while computing the benefits of information production and processing, firms have to take into view the benefits that accrue to all the users of corporate information who have a stake in the corporate firm.

Litigation costs arise when the corporate has to face a dispute in a legal forum. The prompt public release of information as well as corrective information, if any, can reduce the potential losses to shareholders and the potential exposure of the firm and its management in subsequent litigations.

Political costs arise in situations where the perception of government and policies of government are influenced by the disclosure of corporate information which influences the government to take actions which transfer resources from the corporate to the other constituents of society through

fiscal and other measures. In these circumstances, firms may choose accounting methods that they perceive will reduce the likelihood of large profit increase being reported in any one year.

Competitive disadvantage costs arise when firms choose to reveal a portion of proprietary information. Typically, firms choose to keep strategic information such as information on research and development, new products, advertising expenditure, break down of major customers and forecasts of gross margin, income or sales by individual lines of business, when they perceive that they have an advantage over competitors in these areas. However, they face a difficult situation when they want to raise new capital. In such a situation, irrespective of whether the firms disclose the information or not, the firm stands to experience a reduction in its value. For instance, unless firms provide some information pertaining to their research and development activities or new products, the capital market is not likely to support a new share offering, and yet, if they do provide detailed information, they may reduce the lead time with which competitors learn about developments within the company.

Disclosure of certain types of information by managers imposes constraints on their behaviour and may lead to a conflict between their efficiency and reputation. For example, earnings forecasts and their disclosure to the public put pressure on managers to implement policies that result in the actual earnings converging towards the forecast values.

Regulatory forces also influence the disclosure and timing of release of information by firms. A number of regulatory agencies govern the functioning of corporate and regulate their information disclosure. Such agencies can be broadly discussed under four levels: (i) level one consists of the executive, legislative, and judicial branches of the government. The legislative makes laws which are enforced by the executive. The legislative and executive define the manner in which the corporate has to disclose information. The judiciary exerts influence on the disclosure practices by its rulings; (ii) level two includes government regulatory bodies. As discussed briefly in the earlier sections, in India, this level includes the Securities and Exchange Board of India (SEBI), the Company Law Board, and the Department of Company Affairs under the Ministry of Finance. These agencies are often delegated with the authority of overseeing the adherence of rules and procedures by corporate firms; (iii) level three includes private sector regulatory bodies such as Accounting Standard Board, the Institute of Chartered Accountants of India, and Stock Exchanges. Professional bodies, through conducting seminars and publication of discussion papers and in-depth analysis, from time to time, recommend standard practices to be followed in the preparation of balance sheets, cash flow statements and profit and loss accounts; (iv) level four includes lobbying groups that attempt to influence the decisions made by the parties in the above three levels. These professional bodies include industrial and trade associations, investor associations and other interest groups.

The market forces and regulatory forces, described above, influence the

decisions of both the corporate firms and non-firm information sources such as brokerage houses, and industry and trade associations as to what to disclose and when to disclose. The decisions of corporate firms and decisions of sources other than corporate firms influence each other.

However, not all information disclosed by the companies are mandated by regulation. Companies also choose to disclose voluntarily information like the social services performed by them, the company philosophy, objective, business they are operating, the market share of the business, etc. However, as sated earlier, companies would be hesitating to provide information, which would reveal their competitive advantage to the competitors. For instance, the ICAI introduced a new accounting standard on Segment Reporting (AS-17) with effect from 2001. However, most companies still do not provide this information despite being made mandatory by claiming that they are single segment company. This is because as per this standard, companies are supposed to disclose their financial information based on the different segments. Prior to 2001, investors did not know whether companies were performing good in all the segments in which they were operating. For instance, prior to 2001 investors did not know whether L&T was performing well in their cement or construction segment. Only the performance of L&T was made known to the companies.

There has been tremendous improvement in the last few years in the disclosure level of the Indian companies. This is mainly due to the new accounting standards introduced by the ICAI like consolidation of accounts, segment reporting, revealing the related party transactions, revealing the intangible asset valuation etc. Apart from this the listing requirement had also been tightened.

And listing requirements demanded more information from the companies. One such latest requirement is the introduction of the Clause 49 on corporate governance code. Accordingly, every company wanting to get listed in the stock exchange will have to disclose the corporate governance systems and procedures existing within the company. Detailed aspect discussion on this made had been made in the next section.

Activity 3

Compare for any one company, the annual reports of the year ending March 2000 and March 2003. Identify major changes that you have seen on the items disclosed by the company.

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Corporate governance plays an important role in building a good relationship with the investors. This is because when companies are able to keep their investor well informed about the way the business is done in a transparent manner, this would definitely present a positive image. No investor would want to do away his investment from such a company. McKinney in one of their surveys (2000) reported that investors are willing to pay more for companies with good governance. And the premium the investors would be willing to pay for well-governed companies, they reported, differed by country. As reported, the investors were willing to pay 18 percent more for the shares of a well-governed UK or US company, for example, than for the shares of a company with similar financial performance but poorer governance practices. But they would be willing to pay a 22 percent premium for a well-governed Italian company and a 27 percent premium for a well-governed company in Indonesia. A well-governed company is defined as having a majority of outside directors on board with no management ties; holding formal evaluation of directors; and being responsive to investor's requests for information on governance issues. In addition, directors hold significant stockholdings in the company, and a large proportion of director's pay in the form of stock options. (Monks, 2001).

However, the existence of corporate governance by itself does not become a sufficient condition for the better performance of a firm. It can, however, become a necessary condition in the highly competitive world, particularly when the market has become global. But why does it become a necessary condition? Corporate governance can do a lot of things for the better performance of the company:

- 1) Good corporate governance helps the company to evaluate the better investment decisions.
- 2) It would help resolve the agency cost of debt and equity.
- 3) It can help retain the existing investors.
- 4) It can attract more and more investors, implying raising capital would be easier.
- 5) Suppliers would be willing to deal with such companies.
- 6) Lenders would not be hesitating to lend to such companies, as the systems are transparent and the performance of the company is well revealed.

Companies like Infosys could be shown as a good example for maintaining good corporate governance. The corporate governance report of the Infosys Technologies Ltd., for the year 2003 as required under clause 49 is given in Appendix to this Unit.

Activity 4

Find and write a brief report on events that lead to appointment of Cadbury Committee on Corporate Governance in the UK.

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Activity 5

Find from your stock market investor friend whether he or she is happy with the corporate governance set up of Indian companies.

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15.7 INVESTOR SERVICE

In the earlier sections we had discussed about the importance of companies maintaining a good relation with the investors. We had seen that companies gain a substantial advantage by transparent policies and disclosure practices. However, in order to sustain the good relationship earned, the companies need to provide the right information at the right time at the right place. Further they must also attend to the queries of the investors promptly and provide them a better service.

Though most of the information discussed above is filed with the stock exchanges, information in the annual report are sent to the shareholders by post. Some information are sent to the interested parties on demand. The better practice has been that companies these days provide almost all information in their websites. In fact, this is also mandatory by regulation. The quarterly returns filed with the stock exchange have to be made available in their website as well.

Some good governance companies provide a lot of these information in a systematic manner in their websites; for instance the website of Infosys technologies covers almost all information filed with the regulatory agencies.

As part of the annual reports, companies furnish the following details which are useful to investors.

- 1) Financial calendar specifying the dates of holding the annual general meeting

- 2) Dates on which the quarterly returns are to be released
- 3) Dates of book closure for different purposes like share transfer and dividend payment
- 4) The addresses of the companies and the head office
- 5) Listing in stock exchanges
- 6) Information on dividend payment
- 7) Details about the investor grievances committee
- 8) Method of voting by proxy
- 9) Shareholding pattern of the company
- 10) The number of shareholders present in the company supplying the different range of shares held.
- 11) Market price data of the shares traded in the listed stock exchanges and a comparison of the share performance with the indices are also given.
- 12) Share transfer procedures. Though all the share trading is performed these days in the demat mode, the details of the same are also given.
- 13) Plant locations

Investors are comfortable dealing with companies that furnish the maximum information for the shareholders and also provide them good service.

Activity 6

List down the procedure to be followed when a shareholder has grievance against the company. What are the alternative avenues available to investors and what is the role of SEBI in handling investor’s grievances?

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Activity 7

Visit SEBI's web site (www.sebi.gov.in) and visit EDIFAR link and write a brief note on EDIFAR and its usefulness to investors.

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15.8 SUMMARY

Mr. Narayanamurthy of Infosys stated that "The primary purpose of corporate leadership is to create wealth legally and ethically. This translates to bringing a high level of satisfaction to five constituencies -- customers, employees, investors, vendors and the society-at-large. The raison d'être of every corporate body is to ensure predictability, sustainability and profitability of revenues year after year." Some companies not only state their philosophies in just letter but they act on it as well. Having a mission statement, underlying principles for achieving the mission and delivering value to the owners and the other stakeholders enables the companies to have a long-term good relationship with its investors. If the companies do not sustain such long-term good relationship, we have seen that most companies get liquidated in the process of cheating the investors. Hence, maintaining a good relationship with the investors and performing the operations in the most transparent manner helps the companies in the long term.

15.8 SELF-ASSESSMENT QUESTIONS

- 1) Who are the stakeholders of a company?
- 2) Why is that the investor relationship gains more importance in corporate form of business organization rather than the other forms of business structures. Does it really matter or apply for other forms of business organizations? If so, how?
- 3) What are the forces that drive for information from the company?
- 4) What type of information is demanded by the different type of stakeholders including the shareholders?
- 5) Do you think corporate governance matter in investor relationship?
- 6) Find out about 5 companies who have been rated as 'Good Corporate Governance' company and examine their investor relationship. Are the information provided by these companies to the investors differ to a great extent? If so, list down in what aspects they differ.
- 7) What are the regulatory agencies that govern the disclosure of information by companies. List them and their roles.
- 8) How does the information demanded by the inside shareholders differ from the retail or external investors?

15.9 FURTHER READINGS

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