Disclosure and Shareholder Voting: Evidence from India

Wen He, Ankit Jain and Shyam V. Sunder

Shareholders participation in major decision making process is considered to be an important element for better corporate governance. Granting voting power to shareholders may help to discourage board members from taking any value-destroying corporate actions, such as mergers and acquisition, equity issuance and related party transaction (RPTs). Many countries are opting to make shareholders voting mandatory before taking such policy actions. But, it is still not clear how shareholders actually use their voting power and which information can actually help them to make an informed decision. In order to make the mandatory voting power effective the policy maker has to ensure that all shareholders get relevant information well before the day of exercising the voting power. Besides, it is important to examine the significance of information disclosure on a proposed decision.

In this context, RPTs received regulatory attention in multiple occurrences across countries, as corporate insiders used this route to expropriate firms' resources to outside investors. Particularly, in a country where ownership is concentrated and decisions are taken by a few individuals, RPTs can be used to benefit a small set of people without any consent to the larger community of investors. To overcome this shortcoming, India amended its Companies Act that mandated investors' approval before taking any decision related to material RPT. Accordingly, SEBI declared an additional requirement in the listing agreement that specified a RPT will be classified as 'material RPT' if a firm's total RPT with an individual party is more than 10% of total revenue in a financial year. Then the particular RPT has to be approved by 'uninterested' investors who are not directly related to the RPT.

Post this amendment, there is a significant fall in total RPTs, and out of all RPTs announced around 7.78% proposals failed to get an approval from uninterested shareholders. Under this provision, firms disclose the information through postal ballot notices and public announcement. Using textual information on such disclosure during 2014-18, He, Jain and Sunder (2019) in their recent study "Disclosure and Shareholder Voting: Evidence from India" have examined how disclosure of RPT related information affects investors' voting decision. They collected disclosure related information from IIAS Adrian. The database provides detailed information on all shareholder resolutions including postal ballot notice, voting recommendation and voting outcome. The voting outcome contains data total number of shares held, number of votes polled, number of votes in favour, number of votes against, separately for institutional shareholders and non-institutional (retail) shareholders. Besides, they used accounting and stock return data from prowessdx. After combining both the datasets using company name, the final data has 663 unique resolutions from 491 unique meetings for 278 unique firms during 2014-18. They constructed two indexes based on disclosure information, *viz*. gunning-fog index and tone of disclosure. The fog index captures the readability of disclosure and the tone is calculated as the difference between the optimistic and pessimistic words, divided by the number of total words in the disclosure.

They used Tobit regressions of investors' participation in voting on measures of information disclosure of proposed RPTs. The dependent variable is estimated as the percentage of eligible shareholders who cast vote on the RPT resolution. The independent variables include the fog index, tone index and important firm characteristics such as percentage of promoter holding, market capitalisation, total assets, annual returns, risk of returns, percentage of independent directors, share of net income to total assets (ROA), etc. Besides, they have included dummy variables for special resolution (voted outside of annual general meeting), postal ballot resolution and IIAS recommendation in favour of the resolution. Other RPT related variables like value of RPT transaction and total RPT as a share of total asset are also included in the model.

The study found that the readability of RPT disclosure does not have much impact on investors' decision, but tone of such disclosure has affected their decision significantly. Particularly, positive tone in the disclosure has increased the share of votes in favour of the RPT considerably. This is mainly driven by the participation of institutional investors, which is not true for individual investors. But, positive tone of RPT disclosure did not affect the probability that the resolution will be passed, perhaps due to the fact that the data does not have much variation in terms of voting outcomes where only 1% of all RPTs are actually banned.

They have further examined whether the positive association between positive tone and institutional investors' vote in favour of RPT is due to its future profitability of the firm. This hypothesis was tested by examining the relation between positive tone of RPT disclosure and its impact on future performance of the particular firm. Towards this, they used ROA in the coming year to measure future profitability of the firm. However, the analysis could not show any positive relation between the tone of disclosure and future profitability of the firm.

The study also examined the market reaction to the voting outcome of RPT. In order to get an unbiased estimate, they have considered those days in the analysis when only one RPT resolution was voted. They used cumulative market-adjusted returns to capture market reaction that shows tone of RPT resolution is negatively related to market reactions even after controlling the magnitude of RPT and firm characteristics. This finding may suggest that a positive tone in RPT resolution may not necessarily have positive signal about future performance.