THE ECONOMIC CONSEQUENCES OF 'SEBI' REGULATION ON CORPORATE GOVERNANCE' ON INDIAN STOCK MARKET

Thesis Abstract

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Abstract: The issue of corporate governance has attracted considerable attention from the early 1980's. Subsequently, many countries implemented a code on corporate governance to enhance investor protection. Cadbury Committee is the foremost to propose a Code on corporate governance; this Code is applicable to the listed companies in the United Kingdom. The long lasting East-Asian crisis, Enron and Worldcom debacles has required regulators of different countries to strengthen their corporate governance practices. In India, Securities and Exchange Board of India has implemented a Code (regulation) on corporate governance in the year 2000, upon the recommendations of Kumar Mangalam Birla Committee, to improve transparency and accountability and other corporate governance practices of publicly traded companies. These recommendations are applicable as clause 49 of the listing agreement. The main objective of this Regulation is shareholder wealth maximization through appropriate governance mechanisms and by reduction of information asymmetry between the managers and the investors.

Prior to the Regulation, there was limited regulatory emphasis on financial disclosures and corporate governance mechanisms. Disclosures were regulated by the Companies Act, 1956, listing agreement and Accounting standards formulated by the ICAI. The mandatory disclosures required under these statutes were limited when compared to disclosures required in advanced countries. Also, very few companies' voluntary disclosed information necessary for the shareholders to accurately value the company. Keeping all these limitations in mind, the Regulation is indeed an important measure taken by SEBI to enhance investor protection and strengthen the capital markets in India.

The objective of our empirical study is two fold; to understand the economic implications of this Regulation on stock market variables and to understand the role of various corporate governance structures on agency costs of publicly traded companies.

We conduct a quasi-experimental research study with two time periods, pre-regulation time period and post-regulation time period. For the purpose of this study, we consider pre-regulation time period from 1st June 1998 to 31st May 1999 and the post-regulation time period from 1st June 2001 to 31st May 2002. We classify all the companies, whose data is available on Prowess database, into experimental group, quasi-experimental group and control group. We hypothesize

functioning of a company. Similarly, we also observe that independent directors do not have any effect on the agency costs of companies. This result is contrary to the expectations of Kumar Mangalam Birla Committee that independent directors will help in improving the performance of the companies.

Thus, our results provide evidence that the Regulation has been effective in reducing the beta of the experimental group of companies and that FII and promoter ownership are effective in reducing the agency costs. These results, to a limited extent, prove that Regulation has been effective in addressing the ‘information asymmetry problem’ and the ‘agency problem’. Understanding the effect of this Regulation on stock market efficiency and on voluntary disclosures made by publicly traded companies can be an extension of our study.

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