excellence enablers CORPORATE GOVERNANCE SPECIALISTS
(AN M. DAMODARAN INITIATIVE)

Expert Expressions
Corporate Governance Demystified

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A series of interfaces with the entire range of stakeholders of Corporate Governance, has given rise to a number of questions, issues, concerns and, happily, some suggestions and solutions. In each issue of this monthly newsletter, we will be getting two experts to articulate their thoughts on a specific topic. The second issue is now with you. Needless to add, we welcome your feedback.

Editor

QUARTERLY ACCOUNTS – BOON OR BANE?

M. Damodaran
Chairperson,
Excellence Enablers
Former Chairman,
SEBI, UTI and IDBI

The question "Whose purpose do quarterly accounts serve?" is beginning to get increasingly asked in corporate circles. It is well recognised that a quarter as an accounting unit breeds short termism. Taken together with guidance provided by managements, and the expectations of the street (read analysts), this sometimes leads to financial engineering such as postponing bad news and artificially phasing in revenue to show continuing improvement in performance. Countries such as UK, Australia and South Africa have lived with half-yearly financial statements, and are none the worse for it. It is clearly established that there is no correlation between a lesser frequency in financial statements and the occurrence of corporate frauds. Is the rendering of quarterly financial statements, premised on the need for reducing information asymmetry, a solution worse than the problem? In the process, does compliance tend to pre-empt significant management bandwidth at the expense of business? Y.M. Deosthalee and Ashish Chauhan offer their take on the subject.

Y.M. Deosthalee
Chairman,
L&T Finance
Holdings

Ashish Chauhan
MD & CEO,
Bombay
Stock Exchange

Over the past few decades, increasing shareholder activism has forced market regulators around the world to enforce more frequent financial reporting for listed companies; the primary rationale being the need to eliminate information asymmetry between retail and institutional shareholders.

The resulting information overload has led to increased volatility in global stock markets as investors constantly react to fresh data. The pressure on quarterly results often leads to postponement of recognition of adverse effects in the hope that the situation would be rectified in succeeding quarters. This leads to accumulation of bad news in a particular quarter leading to wild fluctuations in stock prices.

Joint stock companies and double-entry book keeping system, in my opinion, are amongst the most important social innovations the world has witnessed in last millennium. Together, they have helped the world progress materially and allowed people to share their capital for committing to future.

Joint stock companies, constituted as early as 13th century, with double-entry book keeping in 1494 paved the way for incorporation of limited liability entities, the East India Company in 1600 being one famous example.

There has always been an asymmetry of information between "Insiders" whom we know as promoters or

Companies are also under constant pressure to meet quarterly expectations of analysts which forces them to focus on short-term objectives instead of executing long-term strategies.

Mandating quarterly declaration also results in the unintended consequence of companies' Finance & Accounts teams spending more time in reporting and interacting with auditors at the expense of other functions.

While in theory the increased frequency of financial reporting should result in elimination of accounting fraud; in practice, international examples like Enron and WorldCom, both of whom used to declare quarterly results, demonstrate the limitations of this approach.

The London Stock Exchange (LSE) has made quarterly financial reports optional since 2014 and there are calls for similar changes in the US-SEC. Perhaps it is time for Indian regulators to also look beyond quarterly reporting and instead focus on continuous disclosure as a tool for reducing information asymmetry between various classes of investors.

managers; and other shareholders whom we will call "Outsiders" in this article. Outsiders are legitimate owners but have much less information available to them. Over time, regulations and pressure from Outsiders, periodicity as well as the quality of the disclosures has increased. Quarterly results and other disclosure requirements as well as the use of technology have helped the corporates to reduce the asymmetry of information to some extent. We have come a long way in reducing malpractices of insiders over last two decades in India and abroad.

I will not be surprised, if some tech savvy companies start giving monthly, weekly, daily or real time disclosures on the operations of the company to provide comfort to the outsiders to show them that the system is not loaded against them. Of course, as the CEO of the largest stock exchange in the world by number of listed companies, I would be delighted if an Indian company decides to do this and lead the world in corporate governance.