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Mandatory Disclosure: Transparency of the Company

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Disclosure not only creates transparency but shows fairness and accountability of the company to the public. In a public corporation specifically, this would be beneficial as the shares being bought by the public, have a general right to know about the working of the company and this ensures that right is being fulfilled. This provides an incentive to the shareholders to get more involved with their investment when the opportunity is provided by it in selling or purchasing of shares. The controlling shareholders tend to hoard resources and this leaves the minority shareholders with minimal to nothing to gain, so disclosure ensures that the wealth maximization is not only for the controlling shareholders but also for the common stock shareholders as well. The mandatory disclosure policy can be used by corporations specifically for their benefit but sometimes it is also used by rival companies against them. A company with proper disclosure is likely to attract rivals to misuse the information and increase the competition. A mandatory disclosure ties the hands of the controlling shareholders and decreases external finance. But at the same time for firms with a low level of diversion, it would end up being a benefit as it would influence more external financing. An investor before investing in a company would analyze the firm and then decide to invest in the company. So disclosure on part of the company enables the prospective investors to understand the working of the company and the existing profits or losses and the product involved which helps the investors to make a decision. So when the investor and the firm have a bond of trust, it makes it very convenient and highly likely for the investor to invest more in case of liquidation for maximizing the wealth of the firm.

Keywords: *disclosure, company, transparency.*

INTRODUCTION

Corporations have been established all around the globe. The primary objective of establishing any corporation is earning profit. The companies have their own set of rules and regulations which are mentioned in the Articles of Association and the Memorandum of Understanding. A well-established corporate governance structure implies effective control and accounting systems, rigorous monitoring, effective regulatory mechanisms, and efficient resource utilization, all of which lead to enhanced performance. The Companies focus primarily on profit-making as without profits there would be no financial stability in the company and would end up being liquidated. A person who comes up with the idea of starting a company does not mandatorily have the financial position to run a company, so he would require an investment into the company. Now any person investing in the company would need a solid reason to invest and while investing would want profits for himself as well. The likelihood of the investor being ignorant of the profit is very unlikely. So, to understand the process of how the company attracts investors and how the company deals with an issue in case of facing continuous losses, it is important to learn the concept of Mandatory disclosure and Shareholder wealth maximization.

SHAREHOLDER WEALTH MAXIMIZATION AS A MEANS TO AN END

A company[1] in Delaware facing a declining/deteriorating cash position has to decide to save the company. It is left with the option to 'Gamble' where all the assets are deployed for a new business which would either be a 100% success or a 100% failure; or go for 'Sure Thing' where it would go for liquidation. But the option needs to be exercised after considering the financing of the Company if the Sure Thing option is taken up then the probability of the proceeds being absorbed by the senior contract claims is high and it would leave the common stockholders with nothing. When any conflicting interest issue arises, the Directors are called upon to mediate the conflict. The Board of the company has a role in the renegotiations which gives the shareholders the role to ensure the wealth maximization of the corporate. Where the Directors, in general,

[1] Robert P Bartlett II, 'Shareholder Wealth Maximization as Means to an End' (2015) 38(2) Seattle University Law Review

would opt for maximizing the returns of the common stockholder, the Board would likely opt for a riskier option for the corporate assets but if that entails changing business lines then the Board has to satisfy the lender of its profitability. The investors are entitled to a veto right to regulate the conduct of the business and they opt out of shareholder wealth maximization when they appoint their director-designees. Fiduciary duties minimize the cost of ex-post renegotiation and even when directors might be inclined towards the benefits of a shareholder, they owe the duty to maximize the firm value. Previous decisions where shareholder wealth maximization is an end, would not be hampered when board decision-making is conceptualized.

Including all possible contingencies in a financial contract are not possible and the party holding residual rights might hold the upper hand during bargaining. The Bargaining model of the board contains two settings for deciding the residual rights; one being shared control of the board and the other being unilateral control. When a liquidity-restrained Founder lacks the capital to develop a business plan, the remedy is available with an external equity investor (VC). The purchase of a senior equity security with certain economic preferences, such as a dividend priority and a liquidation preference payable to the VC upon an acquisition or liquidation of the company before any payments on the company's common stock can be made is one contractual device generally used. The VC can also have several rights including abandoning the investment, veto right in corporate actions, monitoring progress, and board representation which would virtually give control to the VC. To avoid this, the Founder and the VC have shared board control and a third-party vote would decide in case of any conflict. But the probability of the third party siding with the VC to remove the Founder if that would maximize the wealth of the firm is likely which takes us to unilateral control which entails that the rights of the investor are restricted and foreseeable contingency rights are given to the investor, subject to bargaining if need be. This would not give complete control to the investor and allow the Founder control while ensuring that the investor still has considerable control over his investment.

The directors have a fiduciary duty to maximize the value of the firm and when the financing maximizes the firm value by funding, by a Coasian bribe to the VC, the firm would also give the

common stockholders a chance to get some return in case of liquidation. Since the duty of the director is to the corporation first, it would stand in consonance with the decision of financing. When the transaction is done in good faith and for the corporation, it is considered to be all right. So having shareholder wealth maximization would not be the only means of maximizing the firm's value. Finally, for many companies that are still in the early stages of development and require outside funding, cross-listing is not a viable option. As a result, many corporations' disclosure regimes are primarily confined to what is offered by their home country or domestic exchange. The benefit of legislating a strict disclosure regime is that not all businesses will want to commit to it, even if it is in their best interests.

Regardless of the benefits, every particular firm's capacity to implement a credible obligatory disclosure regime for itself through charter clauses or other contractual arrangements is severely constrained. The Courts in Delaware have stated that the directors can be sued by the stockholders[2] and the duties run for both the corporation and the stockholders[3]. But when a diverging scenario comes up, the Courts have stated that the directors can show their decision to be in the best interest of the corporation.[4] Maximizing the value of the firm is ordinarily good for the stockholder value as well but no proper standard for the directors has been laid down by the Courts. The Delaware Courts via eBay Domestic Holdings, Inc. v Newmark[5] and In re Trados, Inc.[6] have tried to analyze whether the value maximization of the firm leads to value maximization of the stockholders or vice versa. Though no certain conclusion can be drawn from them, it can be understood that the effect of value maximization of the firm and the stockholders are subject to each case.

Indian Context

Wealth maximization is a concept that is the goal of every corporation. A corporation without profit would never strive. Corporations in India are no exception to that. Even though Indian

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[2] *Taylor v Miami Exporting Co.* [1831] 5 Ohia 162, 166

[3] *Loft Inc. v Guth* [1938] 2 A.2d 225, 238 (Del)

[4] *Guth v Loft. Inc.* [1939] 5 A.2d 503 (Del)

[5] *eBay Domestic Holdings, Inc. v Newmark* [2010] 16 A.3d 1 (Del)

[6] *Re Trados, Inc.* [2013] 73 A.3d 17, 17 (Del)

law does not explicitly mention wealth maximization the Companies Act, 2013 calls for good governance. Since 1998, multiple committees constituted by the Ministry of Corporate Affairs (MCA) and the SEBI have worked diligently to develop both mandatory and voluntary corporate governance principles.[7] The introduction of the 2009 Mandatory Corporate Governance Voluntary Guidelines, which must be followed by companies listed on stock exchanges under Clause 49 of the Listing Agreement, including mandatory codes to be followed by companies about the board of directors, audit committees, and various disclosures for related party transactions, whistle-blower policies, and so on, marked a significant shift in the corporate sector.[8]

Good governance is the best management and strategy that should be used by the company in good faith for the benefit of the company and the stakeholders. Wealth maximization is a strategy that calls for the decision-makers in the company to make decisions that would be the best possible way for obtaining or maintaining the wealth of the company. A total analysis of the cash flow of the company enables deciding on profit maximization.[9] In India, the Companies Act entrusts higher management to ensure that the company has the best strategies to make a profit for the company and the stakeholders.[10] Asserting shareholder confidence and implementing long-term financial strategies have become critical for an organization's long-term survival. As a result, value-based management has acquired a lot of traction and has become a major metric for evaluating an organization's financial growth. Organizations in the modern economy try to persuade their shareholders that they are a worthwhile investment by showcasing the genuine value of the organization through the disclosure of essential information in annual reports, mission, and vision statements.

Firms are prioritizing the importance of shareholder wealth to attract long-term investments from shareholders while preserving a trusting relationship with them. Furthermore, the idea of

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[7] Anith Johnson, 'Corporate Governance under the Companies Act, 2013' (*Ipleaders,* 10 October,2017) <https://blog.ipleaders.in/corporate-governance-companies-act-2013/> accessed 15 January 2023

[8] *Ibid*

[9] 'Espousing Corporate Governance' (*ICSI*) <https://www.icsi.edu/media/webmodules/gstheadlines/Knowledge_Paper_on_Wealth_Maximization_V2_FINAL.pdf> accessed 10 January 2023

[10] *Ibid*

shareholder wealth maximization states that a corporation's immediate operating goal and ultimate goal is and must be to increase return on equity capital. The shareholder wealth maximization definition of what is commonly referred to as a corporate goal aligns with the operating objective and ultimate goal: investors and managers should focus on shareholder wealth maximization.

THE CASE FOR MANDATORY DISCLOSURE IN SECURITIES REGULATION AROUND THE WORLD[11]

Mandatory disclosure in securities is a highly debatable concept. The disclosure might increase the stock price, but at the same time might end up being beneficial for the market forces to harm the firm. In countries with dispersed ownership structures, mandatory disclosure serves the interests of the shareholders but many countries in the world have concentrated ownership structures. The people against mandatory disclosure express that a firm selling the finest quality product disclosing the information would show the consumers of the quality of the products and attract them, which in turn would compel the lower quality firms to disclose too to prevent being misunderstood for an even lower quality product. This chain is created by the market and would be voluntary so there is no requirement of having mandatory disclosure. This in turn attracts shares and investors to invest in the firm and increase the firm value. Disclosure is not a costless procedure and involves charges and the chance of loss of competitive advantage which might result in a trade-off of costs and benefits.

The shareholders in many firms divert the resources towards themselves (Tunnelling) and mandatory disclosure can adversely affect their ability to do so. The controlling shareholders are likely to ignore the minority shareholders' interest while deciding the course of action. This would also increase the competition in the product market. The engagement of the controlling shareholders in tunneling makes it not preferable for them to disclose this information to the public. The empirical studies have shown that the higher the controlling shareholders get private benefits, the lower the level of disclosure of the firms and vice versa. But the diversion

[11] Allen Ferrell, 'The Case for Mandatory Disclosure in Securities Regulation around the World' (2007) 2(1) Brooklyn Journal of Corporate, Financial & Commercial Law

is not always a bad thing and can be compensated for the monitoring of the firm's management and not cause any social loss. Non-disclosure might be a benefit for the minority shareholders when the shares are issued at a discount. Firms reliant on external financing might end up with lower capital with a stricter disclosure regime. A firm with higher value would get more financing whereas a firm with lower value would get lesser financing since the quality would be assumed to be lower than that of the higher-value firm. Expected returns are higher for securities with a high level of private information trading. A higher expected return would get a higher cost of capital. So a firm can benefit from not only credibly committing to meeting demanding disclosure standards when raising external capital but also credibly committing to meeting demanding disclosure requirements in the future.

Disclosure would enhance external finance since it would show low diversion of the assets and thus, the profit of the firm being larger for all the shareholders. Firms with sufficient internal funding face a decline in investment in comparison to firms requiring more external financing. Some firms might support the mandatory disclosure as it would likely give the controlling shareholders more profits than what they would've gained by diverting the resources.

The hostility of larger corporations to the prospect of increased competition influences if the government reacts to the demands of some firms to make enhanced disclosure standards available to them. In other words, improved disclosure criteria will typically benefit outsiders to the exchange's internal decision-making process when it comes to determining listing rules. Refusing to implement or enforce a meaningful disclosure regime by the government or an exchange can be a justifiable decision. Putting in place a required disclosure framework with significant enforcement is a costly and, perhaps more crucially, difficult undertaking. This includes permissible levels of judicial corruption and a minimum level of judicial expertise in evaluating the merits of these cases. In case of poor disclosure, having controlling shareholders would most likely be beneficial for the management of the firms.

Indian Context

In today's competitive market, any organization views effective corporate governance to be a requirement for achieving the goal of maximizing shareholder wealth. Management responsibilities and procedures are aimed at giving strategic direction, ensuring that the goal is met, ensuring that risks are correctly handled, and that resources are effectively employed. When a company is committed to increasing shareholder value, investors and shareholders look for answers to questions like what information has been supplied or made available to shareholders in the past and what promises are being made in the future to increase long-term shareholder value. In a study conducted on value disclosure practices in India, it has been stated that in competitive markets like India, excellent corporate governance aids companies in achieving their business purpose. Every business aims to improve the firm's worth over time, ultimately improving long-term shareholder value. The goal is to increase qualities like transparency, professionalism, accountability, and fair disclosures over time to gain shareholder trust.[12]

Mandatory disclosures are required in India under the Companies Act 1956 and its subsequent revisions. With the Companies Act of 2013, India became the first country to require corporate social responsibility. Voluntary disclosures are those made by firms in their annual reports without being compelled to do so by a regulatory entity.[13] In India, revised Clause 49 of the Listing Agreement mandates that all listed businesses file a CG report every quarter. The amended Clause 49 has effectively carried out the original aim of safeguarding investors' interests through improved governance measures and disclosures.[14]

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[12] Merugu Venugopal & Dr. M. Ravindar Reddy, 'Shareholder Value Disclosure Practices I India: A Content Analysis' (2017) 8(2) IOSR Journal of Economics and Finance <https://www.iosrjournals.org/iosr-jef/papers/Vol8-Issue2/Version-4/A0802040108.pdf> accessed 16 January 2023

[13] 'India: Disclosures Under SEBI (Listing and Disclosure) Regulations, 2015' (*Mondaq*, 14 October 2015) <https://www.mondaq.com/india/securities/434208/disclosures-under-sebi-listing-and-disclosure-regulations-2015> accessed 17 January 2023

[14] K. Banupriya & Dr. C.V. Vethiraja, 'Corporate Disclosure Practices in India: A Study' (2015) 5(12) IJAR <https://www.worldwidejournals.com/indian-journal-of-applied-research-(IJAR)/fileview/December_2015_1448964552__55.pdf> accessed 18 January 2023

There are two types of disclosure: mandatory disclosure, which occurs when regulatory authorities require companies to disclose certain elements of information, and voluntary disclosure, which occurs when companies choose to disclose more information than is required because they believe it will benefit them. Managers should carefully consider their disclosure strategy since the benefits include improved market reputation, reduced political and regulatory intrusion, and increased stock liquidity.

Policies and working but also the details of the existing shareholders and the Directors and Board members to create trust in the minds of the prospective investors. If there is a major change in accounting policies in the current period, the amount by which any item in the financial statements is affected by the change should be stated to the extent possible. If the sum cannot be determined in whole or in part, the fact should be stated. Specific disclosure is not required provided the fundamental accounting principles of going concerned, consistency, and accrual are followed in financial statements. The information should be stated if a fundamental accounting assumption is not followed.[15] Additional and upgraded information should be offered to investors for them to properly assess company performance. In this new era of financial reporting, voluntary disclosures of value-added, human resource accounting, and social reporting are strongly encouraged and appreciated. Additional corporate disclosure is also required to include new business and economic factors.[16]

CONCLUSION

A company with transparency is likely to attract more investors which would be beneficial for the finances of the company as well as in maximizing the wealth of company. In cases where the shareholders are involved in the decision-making of the company, the shareholders and investors have a say in where the investment goes which also is likely to bring good ideas to the table. Even when the competition would be higher due to disclosure, it also is likely that the disclosure would get more consumers due to the clarity of the consumers on the quality of a

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[15] *Ibid*

[16] Mamillapalli Venkata Amuktha & Rajiv Nair, 'Corporate Social Responsibility and Shareholder Wealth- "Evidence From Indian Manufacturing Sector"' (2019) 8(8) IJITEE <https://www.ijitee.org/wp-content/uploads/papers/v8i8/H7502068819.pdf> accessed 15 January 2013

product. The rights given to the shareholders to control the affairs of the firms need to be regulated as an excess power allotment to the shareholders creates the threat of a hostile takeover as had been the main contention in the eBay case.

People in India have a mentality that a product with a higher price is a better product. So when the disclosure takes place and a company's value is higher, the crowd tends to believe the product to be of higher quality. This is beneficial for the company with higher value and gets more investors but in turn, hampers the companies that have lower value even though the quality of the product is not compromised. Higher value attracts higher financial investment so even with conflicting interests for the higher value and lower value companies, it is beneficial for the economy of the country.

The current disclosure system fails to distinguish between the many diverse needs of financial reporting information users. While some users may be content with lengthy disclosures, the majority are burdened with information that is far too extensive and complex for them to understand and utilize. Disclosure regulations in the common core should be kept to a bare minimum to enable effective communication.[17] When a company is incorporated, the target is wealth maximization which is achieved by the strategies made by the Board members, and disclosure of the same impacts the investments that the company gets. It is needless to say that even when the minds of all the shareholders are not involved, the financial backing that the shareholders provide, enables the working of the company so it is important to make decisions that would be for the benefit of those shareholders.

[17] K. Banupriya (n 14)