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Decoding Risk Disclosure: Do Board Characteristics Matter in Indian Firms?

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Abstract

The research question of the research study is whether the board characteristics have an impact on the risk disclosures of the listed companies in India. This study uses the sample data of non-financial companies that are listed on the Bombay Stock Exchange (BSE). The findings of the Fixed effect model and GMM regression indicate that the ownership of the company (family ownership, Government ownership and Management ownership) does not have any significant impact on the risk disclosure of Indian companies. The presence of woman directors (WD), firm size, CEO duality and firm age is positively associated with risk disclosure. The results support the empirical evidence on the influence of internal authority mechanisms on the behaviour of businesses in reporting their activities in India, and provide insights for regulators, investors, and policy makers to enhance the quality of accountability and disclosure.

Keywords: Corporate Risk Disclosure, Board Characteristics, Fixed Effect and Random Effect, GMM.

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Introduction

The debate on corporate accountability and transparency in the past two decades has been given centre stage for the issue of corporate governance and risk disclosure. The growing complexity of business processes and the stakeholders' focus on companies has led to the need for corporations everywhere to enhance the quality and quantity of the risk information they disclose in their annual reports. Risk disclosure can help investors, regulators, and analysts to evaluate how a firm is exposed to uncertainties and determine how well the management of a firm can withstand the impact of these risks (Elshhidat et al., 2018; Khlif and Hussainey, 2014). As per agency theory (Jensen and Meckling, 1976), risk communication reduces the amount of information asymmetry between shareholders and managers, thereby reducing any opportunistic behaviour and agency costs. However, despite the emphasis on corporate transparency in the regulatory requirements, the level and extent of transparency in the disclosure of risks in companies are far from homogeneous (Al-Hadi et al., 2019; Elgammal et al., 2018).

A few business scandals have been revealed worldwide, such as Enron (2001), Lehman Brothers (2008), and Wirecard (2020), and these have emphasized the dangers of not reporting risks in an honest manner and of not having a set of effective governance mechanisms in place that can lead to catastrophic business failures. The events have led the controllers and researchers to revisit the link between the attributes of board governance and disclosure practices of firms (Linsley and Shrives, 2006; Abraham and Shrives, 2014). In developed markets, the factors affecting the corporate risk disclosure have been widely studied, while the topics covered in the board disclosure include the composition of the board, the independence and diversity of the board (Ntim et al., 2013; Elshandidy and Neri, 2015; Allini et al., 2016). Nevertheless, the evidence provided by the emerging economies, in particular, India, is rather scanty and inconclusive (Saggar & Singh, 2017; Haldar and Raithatha, 2017). Emerging market institutional and regulatory frameworks are also distinctly different to those of the developed countries, and they affect the dynamics of disclosure practices. Thus, the examination of how the structure of boards relates to corporate risk disclosure in India will yield some of the unique insights into the translation of governance change into transparency effects in the developing market context.

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There has been a vast transformation of the corporate governance framework in India since the liberalisation reforms of the 1990s. Through such measures as Clause 49 of the Citation Arrangement, the Companies Act, 2013 have helped formalise and establish governance norms such as board independence, gender diversity and the establishment of audit committees. In addition, in 2018, amendments made by the National Financial Reporting Authority (NFRA) and SEBI to enhance the regulation of the performance of boards and compliance with disclosure obligations were made. But the studies have found that there is still a lack of uniformity among Indian firms in terms of risk reporting, and that risk reporting is symbolic rather than regulatory based as it focuses more on regulation and not transparency (Haldar et al., 2020). This gap between the regulation and practice raises a number of important questions about the effectiveness of the regulation in the shape of the board for purposes of encouraging credible risk disclosure.

The role of the board of directors is very important to ensure transparency, accountability and good communication with the stakeholders. Board attributes that impact on the quality of disclosure and monitoring include the size of the board, board independence, diversity, and leadership style, along with the frequency of board meetings (Adams and Ferreira, 2009; Garcia-Sanchez et al., 2020). Better decision-making and increased scrutiny of disclosure processes have been argued to be enhanced through bigger boards since they bring different expertise and different angles (Elzahar and Hussainey, 2012). However, a too large-sized board might lead to the challenges of coordination, which leads to the lack of monitoring and reporting (Khan et al., 2021). Similarly, Board independence is considered as a positive factor, which can add objectivity and reduce managerial opportunism and increase the reliability of the information reported in the financial statements (Ho and Wong, 2001; Barako et al., 2006). However, the empirical evidence is inconclusive, as both studies conclude that there are positive relationships (Oliveira et al., 2011; Ciampi, 2015) and other studies that find no or even negative effects (Dominguez and Gamez, 2014).

Another important aspect of governance that has come out as having an impact on risk communication is gender diversity on corporate boards. Women directors are thought to be more ethical, more stakeholder-oriented and more holistic in their risk management (Adams and Ferreira, 2009; Terjesen et al., 2016). The recent findings that have been validated in the

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European and Asian markets show that gender-diverse Boards tend to be more likely to make more detailed and balanced risk disclosures (Kassinis et al., 2022; Bhatia and Bansal, 2021). The legislations of at least one-woman director under the Companies Act (2013) have led to a greater representation of women on the boards of companies; however, very few studies have investigated the impact of the legislations on disclosure behavior in India (Haldar et al., 2020; Sahoo and Sahu, 2023).

Using the complementary explanations, the relationship between board qualities and disclosure can be explained on the basis of agency theory, stakeholder theory, and resource dependence theory. The agency theory has highlighted the function of independent boards to keep an eye on the actions of the managers and ensure that their actions will be in accordance with the interest of the shareholders. More emphasis on transparency as means to attain legitimacy and meet the needs of the various stakeholder groups (Freeman, 1984; Amran et al., 2009) is placed in stakeholder theory. Resource dependence theory, in its turn, considers board diversity and expertise as helpful resources that increase the capability of the firm to handle risks as well as to interact with the external parties in a more effective manner (Hillman and Dalziel, 2003). The combination of these views highlights the fact that the effective boards are not only good at reducing information asymmetry but also is a strategic asset that can influence legitimacy and competitiveness of firms due to the enhanced risk disclosure.

Methodology

Table 1. Sample Selection

Particulars	Number of firms
Total firms available in BSE 500 Index	500
Less: Financial Companies and not registered in North	390
Less: Companies with missing values	31
Final sample located in North Region	79*5 years =390

Source: The Author

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The following table shows the descriptive data of all the variables using 390 firm-year observations. It shows a medium level of disclosure: mean = 72 and is highly dispersed: SD = 12. It indicates that the mean of the Corporate Risk Disclosure (CRD) is 72, indicating medium level of disclosure and has very high dispersion: SD = 12. The ownership levels in terms of government, family and managerial ownership (GO, FO, MO) are low on the average, whereas board characteristics indicate that boards have approximately 9 members (BS), undertake approximately 8 meetings per year (BM) and have very few women directors (WD) and very uncommon CEO duality (CD). There are executive directors (ED) averaging at about 5. There is a medium variation in the firm size (using log of total assets) and firm age in the case of 35 years on average. The financial indicators suggest that the current ratio is generally quite low (CR 2) and the debt-equity ratio is quite low (DER 1.86) but there could be a handful of highly leveraged firms.

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Results and Discussion

Table 2. Descriptive Statistics of study variables

	CRD	GO	FO	MO	BB	BM	BS	ED	CD	WD	FS	FA	CR	DER
Mean	72.097	11.587	14.804	20.467	2.077	8.503	9.485	5.095	0.108	0.131	3.885	35.385	2.007	1.862
Median	74.000	0.000	1.325	0.028	2.000	8.000	10.000	5.000	0.000	0.000	3.860	32.000	1.444	0.166
Maximum	169.000	89.180	90.635	76.406	9.000	31.000	18.000	11.000	1.000	1.000	5.636	86.000	19.718	459.258
Minimum	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	1.812	4.000	0.177	0.000
Std. Dev.	30.499	25.288	23.408	24.737	2.093	5.109	2.837	2.351	0.310	0.338	0.689	14.912	1.994	23.625

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Observat ions	390	390	390	390	39 0	390	390	390	39 0	39 0	390	390	390	390

Source: The Author

The following table shows the descriptive statistics of all the variables of the study using 390 firm-year observations. It reveals that the Corporate Risk Disclosure (CRD) has a mean of 72, which represents medium levels of disclosure, and it is very dispersed. The ownership levels in terms of government, family and managerial ownership (GO, FO, MO) are low on the average, whereas board characteristics indicate that boards have approximately 9 members (BS), undertake approximately 8 meetings per year (BM) and have very few women directors (WD) and very uncommon CEO duality (CD). There are executive directors (ED) averaging at about 5. There is a medium variation in the firm size (using log of total assets) and firm age in the case of 35 years on average. The financial measures suggest a relatively low current ratio (CR 2), and a relatively low debt-equity ratio (DER 1.86), but that the upper bounds allow for a few highly leveraged firms. All in all, the standard deviations and the wide range show that there is a lot of heterogeneity among firms in terms of ownership structure, governance practices, and financial characteristics.

Table 3. Correlation

	CRD	GO	FO	MO	BB	BM	BS	ED	CD	FS	FA	CR	DER
CRD	1												

GO	-0.061	1											
FO	-0.108	-0.291	1										
MO	0.006	-0.380	-0.349	1									
BB	-0.009	0.093	-0.024	-0.090	1								
BM	-0.074	-0.112	0.082	-0.029	-0.090	1							
BS	0.218	0.093	-0.272	0.099	0.076	-0.007	1						
ED	0.032	0.093	0.045	-0.018	-0.027	-0.003	0.076	1					
CD	0.010	-0.016	0.095	-0.062	-0.044	0.100	0.008	0.011	1				
FS	0.058	-0.071	-0.038	0.127	-0.145	0.041	-0.050	-0.080	0.062	1			

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FA	0.117	0.371	-0.551	0.072	0.092	-0.044	0.384	-0.069	-0.075	0.043	1		
CR	0.160	0.199	-0.274	0.086	0.085	-0.120	0.299	-0.016	0.010	0.082	0.282	1	
DER	0.042	-0.027	-0.040	0.062	-0.012	-0.008	0.004	-0.017	-0.020	0.006	0.060	-0.072	1

Source: The Author

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With the correlation table, the strongest and the direction of the linear relationships between the variables studied can be seen, and most of the numbers in the table are very weak to moderate, meaning there is no serious multicollinearity. Corporate Risk Disclosure (CRD) is also weakly associated with all variables with a small positive association with the board size (0.218) and firm age (0.160) and extremely small negative associations with government ownership (–0.061) and family ownership (–0.108). The correlation is moderately negative between the ownership variables, with government ownership being least correlated with family ownership (-0.291) and family ownership being least correlated with managerial ownership (-0.349), indicating that companies with a specific type of ownership are less likely to have the other type of ownership. The correlation of the attributes of boards is moderately low overall (CRD) and between the attributes themselves, meaning that the attributes are independent. There is a weak negative relationship between size and the board size (-0.384) or government ownership (-0.371), suggesting that larger companies tend to have slightly smaller boards and government ownership. Financial ratios such as current ratio (CR), debt-equity ratio (DER) have insignificant relationships with CRD and other governance ratios. In general, the low correlation coefficients corroborate the fact that there is no excessive overlap of the variables, and they can be used in the multivariate analysis.

Table 4. Results of the Panel GMM model

Variable	Coeff.	Std. Err.	T-statistics	Prob.
CSRD L	0.1623	0.1012	1.60	0.109
FO	0.1362	0.3264	0.42	0.676
GO	0.3873	0.0507	0.37	0.712
MO	0.1254	0.2485	0.50	0.614
FS	0.097	0.0363	3.13	0.002
CR	0.4231	0.6375	2.22	0.027
DER	0.2039	0.2039	-0.20	0.78
WD	0.7016	0.6447	1.01	0.012
BM	0.4065	0.4065	0.33	0.742

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BB	0.8583	0.8583	0.63	0.531
ED	0.6916	0.6916	0.82	0.415
BS	0.9682	0.2959	3.06	0.002
FS	0.8736	0.9843	0.00	0.3
FA	0.4493	0.3936	1.80	0.06
PBR	0.0088	0.0968	0.00	0.92
MC	0.9473	0.9473	1.41	0.157
_cons	0.3111	0.2581	-1.00	0.00
No. of Instrument variables		22	No of Obs	234
Wald Chi-square	175.47		No of groups	78
Prob > Chi-Sq	0.00001			

Source: The Author

The study has used the generalised method of moments (GMM) regression because it is resistant to endogeneity and can be utilised to make large sample estimates. The results of regression are shown in Table 7. The results show that the family ownership (FO), Government ownership (GO) and Management ownership (MO) have a positive and insignificant impact on corporate risk disclosure in Indian based companies. This implies that regardless of the nature of ownership adopted by the companies, it is not having a significant impact on the corporate risk disclosure in Indian companies.

Conclusion

The problem statement for this study is to find out if the board characteristics have any impact on the risk disclosure practices of listed companies in India. The analysis is conducted using firm panel data over the years with the use of board size, board meetings, board busyness, CEO duality, female directors, family ownership, managerial ownership and government ownership to determine the extent of disclosing information about risk in annual reports. The findings from the Fixed effect model and the generalised method of moments (GMM) regression indicate that family ownership (FO), Government ownership (GO) and Management ownership (MO) has a positive but insignificant relationship with corporate risk disclosure in Indian companies, suggesting that whatever the form of ownership for the Indian companies, it is not significantly affecting the corporate risk disclosure in Indian companies. Women directors (WD), size of the firm, firm's CEO duality and age of the firm are also positively related to risk disclosure.

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