INVESTORS' REACTION TO THE PASSING OF THE INDIAN COMPANIES ACT, 2013

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Abstract:

This research seeks to determine whether mandated corporate social responsibility (CSR) is value relevant to investors, specifically investors of Indian companies affected by the Companies Act, 2013 which requires companies meeting specific financial criteria to spend 2% of their three-year average net profits towards "social initiatives." Recommended social initiatives include the development and implementation of environmentally sustainable business practices. Using the event study methodology, this study compares the cumulative abnormal returns (CAR) of companies perceived as environmentally friendly on the Bombay Stock Exchange (BSE) with those not considered environmentally friendly. Environmentally friendly (EF) companies were determined through the use of the BSE Greenex and Carbonex indices which track firms' sustainability policies, strategies and accomplishments. This research has found that affected companies considered environmentally friendly are impacted significantly less negatively in terms of CAR than other affected companies. This finding suggests that mandating CSR is relevant to investors concerned with environmental sustainability.

Introduction/Background:

Fama, Fisher, Jensen and Roll (1969) introduced the event study methodology, proposing that investors reflect their reactions to "events" affecting their investments through the capital market by producing abnormal returns in the market during the "event window." Recent capital market-based research studies utilize this methodology indicate that investors do react significantly through the capital market and that they do react significantly to CSR-related events. As Section 2013 of the Indian Companies Act, 2013, passed on Thursday, August 29, 2013, is the first legislation in the world to set a minimum mandatory amount for CSR expenditure on public companies, this study will catalog abnormal returns surrounding its passing to determine whether or investors view the legislation as value-creating to their investments and refine our understanding of CSR and how it affects companies and their investors.

Event Study Methodology:

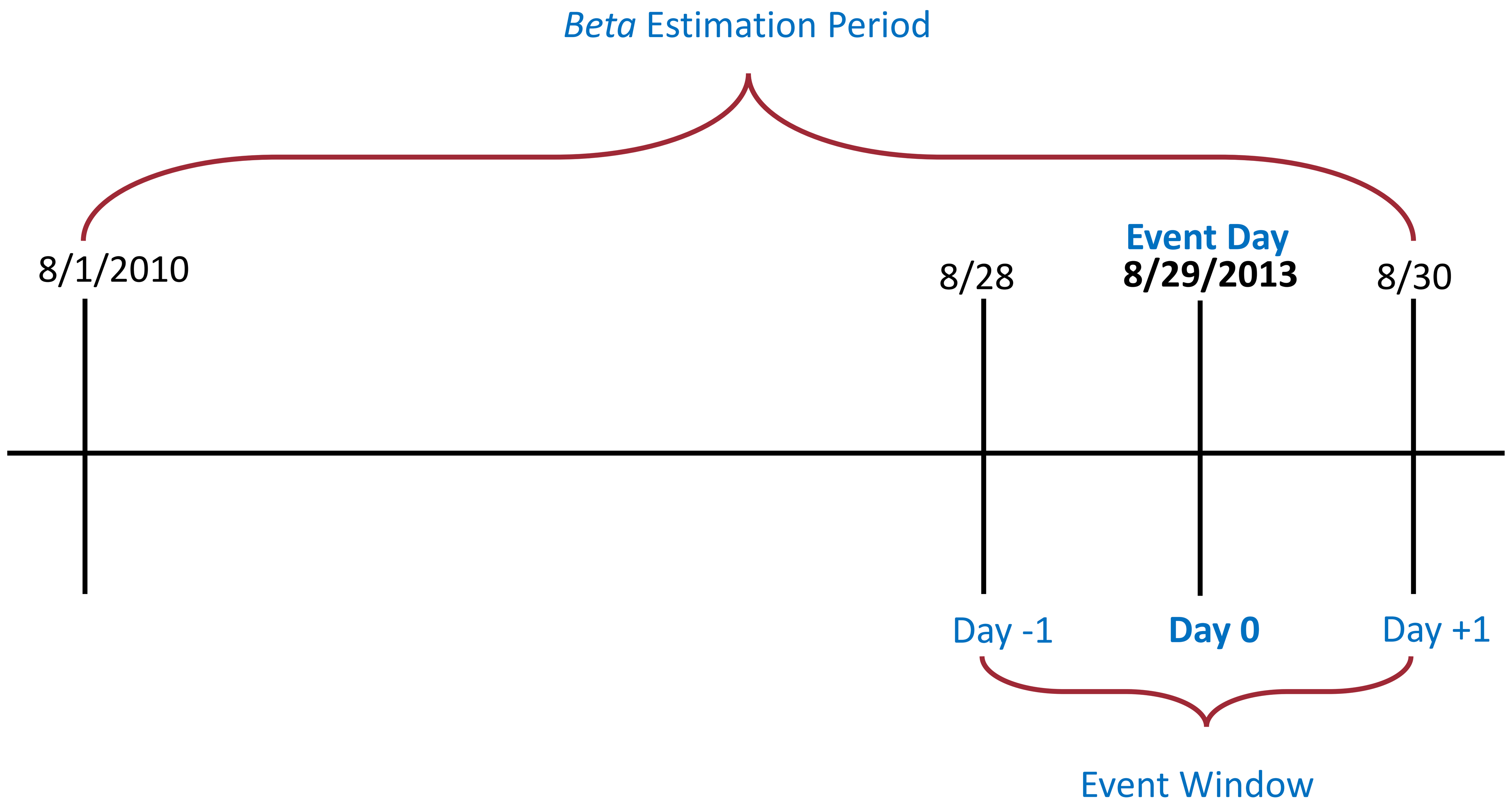
1) Define Event: Thursday, August 29, 2013

2) Select by Criteria: Publicly traded companies on the Bombay Stock Exchange (BSE) with:
NW > Rs. 5 billion *or* Sales > Rs. 100 billion *or* RS. NP > 50 million

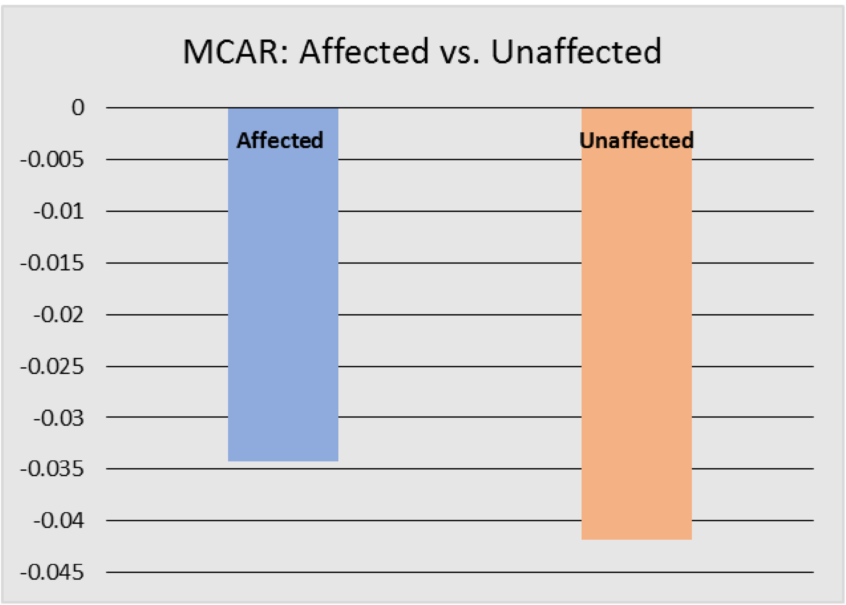
3) Derive Expected and Abnormal Returns:
Collect daily share prices: event window (Days -1, 0 and +1)
Expected return (ER): Sharpe's *Capital Asset Pricing Model (CAPM)* = $E(R_{it}) = R_{ft} + \beta[E(R_{mt}) - R_{ft}]$
Abnormal return: $AR_{it} = R_{it} - E(R_{it})$
Mean cumulative abnormal returns: $MCAR = \frac{1}{n}\sum AR$

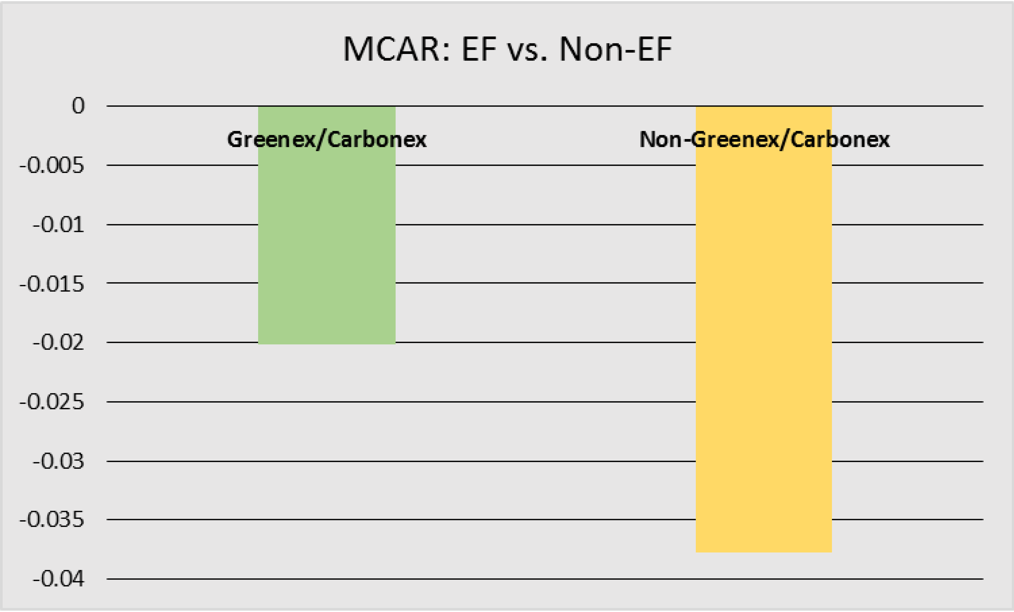
4) Estimate *Beta*:
Collect monthly share prices: 36 months before event
Belkaoui's *beta* estimation: $\beta = \frac{\sigma(R_{it}, R_{mt})}{\sigma^2(R_{mt})}$

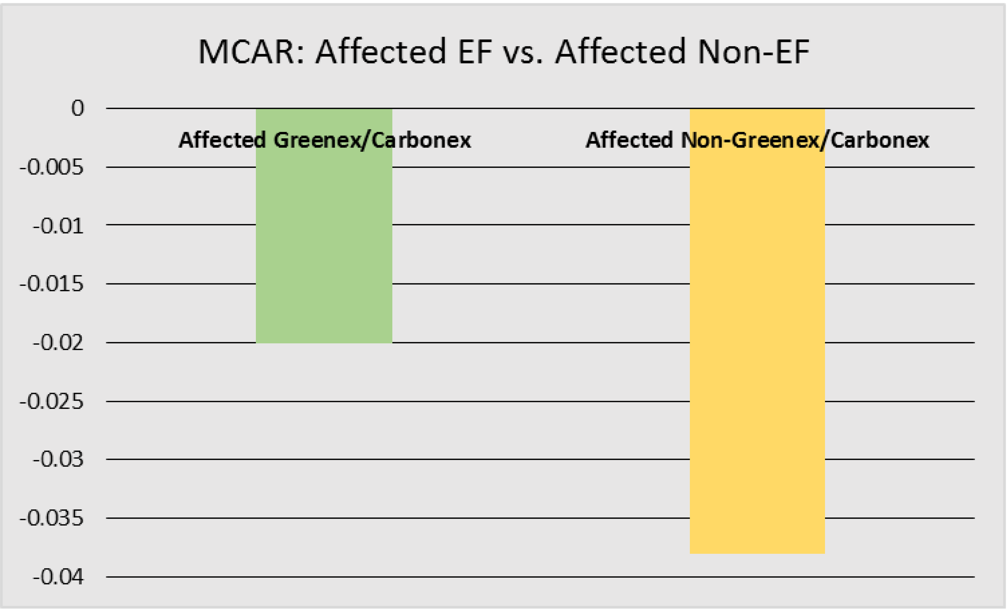
5) Research Questions:
a) Did MCAR = 0?
b) Did MCAR differ for affected companies vs. non-affected companies?
c) Did MCAR differ for EF companies vs. non-EF companies?
d) Did MCAR differ for EF affected companies vs. non-EF affected companies?



Results:







Conclusions:

a) In general, investors reacted negatively to the event as indicated by negative MCAR.
b) Investors of affected companies reacted significantly less negatively.
c) Investors of EF companies reacted significantly less negatively.
d) Investors of affected EF companies reacted significantly less negatively.

Future work:
- Did MCAR for companies with larger expected CSR expenditure differ from companies with smaller expected CSR expenditure?
- Did MCAR for companies in industries with higher risk differ from companies in industries with lower risk?

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