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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, this study is centered around the Companies Act, 2013 passed in India on August 29. The legislation requires companies with a net worth of at least five hundred crore rupees (Rs 5 billion), or with a turnover of at least one thousand crore rupees (Rs 10 billion), or a with a net profit of at least five crore rupees (Rs 50 million) to spend at least 2% of the average net profits of its last three financial years on supporting social initiatives. Using the event study methodology, this study observes the share prices of companies listed in the Bombay Stock Exchange (BSE) around the passing of the legislation. It was found that the cumulative abnormal returns (CAR) surrounding the passing of the legislation are significantly different from zero and negative, indicating, negative reaction from investors. The analysis then focuses on companies that were affected by the legislation. The study tests for difference in CAR of affected companies that were included in the S&P BSE Greenex Index and the S&P BSE Carbonex Index with CAR of affected companies that were not included in these index. These two index include companies that are considered environmentally friendly. The analysis finds that CAR of affected companies included in the S&P Greenex and S&P Carbonex Index are significantly different from CAR of other affected companies. The CAR of companies that are considered environmentally friend is significantly better compared to other affected firms. This finding suggests that mandating CSR is relevant to investors. Furthermore, firms that are already involved in CSR, thus, considered environmentally friendly, are the least affected by the legislation. These companies are large companies that were part of the S&P BSE 100, the 100 largest companies in BSE, hence, are arguably scrutinized more compared to smaller companies. Their asset size, net worth, and profitability, may put them under the spotlight and, therefore, increase the costs of compliance and monitoring. The required CSR outlay outlined in the legislation may be perceived as positive information due to its ability to reduce uncertainty regarding required CSR expenditure. The passing of the legislation may also serve as affirmative confirmation in regards to these companies' CSR strategy.

Keywords: Mandatory CSR, Indian Companies Act 2013, Event Study