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**RELATED PARTY TRANSACTIONS AND
STOCK PRICE CRASH RISK: EVIDENCE
FROM INDIA**

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Abstract

Related Party Transactions disclosures in Annual Reports have recently gained more attention of the Indian policymakers. This paper aims at finding out the effect of related party transactions disclosure on the stock price crash risk faced by the firms. Using a large sample of all the NSE listed firms for the period 2005-2012 this study provides evidence that related party disclosure decreases the stock price crash risk faced by the firms. This study is consistent with the view that information asymmetry increases crash risk. Related party transactions disclosure decreases information asymmetry in the market and thus reduces stock price crash risk. Moreover the study shows that the effect of disclosure about related party transactions is significantly more for higher risk firms.

Keywords: *Related party transactions, Stock price crash risk, Ownership structure, India*

JEL Codes: *G12; G14; G32*

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INTRODUCTION

Stock price crash risk is an important concern for investors and regulators all over the world. Stock price crash risk is generally defined as the frequency of extreme negative stock returns. Stock returns are function of markets' expectation about future earnings of the firm. This in turn depends on the informativeness of stock prices, the extent to which value-relevant information about a firm is available to investors and can be incorporated into stock prices. In addition to taking measures to improve market efficiency and liquidity that accommodates the flow of information in the market, stock market regulators around the world have also focused upon higher information disclosure of publicly available information through regulated laws and highlighting voluntary best practices which can become norms in future course of time. Apart from the information about the earnings, acquisitions, board meetings etc, additional impetus has been given on the corporate transactions. More recently, the focus has been on the disclosures about Related Party transactions (RPT).

Related party transactions refer to the transactions between two parties who are connected by any special relationship. Such relationship may be that of a holding company and its subsidiary, companies belonging to same owners or ownership groups etc. Formal definitions of related parties, RPT, as according to the laws have been given in the following section. Related Party transactions are very normal feature of commerce and business. Business entities are often required to carry out certain parts of their operations through their subsidiaries, joint ventures and associates. In many cases such transactions may be inevitable, useful, and recurring in ongoing operations. However, several scandals like Enron, Parmalat, Satyam Computer Services have cited RPTs to be detrimental to outside shareholders. RPTs are often known to cause conflicts of interest between the company, its executive officers and the shareholders. It may be used by the companies to "tunnel" resources out

of the company to its related party. These will detriment the welfare of the share holder. Again it may be used to "propel" resources from the related parties. In many cases, the manager or the Executives of the companies are provided with equities of the company. It is done as a measure to control shirking by the managers. However in such a scenario, even if the company is not doing well, the executive directors and managers can use related party transactions to draw funds from the associated enterprises to cover up the true position of the company and to prevent a fall in the share prices of the company. So, share prices will remain high even though the company has no true productivity or asset to back for it. This creates a bubble in the share price of the particular company and generates a risk for stock price crash. Other related party transactions may include the unnecessary use of company resources by the company executives for their personal benefits. This is also detrimental to the welfare of the share holder.

However, all related party transactions are not illegal and detrimental to the welfare of the shareholder. Some related party transactions are necessary for proper functioning of the company and are carried out at competitive terms i.e. at "arm's length". RPTs done at arm's length can reduce transaction costs and further increase the profitability of the company thereby increasing the overall value to the shareholders.

Related Party disclosures increases publicly available information about the firm in the market. This reduces information asymmetry in the market, and thus helps the equity market to function effectively. It also increases investors' confidence on the company. These in turn reduce the crash risk faced by the enterprise.

Firms across the globe use RPT to transfer income and assets across their related parties. Studies have shown that firms in developed countries also use RPT as a means to transfer out income and assets for

the benefit of those who control them (Johnson *et. al.* ,2000). However, RPT is more prevalent among the group firms. Concentrated ownership and business groups are popular among the emerging countries. Researchers have found that almost 70 percent of listed companies East Asian economies are group affiliated (Claessens, Fan, and Lang, 2002). Such group ownership structure increases the scope for RPT due to the inter-linked ownership structure that creates the internal capital market for the affiliates. India, also has concentrated ownership structure. A major portion of companies and businesses are owned by large business groups and are family owned. These businesses can use their pyramidal structures to conduct related party transactions to inflate or deflate their profits in order to evade taxation, to manipulate their earnings either upward or downwards, to decrease shareholder return, or simply to maximize the individual benefit of the executive officers. Withholding RPT information increases information asymmetry in the market. This decreases transparency in the market. This in turn adversely affects the efficiency of the equity market and increases the crash risk, as elaborated in the previous section. When this type of activity is under taken by a large number of firms it will have cascading effect on the equity market as a whole

One of the recent accounting frauds in Indian corporate sector (Satyam Computers) led to the mandatory RPT disclosures in the corporate governance report. In 2008 Satyam's board chaired by the promoter Mr. B. Ramalinga Raju put forward a proposal to buy a company Maytas, which was owned by relatives of the Satyam promoter. This deal was further called off due to resistance from the investors. Following the disapproval, on January 7, 2009 Mr. Raju resigned from the chairmanship and confessed about fudging the accounts of the company of over Rs. 7800 crore. Profits, cash flows and income for the firm were inflated. To justify this, the company had to carry additional amount of resources and assets. To fill this gap the decision to buy Maytas was taken. Following this event Mr. Raju and other CEOs were arrested and

51 percent stake of the company was auctioned. This case study shows how RPT can be used by firms to manipulate earnings. Such activities when carried out in large scale, without proper disclosure will effect investors' confidence and increase crash risk. This link between information disclosure and crash risk motivates us to investigate if the stock price crash risk faced by firms can be explained by RPT disclosure keeping all other things constant.

The primary objective of this paper is to investigate the relationship between related part transactions and stock price crash risk of Indian firms. Specifically, contributions of our study are as follows:

- ✓ To analyze whether stock price crash risk can be explained with the related party transactions disclosures and if such disclosures can effectively reduce stock price crash risk, in a concentrated ownership structure
- ✓ To analyze whether the effect of related party disclosures on stock price crash risk varies across different quantiles of risk.

This paper is organized as follows. Next section provides an elaborate discussion about the regulatory framework to present the definition of the related parties, transactions covered under RPT and laws governing such parties and transactions in India. Section three reviews the empirical literature on the related party transactions and stock price informativeness to build our hypotheses. Section four describes the data and methodologies that we use to analyze the empirical question. Section five presents the empirical findings and section follows concludes our study.

RELATED PARTY TRANSACTIONS: THE REGULATORY FRAMEWORK

Definition of Related Parties

An appropriate definition of related party is very important to start with. There exist several ambiguities in the definition of the term itself.

According to the **Accounting Standard 18 (AS 18)** parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

According to AS 18 related parties include:

- two or more enterprises that are controlled by or are under common control.
- two or more parties who invested in a joint venture
- individuals who directly or indirectly have voting power in the enterprise and hence have significant control or influence over the enterprise; and relatives of such individuals
- key management personnel and their relatives
- enterprises that have some common directors, major share holder or member of management.

With an intention to remove differences among different accounting aspects and to bring about standardization the Ministry of Corporate Affairs (MCA), India On February 25, 2011, notified **the Indian Accounting Standard (Ind As 24)**, which was more or less in line with [International Financial Reporting Standards \(IFRS\)](#). However, the date of its implementation is yet to be notified. These laws are mentioned in Appendix box 2.

Related Party Transactions

Transactions between the related parties defined above are known as related party transactions. Such transactions can be of the following types:

- transactions that involves the sale or purchase of goods and services
- transactions involving sale or purchase of property and/or assets
- transactions involving lease of property and/or assets

- transactions involving provision or receipt of services or leases
- transactions involving transfer of intangible items (e.g. research and development, trademarks, license agreements)
- transactions involving provision, receipt, or guarantee of financial services (including loans and deposit services)
- transactions involving the assumption of financial/operating obligations
- transactions involving the subscription for debt/equity issuances
- transactions involving the establishment of joint-venture entities

Laws and Regulations in India

Over the last decades, related party transactions have gained more importance in the Indian economy. There had been several amendments in the related regulations, some of which are:

1. The Companies Act, 1956
2. Indian Accounting Standard 18
3. Clause 49 of the Listing Agreement
4. Companies Act, 2013

The Companies Act, 1956

The Companies Act, 1956 has governed Indian companies. Prior to the amendment in 1999, it had provided limits on investment by a company in other corporate bodies, whether in the same group or outside the group (Sections 372 and 370). Similar limits were applied to inter-corporate loans as well as loans that could be advanced to companies in the same group. After a special resolution is passed in the general meeting, central government approval was required for loans exceeding this limit (Ramaiya, 1988). This law was amended and Section 372A was introduced. This provision now applies to include inter-corporate loans deposits, investments, guarantees, and securities in connection with loans to another public body corporate. Any transactions beyond the specified limits need approval by the annual general meeting through a special resolution. This does not apply for the loans given to any

individual firm, trust, or mutual fund. It also mentions about penalty if this is violated. Section 299 of the Act requires the disclosure of interest by a director in a board meeting in case the director is interested in any contract that the company is proposing to enter into.

Indian Accounting Standard 18

The Indian Accounting Standard 18 (Ind AS 18) covers the disclosure requirement of RPTs. Detailed definition of related parties under Ind AS18 is given in Box 1 of Appendix. There is no specific format for reporting RPTs under AS18. It gives a provision for aggregating the transactions that are less than 10 percent of the monetary value of the total transactions of the same nature. The requirement of disclosure includes:

- name of the related parties involved in transactions;
- description of the relationship between the involved parties;
- description of the nature of transactions between them;
- volume of the transactions done either as an amount or as an appropriate proportion
- any other necessary elements of related party transactions or an understanding of the financial statements; and
- Amount or appropriate proportions of outstanding items.

Kumar Mangalam Birla Committee Report and Clause 49

In early 1999 a committee was set up under the leadership of Mr. Kumar Mangalam Birla, which focused on promoting and raising the standards of good corporate governance in India. In the year 2000, stock market regulator, Securities and Exchange Board of India (SEBI) accepted the key recommendations of Birla committee and incorporated these into Clause 49 of the Listing Agreement of the Stock Exchanges. Clause 49 requires a company to disclose materially significant related party transactions that may have potential conflict with the interests of company at large, this may include transactions of material nature, with

the promoters, the directors or the management, subsidiaries of the company or relatives etc.

Companies Act, 2013

The Companies Act 2013, brought about some changes in provisions for related party transactions. However, most of the provisions under Section 188 of 2013 Act are quite similar to the requirements under sections 297 and 314 of the 1956 Act. Some of the important changes as in the 2013 Act include the following:

- Need for central government approval for loans exceeding the permissible limit was removed.
- It widened the list of transactions such as leasing of property of any kind, appointment of any agent for purchase and sale of goods, material, services or property.
- Cash at prevailing market price was replaced with 'arm's length transaction'.
- Related party transactions has to be included in the board's report along with justification for entering into such contracts and arrangements.

Other than these, The Income Tax Act 1961 also contains provisions related to transfer pricing issues on related party transactions.

International Laws and Peer Comparison

International Accounting Standard, IAS 24, of IFRS was issued at 1st January 2012 under. This gives the international definition of Related Party transactions and lays down norms for related party disclosures, from an international perspective. It defines a related party transaction as "a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged".

Any entity involving in any related party transactions during periods covered by the financial statements is required to disclose about nature of the related party relationship. At a minimum level, disclosures shall include amount of transactions and outstanding balances inclusive of commitments. Terms and condition of the transactions, details of any guarantees received or given, provision of doubtful debts and the expenses with respect of doubtful debts. Disclosures should be done separately for *“the parent, entities with joint control or significant influence over the entity, subsidiaries, associates, joint ventures in which the entity is a venture, key management personnel of the entity or its parent and other related parties”*.

Next a peer comparison is conducted across countries where regulation requires disclosure of RPT. This also includes a brief study of the history of RPT laws in country, corporate ownership structure in the country, definition RPT as per the norms and RPT disclosure laws of the country. This section summarizes the peer comparison. The detailed comparison has been provided in Appendix.

All of the countries studied, i.e. China, Brazil, Belgium, Italy, Israel, Korea, South Africa have more or less concentrated ownership structure, France and South Africa being the ones with lower extent of concentrated ownership structure. China has a different ownership structure with a major participation of the state. In Korea the term “Chaebol” is commonly used to refer to conglomerates consisting of many related companies, including a number of companies listed on the stock exchange, which are engaged in a broad range of industrial and service businesses. Most chaebol have highly centralized, autocratic management under the founder and his immediate family members. This type of ownership structure enhances the existence of related party transactions between the controlling shareholders or related companies either directly or through company groups.

Most of these countries, like Belgium, France, Italy, Israel, Brazil, Russia, South Africa follows IFRS i.e. IAS 24 for their definition of Related Parties and disclosure norms. China diverges somewhat from the IFRS because of its different ownership structure. China does consider the transactions between state owned enterprises as Related Party Transactions. However there are some minor differences across the countries. For example, Belgium applies IAS 24 rules on the consolidated accounts. The French legal system makes a distinction between “related party transactions” which are accounted for and reported according to IAS 24 standards within the context of consolidated company group accounts, and a specific approval process called “conventions réglementées” (literally this can be translated as “regulated agreements”). Brazil requires disclosure according to IAS 24 both in the consolidated and individual account. In South Africa, it has been expanded beyond IAS 24 to include related-party transactions with jointly controlled entities, and to include related-party transactions where both parties are controlled by the state. Other countries like Chile and Korea does not follow IAS 24. Chile’s Companies Law states that a listed company can only undertake a Related Party Transaction (RPT) if the transaction complements the company’s social interest, is conducted according to market practices, and is disclosed to and approved by the majority of the board. Most of the countries have a threshold limit. Any related party transaction above that limit is considered to be material and it must be disclosed.

At present, Indian Accounting Standards does not follow IFRS. However, with the Ind IAS 24, India is also trying to converge with the international norms

LITERATURE REVIEW

We review the existing literature across two different segments. First, the framework that is based on agency problem in corporate governance

issues and other factors that may lead to related party transactions. Second, the studies finding determinants of stock price crash risk. Separation of ownership and control are known to cause agency problem due to asymmetric information, unobservable efforts of the managers (moral hazard), and the managers' ability to take self-serving actions (such as appropriating funds for over consumption of perquisites, empire building) at the expense of the dispersed shareholders (Jensen and Meckling 1976). Corporate governance issues, like those with related party transactions, arise because of asymmetric information problems between external capital markets and the firms' managers. If external capital markets are able to perfectly observe the managers investment actions and effort, there would be no need for corporate governance mechanisms to help monitor the manager.

In Asian economies including India, concentrated ownership and control is the rule rather than the exception. Under concentrated ownership and control, the nature of the agency problem is essentially different from that present in diffused ownership structures. While in the latter, agency problems arise on account of shareholder manager conflicts, dubbed in the literature as Type I or vertical agency problems, in the former, agency problems arise primarily due to conflicts between the two categories of principals—the controlling inside shareholders and dispersed minority outside shareholders, dubbed as Type II or horizontal agency problems (Roe, 2004). Type I agency problems are likely to be alleviated under concentrated ownership and control as the incentives of controlling shareholders to monitor management would be stronger on account of their substantial stakes in the corporation. This, however, does not preclude Type II agency problems, of the incentives of controlling shareholders from seeking to extract and optimise private benefits for themselves at the expense of the minority shareholders (Morck and Yeung, 2004).

Related Party Transactions can be looked upon from two different perspectives – efficient contracting and agency theory. First, related party transactions can be a component of the overall formal or informal compensation package. Such transactions can substitute for cash-based compensation to officers and directors, or provide more liquid compensation to officers and directors when executives have high stock option levels. This provides financial incentives for insiders to enter into RP transactions. Secondly, RP transactions raise concerns based on agency theory. Agency theory suggests that managers will over consume perquisites. This over-consumption damages the stakeholders' value (Jensen and Meckling 1976, Holmstrom, 1979, 1982). Related party transactions that favor the related party to the firm's detriment represent examples of perquisite consumption (i.e. inappropriate wealth transfers). RP transactions can also alter the reliability of financial statements thereby reducing the effectiveness of contracts designed to reduce agency conflicts which in turn results into a lower firm valuation (Kohlbeck and Mayhew, 2004).

Within a group ownership setting, related party transactions, can be an upward manipulation of the earnings of the troubled firms in a group, by diverting away cash and profits from other group members. Such an effect should result into reduced profitability in general. Indeed, RPTs have found to negatively affect the company's operating performance measured by return on assets of Indian companies (Srinivasan, Padmini 2013).

Agency perspective provides a background to understand the role of information asymmetry and crash risk. To enjoy private benefits, managers have an incentive to withhold bad news for extended periods which leads to higher future stock price crash risk. With regard to the stock price crash risk, agency perspective of corporate tax avoidance is positively associated with the firm specific stock price crash risk (Kim, *et. al.* 2011). Using the sample of US firms, Kim et al (2011) finds that

presence of external monitoring mechanisms reduce the positive effect of tax avoidance on crash risk. A wide range of incentives, such as compensation contracts, career concerns, and empire building, motivate managers to conceal adverse operating outcomes (Ball, 2009; Kothari *et. al.*, 2009). If a firm's manager withholds and accumulates negative information for an extended period, the firm's share price will be severely overvalued, thereby creating a bubble. When the accumulated negative information reaches a tipping point, it will be suddenly released to the stock market, all at once, resulting in the bubble bursting and a stock price crash (Hutton *et. al.*, 2009; Jin and Myers, 2006). More importantly, hiding negative information about a firm prevents investors and the board of directors from taking timely corrective actions or liquidating bad projects early. As a result, unprofitable projects are kept alive for too long and their poor performance accumulates over time, until an asset price crash occurs (Bleck and Liu, 2007). Using earnings management as a measure of opacity, Hutton et al (2009) find that opaque firms which reveal less information are more prone to stock price crashes. Consistent with these conjectures, recent research shows that the lack of information transparency increases future crash risk by enabling managers to hide and accumulate bad news (Hutton *et. al.*, 2009; Jin and Myers, 2006; Kim et al, 2010).

Market can comprehend information related to managerial incentive to extract private benefits and react in the form of crash risk. For example, excess perks are positively correlated with crash risk in Chinese SOEs (Nianhang et al 2014). The authors argue that to enjoy more perks, executives will try to build up their empire by pretending to have valuable investment opportunities, which is, in turn, masked by presenting the firm's good performance. The aforementioned diversions of firm resources incentivize executives to withhold bad news for extended periods. Bad news hoarding eventually reaches a tipping point and leads to a stock price crash. However, strong external monitoring makes it harder for executives to withhold bad news from investors and,

in turn, can mitigate the impact of excess perk consumption on crash risk.

Taking the evidence together, we hypothesize that the empirical nature of association between related party transactions and stock price crash risk in Indian context which is institutionally different from other emerging markets due to dominance of owner-managers in corporate sector.

DATA AND METHODOLOGY

To provide systematic evidence on the association between related party transactions disclosures and crash risk we use a sample of all 1757 firms listed on National Stock Exchange (NSE) during 2014. The time period for study is 2005 to 2012. We collect information on ownership structure, stock prices and financial variables for these firms from Prowess database maintained by Center for Monitoring Indian Economy. After excluding missing observations on variables, we are left with 1564 companies. Related party transactions is available for different types of related parties i.e. Subsidiaries, holding company, parties where control exists, Key personnel and their relatives, and others. Under each category there were four main transactions namely Capital account payments and receipts, and total revenue income and expenditure. Total value of all these categories is considered as total RPT for our analyses. Table 1 shows the frequency of disclosure of RPT in our sample firms.

The testable hypotheses are defined as follows:

H1: Related Party Disclosures Decrease the Crash Risk Faced by the Companies

This prediction of negative relation is based on the fact that disclosure of related party transactions decreases the information asymmetry in the market, which is one of the factor responsible for elevating the crash risk

faced by a company and hence it decreases the crash risk faced by the company.

H2: Related Party Disclosures Decrease the Crash Risk for the Companies with Higher Crash Risk

Effect of RPT disclosure on risk may not be same for all level of risk. Acceptance of this hypothesis implies that companies with higher risk can decrease their risk by disclosing the related party transactions. Companies with low crash risk have low information asymmetry and high investor confidence. For such companies disclosure may not have any effect. However, for companies with high crash risk have high information asymmetry disclosure of RPT reduces information asymmetry and decreases risk.

Table1: Number of Listed Firms and Number of Firms Disclosing RPT Over Years

Fiscal Year	No. of Firms	Firms Disclosing RPT
2005	1112	167
2006	1187	163
2007	1314	171
2008	1376	181
2009	1405	184
2010	1486	186
2011	1542	195
2012	1564	195

Further we define the measures of crash risk in terms of two measures as follows.

The Negative Conditional Return Skewness (NCSKEW) Measure (Chen *et. al.* 2001):NCSKEW for a given firm in a fiscal year is calculated by taking the negative of the third moment of firm-specific weekly

returns for each sample year and dividing it by the standard deviation of firm-specific weekly returns raised to the third power.

Specifically, for each firm j in year t , we compute NCSKEW as

$$NCSKEW_{j,t} = - \frac{\left[n(n-1)^2 \sum R_{j,t}^3 \right]}{\left[(n-1)(n-2) (\sum R_{j,t}^2)^{\frac{3}{2}} \right]}$$

The Down-to-up Volatility (DUVOL): This computed as follows: For any stock i over a particular year t ; we separate all the days with returns below the period mean ("down" days) from those with returns above the period mean ("up" days), and compute the standard deviation for each of these subsamples separately. We then take the log of the ratio of (the sample analog to) the standard deviation on the down days to (the sample analog to) the standard deviation on the up days. Thus we have

$$DUVOL_{j,t} = \log \left\{ \frac{[(n_U - 1) \sum_{DOWN} R_{j,t}^2]}{[(n_d - 1) \sum_{UP} R_{j,t}^2]} \right\}$$

Where R_{jt} represents the sequence of de-measured daily returns to stock j during period t ; and n is the number of observations on daily returns during the period, n_U and n_d are number of days when the price moved up and down respectively. In both the cases a higher value indicates a greater crash risk.

To check for the **H1** we check for the following regression equation:

$$Risk_t = \alpha_0 + \alpha_1 RPT_{t-1} + \sum_{q=2}^m \alpha_q (\text{qth control variable}_{t-1}) + \varepsilon_t \quad (1)$$

Here RPT_{t-1} is a dummy variable. It takes 1 if the company have disclosed RPT, zero otherwise.

We also run a logistic regression to see how amount of RPT disclosed affects the probability of facing a crash risk.

$$\text{Log(odds of having a stock crash)}_t = \alpha_0 + \alpha_1 \text{LnRPT}_{t-1} + \sum_{q=2}^m \alpha_q (\text{qth control variable}_{t-1}) + \varepsilon_t \quad (2)$$

For **H2** we run quantile regressions for the equation (1) at different quantiles.

The set of control variables includes SIGMA_{t-1} , RET_{t-1} , SIZE_{t-1} , LEV_{t-1} , ROA_{t-1} , PROM_{t-1} and MBVR_{t-1} . The variable SIGMA_{t-1} is the standard deviation of firm-specific weekly returns over the fiscal year period $t - 1$. It gives the volatility of the stock. Stocks with higher risk are more volatile. The variable RET_{t-1} is defined as the arithmetic average of firm-specific weekly returns in year $t - 1$. The authors also document that stocks with high past returns are more likely to crash. The variable SIZE_{t-1} is defined as the log of the market value of equity in year $t - 1$. Studies have given a positive relation between size and crash risk. The variable LEV_{t-1} is the total long-term debt divided by total assets. The variable ROA_{t-1} is defined as income before extraordinary items divided by lagged total assets. High leverage may result in higher risk and high operating performance may result in low risk. PROM_{t-1} is the promoter share holding ratio. MBVR_{t-1} is the market value of equity divided by the book value of equity in year $t - 1$. Several studies have shown that growth stocks are more likely to experience future price crashes.

We also include group dummy variable that equals one if the firm belongs to business group and zero otherwise. Further, industry dummy variables are included to control for industry specific characteristics using National Industrial Classification (NIC) codes at two digit level. Firms in the sample are being classified into 21 industries. Finally year dummies for the eight years have been included.

EMPIRICAL RESULTS

Table 2 below shows the percentage of firms facing stock price crash risk (for both NCSKEW and DUVOL) across years. Here, the average value of NCSKEW is 20.9 and DUVOL is 18.4. This means, on an average, 20.9 percent (by NCSKEW measure) and 18.4 percent (by DUVOL measure) of firms face stock price crash risk. Crash risk reaches to its maxima at 2008, which corresponds to the great recession of 2008.

Table2 : Firms Facing Crash Risk Over the Years

Fiscal Year	No. of Firms	Firms with Crash Risk		Percentage of Firms with Crash Risk	
		NCSKEW	DUVOL	NCSKEW	DUVOL
2005	1112	110	83	9.9	7.5
2006	1187	300	211	25.3	17.8
2007	1314	132	105	10	8
2008	1376	652	646	47.4	46.9
2009	1405	180	141	12.8	10
2010	1486	239	186	15.9	12.5
2011	1542	405	418	26.3	27.1
2012	1564	279	236	17.8	15.1
Total	10986	2297	2026	20.9	18.4

Figure 1: Crash Risk Over Years

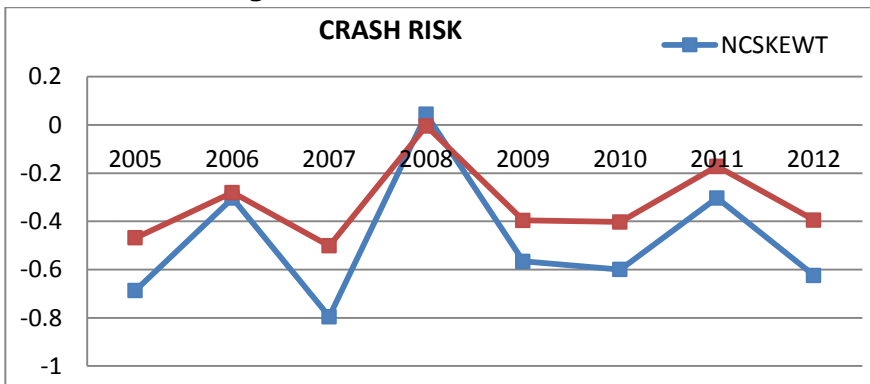


Figure 2: Crash Risk Over Years For Different Ownership Structures

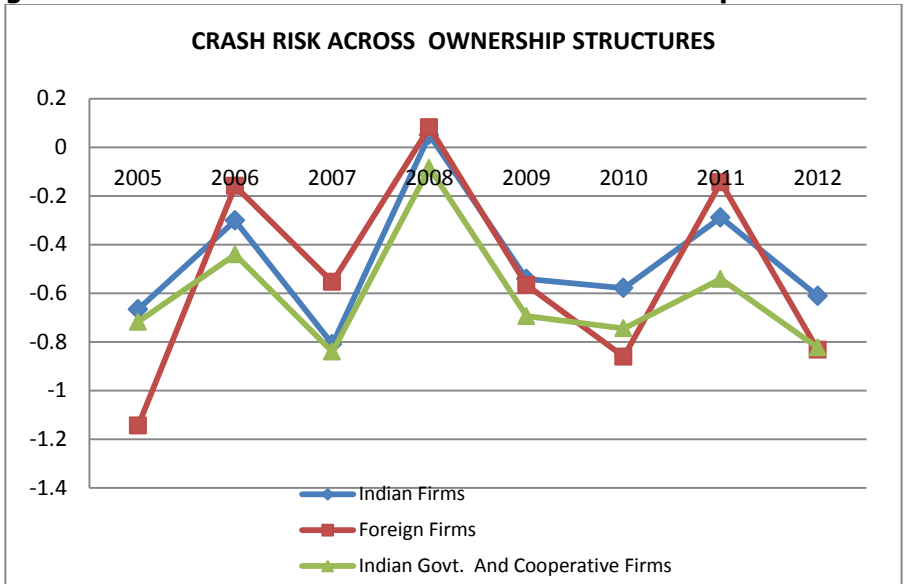


Figure 1 shows crash price risk of all the NSE listed firms across years and figure 2 shows the same according to the ownership categories. In 2008 crash risk faced by the firms increased. From figure 2 it can be seen that the foreign firms listed in NSE were more affected by the crisis.

Table 3: RPT_{t-1} (in Rs. Millions)

Fiscal Year	No. of Firms	Firms Disclosing RPT	Percentage of firms disclosing RPT	Mean	Standard Deviation	5 percent	25 percent	Median	75 percent	95 percent
2005	1112	167	15.0	2120.6	9833.4	1.0	28.8	207.8	1223.8	8061.2
2006	1187	163	13.7	3156.7	13151.4	2.0	26.9	242.8	1376.2	10847.9
2007	1314	171	13.0	2417.7	14812.4	1.0	25.6	139.5	851.4	4614.3
2008	1376	181	13.2	2657.9	10772.7	1.0	22.7	178.2	1136.3	9848.9
2009	1405	184	13.1	3037.3	16457.2	1.0	16.8	185.1	1188.6	7909.6
2010	1486	186	12.5	4203.7	21959.1	1.0	21.8	213.6	1456.6	19029.7
2011	1542	195	12.6	4068.6	18727.7	1.0	18.5	206.2	1166.7	13490.5
2012	1564	195	12.5	5467.6	23418.4	1.0	37.4	327.0	2022.9	22618.7

Table 3 shows the percentage of firms disclosing RPT, across years. This percentage varies from 15 percent to 12 percent on an average. On an average only 13 percent firms disclose RPT.

Table 4: Risk and RRT_{t-1} (in Millions) Across Different Promoter Share Holding Categories

Promoter Share Holding Ratio	NCSKE W_T	DUVOL $_T$	Total RPT_{T-1}	Holding Companies	Subsidiaries	Parties Where Control Exists	Key Personnel and Their Relatives
less than 25 percent	-0.404	-0.278	226.531	19.402 (8.565 percent)	77.625 (34.267 percent)	128.073 (56.537 percent)	1.431 (0.632 percent)
25 percent-50 percent	-0.452	-0.318	211.869	18.924 (8.932 percent)	35.672 (16.837 percent)	156.186 (73.718 percent)	1.088 (0.513 percent)
50 percent-75 percent	-0.481	-0.328	600.468	177.897 (29.626 percent)	222.765 (37.099 percent)	196.909 (32.793 percent)	2.897 (0.483 percent)
75 percent to 100 percent	-0.522	-0.350	866.735	276.449 (31.895 percent)	515.909 (59.523 percent)	69.257 (7.991 percent)	5.120 (0.591 percent)

Table 4 shows the distribution of risk, total RPT, and RPT undertaken with different related parties. It can be seen that risk is lower for the firms with higher promoter share holding ratio. Firms where promoters hold more than 75 percent percent of the shares disclose the maximum amount of RPT. For firms with low promoter share holding ratios major portion of RPT disclosed is undertaken with Subsidiaries and Parties where control exists. Whereas in case of companies with higher promoter share holding ratios maximum transaction is with holding companies and Subsidiaries.

Table 5: Descriptive Statistics for all Variables

Variables	Mean	S.D.	5 percent	25 percent	Median	75 percent	95 percent
Risk Measures							
NCSKEW _T	-0.478	1.025	-1.746	-0.940	-0.459	-0.074	0.594
DUVOL _T	-0.324	0.427	-0.939	-0.588	-0.331	-0.084	0.295
RPT Measures							
Total RPT _{T-1}	3442.115	17012.79	1.000	24.300	207.00	1223.80	10665.00
Control Variables							
RET _{T-1}	0.000	0.005	-0.007	-0.002	0.000	0.002	0.005
SIGMA _{T-1}	0.035	0.012	0.019	0.028	0.034	0.041	0.053
ROA _{T-1}	0.910	0.898	0.062	0.384	0.790	1.228	2.188
LEV _{T-1}	0.430	1.690	0.010	0.144	0.315	0.474	0.794
SIZE _{T-1}	7.789	2.134	4.598	6.283	7.610	9.195	11.556
PROM _{T-1}	51.78119	17.87249	20.25	40.335	52.59	64.8	78.16
MBVR _{T-1}	2.252	15.883	0.118	0.665	1.304	2.627	7.346

Table 5 gives the descriptive statistic for all the variables i.e. for the dependant variable, for the main independent variable and for the control variables. The mean value for NCSKEW is -0.48 and for DUVOL is -0.32. This suggests that the sample studied is not crash prone on an average. The average value of total RPT transaction is Rs. 3442.115 Millions.

Table 6: Correlation Coefficients

	DUVOL _T	NCSKEW _T	RPT _{T-1}	RET _{T-1}	SIGMA _{T-1}	ROA _{T-1}	LEV _{T-1}	SIZE _{T-1}	PROM _{T-1}	MBV _R _{T-1}
DUVOL _T	1									
NCSKEW _T	0.8553	1								
RPT _{T-1}	-0.0075	-0.0137	1							
RET _{T-1}	0.1743	0.1401	0.009	1						
SIGMA _{T-1}	-0.0774	-0.0362	-0.1677	-0.0042	1					
ROA _{T-1}	-0.0341	-0.0213	0.0327	0.0665	-0.0316	1				
LEV _{T-1}	0.0259	0.02	-0.0339	-0.0145	0.0742	-0.06	1			
SIZE _{T-1}	0.0804	0.0512	0.2499	-0.1251	-0.4935	-0.0791	-0.1173	1		
PROM _{T-1}	-0.0368	-0.0324	0.1151	0.0375	-0.079	0.1185	-0.07	0.1571	1	
MBVR _{T-1}	-0.0024	-0.0035	0.0357	0.0033	-0.0423	0.0285	-0.0134	0.1041	0.0365	1

Table 6 shows the correlation coefficients for all variables. Both the measures of risk, NCSKEW and DUVOL are highly correlated, with a correlation coefficient of 0.86. RPT is negatively related to both the crash

risks, which is consistent with our predictions that RPT disclosure reduces future crash risk.

H1 predicts that RPT disclosure is negatively related to future stock price crash risk because it reduces information asymmetry in the market. Tables 7, 8 and 9 present the multivariate regression analyses for testing H1, with the full set of control variables. In each of these tables Model 1 uses NCSKEW as a risk measure, model 2 uses DUVOL and model 3 uses a cross measure of both NCSKEW and DUVOL. Model 3 considers a firm to be risky if and only if it is risky by both the measures. Table 7 and 8 uses a pooled regression set up. To alleviate concern about potential cross-sectional dependence in the data, we report t-values (z-values) on an adjusted basis, using robust standard errors corrected for industry clustering.

Table 7 reports a pooled regression with industry and year dummies. Here RPT measure is a dummy variable which takes the value 1 if the company discloses RPT else it is 0. For model 1 and 2 the coefficient of RPT is -0.084 and -0.034 respectively. This implies that on average, other things remaining constant, for firms disclosing RPT crash risk is lower than those not disclosing RPT by .084 (for NCSKEW) and .034 (DUVOL).

The sample contains firm-years from 2005 to 2012. The z-values (t-values) reported in parentheses are based on standard errors clustered by industry. Industry and Year fixed effects are included.

**Table 7: Effects of RPT Disclosure on Stock Price Crash Risk
(Pooled)**

	NCSKEW_T	DUVOL_T
<u>RPT Measures</u>		
RPT _{T-1}	-0.084*** (-3.810)	-0.034** (-2.350)
<u>Control Variables</u>		
RET _{T-1}	40.424*** (8.490)	21.641*** (-3.81)
SIGMA _{T-1}	3.070*** (3.010)	1.397*** (-3.27)
ROA _{T-1}	-0.005 (-0.200)	-0.005 (-1.070)
LEV _{T-1}	0.058*** (2.850)	0.029** (-2.22)
SIZE _{T-1}	0.044*** (12.670)	0.023*** -17.57
PROM _{T-1}	-0.002*** (-3.910)	-0.001*** (-4.310)
MBVR _{T-1}	-0.001 (-1.150)	0 (-1.260)
Intercept	-1.093*** (-16.740)	-0.665*** (-28.020)
Ownership Dummy	Yes	YES
Industry Dummy	Yes	YES
Year Dummy	Yes	YES
R2	0.097	0.19

Note: Here *, **, and *** indicate statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively. Here a pooled OLS model has been used.

This table presents the results of the effects of RPT on stock price crash risk using a Logit model. The sample contains firm-years from 2005 to 2012. The z-values (t-values) reported in parentheses are based on standard errors clustered by industry. Industry and Year fixed effects are included..

**Table 8: Effects of RPT Disclosure on Stock Price Crash Risk
(Pooled Logit)**

	NCSKEW_T	DUVOL_T	BOTH NCSKEW_T AND DUVOL_T
<u>RPT Measures</u>			
RPT _{T-1}	-0.033* (-1.870)	-0.045*** (-4.820)	-0.047*** (-5.700)
<u>Control Variables</u>			
RET _{T-1}	65.394*** (13.960)	53.798*** (-6.7)	69.252*** (-14.16)
SIGMA _{T-1}	5.114* (1.670)	5.371* (-1.72)	4.142 (-1.28)
ROA _{T-1}	-0.133*** (-6.420)	-0.056* (-1.630)	-0.125*** (-4.090)
LEV _{T-1}	0.170*** (2.960)	0.069 (-1.27)	0.084* (-1.79)
SIZE _{T-1}	0.152*** (20.200)	0.132*** (-10.21)	0.156*** (-13.1)
PROM _{T-1}	-0.004*** (-3.660)	-0.005*** (-4.020)	-0.005*** (-4.190)
MBVR _{T-1}	0.000 (0.000)	0 (-0.150)	0 (-0.250)
Intercept	-3.463*** (-18.020)	-3.598*** (-14.780)	-3.893*** (-14.280)
Ownership Dummy	Yes	Yes	Yes
Industry Dummy	Yes	Yes	Yes
Year Dummy	Yes	Yes	Yes
Pseudo-R2	0.097	0.118	0.109
<i>Marginal effect of RPT_{t-1} (at means)</i>	<i>-0.0048*</i> <i>(-1.83)</i>	<i>-0.0057***</i> <i>(-4.61)</i>	<i>-0.0051***</i> <i>(-5.15)</i>

Note: Here *, **, and *** indicate statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively.

This table presents the results of the effects of RPT on stock price crash risk (Logit model in a panel data frame work) The sample contains firm-years from 2005 to 2012. The z-values (t-values) reported in parentheses. Industry fixed effects are included. Here *, **, and *** indicate statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively.

TABLE 9: Effects of RPT on Stock Price Crash Risk (Panel Logit)

	NCSKEW_T	DUVOL_T	BOTH NCSKEW_T AND DUVOL_T
<u>RPT Measures</u>			
RPT _{T-1}	-0.036** (0.016)	-0.051*** (0.017)	-0.052*** (0.018)
<u>Control Variables</u>			
RET _{T-1}	86.574*** (7.784)	82.011*** (8.066)	91.045*** (8.554)
SIGMA _{T-1}	-16.956*** (3.246)	-22.137*** (3.479)	-19.020*** (3.684)
ROA _{T-1}	-0.133** (0.053)	-0.077 (0.053)	-0.133** (0.058)
LEV _{T-1}	0.211*** (0.069)	0.095* (0.049)	0.101** (0.049)
SIZE _{T-1}	0.141*** (0.018)	0.119*** (0.019)	0.146*** (0.020)
PROM _{T-1}	-0.006*** (0.002)	-0.007*** (0.002)	-0.007*** (0.002)
MBVR _{T-1}	0.000 (0.002)	0.000 (0.002)	0.000 (0.002)
Intercept	-1.569*** (0.239)	-1.341*** (0.246)	-1.823*** (0.260)
Ownership Dummy	Yes	Yes	Yes
Industry Dummy	Yes	Yes	Yes
<i>Marginal Effect of RPT_{t-1} (at means)</i>	<i>-0.036*</i> <i>(-2.24)</i>	<i>-0.051***</i> <i>(-3.05)</i>	<i>-0.052***</i> <i>(-2.95)</i>

Note: Here *, **, and *** indicate statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively

Tables 8 and 9 test the primary hypotheses using logistic regression. In both the cases RPT_{t-1} is the log of the total amount of PRT. Table 8 uses a pooled regression setup. Here, the coefficients of RPT_{t-1} are -0.033, -.045 and -0.047 for models 1, 2 and 3 respectively. This implies that disclosure of RPT is negatively related to stock price crash risk. To find out the economic significance of the results we computed the marginal effects. The marginal effect of RPT_{t-1} on crash risk is -0.48

percent, -0.57 percent and -0.51 percent respectively. All the marginal effects are also significant. This implies that for every percentage increase in amount RPT disclosed probability of a firm facing a stock price crash decreases by the above percentages that is, by 0.5 percent on an average.

In the above regression setup we included year dummy and industry dummy variable to control for year and industry heterogeneity. However individual firm heterogeneity was not captured in the above model. So next in table 9, we used the same regression in a panel data frame work. Under this setup also the results were similar. Here the coefficients of RPT_{t-1} are -0.036, -.051 and -0.052 respectively. This implies that disclosure of RPT is negatively related to stock price crash risk. The marginal effect of RPT_{t-1} on NCSKEW, DUVOL and Both NCSKEW and DUVOL are -3.59 percent, -5.12 percent and -5.2 percent respectively. All the Marginal effects are significant. This implies that for every percentage increase in amount RPT disclosed probability of a firm facing a stock price crash decreases by the above percentages.

Given that on an average 20.9 percent (by NCSKEW measure) and 18.4 percent (by DUVOL measure) of listed firms in India faces crash risk, these results suggests that association between crash risk and RPT disclosure is important for the economy as a whole.

The coefficients of the control variables are generally consistent with the findings of prior studies. $PROM_{t-1}$ was negatively related to crash risk. This implies that promoter share holding in a particular firm signals the market about the firm. A firm with higher promoter share holding percentage gives a positive signal to the market. $SIGMA_{t-1}$, RET_{t-1} , $SIZE_{t-1}$, LEV_{t-1} have positive impact on the crash risk and ROA_{t-1} is negatively related. $MBVR_{t-1}$ was insignificant in all the cases.

H2 predicts that RPT disclosure reduces stock price crash risk for the high risk companies. Effect of RPT disclosure may not have the same effect for all the firms. Company where crash risk is very high indicates that information asymmetry is very high which implies that for such companies RPT disclosure reduces the information asymmetry in the market and hence reduces stock price crash risk. On the other hand, companies with lower crash risk have lower information asymmetry and therefore have higher investors' confidence. For such companies disclosure of RPT may not have any significant effect.

Table 10 presents the multivariate regression analyses for testing H2, with the full set of control variables. We use a quantile regression for this purpose. We estimate the relationship between RPT disclosure and crash risk at 5 percent, 10 percent, 25 percent, 50 percent, 75 percent, 90 percent and 95 percent quantiles of crash risk respectively. Industry and year dummies have been included to account for year and industry heterogeneity which may contribute to the crash risk of the stock irrespective of disclosure practices. RPT measure is a dummy variable which takes the value 1 if the company discloses RPT else it is 0. To assign firms in crash risk quantiles, DUVOL has been used as a measure of stock price crash risk. Regression coefficient for RPT variable was significant for 50 percent (-0.025), 75 percent (-0.045), 90 percent (-0.048) and 95 percent (-0.074) quantiles respectively. It is insignificant for the quantiles below 50 percent. This shows that RPT disclosure does not have the same effect on crash risk for all levels of risk. RPT disclosure reduces crash risk for the companies with very high crash risk. Also, it can be noted that the absolute value of the coefficient increases from 50 percent quantile to 95 percent quantile. This implies that impact of RPT disclosure on crash increases with the risk level of the company.

**Table 10: Effects of RPT on Stock Price Crash Risk
(Quantile Regression)**

	95 Quantile	90 Quantile	75 Quantile	50 Quantile	25 Quantile	10 Quantile	5 Quantile
<u>RPT Measures</u>							
RPT _{T-1}	-0.074*** (-2.860)	-0.048** (-2.400)	-0.045*** (-3.060)	-0.025** (-1.990)	-0.016 (-1.340)	-0.021 (-1.230)	0.009 (0.360)
<u>Control Variables</u>							
RET _{T-1}	20.159*** (3.580)	15.893*** (5.100)	13.273*** (7.890)	13.637*** (11.070)	11.892*** (11.410)	10.772*** (7.740)	5.694*** (2.680)
SIGMA _{T-1}	-0.691 (-0.480)	1.368 (1.490)	2.105*** (3.570)	2.115*** (4.470)	1.501*** (3.320)	2.038*** (2.990)	2.132** (2.720) *
ROA _{T-1}	-0.009 (-0.610)	-0.006 (-0.530)	-0.005 (-0.640)	-0.008 (-1.150)	-0.004 (-0.590)	0.001 (0.150)	-0.006 (-0.500)
LEV _{T-1}	0.096*** (9.040)	0.071*** (8.550)	0.043*** (6.170)	0.013** (2.180)	0.020*** (2.950)	0.021*** (3.650)	0.028** (3.600) *
SIZE _{T-1}	0.016*** (2.540)	0.018*** (3.910)	0.024*** (7.560)	0.028*** (11.460)	0.029*** (13.390)	0.030*** (9.990)	0.018** (4.510) *
PROM _{T-1}	-0.001* (-1.760)	-0.001 (-1.300)	-0.001*** (-3.100)	-0.001*** (-4.710)	-0.001*** (-4.290)	-0.001*** (-3.620)	- (-2.880) 0.001** *
MBVR _{T-1}	0.000* (1.710)	0.000 (1.420)	0.000 (0.010)	0.000 (-1.100)	0.000** (-2.100)	0.000*** (-3.110)	- (-2.260) 1.073** *
Intercept	-0.032 (-0.360)	-0.321*** (-5.110)	-0.539*** (-12.520)	-0.719*** (-19.890)	-0.889*** (-25.000)	-1.048*** (-20.300)	- (-16.380)
Ownership Dummy	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry Dummy	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year Dummy	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Pseudo-R2	0.080	0.089	0.111	0.127	0.129	0.119	0.111

Note: Here *, **, and *** indicate statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively.

This table presents the results of the effects of RPT disclosure on stock price crash risk for different quantiles of crash risk. The sample

contains firm-years from 2005 to 2012. The z-values (t-values) are reported in parentheses.

CONCLUSION

This paper investigates the effect of related party disclosure on the stock price crash risk using a sample of Indian firms during a period 2005-2012. Given the concentrated ownership structure which leads to higher information asymmetry our study contributes to the literature by examining the role of information disclosure of corporate transactions. Our findings show that related party disclosure decreases by the crash risk faced by the companies. The results obtained are robust to the use of different crash risk measures. The results are also robust to the different models and approaches used for the study. Overall our findings are consistent with the asymmetric information aspect of RPT disclosure. RPT disclosure reduces the information asymmetry in the market about a stock and thus reduces its crash risk.

Our analysis also shows that RPT disclosure reduces the crash risk for the companies with very high crash risk and has no significant effect for the companies with low risk. The effect is greater for the higher risk companies.

The findings of our study can be used to justify the current regulatory requirements in Indian corporate sector that leads to reduce the overall crash risk of the stock market of the economy by emphasizing on mandatory disclosure of related party transactions and by imposing heavy penalty in case the companies do not abide by the disclosure norms. As the sample period used for the study was before the implementation of the Companies Act, 2013, which has given greater importance on mandatory disclosure of related party transactions, our findings provide a pre-Act status of effect of mandatory disclosures of RPT on the crash risk.

APPENDIX

Box 1: Related Parties under the Indian AS18

Indian AS 18 defines related parties as including:

- (a) enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries);*
- (b) associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture;*
- (c) individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual;*
- (d) key management personnel and relatives of such personnel; and*
- (e) enterprises over which any person described in (c) or (d) is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.*

Indian AS 18 explicitly excludes the following parties from related party status:

- (a) two companies simply because they have a director in common, notwithstanding paragraph 3(d) or (e) above (unless the director is able to affect the policies of both companies in their mutual dealings);*
- (b) a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence; and*
- (c) the parties listed below, in the course of their normal dealings with an enterprise by virtue only of those dealings (although they may circumscribe the freedom of action of the enterprise or participate in its decision-making process):*
 - (i) providers of finance;*
 - (ii) trade unions;*
 - (iii) public utilities;*
 - (iv) government departments and government agencies including government sponsored bodies.*

Box 2: Related Parties under the Ind As24

Related party is a person or entity that is related to the entity that is preparing its financial statements (in this Standard referred to as the 'reporting entity').

(a) A person or a close member of that person's family is related to a reporting entity if that person:

(i) has control or joint control over the reporting entity;

(ii) has significant influence over the reporting entity; or

(iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

(b) An entity is related to a reporting entity if any of the following conditions applies:

(i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

(ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

(iii) Both entities are joint ventures of the same third party.

(iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.

(v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.

(vi) The entity is controlled or jointly controlled by a person identified in (a).

(vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

Table A1: Comparative Study of Disclosure Laws Across Countries

Countries \ Details	History	Corporate Holding Structure	Definition of Related party and Related transactions	Disclosure Norms
China	<p>After the Third Plenary Session of the 11th Communist Party of China's (CPC) National Congress in 1978 economic reform progressed in China's urban areas. The main objective was the revitalization of state-owned enterprises (SOEs) to make them more efficient by restructuring the old enterprise system.</p> <p>In 1993, focus was given to transform the SOE management mechanism and establish a system according to needs of a market economy, with clearly defined ownership, rights and responsibilities.</p>	<p>China is characterized by concentrated ownership structure.</p> <p>Until 1978, most Chinese enterprises were state-owned, characterized by its administration-driven, unified and collective governance. After which the focus slowly shifted to establish a system according to needs of a market economy.</p>	<p>According to The <i>Company Law</i> related party relationship refers to the relationship between company's controlling shareholders, actual controllers, directors, executives and the enterprises it controls directly or indirectly, and other relationships which may influence the company's current share holding structure. However, state-owned holding enterprises are not considered to be in a related-party relationship merely because they are controlled by the state as well.</p> <p>In accordance with accounting standards, the following parties constitute related parties of an enterprise: (1) the parent company thereof; (2) the subsidiaries thereof; (3) other enterprises under the control of the</p>	<p>Financial disclosure in China remains weak, this hamper the growth of capital markets.</p> <p>The government is beginning to tackle this problem by establishing procedures for voting and disclosure of related-party transactions as described above.</p> <p>Companies should also voluntarily and on a timely basis disclose information on independent directors' opinions on related-party transactions, and controlling shareholders' interests.</p> <p>Code of Corporate Governance for Listed Companies in China If any Written agreements is entered into for related party transactions among a listed company and its connected parties. Such agreements shall observe principles of equality, voluntariness, and making compensation for equal value. The contents of</p>

	<p>With this view The <i>Company Law</i>, was introduced in December 1993. It laid the foundation for China's corporate governance framework</p> <p>In 2001, China joined the World Trade Organisation and undertook to adopt the <i>OECD Principles of Corporate Governance</i> and improve corporate governance of Chinese listed companies. Corresponding to which The China Securities Regulatory Commission (CSRC) and the National Economic and Trade Commission jointly issued the <i>Code of Corporate Governance of Listed Companies</i> in early 2002, based on the OECD Corporate Governance This introduced the concept of related party</p>		<p>same parent company; (4) investors having joint control over the enterprise; (5) the investors with significant influence upon the enterprise; (6) joint ventures thereof; (7) the associated enterprises thereof; (8) the main individual investors and the close family members thereof (9) key managerial personnel refers to those who have the power of and responsibility for planning, directing and controlling the activities of the enterprise. The close family members of a main individual investor or of a key managerial person refer to the family members who may influence or be influenced by that individual in handling transactions with the enterprise; (10) other enterprises significantly influence by the main individual investors, key managerial personnel, or close family members of such individuals</p>	<p>such agreements shall be specific and concrete. Matters such as the signing, amendment, termination and execution of such agreements shall be disclosed by the listed company in accordance with relevant regulations. Efficient measures shall be adopted by a listed company to prevent its connected parties from interfering with the operation of the company and damaging the company's interests by monopolizing purchase or sales channels. Related party transactions shall observe commercial principles. In principle, the prices for related party transactions shall not deviate from an independent third party's market price or charging standard. The company shall fully disclose the basis for pricing for related party transactions.</p> <p><i>Disclosure of Related Parties</i> also require the affirmation of the connected parties.</p>
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	<p>transactions in China.</p> <p>The <i>Company Law</i> and the <i>Securities Law, 2006</i>, provide the foundation for drawing up and developing a corporate governance framework in China.</p> <p>The issue of fund misappropriation by major shareholders and other related parties was a problem that seriously affected the healthy development of listed companies. To address it, the CSRC drafted regulations imposing a strict limitation on Fund misappropriation in listed companies by controlling shareholders and other related parties. It conducted pilot programmes on "shares for debt" and co-operated with local governments</p>		<p>Related-party transactions refer to the transfer of resources or obligations to and from the listed company, its subsidiaries and Related-party entities.</p>	
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	and other relevant agencies to deal with the difficult problem of debt repayment arrears. The <i>Criminal Law</i> was amended to inflict greater penalties on major shareholders and actual controllers involved in fund misappropriation of listed companies.			
Belgium	The Director's charter 24 Jan 2001, Mentions that it is the duty of the director to avoid any conflict of interest between his direct personal interest and those of the company. He should be acting independently without being influenced by the other shareholders. His works should be in favour of the company and all the shareholders and not for a particular group of shareholders. This introduced the flavor of	Ownership of the listed company sector are changing somewhat in recent years with large shareholders reducing their majority voting bloc until around 2007, after a new takeover code established a threshold of 30 per cent to launch a mandatory takeover offer.	The definition of RPTs and Related Parties (RPs) is according to the International Accounting Standards (IAS), including IAS 24. IAS 24 only applicable to consolidated accounts together with other IAS standards (e.g. IAS 27 and IAS 31). The Belgian accounting standards does not have any similar requirement but Article 524 of the Company Law forces disclosure about some aspects of intra-company transactions. There is also a requirement to disclose the company's policy towards dealing with	The Rozenblum doctrine , under some circumstances , allows directors to consider, the interest of the company group as a whole rather than just the company and the shareholders of the company in which they are a member. In the absence rules to offset it this could weaken minority protection. In addition, the 2009, Belgian Corporate Governance Code7 (CGC) lays down several rules about managing conflicts of interest including with major shareholders. Some of the changes relating to Related Party Transactions, in the Companies Law 2002, are: Article 523 prescribes

	<p>related party transactions without directly mentioning the term.</p> <p>The conflicts of interest between board members and the company were addressed for the first time in the year 1995(Van Der Elst, p. 9) and then again to update the Company Law in 2002 when an approval procedure by independent directors for RPTs was introduced. The law recognises the duties of loyalty and care on the part of board members to the company and these are underpinned by the new Corporate Governance Code (CGC).</p>		<p>related companies and its directors and members of management</p>	<p>that directors shall disclose their own conflicts of interest of a financial nature (including RPTs) to the board, to the auditors and to shareholders They may not take part in the deliberations or vote on conflicted transactions and the board’s decisions in this respect must be minuted, reported to the external auditor and disclosed in the annual report. This also applies to executives who are members of the executive committee.</p> <p>Article 524 mandates an approval procedure involving the board, independent directors and auditors as well as disclosure to shareholders of decisions and transactions of their company granting advantages to other companies of the same group, with the exception of the company’s direct subsidiaries and the direct subsidiaries of the latter.</p> <p>Disclosure Norms: There are requirements to disclose the company’s policy towards dealing with related companies and its directors and members of management. There are requirements to disclose details about RPTs and</p>
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				especially those can be categorized as material and not on market terms..
France		<p>The number of companies belonging to the groups is increasing. In the prevalence of company groups, family control and large block shareholders in most listed companies, issues regarding regulation and prevention of related party transactions has recently been attracting growing attention.</p> <p>Under French law, block shareholders are also able to enhance their control over the company by including in the company charter double voting rights for registered shares that have been held by the same shareholder for at least two years.</p>	<p>The French legal system makes a distinction between "related party transactions" which are accounted for and reported according to IAS 24 standards within the context of consolidated company group accounts, and a specific approval process called "conventions réglementées" (literally this can be translated as "regulated agreements"). Listed companies must follow some special procedures for approval of regulated RPTs based on the French commercial code. RPTs can be defined as " 'direct or indirect agreements' involving non-recurring operations and/or those done under abnormal conditions between a company and its CEO, a designee of the CEO, board members or a shareholder with more than 10 per cent of voting rights in the company, or</p>	<p>In case of any RPT, the interested party is legally required to inform the board of directors about the considered transaction and he has to abstain from voting both within the board and at the shareholders meeting.</p> <p>Although the commercial code requires that regulated RPTs are subject to both board authorisation and ex post shareholder approval involving all disinterested parties, but company executives do have legal authority to enter into RPTs before the board authorises them, and if the board or shareholders vote against such transactions, a court action is still required to nullify the agreement.</p>

			with the company controlling that shareholder." This may include a wide range of transactions involving parties with a direct or indirect interest, including contracts between companies, remuneration of board members and management, retirement and severance packages such as golden parachutes, loans, rental agreements, etc.,	
Italy	The Italian Code of Corporate Governance was first introduced in 1999 and later it was amended in 2002 and in 2006. It contained provisions regarding directors' interests and transactions with related parties (it was the primary source of standards on this matter until Consob issued its regulation in 2010). The revised Code of 2006 went further in defining best practice so as to clarify procedures for	The Italian corporate sector is characterized by concentrated ownership control through opaque corporate structural pyramids and by dominance of a small number of interlinked but competitive entrepreneurs.. Under such circumstances protection of minority investors was weak. This was believed to have led to the underdeveloped capital market. Complex company groups have	According to The New Regulation, definitions of "related party" and "related party transactions" are based on IAS 24. "Related party transaction" - A "related party transaction" is any transfer of resources, services or obligations between related parties regardless of whether or not consideration has been paid. The following are examples of transactions which would be considered related party transactions under the New Regulation: mergers or spin-offs (by incorporation or strictly non-proportional), carried out with related	Article 9 of the comply or explain Code contain the principle: "the Board of Directors shall adopt measures aimed at ensuring that the transactions in which a director is bearer of an interest, on his/her behalf or on behalf of third parties, and transactions carried out with related parties, are performed in a transparent manner and meet criteria of substantial and procedural fairness". The associated criteria state: "the board of directors shall, after consulting with the internal control committee, establish approval and implementation procedures for the transactions carried out by the issuer, or its subsidiaries, with related parties. It shall define, in particular, the specific

	handling the transactions.	been under pressure for some time through“ Italian discount”. This led the companies to reduce their structure. Italian company law and financial regulation is mainly focused on the issue of company groups and shareholder protection for quite some time.	parties; any transaction which would lead to granting of any type of economic benefit to any member of the Board of Directors, the Board of Statutory Auditors or “key management personnel” of the company.	transactions (or shall determine the criteria for identifying those transactions) which must be approved after consulting with the internal control committee and/or with the assistance of independent experts”. The internal control committee can also be the audit committee. Furthermore, “the board of directors shall adopt operating solutions suitable to facilitate the identification and an adequate handling of those situations in which a director is bearer of an interest on his/her behalf or on behalf of third parties”
Israel	ISA Adopted Final Version of the Goshen Report on December 17, 2006. That recommended focus on improvement of director independence, regarding approval of related party transactions and some other aspects. Companies can voluntarily elaborate its decision not to adopt a given corporate governance .Hence, the main protection	Israel corporate sector can be characterized by highly concentrated ownership and prevalence pyramidal company groups. This creates risk in enforcement of shareholder rights and equitable treatment. The pyramidal structure in the Israeli corporate sector is quiet complex and diversified, containing a wide range of industries.	Israeli public companies are required to follow International Financial Reporting Standard (IFRS) requirements, including IAS 24. Because IAS 24 defines related parties as including parent companies and subsidiaries, and companies of the same group (among other related parties), intra-group disclosures are treated under IAS 24 as part of the disclosure of consolidated financial accounts.	Special approval process is required under the Companies Law for the following related party transactions. Some of these are mentioned below: <ul style="list-style-type: none"> • Audit Committee, Board and General Meeting approval is required for all extraordinary transactions of a public company with a controlling shareholder or with another person in which the controlling shareholder has a personal interest, including a private placement; a contract with the controlling shareholder or relative for the provision of services to the company; if he is an officer in the

	<p>extended to minority shareholders, for approval of corporate transactions with controlling shareholders in which conflicts of interest exists. This introduced the concept of related party transaction here.</p>	<p>Several large groups include financial concerns such as banks and insurance companies at their lower levels. Reforms have curtailed banks' ability to play an active role in the pyramids, principally due to the fact that they have been limited in their investments in industrial companies and through company law restrictions on related party transactions</p>	<p>company, regarding the terms of his service and his employment; and if he is a company employee but not an officer, regarding his employment by the company.</p> <ul style="list-style-type: none"> ● To obtain General Meeting approval, the transaction must attract the support of a majority of the votes of the shareholders who do not have a personal interest in the transaction and who are present and voting. The company itself has the responsibility for the classification of shareholders for such votes, but the Israel Securities Authorities (ISA) also checks ex poston whether shareholders have been correctly classified, particularly in cases where they judge that incorrect classification would have the potential to change the outcome of the vote. This "majority of the minority" provision was recently strengthened through Companies Law Amendment 16 to be increased from one-third of disinterested shareholders to a majority requirement. To reduce the risk of abuse by a small minority in cases where few disinterested shareholders are present
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			<p>and voting, the law also allows a measure to be approved even without a majority of the votes of disinterested shareholders of the level of opposing votes among these shareholders does not exceed 2 per cent of total voting rights (increased from 1 per cent under the same amendment).</p> <ul style="list-style-type: none"> • Other transactions relating to employment contracts and remuneration, including employment of company officers, controlling shareholders or their relatives, are also subject to RPT approval processes but are not the focus of this particular review. Company law states that immediate reports must be filed in the case of an "extraordinary transactions" (see previous footnote for definition) between a public company and one of its controlling shareholders or another interested party. The transaction report: "must include every detail concerning the transaction that may be important to a reasonable investor ... for the purpose of voting at the general meeting, including, inter alia: a description of the main points of the transaction; the name of the controlling shareholder who has a personal
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				<p>interest in the transaction; details of the rights that give him control in the company, including his proportional stake in voting rights; the nature of the personal interest; and approvals required or terms that were determined for carrying out the transaction. The report must also include the reasons of the audit committee and the board of directors for approving the transaction, the value of the consideration and the manner in which it was determined, and the reasons of the directors opposing it, if there were any, and the names of the directors who participated in the board and audit committee meetings with regard to the approval of the transaction, indicating who of these is an external director; the manner in which the consideration was determined and the name of each director who has a personal interest in the transaction and the nature of this interest</p>
Chile		<p>Chile is a relatively small, middle-income, open economy. Its public equity market is characterized by a high degree of</p>	<p>Related Transactions include transactions involving board members and their spouses or close relatives, as well as transactions involving third companies</p>	

		<p>defined control and the presence of companies identified with a relatively small number of entrepreneurial individuals and groups. Ownership of publicly traded corporations is highly concentrated, with the three largest shareholders often owning three-quarters of all shares. In addition, Chilean corporations are controlled by a few large groups, which organize their business activities in a pyramidal fashion, with one or more investment companies acting as the control centre.</p> <p><i>Shallow markets, heavy intra-group lending</i></p>	<p>in which such board members perform as members of the board, or directly or indirectly control 10 percent or more of such companies. Chile's Companies Law states that a listed company can only undertake a Related Party Transaction (RPT) if the transaction complements the company's social interest, is conducted according to market practices, and is disclosed to and approved by the majority of the board. Transactions of less than 1 percent of the company's equity are not considered relevant, and therefore do not need to follow the above mentioned requirements.</p>	
Brazil	<p>CVM recommendation on Corporate governance, 2002 mentioned about related party</p>	<p>Companies are mostly owned by families or economic groups, while dispersed ownership of</p>	<p>The accounting standards for Brazilian public companies are fully converged to IFRs. So IAS24 was adopted for defining</p>	<p>Under the Brazilian regulation all the companies must disclosure RPT. Additionally, CVM requires the disclosure of information related to</p>

	<p>transactions in Functioning and Committees of The Board of Directors. And minority shareholder protection. According to which "The board of directors should ensure that transactions among related parties are clearly reflected in the financial statements and were carried out in writing and under market conditions." IBGC 2004 and 2009 also mentioned about RPT.</p>	<p>listed companies is a very recent phenomenon and include a limited number of cases.</p>	<p>related parties and disclosing RPTs which is required for the consolidated financial statements as well as the individual ones.</p>	<p>RPT in the Reference Form (a form that all public companies have to file at the website of the CVM on going basis).</p>
Russia		<p>The Russian corporate environment is characterized by high ownership concentration in firms, especially in the hands of insiders, weak legal institutions that lead to high private benefits of control, underdeveloped capital markets,</p>	<p>The Russian law considers a related-party transaction to be a transaction in which related parties are involved in the transaction in one of the following capacities: i)As a transacting party, a beneficiary , an intermediary, or an agent in the transaction, ii) As an owner of at least 20 percent of the voting shares (participatory shares, units) in a legal</p>	<p>Russian companies need to disclose information on transactions with related parties, in accordance with the criteria set forth by IFRS; information on material transactions of the company and legal entities controlled by it (including related transactions entered into by the company and one and/or more legal entities controlled by it);</p>

		a segmented labor market, and significant involvement of the state in business.	entity that is a party, beneficiary, intermediary or agent in the transaction; or iii) other instances as specified in the charter.	The 2013 code requires: In order to enable the shareholders and investors to make informed decisions, the company should disclose all material information about its activities, even if publication of such information is not required by law. The company should disclose information not only about itself but also about any legal entities which are controlled by and are material to the company.
South Africa	The major South African instruments dealing with governance – the Companies Act, the King Code on corporate governance and the new listings requirements of the JSE – neglect the problems caused by related-party transactions other than those where directors are involved. The South African Institute of Chartered Accountants addressed the issue in 1999 by issuing a new addition to	South African companies possess a relatively sound financial and regulatory structure reminiscent of developed markets, as an emerging market, ownership of a firms is relatively concentrated	Parties are considered related where “One party has the ability to control the other party or exercise significant influence over the other party in making financial and operational decisions.” The definition of related parties is further expanded to include individuals who have significant influence over either enterprise, their close family members and interests, as well as key management personnel, their close families, and interests	In addition, related-party relationships where control exists are to be disclosed irrespective of whether or not there has been a transaction. The accounting statement is based on International Accounting Standard (IAS) 24, and attests to the persuasive power within professional communities of international norms. The South African version has been expanded beyond IAS 24 to include related-party transactions with jointly controlled entities, and to include related-party transactions where both parties are controlled by the state

	GAAP (Accounting Statement 126) that will require disclosure of related-party transactions.			
Korea	<p>Following the 1997 financial crisis, corporate governance reforms and government-initiated corporate restructuring were implemented in Korea. However the Chaebols continued to oppose legal reforms designed to increase accounting transparency. The most dramatic of these initiatives were the "big deals" announced by the government in October 1998, which contemplated mergers and business swaps between the largest chaebol. According to the Commercial Code New intra-group guarantees have been prohibited and existing</p>	<p>In Korea the term " Chaebol" is commonly used to refer to conglomerates consisting of many related companies, including a number of companies listed on the stock exchange, which are engaged in a broad range of industrial and service businesses. Most chaebol have highly centralized, autocratic management by the founder and his immediate family members. Since (until recently) the creation of holding companies was not allowed, each chaebol group was controlled by the founder and his family through an</p>	<p>Paragraph 1(8) of Article 2 of the CITA recognizes "related parties" international business transactions under the following circumstances: (Equity Ownership Test)</p> <ul style="list-style-type: none"> - where one transaction party directly or indirectly owns 50 percent or more the voting shares of the other transaction party; or, - where a third party which directly or indirectly owns 50 percent or more of the voting shares of both transaction parties; or <p>(Substantial Control Test)</p> <ul style="list-style-type: none"> - where one transaction party substantially controls the business policy of the other transaction party or vice versa, and both transaction parties share the same interest by reason of capital contribution, and goods, service or 	<p>r. The listing rules require companies to seek board approval for transactions exceeding 1 percent of annual revenue or total asset value, and to report them to shareholders at a general shareholders' meeting. A set of transactions with a combined value in excess of 5 percent of annual revenue or total asset value is also subject to this regulation.² Outside of the listing rules, chaebols with assets in excess of 2 trillion won (US\$1.7 billion) have a special requirement, made mandatory by the Korea Fair Trade Commission, for related transactions above 10 billion won (US\$8.7 million) or 10 percent of book equity to be approved by the board and disclosed to the public. ³ In any case, no prior shareholder approval of related-party transactions is required.</p>

	<p>guarantees Among the top 30 chaebol, were to be eliminated, by March 2000, . (MRFTA, Article 10-2) To facilitate corporate takeovers, the requirement that a shareholder and related parties acquiring 25 percent of the shares of a listed company must tender for a majority of the company's shares was eliminated by an amendment of the Securities and Exchange Act. This introduced the concept of PRT in Korea</p>	<p>intricate web of cross-company shareholdings and intra-group loans and guarantees</p>	<p>loan transactions; or - where a third party substantially controls the business policy of both transaction parties and both parties share the same interest by reason of capital contribution, and goods, service or loan transactions .</p>	
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