

AN EMPIRICAL INVESTIGATION OF HYBRID CORPORATE GOVERNANCE SYSTEMS IN LARGE FIRMS: EVIDENCE FROM INDIA

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Abstract

The heightened pace of corporate governance reforms has focussed attention on country-specific governance models. Considerable debate has ensued as to whether the outsider Anglo-Saxon system or the insider Continental system is most applicable to India. This paper reports the results of a study of Indian governance which used a primary qualitative approach of twelve interviews of key executives of five large firms in 2008 as well as publicly available documents. A literature review establishes six key characteristics that distinguish the two major systems. The governance characteristics of the Indian firms are classified in terms of the two systems with a view to assessing the extent and nature of hybridization. The findings endorse the hybrid corporate governance system of India, clearly identifying similarities and differences to the two major governance models. In drawing on rich interview data, the paper delves into the national characteristics of India that have influenced the hybrid model such as stewardship, corporate social responsibility and partnerships between the corporate and community sectors. The evolution of the governance practices and the rationale for their existence are also examined. The paper demonstrates that the hybrid governance system has emanated from country-specific culture including values and ideologies, and political orientation of socialism. The scope of this study was limited to large listed companies and business groups. Future research should use a larger and more diverse sample including private and unaffiliated firms for outcomes that can be generalized.

Keywords: Corporate governance, Hybridization, Large firms, India

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Introduction

The heightened pace of corporate governance reforms in developing countries has focussed attention on country-specific governance models, with practitioners and scholars attempting to understand the similarities and differences of the models. One clear indication from the country studies is that a mixed system of governance can emerge in developing countries (Afsharipour, 2009). For instance, Sarkar and Sarkar (2000: 168) observed that 'based on some broad comparisons with the two main

prototype governance systems in the world, the Indian corporate governance system is by and large a hybrid of the 'outsider systems' of the US and UK, and the 'insider systems' of continental Europe and Japan'. Similarly, Dwivedi and Jain (2005) and Gollakota and Gupta (2006) have also found evidence of a home-grown system in India. However, the extant literature discusses Indian governance from an overall evaluation of stock exchanges or large surveys and data sets (Chakrabarti, Megginson & Yadav, 2008; Ghosh, 2006b; Gupta, 2005; Sarkar and Sarkar, 2000). The problem with such data is their inability to

explain a behavioural phenomenon or practice. Alpaslan (2009) voiced this concern when he observed, 'when a corporation accepts responsibility and accommodates stakeholders wishes it may not always be easy to figure out the real intentions of the corporation'. This study seeks to bridge this gap in governance research. By using rich interview data with key executives in large, established Indian businesses, it delves into the origins and rationale of the governance system, the intentions in instituting the governance practices, and the cultural beliefs and assumptions on which the practices are based. In doing so, it highlights the nature of Indian corporate governance as a hybrid system and in particular explains the specific form this hybridization takes. Thus, the key contribution of this research is its uniqueness in its approach to highlighting the characteristics of the Indian system and its commonalities and differences to the two typically referred to systems- namely Anglo-Saxon systems and Continental systems.

Furthermore, an empirical study of governance issues in India, in particular, is thought to be important due to India having a number of unique governance issues (Jackling & Johl, 2009). Not only in terms of governance practice, but also with regard to theory development, India and other developing countries offer tremendous opportunities (Judge, 2009), making this study timely and relevant. Particular governance characteristics are evident in relation to ownership, board structures, role of stock exchange, role of banks and amount of free float. For instance Allen et al. (2007: 22), based on their sample of 2753 Indian non-financial firms, reported that controlling interests in about 78% of the Indian firms reside with a particular individual or family. However, pyramiding, cross-holdings and non-public trusts mean that their governance structures are complex and opaque (Jackling & Johl, 2009). Hence, an analysis of India's home-grown, stylized governance system will provide information for countries such as China and Germany and the South Asian region that have a large proportion of family-owned businesses. For these countries, the development of a 'home-grown' governance system is a necessity, not a choice, if good governance is to take root (Jaffer & Sohail, 2007). Not only do Indian firms need to have an increased understanding of their own practices, with globalization, foreign multinationals doing business in India need to be aware of the Indian governance system (Li & Nair, 2009).

This paper provides empirical evidence of the corporate governance systems in large businesses in India by exploring two types of data: one, the publicly available data from the Indian stock exchanges and the company's annual reports, and two, the interview data from twelve key informants from five established Indian businesses. It firstly reviews the literature in relation to the Anglo-Saxon and Continental governance models before discussing the

characteristics of the Indian governance model. It then presents the methodology and subsequently the interview data ordered by case study organisations. The characteristics are classified in terms of the Anglo-Saxon and Continental systems with a view to assessing the extent and nature of hybridization. The limitations of the study and future research needs are also presented.

Review of Literature

The major corporate governance systems

Several scholars have articulated the key aspects of the main global corporate governance systems. One approach has been to scrutinize the systems at the level of countries; and the other approach has been to examine the systems at the level of firms.

Weimer and Pape's (1999) taxonomy was based on corporate governance systems at the level of countries. The authors delineated two market-oriented systems – the Anglo-Saxon and Germanic, and two network-oriented systems - Latin and Japanese, based on a set of discernible and easily obtained data. The variables used were:

- the prevailing concept of the firm in terms of whether it was oriented to independent shareholders who exercised control through the external stock market, or whether several groups of oligarchic stakeholders influenced decision-making;
- whether the board had a single tier with both executive and supervisory responsibilities or whether there was a dual structure;
- whether the shares were widely held or concentrated in the hands of a few;
- whether the stock market importance was high or low based on two indicators used by the World Federation of Exchanges;
- whether the external market was active;
- the extent to which executive compensation was dependent on corporate performance; and
- the time horizon of economic relationships.

Accordingly, Anglo-Saxon systems were shareholder-oriented, exhibited single-tier boards, accorded high importance to the economy's stock market and hence had an active external market and focused on short-term relationships. In contrast, a Continental system with its cross-shareholdings and inter-locking directorships exhibited long-term relationships, a stakeholder orientation, relatively less-widely held shares and accorded a low importance to the stock market.

In 2001, Nestor and Thompson distinguished the 'outsider' system, or market-based system, from the Continental system or 'insider' system. Accordingly, the 'outsider' system is characterised by a legal and regulatory approach based on the assumption that the dispersed body of investors who own the company need to be protected. Thus, this system 'presumes ample disclosure of information, strict trading rules and liquid stock markets' (p. 23). In contrast, in the 'insider' system, ownership and control is relatively more closely held. Thus, the dispersal of ownership is low with fewer agency problems in comparison to the 'outsider' system.

Garrett (2004: 2) distinguished the governance systems as falling along a "rules-based" versus "principle-based" continuum as follows:

A simple explanation of the difference between the two approaches is illustrated by the different concepts conveyed by the terms "law" and "guideline". The result is a different mindset with respect to corporate governance in the United States, which applies a rule- or law-based approach, where what is not prohibited is permitted, compared to a principles-based approach where greater discretion is vested in a company's management to make decisions regarding governance activities. A principles-based approach to governance is one in which guidelines are clear, but compliance with them is voluntary.

Thus, the rules-based system is more common in countries that adopt the Anglo-Saxon system, while companies relying on principles are more often regarded as operating within the Continental system. Although there are national differences with countries such as UK, Canada and Australia classified as principles-based within an Anglo model.

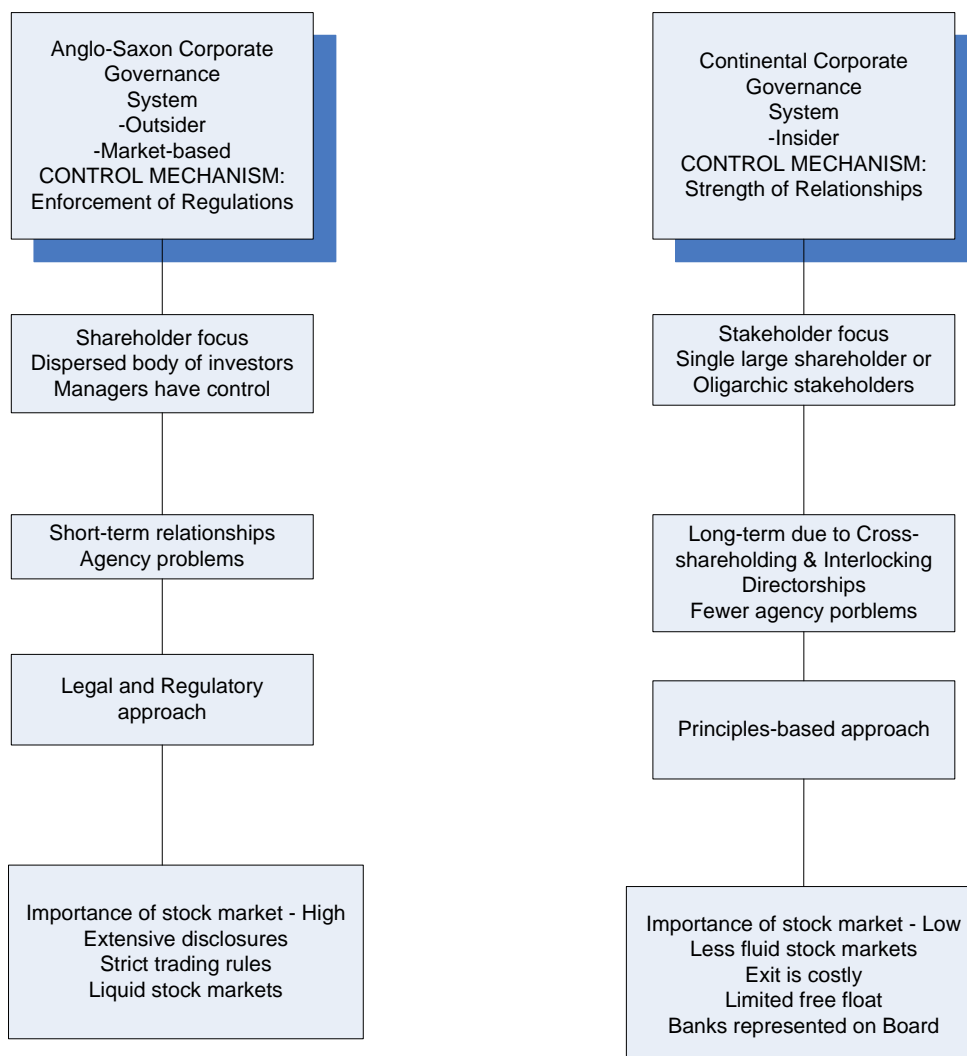
Of those who investigated the firm-level governance systems, Shleifer and Vishny (1997) found that firms in the USA and the UK rely substantially on an extensive system of rules to protect investors, including minority rights, which allows for an easy transfer of shares, with power provided to shareholders for class-action suits or to

sue directors for violations of fiduciary duty. Eighty percent of large US publicly traded firms' shares are widely held, that is, defined as having 'no single shareholder in control of 20% of the voting rights', with the remaining 20% controlled by families, and none controlled by another widely held corporation (Ryan, 2005). Moreover, the influence of trade unions is much less when compared with the Continental model. In contrast, firms in Europe and Japan have less reliance on elaborate legal protections and more reliance on large investors and banks (Shleifer & Vishny, 1997).

Cernat (2004) introduced the terms 'capital-related' aspects and 'labour-related' aspects to differentiate the systems, and argued that the Continental model led to a more secure economic environment, allowing firms to seek higher profits in the long-term as banks are represented on the Board of Directors, as opposed to the short-term view imposed by the stock markets on Anglo-Saxon companies. Furthermore, he reported that 'free float is limited and dividends less prioritized than in the Anglo-Saxon system' which meant that the shareholders did not face the classic Hirshmanian choice of 'voice or exit'. Accordingly, less fluid stock markets make exit more costly, and, therefore, shareholders have a strong incentive to gain a powerful 'voice' in the management of the firm (Cernat, 2004: 154). Morck and Steier (2005) called this domination by the banks, 'bank capitalism', and observed that errant managers could be forced back into order by the banks that could withhold credit and starve the misgoverned firm of capital. However, the authors cautioned that bank capitalism or the Continental system, would allocate capital efficiently only if the bankers were altruistic and competent, and would create significant problems for the firms if the banks are themselves misgoverned.

From the brief review of the major governance systems provided above, it is apparent that two models dominate, namely, the Anglo-Saxon model and the Continental model albeit with some national idiosyncrasies. The distinguishing features of both models are summarized in Figure 1.

Figure 1: Two Major Corporate Governance Systems



Application of the key features in the Indian Governance system

Strength of the Legal System:

The Anglo-Saxon governance system seeks to protect shareholders through a multitude of laws and regulations. The decision criterion for whether Indian governance fits the Anglo model is the evidence of mandatory legal rules, regulations and codes for the governance of companies. The governance system also needs to demonstrate enforcement of the regulations. Given India's tradition of English common law and a democratic political system (Li & Nair, 2009), one would expect Indian corporate governance to adhere more closely to the Anglo-Saxon system. Ghosh (2006) observed that the Companies Act in India in 1956, and the series of

amendments to it have ensured that the 'interests of shareholders and creditors are protected and that shareholder voice is adequately represented in the management of companies' (p. 3). Indeed the Securities and Exchange Board of India (SEBI) has been continuously enhancing the corporate governance standards in India. In October 2002 it constituted a Committee of corporate governance under the chairmanship of Narayana Murthy, the then Chairman of Infosys Technology. Based on the committee's recommendations and public comments, several revisions were made to the standards. In its final version termed Clause 49 which was issued in October 2004 and requiring compliance by December 2005, it became mandatory for listed firms to adopt a formal code of conduct, require their CEO and CFO to certify the financial statements, enhance disclosures

to shareholders especially on related party transactions and proceeds from public or rights and preferential issues, strengthen the responsibilities of the audit committee and amend the composition of the board with respect to the number of independent directors (for details on Clause 49 see SEBI, 2004).

World Bank's (2004: 1) World Bank's Corporate Governance Report on the Observance of Standards and Codes (CG ROSC) for India provided an update on the regulatory framework. It noted:

Since the first Corporate Governance ROSC assessment dated July 31, 2000, a series of legal and regulatory reforms have transformed the Indian corporate governance framework and improved the level of responsibility/accountability of insiders, fairness in the treatment of minority shareholders and stakeholders, board practices, and transparency. These are positive drivers of change.

Importance of the Stock Market to the Economy:

Weimer & Pape (1999) cite Franks and Mayer (1990: 209) who observed, in their study of capital markets, regulation and corporate ownership, that an increased focus on rules and regulations would result in the stock market being accorded a prominent role in the economy. Their argument was premised on the principle of 'equal access to information and protection of small investors from exploitation by dominant shareholders'. Thus, an Anglo-Saxon

governance system with its dominance of regulations would demonstrate a prominent stock market and enhanced market control.

The decision variable for gauging the importance of the stock market is the Market Capitalization of Domestic Companies (MCDC) as a percentage of Gross Domestic Product (GDP). This is in line with the usage by other researchers (see Weimer & Pape, 1999). The Indian economy is compared with USA, Australia and selected European exchanges to highlight the relative degree of stock market prominence. The MCDC data is reported annually by the World Federation of Stock Exchanges (in US\$ millions) and GDP is reported annually by the World Bank (also in US\$ millions). The most recent data available on GDP is for 2007, so the comparative figures for MCDC were also taken for 2007. However, since a single GDP figure is not reported for Europe, selected exchanges and economies in Europe have been used.

Table 1 presents the score on 'importance of the stock market' for various economies. The score is depicted in column 5 of the table and allows us to interpret the relative rank or placement of the economy on the Anglo-Saxon versus Continental continuum. India, with its tradition of rules, as discussed earlier, is expected to accord a high importance to the stock market. However we see from Table 1 that the MCDC as a percentage of GDP is 155% for India in comparison to 177% for the Americas and 125% for the Spanish Exchange.

Table 1. Importance of the stock market in Australia, India, Europe and USA

Stock Exchange	MCDC (USD millions) End 2007	Economy	GDP (USD millions) End 2007	MCDC as a percentage of GDP End 2007	Rank in terms of importance
Swiss Exchange	1,271,047.7	Switzerland	424,367	300%	1
Americas - total region	24,320,319.8	USA	13,751,400	177%	2
Australian Stock Exchange	1,298,315.0	Australia	820,974	158%	3
Bombay Stock Exchange	1,819,100.5	India	1,176,890	155%	4
London SE	3,851,705.9	UK	2,772,024	139%	5
BME Spanish Exchanges	1,799,834.0	Spain	1,436,891	125%	6

Presence and Degree of Influence of a large shareholder:

In a Continental system, one specific shareholder or a large shareholder can often be identified who exerts a substantial influence on managerial decision-making. It is usually either a domestic or foreign promoter. The decision criterion as to whether the governance system would be categorised as Anglo or Continental is the presence of this one significant shareholder, with 'significant' defined as 'ownership interests greater than 20%'. This cut-off point is well acknowledged by other researchers (La Porta et al., 1999: 57; Ryan, 2005). In contrast, the absence of one specific large shareholder would indicate that the governance system is Anglo-Saxon. Thus, while the Continental system accords a high level of power to the controlling shareholder, the Anglo-Saxon system accords power for the managers as the stock ownership is dispersed. India, with its tradition of family-based firms with high promoter holdings means that one would expect the Indian corporate governance to adhere more closely to the Continental system.

Extent of Free Float:

Anglo-Saxon markets are characterized as being very liquid, whereas the Continental system results in less liquidity. As Berghe (2002) observed, the first reason for the low liquidity of the insider systems is the concentrated ownership and the resultant low free float, while the second reason relates to the longer-term perspective of the average shareholders. In comparison, liquidity in the US markets is higher, due to the relatively short-term investment horizon, and the significant role of the day traders. The decision criterion for 'high' free float is a 'free float factor greater than 55%'. This usage of a cut-off point in the range of 50% - 60% is in line with other scholars (Chong & Lopez-de-Silanes, 2007: 233; Kaserer & Wagner, 2004: 14). The free float factor for the Indian listed companies is reported by the Bombay Stock Exchange (BSE, 2009) Mumbai. BSE defines free float as 'the proportion of total shares issued by the company which are readily available for trading in the market. It generally excludes promoters' holdings, government holdings, strategic holdings and other locked-in shares, which will not come into the market for trading in the normal course' (BSE, 2009). It is a standardized calculation and updated data is available in the Business Standard publication. As Biswal (n.d.a.) notes, 'the available free-float in most American companies is above 90 percent whereas, in India, promoters have more than a 50 percent stake in the majority of the large companies', which means that one would expect the Indian firms to exhibit less free float than in the USA.

Role and Control by Banks:

The Anglo-Saxon system exhibits a low level of control by banks on the Boards of firms. The

percentage of equity ownership by banks provided in the 'shareholding pattern' data provides an assessment of the extent of control. In the Continental system, the level of ownership is higher in comparison to the Anglo-Saxon system. Ghosh's (2007) study on the extent of bank debt in Indian firms revealed that large firms had negligible bank debt and, hence, fewer or no nominees on the Board. Thus, for the purposes of this study which uses large firms, one would expect the role of banks to be low.

Structure of the Board of Directors:

Anglo-Saxon systems generally have a single-tier board, composed of Executive (inside) and non-Executive (outside) members, with both categories of members appointed and dismissed by shareholders. The median number of directors is 12 (see Hanson & Song, 2000: 62), in comparison to the Continental system where there are fewer directors. Continental systems have a two-tier board classed as managerial and supervisory. Anglo boards are also comprised of more independent directors compared to continental systems of governance. The decision criterion is 'the number of members on the Board', 'number of tiers visible in the Board', and the 'number of independent directors', as presented in the Annual Reports. In India, the traditional board structure has been single-tier with SEBI proposing a two-tier structure for the Public Sector Undertakings (PSU's) only in June 2005 (see Subramanyan, 2005). This was confirmed by the World Bank's Corporate Governance Report on the Observance of Standards and Codes (CG ROSC) Country Assessment of India in 2004, which observed that Indian firms have a 'unitary board structure' (p. 12). Therefore, it is expected that Indian firms would exhibit a single-tier structure, with a higher number of independent directors.

Methodology

To explore these characteristics a multiple case study approach was used. The sampling method used purposive sampling to locate well-established firms listed on both the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE) in India, which provides for the interviewees to reflect on the evolution of their corporate governance practices over time. This selection of established firms is in line with other studies (see Khanna & Palepu, 2000).

The selection of interviewees was based on expert sampling and ensured that more than one key informant was available from each firm to provide multiple perspectives of the firm. Executives working in the area of Corporate Governance, and/or Corporate Social Responsibility (CSR) and/or as Corporate Secretaries were contacted through email and an appointment sought in their office.

Accordingly, with the exception of one firm which had only one interviewee available, the other four firms had two or more. The final data set consists of twelve in-depth interviews from five businesses

operating in the oil, steel, aluminium and textile machinery industries.

The face-to-face interviews, which lasted close to two hours each, were conducted over three weeks in July 2008 in the companies' offices in India. A semi-structured interview schedule was used in to elicit the responses. Questions were framed to elicit responses from the respondents as to their definitions of governance, what it meant, how it evolved, and what were the key influences. The interviews were conducted by one of the authors and digitally recorded and transcribed. The typed transcripts were sent to the interviewees for verification. None of the interviewees made any changes to the transcript they received. The study adhered to the National Health and Medical Research Council (NHRMC) Ethics guidelines.

This research uses interpretivism which 'stresses the subjective aspects of human activity by focusing on the meaning rather than measurement of social phenomena' (Hussey & Hussey, 1997:53). It claims that social phenomena are not open to direct observation as per the positivists, but are only accessible via the interpretations of individuals and groups, with those involved thus assigning meaning, significance or value (Porter, 1998:14-5). The interpretive paradigm is more appropriate in situations where the researcher is attempting to study real-life experiences by participation in order to better understand and express its values, details and features (Healy & Perry, 2000:119). It is the preferred paradigm when dealing with complex social phenomena involving reflective people who make

choices in the real world, with the choices themselves being contingent upon the environment (Healy & Perry, 2000:120). Thus, interpretation examines the way people think and act, and assumes that bias is removed by accurately describing the meanings and interpretations of participants.

Publicly available data from the World Bank (World Bank ROSC 2004), Government of India business portal, the BSE website, the Business Standard publication and the businesses' Annual Reports were used alongside the interview data to provide the context for the interview data and to interpret the interview data.

For instance, whilst the interviews provided information on the regulations that the firm was complying with, the Government of India's business portal was used to double-check the name and content of the regulations, the date it was introduced and the scope of their application. Similarly, the firms' annual reports were used to collect data regarding stock ownership, dispersal of equity ownership, including ownership by banks, membership on the Board of Directors, and the structure of the Board. Furthermore, the economy specific data was collected from the World Bank and the World Federation of Stock Exchanges.

The comprehensive case data of each firm was used to classify the firm's governance practice as Anglo-Saxon, Continental, or a mix of both governance systems (Hybrid).

The sample respondents from five firms, their designations, and the codes used to identify them in the paper, are presented in Table 2.

Table 2. Interview respondents and codes used

Name of the firm	Respondent	Code used in paper
Oilco	Chairman and Managing Director	CMD
Oilco	Executive Assistant to Chairman and MD	EA
Oilco	Manager Marketing Research, Planning and Analysis	MM
Steelco 1	Vice-President, Corporate Affairs	VP
Steelco 1	Assistant Company Secretary	ACS
Steelco 1	Financial Controller of a Division	FC
Steelco 2	Joint Managing Director	JMD
Steelco 2	Assistant Vice-President Finance	AVP
Steelco 2	General Manager Human Resources	GMHR
Aluminiumco	Company Secretary and Head - Legal	CSL
Aluminiumco	Associate CSR Manager	CSR
Textilemachineryco	Company Secretary	CS

Data and Findings

Case 1: Oilco Oilco is a large Public Sector Undertaking (PSU) engaged in the oil industry. Based in North India, its annual turnover in the most recent fiscal year was US\$25,000 million. It began operations in the 1950s, and since then has entered into mergers with four organisations. A review of the firm's annual reports and the key informant interviews with the Board members and employees demonstrate that its corporate governance has been evolving since the time of its establishment in the early 1990s. Three key executives were interviewed in this company, the Chairman/Managing Director, his Executive Assistant and the Manager Marketing Research, Planning and Analysis.

Oilco's annual report addresses shareholders rather than including other stakeholders.. In the 2008 financial year, it had a two-tier board with 11 directors, 5 of whom were executive directors including the Chairman, 2 were non-executive government directors, and 4 were non-executive independent directors (p. 126). The shareholding pattern reveals that the Government of India holds 51.11%, foreign institutional investors (FIIs) and overseas corporate bodies (OCBs) hold 13.23%, banks hold 0.12%, employees hold 0.12%, and others hold 10.49% of the total shares of 338,627,250 (company website). Thus, bank ownership is very low. Oilco's free float was 48.89% (Business Standard, 2009).

CMD points out that a key driver of corporate governance, especially the PSUs has been India's socialist history and value systems. *'From the beginning when the public sector started, Nehru [India's first Prime Minister Jawaharlal Nehru] had a fundamental belief about being very transparent because, he said it was public money that was getting invested for the public sector, and the management of the public sector is actually the custodian of the public money and is answerable to the Parliament of India which it represented. So, over a period of time, rules and regulations evolved in such a way that transparency was in-built in governance.'*

MM confirms this view and also points out that the firm's governance embeds corporate social responsibility. *'As a public sector we have always been having our responsibilities towards the society at large. As a government company, that is what we have always been doing. Corporate governance as a law, as a rule, has come in later, and yes, we became more aware of what corporate governance is. Otherwise ... it (social responsibility) is an in-built thing which the company has been doing.'*

CMD adds that the principle of stewardship was also followed by large private sector business houses. *'Even in the private sector, there were companies like the Tata's, the Godrej, a number of those old Parsi companies ... they always had a very transparent way of doing business from the start. The Tata's have*

always had a reputation for honesty, straightforwardness ... and even the current Chairman, Ratan Tata, makes it very clear that they are not here to make a huge profit. But, at the same time they do make profits.'

This value based approach to governance and its link to regulatory oversight is further evident from his comments on Oilco's compliance status when SEBI introduced Clause 49 Compliance, a corporate governance regulation. *'When Clause 49 was introduced we found out that barring one or two items we were actually practising all of them...For instance, we have always had an audit committee. So, when Clause 49 came in, it was easy for us. We had to formalize the committee in the form of a letter; that was all we had to do.'*

From the governance perspective, the focus was on stakeholders rather than shareholders. As MM reminisces, *'In 1994, that was the time we suddenly realised that there is someone called a shareholder and we need to take care of his interests as well. Until then, predominantly we had been looking at the society, taking care of the people or the public'. EA's comment defines 'stakeholders' quite broadly and aids in highlighting how CSR came to be embedded in the Indian governance system. 'The stakeholders are not just your employees or the vendors but also the public who are residing around the factory or premises.'*

In applying principles CMD spoke of the importance of non-discrimination and transparency although adding the problematic nature of corruption in Indian society. CMD explains, *'what actually it (corporate governance) means to us is that a) transparency, b) that we do not distinguish in terms of caste, religion, language when we do business, for our employees or for our customers, c) unless it happens accidentally, we normally don't cheat people'. Furthermore, 'the performance appraisal is very transparent. The employee can see what is written'. However, he hastens to add that it does not mean that his firm is free of corruption. 'There is always some petty corruption. We cannot escape from the society in which we live, because what is an organisation? It is a microcosm of the society that we live in. So whatever ills in society are there, some form or the other will happen here. We cannot eliminate that. But, we can mitigate it by putting in various interventions'. He cautions that smaller private firms exist who are focused only on profits and 'are out there to cheat the government'.*

Do the firms benefit from the principles based approach? As CMD observes, *'transparency brings us a lot of happiness and at the end of the day it is also a good business decision. People are comfortable doing business with us. My company is known for its values and transparency. That's the reason that we get some of the best companies in the world as partners. That makes us feel all the more that better governance is good business.'*

Case 2: Steelco 1. Steelco 1 is one of the oldest integrated steel companies in India and manufactures and markets steel, steel building and construction applications. It was established in the early 1900s in India, and today its operations span the globe. Its corporate governance system was firmly established by its founders and was formalized in the 1990s when the corporate governance agenda was discussed in the public forum. Steelco 1 is part of a large, diversified, family-based group consisting of 13 listed companies. Based in North India, the global conglomerate derives 61% of its revenues from international operations and is reported to have US\$62.79 billion in total revenues. Its total market cap was US\$41.7 billion in June 2009. Three key executives were interviewed in this company; Vice-President, Corporate Affairs, Assistant Company Secretary and Financial Controller of a Division.

Steelco 1's annual report addresses only shareholders and the Chairman's statement begins 'Dear Shareholders'. In the 2009 financial year, the Board of Directors was two-tiered with the Executive Committee and a Joint Executive Committee, alongside a third committee specifically for a main division of the company. It was comprised of 14 directors, of which 8 were independent. It had a non-Executive Chairman, and the non-executive directors made up more than 50% of the total number of directors. The shareholding pattern reveals that promoters, including family and group companies, hold 33.95%, foreign institutional investors (FIIs) hold 13.20%, banks hold 19.82%, and the general public owns 24% of the total shares of 730,592,471 (company website). Thus, banks are among the three major institutional investors along with the FIIs and the Mutual Funds/Unit Trust of India. Steelco 1's free float was 66.05% (Business Standard, 2009).

As with Oilco, the linking of governance and CSR were fundamental to Steelco1's philosophy and vision, and was put in place by the founder. As observed by ACS, '*corporate governance in Steelco1 has been a very important aspect of running the affairs of the company. Basically, in the Steelco1 groups, it will seem the corporate governance is also the philosophy of the company...Our vision says that we will take all steps for value creation, and safety and environment, people, and to protect the interest of all the stakeholders... It was the vision and the belief of the founders. They always felt that what comes from the people should go back to them, many more times than what we get from them. It was a sort of welfare measure wherein they wanted the people to be not only working in the factory but also enjoying their personal life and then a decent community. So, a lot of community welfare activities were done*'.

Her colleague, VP, affirms the principles based approach and adds that even the code of conduct was similarly a part of the philosophy and practice and was simply formalized decades later. '*It (the code of conduct) was first handwritten and we all followed it.*

There were no documents. In 1996 we formally documented it'.

The data reveals that the 100 year old company had institutionalized best practice governance from the 1940s based on values and principles, rather than regulation. In fact, the practices followed by this company became mandated by legislation several years later, when the Government of India realized the benefits of such governance standards.

ACS describes how their practices led the way for legislation. '*The many facilities which we are offering to the shareholders, we were doing this without thinking about regulations...Even right from the early 90's if you see, we had so many practices which were not sort of laid down on a legislative level. ... like the 8 hour working, the maternity leave provision, the provident fund and the bonus, which subsequently the government realized are very important employee welfare activities. And, that's how the legislations were founded. It (our practices) was the origin of several legislations like the Factories Act, the Provident Fund Act, the Payment of Bonus Act, the Maternity Leave Provision. Steelco1 was already having some of the committees like the audit committee which have been subsequently made mandatory by the Clause 49. We had set it up in 1986 whereas the legislation came in 2001. Again, take the whistle blower policy. At Steelco1 we have had the policy and it has been made mandatory. We also have an ethics counsellor and an ethics committee*'. She points out that the Clause 49 regulation and compliance in its current form states the whistle blower policy as 'optional'.

Due to its exemplary standards, Steelco1 has been a role model for several businesses in India. This has been corroborated by Oilco in their interview data above, where they mentioned some of the firms for their excellent governance standards.

However, the introduction of legislation does not mean that the standards will become pervasive. Its implementation is critical and as observed by ACS, the Indian governance system is lagging on this front. '*If you legislate but you don't monitor, then that legislation becomes a piece of paper. So it lacks teeth. SEBI is the watchdog. But it lacks teeth. It cannot pursue, it cannot prosecute or take any action against the offending companies*'. Thus, she adds that despite the strict Clause 49 compliance, some firms '*might fulfil it in terms of the substance but not in the true spirit*'.

Case 3: Steelco 2. Like Steelco 1, Steelco 2 is also part of a large, diversified, family-based group with interests in manufacturing and marketing steel, energy and infrastructure and logistics. The business group was established in 1982, and incorporated its steel business in South India in 1992. Steelco 2 reported annual revenue of INR.1706430 lakhs (approximately US\$ 3.6 billion at current exchange rates of US\$1 = 47.68 INR) in the most recent financial year. The Group is a US\$10 billion

conglomerate with 12 steel plants in India and 2 steel plants in the USA. Three key executives were interviewed in this company; Joint Managing Director, Assistant Vice President Finance and General Manager Human Resources.

Steelco 2's annual report for 2008-09 addresses only the shareholders as the letter from the Vice-Chairman and MD starts 'Dear Shareholders'. In the 2009 financial year, the structure of the Board of Directors was single-tiered and was comprised of 15 directors of which 11 were non-Executive. Steelco 2 had 8 independent directors and mentions that this proportion is more than the stipulated 50% requirement. Apart from the Chairman, the Vice-Chairman and the MD, no other directors were family members (Annual Report 2009: 39). Its shareholding pattern reveals that promoters, including family and group companies, hold 45.02%, foreign institutional investors (FIIs) hold 29.03%, banks hold 1.51%, employees own 0.04%, and the public owns 9.07% of the total shares of 187,048,682 (p. 51). Thus, ownership by banks is low. Steelco 2's free float was 41.25% (Business Standard, 2009).

In regard to governance and the impact of regulation JMD states: *'The message we get from our management is that we should always follow all the rules, regulations, laws and we should always be on the right side of the law. So, we have no pressure to do anything wrong, ever'*.

Both JMD and his colleague GMHR are of the view that good governance includes the aspect of embracing the community surrounding their firm. *'One philosophy that our company has is that unless the people around you are happy, you cannot grow. We need to have them in with you'* [GMHR]. JMD adds, *'this factory and its surroundings ... we are married to each other. These are the people in whose land this factory has come up. We have to deal with them every day and they have to deal with us. Some of them have got benefit out of it; some of them have not got benefit out of it. Those who have got benefit by direct employment, or indirect employment, or contracts, or suppliers, are fine. But, there are many others who have not got benefit. Our responsibility is towards them also'*. JMD highlights the crucial interdependency of the firm and its community. According to him, when the firm supports the surrounding community irrespective of whether they are its employees or not, the goodwill in turn provides a protective moat for the firm. *'And that responsibility (supporting the community) is a requirement. It is not something to talk about. That is the basic need to run this organisation. If you have good relations with them, nothing will go wrong.'* He cites instances of how their firm avoided strikes and lock-outs due to this strong positive relationship. AVP also sums up the broad approach of Steelco2 to this principle. *'Our management has this outlook, that if we introduce something to the industry, we introduce something for the society and something to the nation too. We (the*

firm) have to take care of the local people, the community. Of course, there is the government. But, government cannot give to everybody. This is the way we are looking at it'.

JMD further links governance to sustainability: *'if we have good corporate governance the company will not go into liquidation overnight'*.

Case 4: Aluminiumco. Similar to Steelco1 and Steelco2, Aluminiumco is part of a diversified, non-ferrous metals and mining group established in 1979. The Group is listed on the London Stock Exchange and has reported revenues in excess of US\$6.6 billion for the year ending 31 March 2009. Aluminiumco is based in South India and was established in 1995. It reported gross revenue of Rs5083.35 million (approximately US\$106 million) in the most recent financial year. Two key executives were interviewed in this company, the Company Secretary and Head – Legal, and Associate CSR Manager.

Aluminiumco's Chairman's report does not address anyone in particular and begins by stating the company's vision. In the 2008 financial year, the Board of Directors was single-tiered with Executive and non-Executive members. Of the total of 8 members, 2 were executive directors and the remaining 6 were non-executive members. Three were independent professional directors. The shareholding pattern reveals that a foreign body corporate classified under promoter group holds 80% of the total shares, with 0% of Indian promoters, FIIs own 6.14%, banks have 0% ownership, and the total institutional shareholding is 6.36%. The non-institutional shareholders comprise bodies corporate, individual shareholders (4.5%), OCBs, and non-resident Indians (NRIs), with total shares of 22,500,000 (company website, p. 54). Thus, banks have no ownership or role. Aluminiumco's free float was 20% (Business Standard, 2009).

The principles-based approach of the Indian governance system elucidated by Oilco and Steelco respondents is also confirmed by this firm. CSL observes, *'The Tata Group, who started 100 years ago ... have built excellent institutes like Tata Institute of Social Sciences ... Even the Birla Group was very pioneering and they have set up institutions ... many schools ... many institutes, temples, planetariums, and this was all voluntary. There was no law which says that you have to spend on corporate social responsibility. Social responsibility of a business entity was always in the minds of the old business houses. The notion that we have earned so much and we should go and give it back to the society was already there but now I think we have a more structured system'*. He adds, *'voluntarily we have accepted the United Nations Global Compact Principles. We believe that governance is something that should come voluntarily. It is going beyond the rules. This is our philosophy'*. His colleague, ACSR observes, *'whether you call it CSR, or whether you call it philanthropy, it doesn't matter. What matters is*

that when you have the capacity to take somebody with you, I think you should do it'.

The value system based on stewardship emanated yet again from the Indian culture and ideologies articulated by Gandhi. *'We believe that trust...the concept of trusteeship given by Gandhiji means that the management of the company is trustee of the shareholders'* [CSL].

CSL stresses the stakeholder perspective of the firm. *'For us, the employees are one of the most important stakeholders; the government too is another important stakeholder'*. ACSR explains this perspective further. *'I look at it this way, the employee finally goes into the community. So doing it (welfare activities) for the employee or the community, one shouldn't make too strong a demarcation between the two'*.

Another line of responding about 'good governance' was the link shown here by CSL: *'corporate governance is more of an ethical issue where ultimately a good governed company will certainly be rewarded by the stakeholders. I say that corporate governance can also bring profits. And also bring value. It takes years to build a good name but it takes seconds to spoil it. So at the same time it's not easy. You have to be really on your toes as people are watching. Every employee should imbibe this culture'*.

Case 5: Textilemachineryco.

Textilemachineryco was founded in 1962 and designs, develops and exports a range of textile machinery. This company is the smallest in the sample used for this study. Based in South India, it reported revenues of Rs133801.39 lakhs (approximately US\$280 million) for the financial year ending in 2009. One key executive was interviewed in this company. The Company Secretary was interviewed for this case.

Textilemachineryco's director's report (p. 42) addresses only shareholders as 'Dear Shareholders'. In the 2008 financial year, the Board of Directors was single-tiered with Executive and non-Executive members. Of the total of 8 members, 2 were executive directors and the remaining 6 were non-executive members, and included an institutional nominee representing the insurance segment. Three were independent professional directors. The shareholding pattern for the 2009 financial year reveals that an Indian body corporate classified under Indian promoters holds 23.37% of the total shares, with 0% foreign promoters, FIIs own 0.31%, banks have 0.02% ownership and insurance companies hold 18.18%, with the total institutional shareholding at 22.20%. The non-institutional shareholders comprise

52% of total shareholders and include bodies corporate (15.11%), individual shareholders (19.74%), and OCBs (13.19%), with total shares of 12,369,250 (company website). The company's shares were listed on the Madras Stock Exchange also. Textilemachineryco's free float was 74.19% (Business Standard, 2009).

Similar to other interviewed businesses, Textilemachineryco's CS explains that the founder had instituted the culture of good governance well before the formal rules and regulations. *'Actually the corporate governance concept and corporate committees were appointed five or six years back. But, even before that we were practising all this, although it was not published in our annual reports. The (company) founder was responsible for this ethical way of conducting the business. This culture that is in practice now in our company has been imbibed at the very beginning itself'*.

Similarly, CS describes the principles-based governance practices followed by the firm voluntarily and proactively without the necessity of legislation. *'Corporate governance as we understand is total satisfaction of all the stakeholders - the shareholders, the promoters, the suppliers, the customers, the workers, that is, our employees, all these people who are connected with and working with the organization. Yes, all these things were in our business routines, even before it was made compulsory, or mandated as law. Voluntarily we have been in compliance with these requirements'*.

Due to its best practice governance standards, Textilemachineryco has become a role model for several firms, similar to Steelco1. *'Many companies follow our model'*. CS explains one aspect of the model is the principle of not taking advantage of the firm's superior market position to exploit others. *'Ours is a monopoly. Even though we are a monopoly, we don't treat our customers that way. When there is a lot of demand suddenly, we don't raise the prices. Another thing is, in whatever we do, we do not discriminate between customers - the small players or the big customers. Whatever the size of the order, we quote the same price. Further, we have a queue (system) for delivery ... we never by-pass the queue. Whatever be the case, no favouritism is shown. Although we have our own group companies we don't give preference to any of our group companies. They should also stand in the queue. Even the foreign competitors are unable to compete with us because of these principles'*.

The findings are summarized in Table 3.

Table 3. Summary of findings

<u>Variables</u>	<u>Anglo-Saxon system</u>	<u>Continental system</u>
Legal system	<p>Strong legal structure but weak enforcement</p> <p>All 5 companies</p> <ol style="list-style-type: none"> 1. The Companies Act, 1956 2. Companies Bill, 2004 3. Securities Contracts (Regulation) Act, 1956, 4. Securities and Exchange Board of India Act, 1992 5. Depositories Act, 1996 [by SEBI] 6. Right to Information Act 2005 [relevant for the PSU firm] <p>Fifteen International regulations and Codes published from 1992 - 2008</p>	
Concentration of ownership and equity by a single shareholder (promoters in all 5 cases)		<p>Aluminiumco had the highest concentration (Foreign corporate bodies: 80%)</p> <p>Oilco (Government: 51%)</p> <p>Steelco 2 (45%)</p> <p>Steelco 1 (34%)</p> <p>Textilemachineryco had the lowest concentration (23%)</p>
Importance of the stock market	India lies between USA and Europe – see Table 1	
Role/control by banks	<p>Aluminiumco (0%)</p> <p>Textilemachineryco (0.02%)</p> <p>Oilco (0.12%)</p> <p>Steelco 2 (1.51%)</p>	Steelco 1 (19.82%)
Structure of the Board of Directors, and total members in the board	<p>Single – Tiered:</p> <p>Steelco 2 (15 directors; 4 Exec)</p> <p>Aluminiumco (8 directors; 2 Exec)</p> <p>Textilemachineryco (8 directors; 2 Exec)</p>	<p>Two-Tiered:</p> <p>Oilco (11 directors; 5 Exec)</p> <p>Steelco 1 (14 directors; 6 Exec)</p>
Extent of free float (%)	<p>Anglo- Saxon systems have free float of > 55%</p> <p>Steelco 1 (66.05%)</p> <p>Textilemachineryco (74.19%)</p>	<p>Continental systems have free float of < 55%</p> <p>Aluminiumco (20%)</p> <p>Steelco 2 (41.25%)</p> <p>Oilco (48.89%)</p>

Discussion

In relation to the strength of the legal system, we expected that the Indian corporate governance system would more closely resemble the due to the presence of extensive regulations. However, data reveals hybridization. While there is an extensive body of regulations, they are weakly enforced. What accounts

for the hybridization? Typically, the Anglo-Saxon system treats the legal rules and ethical customs of the society as external constraints to shareholder value maximisation, while the continental system includes legal rules and ethical customs in the stakeholder loss minimisation objective (Alpaslan, 2009). The inclusion of rules in the stakeholder objective has stemmed from the societal culture and ethical values

of the founders. For instance, the best practice governance practices that ACS refers to in the interview, included: 8 hour shifts and bonuses which were made mandatory much later; establishing a crèche for children of employees; more recently, establishing a whistleblower policy that is not mandatory but is an option in Clause 49 regulation; engaging in a new initiative of holding AGM's not only in the headquarters of the firm but also in different cities so as to benefit the retail shareholders who cannot travel; and improvements in investor relations by attempting to locate individual shareholders with unclaimed monies with the firm, and sending them their money instead of simply following the rule of sending unclaimed monies to the Government. A wider view of stakeholders than what is legally required or traditionally seen in a stakeholder model is evident, along with a community focus. This appears to be the different 'normative core' of a stakeholder model as observed by Alpaslan (2009).

But, the presence of corruption in the society and lack of enforcement of the rules stemming from unethical behavior also exists simultaneously as pointed out by CMD. The World Bank's CG ROSC for India (2004) identified regulatory arbitrage as the main reason for this weakness of the governance system. It stated that the 'Department of Company Affairs (DCA), SEBI and the stock exchanges share jurisdiction over listed companies. This creates a potential for regulatory arbitrage and weakens enforcement' (p. 15). Fremont and Capaul in (2002: 2) in their survey of 15 countries observed that poor enforcement was a result of under-financed courts who are unmotivated and unclear as to how the law applies, unfamiliar with economic issues, or even corrupt; and, securities regulators who have little direct power to enforce penalties.

In examining the importance of the stock market we expected that India with its tradition of rules would accord a high importance to the stock market. However the data points to hybridization yet again with the importance of the Indian stock market placed between the Americas and the Spanish exchanges.

In evaluating the presence of a significant shareholder, the tradition of family-based firms in India would imply the presence of a single, large shareholder or promoter having a high degree of influence thus adhering more closely to the Continental system. The data supports this. The shareholding data from the Annual Reports reveals that all five firms had a strong concentration of equity held by promoters, ranging from 80% in Aluminiumco, to 23% in Textilemachineryco. The data further reveals that the founders had a high degree of influence on their organization's corporate governance practices.

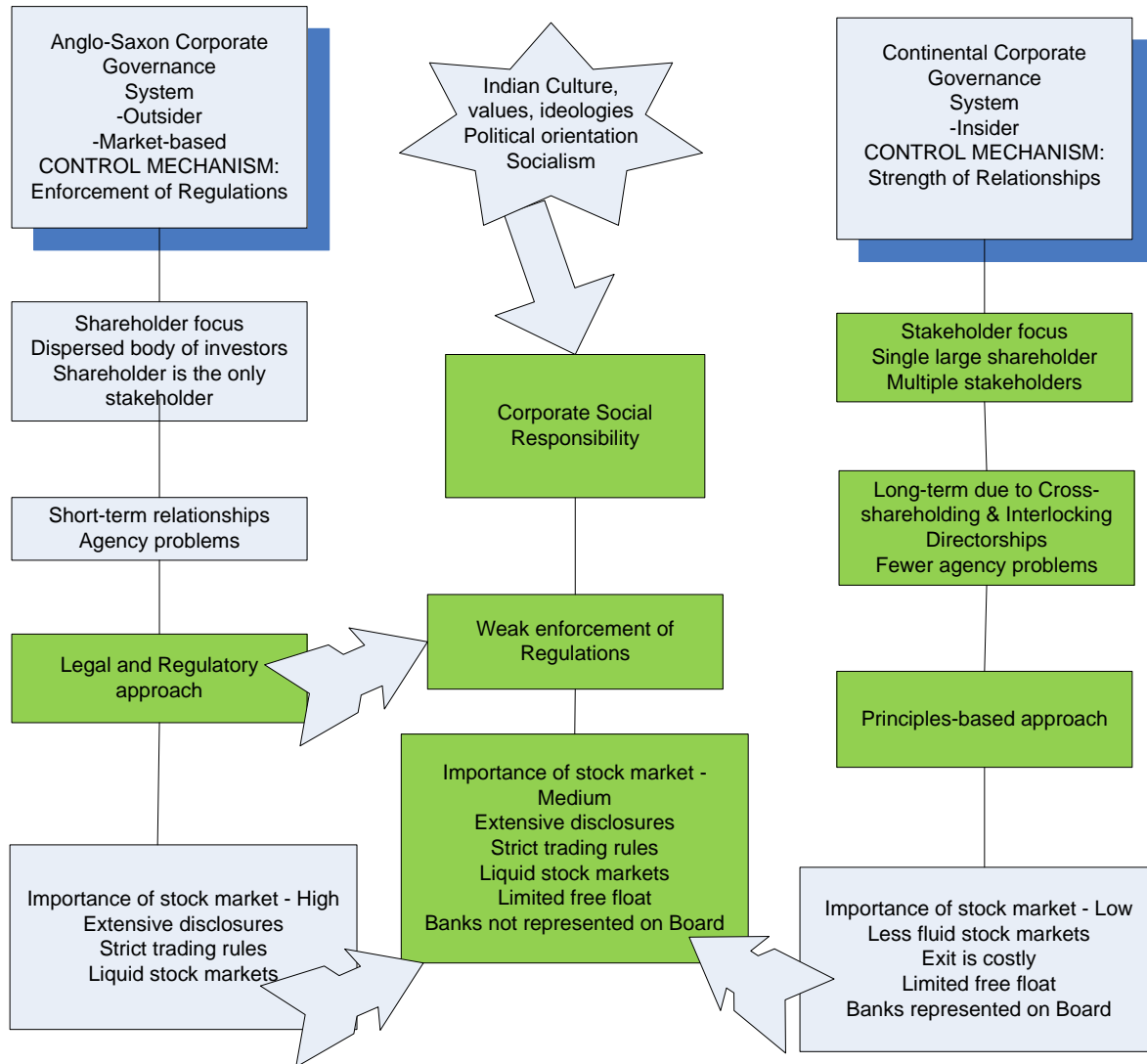
As to the shareholding pattern, India's promoter-based holding patterns would mean a low free float factor as typically found in Continental systems. The data confirms that the free float factor is very low for all five firms, thereby revealing similarities to the Continental governance system.

In comparing systems we have also argued that the Anglo-Saxon system exhibits a low level of control by banks on the Boards of firms. Indian businesses with their low bank debt implying low control by banks provide similarities to the Anglo-Saxon system. Data confirms the resemblance of the Indian governance system to the Anglo-Saxon system, as only one firm had approximately 20% ownership by banks, while the remaining four firms had 0% to 2% ownership.

Finally, the assumption of extensive regulations implies a single-tier board with a high proportion of independent directors, typical of an Anglo-Saxon system. Data points to hybridization as the sample firms exhibit both single-tiered boards, as well as two-tiered boards. The number of board members also exhibits the presence of a mixed system. Those firms using a single-tier structure, however, displayed greater director independence.

The Indian hybrid corporate governance model is portrayed in Figure 2. It demonstrates that the hybridization has evolved not only through a combination of characteristics from both the Anglo-Saxon and Continental systems, but also due to the country-specific culture, values, ideologies and religious faith.

**Figure 2: Indian Hybrid Corporate Governance System
A case of mix-and-match?**



Concluding remarks

A cycle has been in motion since the collapse of Enron where corporate governance failures have led to increased regulation; a new loophole in the regulation is exploited leading to additional governance lapses, which in turn prompts further regulation. However, what we have failed to notice is the possibility of the existence of a virtuous cycle in reverse: exemplary corporate governance practices being mandated as law and the birth of best practices continuing to become a regulation. This is evident from this study, albeit a very small sample. This aspect requires further research using larger samples.

What does India’s future corporate governance system look like? The study highlights that corporate governance systems evolve and change as firms engage in proactive or reactive practices. For the large Indian business groups, PSUs and other private firms which had been following best practice principle-based governance practices, it seems to be merely a matter of reporting and disclosing what they had been doing all along. The public became aware of these firms’ exemplary practices. Thus, the regulations and disclosure policies benefited them. However, the interview data hints that smaller private firms may have a different governance system. The comment links profits to cheating. The scope of this study was limited to large listed companies and business groups.

A wider sample that includes smaller private firms and unaffiliated firms will provide data that can be generalized.

As Thyl and Young (2009) observed, 'after India's independence in 1947, corporate governance practices in India were modelled on the values and philosophy of India's political leaders, Mahatma Gandhi and Jawaharlal Nehru, who instilled in the public mind the concepts of "trusteeship" and social justice'. All five firms reported that CSR activities were a part of their good governance agenda. This approach stemmed from the principle of 'giving back to the society'. The data highlights that the firms have traditionally encompassed several stakeholders, included CSR as part of good governance, and voluntarily embraced a principle-centred approach. Clearly, this wide stakeholder embrace has benefitted the firms by providing them with the stability and security needed for sustainable business, and exhibited beneficial flow-on effects to the general public in the vicinity of the firm, and the local government, forging a bond between the firm and its surroundings. It could be regarded that these firms' exemplary practices include proactive disclosures, community relations and green management that are yet to be mandated by laws, a continuous improvement in transparency of their processes and enhanced equity and justice. Thus, as pointed out by several researchers (see West, 2009), it is also necessary to understand the fundamental sets of values, attitudes, and beliefs that underpin India's legal and economic structures so as to identify the 'appropriate' governance structures for India and gauge the effectiveness of the hybrid system.

There does not appear to be one-best-way with the inherent flexibility in the approach provided by the principles-based approach. As Nestor and Thompson (2001: 37) observed, although convergence is occurring in corporate governance due to the globalization of financial and product markets, one should not expect uniform corporate governance institutions and arrangements throughout the world, because ownership and control structures emanate from the particular society's core characteristics, and, hence, will remain idiosyncratic to a considerable degree. Also, as observed by Yoshikawa and Rasheed (2009), a comparative study of hybrid practices in different countries is also needed to provide insight into whether convergence is inevitable or not.

This paper has revealed India's home-grown corporate governance system and the extent and nature of hybridization within the system. The interview data in particular has explored statements around values and established practices, thereby highlighting the explicit culture and norms of Indian firms. As West (2009) argued, 'corporate governance models worldwide should be mapped according to culture, rather than the legal system, for a more accurate and useful picture' as the evolution of country-specific governance is 'path dependent'. This

paper in exploring a set of large established firms highlights the interdependencies of the legal systems, values, culture and norms in governance leading to a particular set of governance practices, ownership structures and organisational purpose.

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