TITLE PAGE

An empirical investigation of hybrid corporate governance systems in large firms: Evidence from India

IFSAM TRACK: G4 – Governance

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Abstract
The heightened pace of corporate governance reforms has focussed attention on country-specific governance models. In relation to India, scholars have observed that a hybrid of the outsider Anglo-Saxon system and the insider Continental system is likely. This paper reports the results of a study that investigated the corporate governance system of five large firms in 2008. It presents evidence based on publicly available documents and twelve key executive interviews. The paper initially presents a literature review and establishes six propositions based on the distinguishing features of the two major systems, and then presents the methodology, findings and discussion. 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 in India. However, 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

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. At first glance, this hybridization may appear to be merely an outcome of globalization (Yoshikawa & Rasheed, 2009). However, a literature review of the Indian governance system reveals that its hybrid corporate governance system ‘has been in existence for a considerable period of time’ (Kar, 2001: 249).

An empirical study of governance issues in India, in particular, is thought to be important due to the possibility of 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. Furthermore, 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). With globalization, not only do Indian firms need to have an increased understanding of their own practices, but foreign multinationals doing business in India need to be aware of the Indian governance system (Li & Nair, 2009).

This paper attempts to provide empirical evidence on 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. The first section of the paper presents the theoretical underpinnings of the Anglo-Saxon and the Continental systems, and frames a series of propositions on the distinguishing features of the two major systems. The methodology, findings and discussion are then presented. The specific characteristics of the corporate governance systems in the Indian businesses are explored and an attempt is made to classify the characteristics in terms of the Anglo-Saxon and Continental systems with a view to assessing the extent and nature of hybridization. The verification of the propositions follows. The limitations of the study and future research needs are also presented.

Theoretical underpinnings of the Anglo-Saxon and Continental systems

Several scholars have articulated the key aspects of the main global corporate governance systems. While one approach has been to scrutinize the systems at the level of countries, the other approach examines the systems at the level of firms. For instance, 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 exercise control on the firm through the external stock market, or whether several groups of oligarchic stakeholders influence decision-making in the firm; whether the board had a single tier with both executive and supervisory responsibilities or whether this was split in two; 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.

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 easy transfer of shares, with power 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 of the firms 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 that allows firms to seek higher profits in the long-term as banks were 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 would 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.

Propositions used for this paper

Based on the distinguishing features of the Anglo-Saxon system and the Continental system, a series of propositions were framed. In addition, a decision criterion based on the literature was established to aid the classification of the Indian firms.

Proposition 1: 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 this proposition is ‘evidence of mandatory legal rules, regulations and codes for the governance of companies' and 'evidence of degree of enforcement'. India's tradition of 'English common law and a democratic political system' (Li & Nair, 2009) means that one would expect Indian corporate governance to adhere more closely to the Anglo-Saxon system.

Proposition 2: Concept of the Firm:
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 is the presence of one significant shareholder, with 'significant' defined as 'ownership interests greater than 20%'. This cut-off point is well acknowledged by La Porta et al. (1999: 57), and other researchers (see Ryan, 2005). In contrast, the absence of one specific large shareholder would indicate that the governance system is Anglo-Saxon. Thus, the Anglo-Saxon system accords a high level of power for the managers, while the Continental system accords that power to the controlling group of shareholders. India, with its large proportion of family-based firms and high promoter holdings, means that one would expect Indian corporate governance to adhere more closely to the Continental system.

Proposition 3: Importance of the Stock Market to the Economy:
Economies that accord a high importance to the stock market adhere to the Anglo-Saxon system (Weimer & Pape, 1999). The authors cite Franks and Mayer (1990: 209) who observed, in their study of capital markets, regulation and corporate ownership, that the prominent role of the stock market is an outcome of the focus on rules and regulations in an Anglo-Saxon system, which does so on the principle of 'equal access to information and protection of small investors from exploitation by dominant shareholders'. The decision criterion for gauging the importance of the stock market is the Market Capitalization of Domestic Companies (MCDC) as a percentage of Gross Domestic Product (GDP). India, with its tradition of rules, as discussed earlier, is expected to accord high importance to the stock market.

Proposition 4: 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.

Proposition 5: 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. 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 Securities Exchange Board of India (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.

Proposition 6: 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 (see 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) 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.

Method

In this paper, the publicly available data is quantitative in nature, for instance, the GDP figures of the country, the value of the stock exchange, or the stock ownership data. The numerical data is used to investigate the propositions. The qualitative interview data is used to uncover in-depth understanding about the governance systems and provide greater insight than what simple numerical figures provide. To achieve this, the qualitative data uses interpretative measures. Interpretivism '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). Hence, interpretation examines the way people think and act, and assumes that bias is removed by accurately describing the meanings and interpretations of participants.

Sample and Variables

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 allows us to trace 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 due to lack of availability, the other four firms had two or more.

Two types of data were used in the study. The publicly available data from the Indian stock exchanges and the company's annual reports were used alongside the interview data from twelve key informants from five established Indian 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. The interviews were digitally recorded and transcribed and the typed transcripts were sent to the interviewees for verification. The study adhered to the National Health and Medical Research Council (NHRMC) Ethics guidelines. Interview data were analyzed and classified into two major themes, namely, evidence from traditional governance systems and practices as to whether they were Anglo-Saxon or Continental, and evidence on a voluntary approach to principle-centred governance rather than as a response to laws and regulations.

A brief background of each of the five firms is provided below.

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 evolved since the time of its establishment in the early 1990s. Three key executives were interviewed in this company.

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.

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.

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.

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 12 sample respondents, their designations, and the codes used to identify them in the paper, are presented in Table 1.

[Insert TABLE 1 about here]

Source of the publicly available data

The source of data regarding the strength of the Indian legal system and the regulations and rules was the World Bank's ROSC 2004, Government of India business portal and the BSE website. The data regarding concept of the firm, dispersal of equity ownership and role and control exerted by banks, are sourced from the 'Shareholding patterns' reported in the firms' annual reports. Evidence of the importance of the stock market in India, Australia, USA and European economies is sourced as follows: 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). This is in line with the usage by other researchers (see Weimer & Pape, 1999). The most recent data available on GDP is for 2007, so the comparative figures for MCDC were also taken for 2007. The Indian economy is compared with USA, Australia and Europe to highlight the relative importance. However, since a single GDP figure is not reported for Europe, selected exchanges and economies in Europe have been used. The structure of the board of directors is sourced from the Annual Reports of the firms, and, the extent of free float is sourced from the Business Standard publication's website.

Findings and Discussion

Oilco Oilco's annual report addresses only shareholders and the Chairman's message begins 'Shareholders'. 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).

Steelco 1 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).

Steelco 2 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).

Aluminiumco 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).

Textilemachineryco 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).

The individual firms' data, including the rules and regulations that the firms are required to adhere to, and their shareholding pattern including the equity ownership by promoters and banks, is classified in Table 2.

[Insert Table 2 here]

Table 2 reveals that the legal system is clearly Anglo-Saxon. Ghosh (2006) observed that the Companies Act, 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). The board structure and the membership of the boards are mixed, reflecting features of both the Anglo-Saxon and Continental systems.

Importance of the stock market Table 3 presents the importance of the stock market for various economies.

[Insert Table 3 here]

The data reveals that India accords a lower importance to the stock market than the Americas and Australia. However, Europe accords an even lower importance than India.

Ownership is concentrated in all cases although the role of banks is minimal. Board structures are mixed although those that are single-tiered exhibit greater director independence. The extent of free float is also mixed although those companies displaying Anglo structures also have a tendency to a greater free float. Thus, the Indian governance model is positioned midway, implying a hybrid practice.

Interview Data

Evidence from traditional governance systems and practices in India

The Prevalence of Trusteeship and Justice

As [author names removed for refereeing process] (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*'. The impact is clearly seen in the unanimous responses from all five firms. As CMD observes, '*… right from the beginning when the public sector started, Nehru had a fundamental belief about being very, 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 had evolved in such a way that transparency was in-built'* [CMD].

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. 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' [CS]*. MM confirms the view of others. '*But, 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 is an inbuilt thing, which the companies have been doing'* [MM].

It is worth noting that the large private sector business houses also followed this principle of stewardship. '*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* [CMD].

<u>Stakeholder approach to governance</u>
These firms did not go by the Anglo-Saxon shareholder focus but embraced the stakeholder perspective. For instance, Oilco's vision was broad and holistic and explicitly included several stakeholders. As observed by ACS, '*We derive everything from our vision. 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'* [ACS]. 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' [MM].*

Similarly, CS states their traditional approach to governance, '*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' [CS]. 'It (the code of conduct) was first handwritten and we all followed it. There were no documents. In 1996 we formally documented it'* [VP]. And EA goes a step further and includes the public community who may not necessarily be employees of the organization, as a major stakeholder. '*The stakeholders are not just your employees or the vendors but also the public who are residing around the factory or premises' [EA]*.

Evidence of a voluntary approach to principle-centred governance rather than as a response to laws and regulations

<u>Evidence of principle-centred governance practices</u>
They explained the process by which their principles were later formalized and made mandatory. Although the legal system is thus quite strong and outwardly exhibiting an Anglo-Saxon system, clearly the intention of the law is principle-based and the adoption of the law is also based on principles, and not a knee-jerk response of control as in the case of say the Sarbanes-Oxley. Thus, the law when enacted, is followed in spirit as well as letter. .As ACS observed, '*Right from the early 90's we had so many practices which were not sort of laid down on a legislative level. We had those practices like the 8 hour working day, the maternity leave provision, the provident fund, the bonus, all of which subsequently the government realized were very important employee welfare activities. That's how the legislations were founded'* [ACS]. As Oilco's Chairman observes, '*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. Yes, we became more aware of what corporate governance is ... Clause 49 (of SEBI) lists all the various items … and we found out that, barring one or two items, we were actually practising all of them* [CMD]. ACS continues, '*In fact, this (the governance regulations) made us proud of ourselves; the many facilities which we are offering to the shareholders, we were doing this without thinking about regulations'* [ACS].

CSR was integral and spontaneous response based on the principle of 'giving back to the society'.

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' and the interview data reveals their continuous and pro-active approach to CSR. For instance, CSL traces the traditional approach of the large business houses in India. '*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'* [CSL]. And GMHR adds, '*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. Many of them have flourished'* [GMHR]. AVP sums up the very broad approach to this principle. '*Our management has this outlook, that we introduce something to the industry, we introduce something for the society and something to the nation too. That is the way we are looking at this. So it is not that we are collecting the money, so, once we get the return it is enough. 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'* [AVP].

Good governance was voluntarily engaged in due to its positive effects on firm performance

JMD explains that good governance in their firm includes the aspect of embracing the community surrounding their firm, and highlights a crucial interdependency. 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. '*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 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. And that responsibility is a requirement. It is not something to talk about. That is the basic need to run this organisation; it means having a good relationship with them. If you have good relations with them, nothing will go wrong. Nobody can come here from 15 kilometres and disturb the factory. Somebody from a town 13 kilometres away can come one day with 500 people to disturb us. And if these guys are with the factory, nobody dare come here because they know that the surroundings (of the firm) are very powerfully attached to the organisation'* [JMD].

CS explains that his firm's principle of not taking advantage of their superior position has, in fact, become a competitive advantage. '*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'* [CS].

As CMD observes, '*the performance appraisal is very transparent. The employee can see what is written. Because of this the employee grievances have also come down quite a bit'* [CMD]. JMD notes the sustainable advantage: '*if we have good corporate governance the company will not go into liquidation overnight'* [JMD].

Thus, the interview data reveals that Indian firms are embracing the stakeholder-focused Continental governance practices and system. 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 the 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. This was supported by a firm-wide code of conduct, principles and regulations, and strict enforcement. The economy has had a strong legal system since the 1960's beginning with the Corporations Act, and the government firms and large business houses adhere to them.

Verifying the propositions based on the publicly available data and interview data

In verifying proposition 1, that the Indian governance system adheres more closely to the Anglo-Saxon system based on the strength of the legal system, the evolution of India's legal system is pertinent. Prior to liberalization in 1991, the Indian economy had a systematic and comprehensive legal, rules-based Anglo-Saxon system. This is confirmed by all five firms unanimously. As JMD affirms, '*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' [JMD]*. Post-liberalization, the legal system was strengthened further. The World Bank's (2004: 1) CG ROSC for India noted this increased formalization of rules in India:

> *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. However, enforcement and implementation of laws and regulations remain important challenges.*

Indeed, De Nicolo et al.'s (2008) Corporate Governance Quality Index for emerging economies and developed economies over the period 1994–2003 found that governance quality had improved in the Asian countries, while in India the improvements were 'more muted'. The formalization is a necessity, with corporate governance becoming an important issue for Chinese and Indian firms as they increasingly interact with regulators and investors from developed markets (Li & Nair, 2009). Thus, for the business groups, PSUs and other private firms which had been following good governance principles, it seems to be a matter of reporting what they had been doing all along. The public became aware of those firms who had a long tradition of good governance and had adopted a principle-based governance system voluntarily, in contrast to others who merely reacted to the regulations in letter and not in spirit.

Furthermore, the findings from this study show that the enhanced formalization has had a positive benefit for the firms exhibiting good governance. As CMD mentions, '*That (transparency) brings us lots 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 as partners some of the best companies in the world. These are the advantages of transparency. That makes us feel all the more that better governance is good business. That is the key* [CMD]. Similarly, ACS observes, *'But to distinguish yourself from the others there has to be something that is required, so, if you are more transparent, if you are more accountable, you are more open towards the investing public and not just making tall claims, but substantiating that with your results or your performance, or market capitalization, these are the indicators that people prefer* [ACS].

This positive link between good governance and business performance is similar to Afsharipour's (2009) observation that larger Indian firms welcomed Clause 49's reforms because 'they appear to have benefited from the more robust corporate governance rules' imposed by the Clause. These large firms witnessed a 'significant increase in the share price' subsequent to SEBI's announcement to adopt corporate governance (Black & Khanna, 2007). As Fremond and Capaul (2002: 1) put it, succinctly, 'good corporate governance increases the efficiency of capital allocation within and across firms, reduces the cost of capital for issuers, helps broaden access to capital, reduces vulnerability to crises, fosters savings provisions, and renders corruption more difficult'.

However, enforcement of the Anglo-Saxon oriented rules and regulations is weak. This is similar to the situation in 15 countries surveyed by Fremond and Capaul (2002: 2) who observed that the 'courts are under-financed, unmotivated, unclear as to how the law applies, unfamiliar with economic issues, or even corrupt. Moreover, securities regulators have little direct power to enforce penalties. Enforcement of prevailing rules and regulations is mostly the responsibility of the courts. This leads to poor enforcement of the rules and regulations underlying corporate governance'. Fremond and Capaul (2002) recommended that 'in countries with weak regulatory environments, concentrated enforcement through the market regulators may be preferable to enforcement through the courts'. Data from this study reveals that India seems to suffer from this weak enforcement. As observed by ACS, *'If you legislate but you don't monitor, then that legislation becomes a piece of paper. So it lacks teeth. And you know the SEBI is the watchdog. But it lacks teeth. It cannot pursue, it cannot prosecute or take any action against the offending companies'* [ACS]. CMD provides further evidence: '*But, all these things together do not mean that there was no corruption in the company. There is always some petty corruption. And we always say that, and in most cases when I talk about corporate governance in any gathering, I say that we say that 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 there. Now, we cannot eliminate that. But, what I always feel is that, we can mitigate it by putting in various interventions'* [CMD]. The World Bank's CG ROSC (2004) lists strengthening the enforcement of rules as an area for policy improvement for India, and identified the reason for weakness as follows: '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). Therefore, in examining Proposition 1, the Indian corporate governance system can be classified as mixed – one with a strong legal structure but weakly enforced.

In examining Proposition 2, that India with its large proportion of family-based firms and high promoter holdings means that one would expect Indian corporate governance to adhere more closely to the Continental system, the data reveals that all five firms had a strong concentration of equity held by promoters, ranging from 80% in Aluminiumco, to 23% in Textilemachineryco, thereby revealing a Continental governance system.

In terms of Proposition 3, namely, in Anglo-Saxon systems the importance of the stock market is very high, the Indian governance system is neither Anglo-Saxon nor Continental, and falls midway along the continuum, revealing the hybridization of its system.

Proposition 4 states that the large firms in India may have fewer or no nominees of the bank on the Board with the role of banks low as in Anglo-Saxon systems. Data on the role and control by banks reveal the Anglo-Saxon bias of the Indian governance system, with only one firm exhibiting close to 20% ownership by banks, and the remaining four firms having 0% to 2% ownership. Thus, according to Proposition 4, the Indian governance system is Anglo-Saxon.

According to Proposition 5, namely, the Anglo-Saxon system is more likely to have single-tier boards with greater number of independent directors, the Indian governance system depicts hybridization. The firms exhibit both single and two-tiered boards. The number of board members also exhibits the presence of a mixed system. Those firms using a single-tier structure, however, do display greater director independence.

Finally, as per Proposition 6, namely, that the Continental systems exhibit low free float, the free float factor is very low for all five firms, revealing similarities to the Continental governance system.

The study also highlights the way corporate governance systems evolve and change as firms engage in proactive or reactive practices. For instance, recently, Zattoni et al. (2009) observed that the unaffiliated firms in India started to change their corporate governance systems to align with global governance standards, while business group-affiliated firms which were bound together by overlapping ties such as cross-ownership, interlocking directorates, inter-company loans and social relationships continued to depend on their internal product, labour, and capital markets and did not feel pressured to comply with the global governance standards. This study reveals that there are varying degrees of acceptance and adherence to these global standards. Some firms use what are generally regarded as 'best practice' Anglo governance structures, whilst all display greater ownership concentration than one would find in a typical Anglo firm. Others display a more relationship-focused approach with two tier boards, and greater executive director involvement. As ACS stated, '*I am not saying that it is a static situation of the best corporate governance practices. It is always evolving and it is evolutionary. There is something new to contribute. And because of the people that we have, they bring with them the experience, they can share ... and they are very fascinated by some of the best practices that we have. And that's only done by improvement - we are already here and we just need to scale up to be perfectionists* [ACS]. The best practices that ACS refers to above, 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; 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 traditionally seen in Anglo firms is evident, along with a community focus and work practices that are ahead of community norms.

Concluding remarks

What does India's future corporate governance system look like? 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.

The scope of this study was limited to large listed companies and business groups. It would be interesting and informative to expand the study to include a larger and more diverse sample, including private and unaffiliated firms. The interview data hints that smaller private firms have a different governance system. As the The CMD observes "there is a different type of private business who are out there to influence the government and cheat the government; absolutely profit-oriented. There is only one-track mind on profit-orientation". The wider sample will thus provide a better view of the governance system.

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. 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'. [Names removed for refereeing process] (2009) in tracing the evolution of Indian corporate governance and CSR practices observed that the tradition, culture and values had resulted in family-owned businesses, government owned firms, professionally owned firms and multinationals, all operating alongside one another. This paper in exploring a set of key group-affiliated 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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TABLE 1: 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

TABLE 2: SUMMARY OF FINDINGS

Variables	Anglo-Saxon system	Continental system
Legal system	Strong legal structure but weak enforcement All 5 companies 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] Fifteen International regulations and Codes published from 1992 - 2008	
Concentration of ownership and equity by a single shareholder (promoters in all 5 cases)		Aluminiumco had the highest concentration (Foreign corporate bodies: 80%) Oilco (Government: 51%) Steelco 2 (45%) Steelco 1 (34%) Textilemachineryco had the lowest concentration (23%)
Importance of the stock market	India lies between USA and Europe – see Table 3	
Role/control by banks	Aluminiumco (0%) Textilemachineryco (0.02%) Oilco (0.12%) Steelco 2 (1.51%)	Steelco 1 (19.82%)
Structure of the Board of Directors, and total members in the board	Single – Tiered: Steelco 2 (15 directors; 4 Exec) Aluminiumco (8 directors; 2 Exec) Textilemachineryco (8 directors; 2 Exec)	Two-Tiered: Oilco (11 directors; 5 Exec) Steelco 1 (14 directors; 6 Exec)
Extent of free float (%)	Anglo- Saxon systems have free float of > 55% Steelco 1 (66.05%) Textilemachineryco (74.19%)	Continental systems have free float of < 55% Aluminiumco (20%) Steelco 2 (41.25%) Oilco (48.89%)

TABLE 3: 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