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**Evolution of corporate governance in India and its impact
on the growth of the financial market: An empirical analysis
(1995-2014)**

Journal:	<i>Corporate Governance</i>
Manuscript ID	CG-07-2018-0255.R1
Manuscript Type:	Original Article
Keywords:	Comparative corporate governance, corporate governance and financial market growth, leximetrics, law and finance

Evolution of corporate governance in India and its impact on the growth of the financial market: An empirical analysis (1995-2014)

Abstract:

The past few decades have seen a gradual convergence in corporate governance norms the world over, entailing a discernible shift towards shareholder primacy models. It holds particularly true of developing countries, many of which have steadily amended corporate governance norms to enhance the scope of shareholder rights. This is usually justified through the rationale that increasing protection for foreign investors and shareholders would mean greater investment in capital market and overall financial market development. In India, the shift coincides with a series of fundamental economic and financial policy reforms initiated in the 1990s: collectively and loosely referred to as 'liberalisation', this process marks a paradigm-shift from a tightly controlled welfare economy to one considerably more laissez-faire in its orientation. A fallout of which was that the need to attract and sustain foreign investments acquired an unprecedented significance. India's corporate law change initiatives, particularly those pertaining to shareholder rights and allied issues, must be understood in this larger context.

This article empirically tests the hypothesis that enhanced shareholder protection leads to greater levels of investments, and financial developments generally. It then uses regression analysis to detect if the change in corporate governance, making it more friendly, had any effect on growth in financial market. It is divided into two parts. The first tracks the evolution of corporate governance norms in India. A robust qualitative and quantitative analysis is effected to determine the tilt towards a shareholder primacy regime that Indian corporate governance regime now displays. The second chapter deals with the regression analysis where the outcome variable is financial market growth, explanatory variable is change in the governance regime with relevant control variables. We find that change in shareholder primacy corporate governance has little effect on financial market growth in India.

We would suggest that instead of changing the law in books, more emphasis should be given to implement those regulations and increase the overall rule of law.

Keywords: *Comparative corporate governance, corporate governance and financial market growth, leximetrics, law and finance*

I. INTRODUCTION

"It is clear that good corporate governance makes good sense. The name of the game for a company in the 21st Century will be conform while it performs." - Mervyn King (Chairperson: King

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11 Report)

12 In the light of the intense competition and dynamism that prevails in the Indian business
13 environment at present, one of the keys to long-term growth and success appears to be the ability to
14 strike a fine balance between sound corporate governance practice on the one hand and a
15 sustainable growth model on the other.¹ Corporate governance has become an integral component
16 of myriad issues ranging from business standards to accounting standards, from corporate social
17 responsibility to supply chain management, from a means for averting potential financial crisis to a
18 tool for ensuring macro/microeconomic stability, to a contributor towards the improvement of the
19 overall political economy². Almost all strands of interdisciplinary studies in law, economics and
20 finance have by now felt the omnipresence and impact of corporate governance. For a long time, the
21 connection between corporate governance and multiple business interests and disciplines was
22 merely ideological and mostly theoretical, whilst on the ground, the impact of scholarly work on
23 corporate governance was at best ignored and at worst ridiculed for its perceived lack of sound
24 business efficacy. However, over the years, with repeated accounting frauds and related crises, there
25 has been a growing clamour for an efficient solution to prevent such issues from arising in the first
26 place and seek to resolve them in an expedited fashion if they do; this, in turn, encouraged
27 theoreticians and practitioners to seek recourse to the traditional notions of corporate governance
28 and 'reinvent' the same, albeit in a modern guise, in the early 1990s.

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36 The emergence, or rather, the revival of this discipline took the world by quite a storm, having
37 captured the attention of many a stakeholder with its potential. This coincided with the period
38 following the grand success of the neo-liberal economic principles of 1980s, which coupled with
39 the fall of the erstwhile Soviet Union, seemed to provide conclusive evidence of the relative
40 superiority of free market principles over interference by the State via a controlled economy. The
41 free flow of ideas across national and notional boundaries soon ensued, which in turn led to quite an
42 intense period that encouraged rapid transplanted of legal ideas –the corporate sector was not
43 outside the sphere of influence of such change and indeed, one may even opine that the two decades
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48 ¹ See generally Jacob Hörisch, Roger Leonard Burritt, Katherine L. Christ, Stefan Schaltegger, (2017) "Legal systems,
49 internationalization and corporate sustainability. An empirical analysis of the influence of national and international
50 authorities", *Corporate Governance: The International Journal of Business in Society*, Vol. 17 Issue: 5, pp.861-875 and
51 Malla Praveen Bhasa, (2004) "Global corporate governance: debates and challenges", *Corporate Governance: The
52 international journal of business in society*, Vol. 4 Issue: 2, pp.5-17 for discussions on diverse governance models to
53 address the challenges to corporate governance in the context of globalization of best practices.

54 ² See generally Louise Gardiner, Catherine Rubbens, Elena Bonfiglioli, (2003) "Research: Big business, big
55 responsibilities", *Corporate Governance: The international journal of business in society*, Vol. 3 Issue: 3, pp.67-77, for a
56 discussion on 'big business' and its growing influence on the rest of the society and the various challenges posed by
57 globalisation requiring fresh perspectives on global corporate governance.
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11 ranging from 1995 to 2014 witnessed a hitherto unforeseen convergence of global corporate law
12 standards on an almost exponential scale.³ The only period which even comes close is the period of
13 imperialism and colonialism, and even then the transplantation of law was a relatively slow process,
14 externally imposed in a forceful manner as it used to be for the most part, rather than consensual
15 cooperation. It was not any colonial power this time that ushered in such transplantation, rather
16 international financial organisations, which thought of this way to be the most efficacious one to
17 consolidate their presence in the global business scenario.
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21 Such organisations promised that '[T]he improvement of corporate governance practices is widely
22 seen as one important element in strengthening the foundation for individual countries' long-term
23 economic performance and in contributing to a strengthened international financial system.⁴ This
24 economic rationale was also picked up by the United Nations Conference on Trade and
25 Development, which stated that improvements to corporate governance would 'facilitate investment
26 flows and mobilize financial resources for economic development.'⁵ The scope of this paper is
27 limited to exploring the degree of fulfilment, at least within the Indian context, of the promise of
28 adopting shareholder primacy and corporate governance norms being beneficial towards higher
29 financial market growth, thereby justifying convergence and transplantation, specifically in the area
30 of company law and corporate governance in developing countries.
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36 The major corporate governance code available around this time period that could serve as a global
37 benchmark was the OECD Principles of Corporate Governance, which was based primarily on the
38 shareholder value corporate governance model, although it also provided limited space for
39 stakeholder models. So in effect what was being recommended to developing countries was a
40 shareholder value model based on the Anglo-Saxon template. The claim that was being popularly
41 extended at that juncture was that if a country adopted a shareholder primacy corporate governance
42 model, then foreign investors would invest in that country, stimulating the financial market, and
43 local investors would also pitch in, leading to further growth of the financial market. Surplus capital
44 can be used for economically useful, but less well-funded, activities, leading to economic growth
45 and a sustainable future. The present paper empirically investigates⁶ these claims in the Indian
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50 ³ See generally Brian R. Cheffins, 'The History of Corporate Governance', in *The Oxford Handbook of Corporate*
51 *Governance*, Douglas Michael Wright et al (eds.), Oxford University Press (March, 2013).

52 ⁴ The 1999 Memorandum of Understanding between the World Bank and the OECD, establishing the framework for
53 the Latin American Roundtable among a series of Regional Corporate Governance Roundtables.

54 ⁵ UNCTAD, 'Guidance on good practices in corporate governance disclosure' UNCTAD/ITE/TEB/2006/3

55 ⁶ See generally G. Clarke, L.W. Murray, (2001) "Frames of Reference in Financial Corporate Governance and
56 Communications", *Corporate Governance: The international journal of business in society*, Vol. 1 Issue: 4, pp.20-27,
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11 context and tries to find out whether changing the corporate governance in India for the 'better',
12 that is, by implementing a pro-shareholder approach, has any correlation with financial market
13 growth.
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15 Part II of the paper provides a brief outlay of methodology adopted in this research, whereas Part III
16 provides a general overview of the Indian corporate governance scenario, to be followed by a
17 qualitative analysis of evolution of corporate governance and its myriad forms in India in Part IV.
18 Part V of the paper continues with the quantitative counterpart of said analysis, thereby
19 complementing Part IV in the process. Part VI seeks to provide a quantitative contrast and analysis
20 of the changes in governance mechanisms in the Indian corporate sphere and explore the correlation
21 of the same to the financial market growth, with the conclusions of the paper being finally reflected
22 in Part VII.
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26 II. METHODOLOGY 27

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29 The research delineated in this paper consists of multiple steps, the first of which has been the
30 creation of a database on the evolution of corporate governance in India for twenty years (1995-
31 2014), consisting of information on fifty-two separate companies using corporate governance
32 variables based on the OECD Principles of Corporate Governance and previous indices during
33 aforesaid period. The variables have been scaled polynomially, i.e., the value could be zero, or one,
34 or two; this necessitated a survey that would go beyond a simple yes/no response in order to take
35 into account systems using optional rules or 'soft law'. A detailed description of variables is
36 available in Appendix A, while the filled-up coded questionnaire for India is available in Appendix
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42 The second step consists of using a graded response model with a Kalman filter, so as to create a
43 dynamic corporate governance index for India, which would in turn allow distribution of the
44 changes identified over a period of time, rather than confining them to just one specific year. It is
45 widely acknowledged that laws and regulations take some time to show their impact in full, hence
46 considering development of corporate governance over a number of years are meant to yield more
47 realistic results. Codes for the model have been made available in Appendix D. A Bayesian factor
48 analysis has been used to build up a separate multiyear index of financial market growth consisting
49 of five variables - foreign direct investment (FDI), market capitalisation of listed companies, S&P
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53 for a discussion on the significance of empirical research being used to identify the strategic power of corporate values
54 in influencing the success of organizations.
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11 global equity index, volume of stocks traded and the number of listed domestic companies to
12 represent the financial growth of countries. These variables are discussed in detail in Appendix B.
13 Three control indices of similar timescales comprised a total of ten variables – annual percentage
14 growth rate of GDP, purchasing power parity conversion factor, current account balance, real
15 interest rate, external debt stocks, commercial bank branches per head of population, mobile cellular
16 telephone subscriptions per head of population, electric power consumption per capita, high-
17 technology (products with high R&D intensity) exports in current USD and the number of patent
18 and trademark applications filed at USPTO; all said control variables are discussed at length in
19 Appendix C. Following this, Bayesian change point analysis has then been used to identify the
20 breakpoints, i.e. the time period or particular year when there was a regime shift (a substantial
21 movement away from the previous distribution or, qualitatively speaking, a ‘complete’ change from
22 the previous system). Codes for this analysis have been made available in Appendix D. In the
23 corporate governance development index, a breakpoint signifies a complete change from the
24 previous system, usually in the form of a completely new corporate governance code that changes
25 the previous system. In the financial market development index, a breakpoint signifies either a
26 market high or low, compared with recent statistics, and so usually coincides with the peak of a
27 boom or the trough of a bust.

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29 Finally, a country level regression model has been constructed, using the five indices. The financial
30 market index has been used as a dependent variable, the dynamic corporate governance index as
31 predictor variable and the three control indices as control variables. In course of the analysis, both
32 Bayesian and classical regression methods have had to be used. All computer codes used in this
33 context have been provided in Appendix D.
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45 III. CORPORATE GOVERNANCE IN INDIA: AN OVERVIEW

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47 According to commentators like Reed, the development of corporate governance in India can be
48 understood as a transition across three distinct models of governance, namely the ‘managing agent’
49 model; the ‘business house’ model; and, lastly, the ‘Anglo-American’ model⁷ (the last two are of
50 especial concern to us). Reed proceeds to explain that the ‘business house’ model was largely a
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54 ⁷ Ananya Mukherjee Reed, ‘Corporate Governance Reforms in India’ (2002) 37 Journal of Business Ethics 249.
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11 creation of the Nehruvian welfare state, where capitalism was tightly regulated.⁸ As Chakrabarti,
12 Megginson, and Yadav have said:⁹
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15 The turn towards socialism in the decades after independence, marked by the 1951
16 *Industries (Development and Regulation) Act* and the 1956 *Industrial Policy Resolution*, put
17 in place a regime and a culture of licensing, protection, and widespread red-tape that bred
18 corruption and stilted the growth of the corporate sector. The situation worsened in
19 subsequent decades and corruption, nepotism, and inefficiency became the hallmarks of the
20 Indian corporate sector.
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24 This gave rise to the class called promoters, who used their proximity to power centres to obtain
25 licences for new industries. ‘The primary function of the *promoter* ... was to float new ventures by
26 contributing a minimum of equity capital, and then raising the rest through public offerings or from
27 public financial institutions (PFIs).’¹⁰ Promoters tended to start several unrelated ventures, and
28 thereby gain control of a number of firms. This gave rise to so-called ‘business houses’, where
29 members of a single family held control interests in an array of unrelated concerns.¹¹ Such
30 arrangements entailed several consequences. One of these, as Reed notes, was that in corporations
31 (and presumably business houses as well), small shareholders and their interests were often
32 marginalised mostly due to the considerable power wielded by the business families that owned
33 them.¹² Gollakotta and Gupta point to a disconnect between equity ownership and actual control
34 that also prevailed widely, mainly due to the nationalised financial institutions (which owned
35 considerable amounts of equity) not exercising the levels of control that they were entitled to. This
36 was because such institutions were not held ‘accountable for the profitability of the investments
37 they made’, which gave them little incentive to actively participate in the day-to-day affairs of the
38 companies they invested in.¹³
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45 The stringent regulations mentioned earlier began to be dismantled in the 1990s, through a set of
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48 ⁸ *Ibid*, 252.

49 ⁹ Rajesh Chakrabarti, William L Megginson, Pradeep K Yadav, ‘Corporate Governance in India’ (2007) CFR
50 Working Paper 08-02, available at: <<https://www.econstor.eu/bitstream/10419/41393/1/582127289.pdf>> (accessed
51 27 February 2017).

52 ¹⁰ Reed 2002, 253.

53 ¹¹ *ibid*.

54 ¹² *ibid* 256.

55 ¹³ Kamala Gollakota, Vipin Gupta, ‘History, Ownership Forms and Corporate Governance in India’ (2006) 12 *Journal*
56 of Management History 185.
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11 reforms collectively referred to as 'liberalisation'.¹⁴ Changes made to the corporate legal regime
12 included augmenting disclosure norms, establishing a National Advisory Committee on Accounting
13 Standards, and so forth.¹⁵ Indeed, much of the corporate governance reforms we talk about owe
14 their origin to this period, such initiatives being the result of the recommendations stemming from
15 several committee reports¹⁶, as stated below.

16 17 18 19 *1. Birla Committee, 1999*

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21 A committee was set up by Securities and Exchange Board of India (SEBI) under the chairmanship
22 of one of the members of the SEBI Board, Kumar Mangalam Birla in 1999 to advance and raise the
23 norms of corporate governance. The Committee was framed with the primary objective to view
24 corporate governance from the perspective of the investors and shareholders and thereby prepare a
25 'Code' that would fit into the Indian corporate regime.
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29 The Report submitted by this Committee is distinctive for characterising corporate governance to
30 also include all other stakeholders apart from shareholders. It thus examines corporate governance
31 from the perspective of the stakeholders and specifically that of the shareholders and investors,
32 since they are the *raison d'être* for corporate governance and furthermore the foremost group that
33 the SEBI is concerned with.¹⁷ The main focus of the Report lies in the arrangement of proposals
34 which recognizes the duties and commitments of the boards and the administration in organizing the
35 frameworks for good corporate governance and stresses upon the rights of shareholders in
36 requesting effective implementation of such framework and norms. Most of these recommendations
37 are mandatory in nature.¹⁸
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42 The Report proceeds on the assumption that shareholders ought to be treated as proprietors of the
43 company, and hence in such capacity, they have certain rights and obligations. Be that as it may, in
44 actuality company cannot be overseen by shareholder choice alone, and shareholders are not
45 anticipated to accept accountability for the administration of corporate issues including compliance
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48 ¹⁴ See generally Jayati Sarkar & Subrata Sarkar, *Corporate Governance in India*, Sage Publications (2012). See also
49 Vasudha Joshi, *Corporate Governance: The Indian Scenario*, Foundation Books Pvt. Ltd. (2004)

50 ¹⁵ Reed 2002, 257.

51 ¹⁶ See generally Asish K. Bhattacharya, *Corporate Governance in India: Change and Continuity*, Oxford University
52 Press (2016).

53 ¹⁷ *Report of the Committee Appointed by the SEBI on Corporate Governance under the Chairmanship of Shri Kumar
54 Mangalam Birla (Birla Committee Report)*, available at <<http://www.sebi.gov.in/commreport/corpgov.html>>
(accessed 28 February 2017), para 1.5.

55 ¹⁸ *Ibid*, para 1.6.
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11 and decision-making. A company's administration must have the capacity to make business
12 decisions in an expedited fashion. This necessitates the shareholders to essentially delegate a
13 significant number of their obligations as proprietors of the company to the directors, who then get
14 to be in *de facto* charge of corporate procedure and operations. The implementation of this
15 methodology is usually carried out by a specialist management team. This relationship subsequently
16 gets the responsibility of the Board and the administration to the shareholders of the company. A
17 decent corporate structure is one that gives sufficient opportunity to the shareholders for powerful
18 commitment in the administration of the company, while demanding an exclusive requirement of
19 corporate conduct without getting involved in the everyday working of the company.¹⁹
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24 The bulk of the Report consists of certain mandatory and recommendatory provisions stretched
25 across various paragraphs. Paragraphs 14.5 to 14.16 not only deal with the rights of shareholders in
26 detail, but also mentions about institutional shareholders. Paragraph 14.5 mentions the basic rights
27 of the shareholders that is inclusive of the right to transfer and registration of shares, obtaining
28 relevant information about the company on a timely and regular basis, participating and voting in
29 shareholder meetings, electing members of the Board and sharing in the residual profits of the
30 company. Paragraph 14.6 subsequently provides the shareholders with a right to be supplied with
31 information with respect to decisions relating to material changes such as takeovers, sale of assets
32 or divisions of the company and changes in capital structure that may lead to shift in control or may
33 result in certain shareholders obtaining control disproportionate to the equity ownership.
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38 Among the recommendations that the Report suggested to be made mandatory for the companies to
39 follow, the prominent ones deserving mention include that data like quarterly outcomes,
40 introduction made by organizations to investigators etc. ought to be displayed on the organization's
41 official website or be sent in such a shape to the Stock Exchange on which the shares of the
42 company are listed, so that the Exchange can put it up on its own website.²⁰ One of the significant
43 non-mandatory suggestions made by the Report involves sending to every family unit of investors a
44 statement of the performance of the company on the financial front including any other significant
45 activity at least once every six months.²¹
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48 The report states that an organization must have suitable frameworks set up which will empower the
49 investors to take an interest in the corporate activities successfully and vote in the investors'
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52 ¹⁹ *Ibid*, para 14.1.

53 ²⁰ *Ibid*, para 14.7.

54 ²¹ *Ibid*, para 14.8..
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Commented [p1]: I am not exactly sure what this sentence intends to convey. Should it be 'This relationship requires the Board and the administration to be ultimately responsible and accountable to the shareholders of the company'?

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11 meetings. The organization ought to likewise keep the investors educated of the guidelines and
12 voting techniques, which administer the general investor meetings.²² As indicated by paragraph
13 14.10 of the Report, the annual general meeting of the organization ought not ever be purposely
14 held in a manner that would render it difficult for most of the investors to participate in. The
15 organization should likewise guarantee that the voting process is not so arranged as to make it
16 difficult or expensive for the investors to make their choice.²³
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20 The Report goes on to recommend in paragraph 14.11 providing postal ballots for key decisions to
21 shareholders who are unable to attend the meetings, with a detailed list of the matters which should
22 require postal ballot being laid down in Annexure 3²⁴ of the Report. Under paragraph 14.12, the
23 Committee put forth a mandatory recommendation that a Board committee under the chairmanship
24 of a non-executive director should be formed to specifically look into the redressing of shareholder
25 complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends
26 etc. Such a suggestion was given, as it was believed that the formation of such a committee will
27 help focus the attention of the company on shareholders' grievances and sensitise the management
28 to address the same in an expedited manner. Paragraph 14.13 lays down a mandatory
29 recommendation that to expedite the process of share transfers, the Board of the company should
30 delegate the power of share transfer to an officer, or a committee or to the registrar and share
31 transfer agents, with such delegated authority attending to share transfer formalities at least once in
32 a fortnight.
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38 Paragraphs 14.14 to 14.16 of the Report mention about the concept of institutional shareholders.
39 According to paragraph 14.14, for instance, as such shareholders have obtained significant stakes in
40 the equity share capital of listed Indian companies, they have or are going to be majority
41 shareholders in many listed companies and possess shares to a great extent; hence in such capacity,
42 they have a greater duty given the weightage of their votes and have a greater part to play in
43 corporate governance as smaller retail investors rely upon such institutional shareholder for positive
44 utilization of their voting rights for the benefit of the company as a whole. The Report thereafter
45 advances along these lines that given the importance of their votes, the institutional shareholders
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49 ²² Paragraph 14.9 of the Report states that a company must have appropriate systems in place which will enable the
50 shareholders to participate effectively and vote in the shareholders' meetings. The company should also keep the
51 shareholders informed of the rules and voting procedures, which govern the general shareholder meetings

52 ²³ Paragraph 14.10 of the Report provides that the annual general meetings of the company should not be deliberately
53 held at venues or the timing should not be such which makes it difficult for most of the shareholders to attend. The
54 company must also ensure that it is not inconvenient or expensive for shareholders to cast their vote.

55 ²⁴ It mentions the post ballot system in detail including the rationale, items requiring voting by postal ballot and
56 procedure for the postal ballot.
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11 can and ought to adequately utilize their power to further the causes of corporate governance.
12 Practices elsewhere in the world have shown that the aggregate stake of the institutional
13 shareholders can indeed prove to be a power to reckon with in this context; together they can
14 influence the company to provide the guarantee that it will in turn focus on matters relating to
15 effective implementation of the corporate governance code with a specific end goal to boost
16 shareholder value. What is essential in the perspective of the Committee is that, the institutional
17 shareholders' voting power must be put to great usage.²⁵
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21 *2. Naresh Chandra Committee, 2002*

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24 The Department of Company Affairs set up on 21 August, 2002 the Naresh Chandra Committee to
25 examine various issues related to corporate governance. Given the limited attention paid by the
26 Committee to the aspects of shareholder rights and allied issues, the Report submitted by it is of
27 mere peripheral significance in the context of this paper. The relevance that it does bear stems from
28 paragraph 2.5 of the Report, which the later Narayana Murthy Committee Report referred to and
29 used as a basis for its subsequent recommendations on shareholder rights. The said paragraph
30 specifically addresses the issue of disclosure of contingent liabilities and proposes that the
31 management ought to give a clear description in plain English language of every material
32 contingent liability and its risks; further, this ought to be supplemented by the auditor's clearly
33 worded comments on such views as expressed by the administration. The segment ought to be
34 highlighted in the significant accounting policies and notes on accounts, as well as in the auditor's
35 report, wheresoever deemed essential. This is critical in the light of the fact that investors and
36 shareholders ought to get a clear and accurate picture of an organization's contingent liabilities, as
37 these might be noteworthy risk figures that could unfavourably influence the company's future
38 monetary condition and after-effects of operations.
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44 *3. Narayana Murthy Committee, 2003*

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47 Under the chairmanship of N. R. Narayana Murthy, the Chairman and Chief Mentor of Infosys
48 Technologies Limited, SEBI subsequently constituted a committee to assess the prevailing
49 corporate governance norms and to enhance and strengthen such practices in keeping with the
50 advancement of the market economy as a whole. The Committee met thrice on December 7, 2002,
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54 ²⁵ *Birla Committee Report* para 14.16.
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11 January 7, 2003 and February 8, 2003, to discuss the issues related to corporate governance and
12 eventually presented its recommendations to SEBI.
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15 The terms of reference of the Committee are set out as under:
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- 17 • To audit the execution of corporate governance; and
- 18 • To decide the part of companies in reacting to talk and other value sensitive data flowing the
19 market, so as to upgrade the integrity and transparency of the market.
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23 The rights of the shareholders have been dealt by the committee under various heads. Under Risk
24 Management, mentioned in part 3.5 of the Committee's report, reference has been made to Board
25 disclosures, with the Committee emphasising the importance for the Board to be completely
26 mindful of the dangers confronting the business, as well for the investors to think about the
27 procedure by which the company chooses to deal with the various obstacles on its path.²⁶

28 In this context, the Committee did look into another useful concept, viz. nominee directors,
29 excluding them in part 3.8 of the Report from the ambit of the definition of independent directors.²⁷
30 The Committee felt that the institution of nominee directors presents a situation that sound
31 corporate governance practices ought to maintain a strategic distance from. Such directors regularly
32 assert that they are liable just to the shareholders who have nominated them and assume no liability
33 for the organization's administration or trustee obligation to different investors. It is vital that all
34 executives, in the case of speaking to organizations or something else, ought to have similar duties
35 and liabilities.²⁸ The Report also states that in the case of appointment of a nominee on the Board,
36 the normal process of election by shareholders must be adopted.²⁹ As a mandatory recommendation,
37 the Report suggests that there may be no one chosen nominee; rather where a foundation wishes to
38 choose a director on the Board, such arrangement ought to be made by the investors. An
39 institutional executive, so selected, should have similar obligations and might be liable to
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45 ²⁶ Part 3.5.1.1: The Committee believes that it is important for corporate Boards to be fully aware of the risks facing the
46 business and that it is important for shareholders to know about the process by which companies manage their
47 business risks

48 ²⁷ Part 3.8.1: Exclusion of nominee directors from the definition of independent directors

49 ²⁸ Part 3.8.1.2: The Committee felt that the institution of nominee directors creates a conflict of interest that should be
50 avoided. Such directors often claim that they are answerable only to the institutions they represent and take no
51 responsibility for the company's management or fiduciary responsibility to other shareholders. It is necessary that
52 all directors, whether representing institutions or otherwise, should have the same responsibilities and liabilities

53 ²⁹ The Report of Shri N R Narayana Murthy Committee on Corporate Governance 2003, available at:
54 <https://www.sebi.gov.in/reports/reports/mar-2003/the-report-of-shri-n-r-narayana-murthy-committee-on-corporate-governance-for-public-comments-_12986.html>

55 Part 3.8.1.3: If the institution, whether as a lending institution or as investing institution, wishes to appoint its nominee
56 on the Board, such appointment should be made through the normal process of election by the shareholders
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11 indistinguishable liabilities from some other director. Nominee of the Government on public sector
12 companies ought to be similarly elected and subjected to the same responsibilities and liabilities as
13 other directors.³⁰ Further, the Report recommends that all the compensation made to the non-
14 executive directors should be approved by the shareholders and may be fixed by the Board of
15 directors.³¹
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20 4. JJ Irani Expert Committee, 2005

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23 Last but not the least comes the turn of a committee that had been constituted under the
24 chairmanship of JJ Irani, Director of Tata Sons, on 2nd December, 2004 with the task of suggesting
25 to the Government the proposed changes to the Companies Act, 1956.
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28 The rights of shareholders have been scattered across various parts in the report submitted by this
29 Committee. While discussing the shifting of registered office of the company, which required such
30 shift taking place from one state to another to be subject to the order of the Company Law Board,
31 the Committee expressed its concern at the delays and costs involved in the process. A view was
32 communicated that this choice ought to be left to the shareholders. In any case, the Committee
33 additionally perceived that interests of stakeholders ought to be made a key consideration for the
34 process, which in turn should be rendered on an urgent basis less complex, speedier and less
35 demanding, without reference to a Tribunal/Court, thus guaranteeing that the new registered office
36 is available to stakeholders for legitimate plan of action, as, when and where required.³²
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41 With regard to contentious issues such as the manner of appointment, removal and resignation of
42 Directors, it was expressed that the ultimate decision to appoint/remove directors ought to be that of
43 the company (in other words, that of the shareholders). On the off chance that the Directors
44 themselves are legitimately precluded to hold directorships, they ought to have an equivalent duty
45 regarding unveiling the reality and purposes behind their exclusion. Government ought not to
46 mediate during the process of appointment and removal of Directors in non-Government
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50 ³⁰ Part 3.8.1.5: Mandatory recommendation: There shall be no nominee directors. Where an institution wishes to
51 appoint a director on the Board, such appointment should be made by the shareholders. An institutional director, so
52 appointed, shall have the same responsibilities and shall be subject to the same liabilities as any other director.

53 ³¹ Part 3.9 Non-Executive Director Compensation: Part 3.9.1.2 forms a mandatory recommendation of The Report of
54 Shri N R Narayana Murthy Committee on Corporate Governance, 2003.

55 ³² *Report on Company Law (JJ Irani Committee Report)*, available at:
56 <<http://www.primedirectors.com/pdf/JJ%20Irani%20Report-MCA.pdf>> (accessed on 28 February 2017), 17.
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11 companies. It was deemed essential that the powers of the Government, under the laws in vogue, to
12 intercede in the appointment of Directors be reviewed and revised, vesting the responsibilities on
13 the shareholders instead.
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16 In the case of Directors' remuneration, the Committee again felt that the issue had to be decided by
17 the shareholders in the light of the prevailing circumstances within the company, including but not
18 limited to its financial health. To enable proper decision-making in this regard, it was important to
19 subject this aspect to a strong corporate governance mechanism on the basis of accurate and
20 transparent disclosures. Therefore, the Committee felt that this decision need not be taken by the
21 Government on behalf of the company, but should be left to its shareholders whose approval should
22 necessarily be taken.³³ Regarding disclosure requirements, as the shareholders in case of a scheme
23 of merger/acquisition need to have complete data, particularly in relation to mergers proposed by
24 the promoters, the Act/Rules ought to mandate providing explicit necessary disclosure requirements
25 in the explanatory statements to be sent to the shareholders with regard to the plan documented
26 under the watchful eye of the Courts/Tribunals.³⁴
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32 The Committee also acknowledged the additional need for administration of punishments
33 comparable with the offense under the provisions of the Companies Act. Activities disregarding
34 governance provisions in a way that deny the shareholders of their rights should be dealt with
35 seriously. The Committee was of the view that all fraudulent conduct ought to be subjected to the
36 stringent punishment, as should be deficient, wrong or false disclosures or activities that do not
37 permit shareholder democracy or a focused market for corporate control to work. On the other hand,
38 infringement of a procedural sort that does not irreversibly harm stakeholder's rights should be dealt
39 with in a different way as per the Committee's suggestions.³⁵
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43 Finally, while discussing the subject of lifting of the corporate veil, the Committee opined that
44 under certain circumstance, notwithstanding the provisions of the company law firmly putting the
45 associated responsibility and the risk on the Board and the officers in default, it might still be
46 possible for the promoters of controlling interests to act in derogation of the spirit of the law while
47 adhering to its letter. Where fraudulent action has been discovered regardless of statutory
48 prohibitions, the law ought to accommodate lifting the corporate veil to identify such promoters or
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52 ³³ ibid 27.

53 ³⁴ ibid 79.

54 ³⁵ ibid 85.
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11 shareholders who are the later ego behind the corporate behemoth and determine whether they can
12 be held liable for said action and if so, to what extent. As the Committee suggested, there ought to
13 be a framework of punishments and sanctions laid down for catering to such situations.³⁶
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16 While the reports submitted by all the aforementioned committees did play a significant role in the
17 evolution of corporate governance within the Indian legal sector, by no means was such evolution
18 confined only within the recommendations made by such reports and the treatment meted out to
19 them by the government, as will be illustrated in the next part of this paper.
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22 23 IV. EVOLUTION OF THE LEGAL REGIME ON CORPORATE GOVERNANCE 24

25 To understand paradigm shifts in Indian corporate governance, one needs to construe the issue in
26 terms of specific questions and how they have transformed across time – the authors have focused
27 on some of the variables from Appendix A, which have been studied in course of this research and
28 taken a more in-depth look at their manner of evolution and contribution to the Indian corporate
29 governance scenario, including the manner in which the leading applicable legislations have sought
30 to incorporate such variables within their ambit.
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33 34 *IV.A Transfer of Shares* 35

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37 Transfer of shares comprises one such example. The Companies Act, 1956 freely allowed such
38 transfer of shares, with Section 111 contemplating the power of the Board of directors to refuse
39 registration of such transfer. A bare reading of the provisions may not reveal much. All cl (1) of
40 said Section says is that in case of refusal, a notice has to be issued within two months to the parties
41 involved in the transaction; cl (2) provides for appeal, and so forth. Several judgments have
42 reiterated that the Board of directors enjoys no discretion to refuse any transfer unless the articles of
43 association sanction such refusal, that is, they confer on the Board the power to refuse transfer.³⁷ On
44 occasion, courts have even struck down what they considered refusal beyond the Board's
45 competence.³⁸
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53 ³⁶ *ibid* 91.

54 ³⁷ See e.g. the Karnataka High Court decision in *Naveen Kumar v. Karnataka Theatres* All India Reporter (AIR) 1999
55 Karnataka 71.

56 ³⁸ *Ibid*.

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11 In cases such as *State of Orissa v. Indian Chemical Products*,³⁹ courts have reiterated that even if
12 the power has been provided for in the articles of association, it must be exercised by the Board in a
13 *bona fide* manner. (The *Indian Chemicals* case is interesting for other reasons as well, since it is on
14 this occasion that the court found that the articles of association did not expressly authorise refusal.
15 Yet after looking at provisions of the Companies Act, 1913 (which applied to the present case),⁴⁰ it
16 concluded that the Act, read with the company's articles of association, did in fact confer on the
17 Board the power to refuse. However, the court then concluded that the power had not been
18 exercised in a *bona fide* manner, and was therefore bad in law.) The Madras High Court⁴¹ held in
19 the context of the 1913 Act that even if the Board is authorised to refuse transfer, it cannot exercise
20 its power for reasons that do not pertain to the transferee personally. Similarly, it was held that the
21 Board cannot exercise its powers of refusal merely on the basis of the opinion of a prominent
22 shareholder who is opposed to the transfer.⁴² On the other hand, it has been made clear that the
23 Board is not bound to provide reasons for its refusal;⁴³ and that the possibility that the transferee's
24 character was such as would 'throw the company into confusion' was a valid reason.⁴⁴

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31 In addition, the Supreme Court's ruling in the leading case of *Bajaj Auto v. NK Firodia*⁴⁵ must be
32 examined in some detail. It began by stating:⁴⁶

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35 Discretion implies just and proper consideration of the proposal in the facts and
36 circumstances of the case. In the exercise of that discretion the Directors will act for the
37 paramount interest of the company and for the general interest of the shareholders because
38 the Directors are in a fiduciary position both towards the company and towards every
39 shareholder. The Directors are therefore required to act *bona fide* and not arbitrarily and not
40 for any collateral motive.

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43 Following the aforementioned pronouncement, the Supreme Court then proceeded to lay down a
44 threefold test to determine when refusal is legitimate, basing on the following considerations: 'First,
45 whether the Directors acted in the *interest of the company*; secondly, whether they acted on a *wrong*
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³⁹ AIR 1956 Orissa 203.

⁴⁰ Section 18 of the 1913 Companies Act read with Table A of Schedule 1.

⁴¹ *The Coimbatore Kamala Mills v. T Sundaram* AIR 1950 Madras 725.

⁴² *TH Condon and A Butterworth v. The Muir Mills Company, Limited of Cawnpore* (1900) 22 All 410. The Allahabad High Court even termed such refusal a breach of fiduciary discretion.

⁴³ *Thenappa Chettiar v. Indian Overseas Bank* AIR 1943 Madras 743.

⁴⁴ *Muthappa Chettiar v. Salem Rajendra Mills* AIR 1955 Mad 665.

⁴⁵ AIR 1971 Supreme Court 321.

⁴⁶ *Ibid*, para 13.

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11 *principle*; and, thirdly, whether they acted with an *oblique motive* or for a collateral purpose⁴⁷
12 (emphasis added). However, it also clarified that this position will not authorise courts to what
13 effectively amounts to micro-managing each instance of refusal: if a court finds that a Board has
14 provided valid reasons for refusing transfer, it cannot intervene merely on grounds that the court
15 itself might have come to different conclusions.⁴⁸
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19 Section 111A was added to the Companies Act courtesy the Depositories Act, 1996. It expressly
20 provides (cl (2)) that subject to the provisions of the section, “the shares or debentures and any
21 interest therein of a company shall be freely transferable.” It also empowers tribunals to make
22 enquiries and then, if necessary, direct depositories and companies to rectify records of transfer. It
23 treats transfer as a right of the shareholder, which can be inferred from its injunction in cl (5) that
24 the provisions of this section shall not affect shareholders’ rights to transfer shares. Once again, this
25 must be understood in the light of judicial rulings. The Calcutta High Court chose to interpret this
26 as not permitting public companies to refuse registration on grounds of limitation, since that was
27 never the intention of the Legislature.⁴⁹ A Division Bench of the Bombay High Court also ruled that
28 Section 111A is not in the nature of a self-contained code, and that there is nothing in the provision
29 that takes away a member’s common law right to seek rectification.⁵⁰
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34 In Companies Act, 2013, issues relating to free transfer of shares are addressed in Section 58.⁵¹
35 Clause (1) specifies that if a private company, ‘whether in pursuance of any power of the company
36 under its articles *or otherwise*’ (emphasis added) refuses to either transfer shares or transmit them
37 by operation of law, it shall accordingly notify the persons concerned. Clause (2) states that
38 securities and other interests in a company are ‘freely transferable’ and also, as the proviso to the
39 clause states, ‘enforceable *as a contract*’ (emphasis added). However, these are to apply without
40 prejudice to cl (1). This suggests an interesting legal situation, where the liberty to transfer shares
41 functions parallel with (and for all practical purposes stands effectively subject to) any discretion
42 that the Board may derive from its articles *or otherwise*. One may recall that decisions like *Naveen*
43 *Kumar* had noted in respect of the 1956 Act that the power to refuse transfer needs to flow from the
44 company’s articles of association. Section 58(1) of the new 2013 Act opens the possibility of such
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50 ⁴⁷ *Ibid*, para 15.

51 ⁴⁸ *Ibid*, para 22.

52 ⁴⁹ *Peerless General Finance v. Poddar Projects Ltd* 2005 Calcutta Weekly Notes 1005.

53 ⁵⁰ 2002 (35) SEBI & Corporate Laws 27.

54 ⁵¹ The 57th Report of the Parliamentary Standing Committee describes this provision as corresponding to Ss. 111(1)
55 and 111(2) of the old Act. See 57th Report of the Parliamentary Standing Committee on the Companies Bill 2011,
56 761.

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11 power being derived from other sources too.
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14 Section 58 owes much to the 57th Report of the Parliamentary Standing Committee on the
15 Companies Bill, 2011.⁵² The Report states *inter alia* that the provision ‘simply seeks to codify the
16 pronouncements made by various Courts’ in regard to transferability of shares, and making
17 enforceable contracts pertaining to share transfer. Judicial pronouncements also appears to endorse
18 this view. The Bombay High Court in *Bajaj Auto v. Western Maharashtra Development*
19 *Corporation*⁵³ held that it merely restates in systematic terms the existing law on pre-emption
20 agreements: ‘In other words, what was implicit in the provisions of section 111A of the Companies
21 Act, 1956 has now been made explicit in section 58 of the Companies Act, 2013.’
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25 Section 59 of the 2013 Act is similar in its language to Section 111A of the old Act.⁵⁴ The Mumbai
26 Bench of the Company Law Board had occasion in *Neptune Overseas v. National Multi Commodity*
27 *Exchange*⁵⁵ to examine the relation between the two. It acknowledged that the provision is ‘akin to’
28 Section 155/111 [*sic* 111A?] of the 1956 Act and Section 38 of the 1913 Act.⁵⁶ And for this reason,
29 Section 59 can well sustain an appeal in respect of a cause of action that arose when the 1956 Act
30 was in force.⁵⁷ This would appear to treat the two provisions as in substance *in pari materia* in
31 respect of one another.
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35 *IV.B Annual Reports*

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38 Another issue pertains to whether annual reports are to be regularly sent to shareholders and a
39 central registry. The law remains largely unchanged on this point from 1913 onwards. Section
40 219(1) of the 1956 Act mandated that copies of annual reports be sent to each member at least
41 twenty-one days prior to any general meeting where the report is to be presented. Clause (2)
42 extended to members, debenture-holders, and depositors the right to obtain balance sheets, profit
43 and loss accounts, and so forth. In *Re Murarka Paint and Varnish Works*,⁵⁸ decided in the context
44 of the 1913 Act, the Court held that copies of documents to which only members are entitled to,
45 cannot be given to non-members, nor even to individuals whose names have been struck off the
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49 ⁵² *Ibid*, 104. (Incidentally, *Bajaj Auto* (in paragraph 39) attributes the statement to page 86 of the Report.)

50 ⁵³ 2015 (4) Arbitration Law Reporter 470 (Bom), para 40.

51 ⁵⁴ The 57th Report of the Parliamentary Standing Committee (p 761) describes this provision as ‘correspond(ing) to
52 section 111A of the Companies Act, 1956’.

53 ⁵⁵ Manupatra citation MANU/CL/0080/2014.

54 ⁵⁶ *Ibid*, para 24.

55 ⁵⁷ *Ibid*, para 18.

56 ⁵⁸ (1948) 52 Calcutta Weekly Notes 590.
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11 register of members and who are in the process of challenging such removal. Section 136 of the
12 2013 Act expands the scope of the provision to span a range of documents including financial
13 statements, consolidated financial statements, auditors' reports, and 'every other document required
14 by law to be annexed or attached to the financial statements'; and also a range of recipients
15 extending to members, trustees for debenture holders, and other entitled persons.
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18 19 *IV.C Interested Directors*

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21 The issue of interested directors is one that is surely fundamental to corporate governance. Section
22 297 of the 1956 Act specified that only with the Board's sanction could a company enter into
23 certain specified transactions with a director of the company or her relative; or firms or companies
24 where a director or her relative was a partner or member or director. Cl (3) made an exception for
25 urgent circumstances; cl (4) specified the procedure for obtaining the board's consent; and cl (5)
26 made unauthorised transactions voidable at the option of the board. Section 299(1) of the 1956 Act
27 also required directors directly or indirectly 'concerned or interested' in any transaction to disclose
28 the nature of this concern or interest. Section 300(1) of the 1956 Act forbade directors from voting,
29 or even participating in discussions related to, contracts or transactions in which he was directly or
30 indirectly interested. It also specified that the presence of such a director shall not be included for
31 determining if a quorum exists, and if a director did vote in violation of the foregoing, the vote
32 stood voided. Section 301 of the 1956 Act required a register to be maintained where particulars of
33 all interested party transactions were to be recorded. That the legislation intended the provisions to
34 cover a wide ambit is clear from the wording employed, and yet certain vital issues were left
35 unresolved. For instance, terms like concern and interest were not defined either in the above
36 provisions or in the definitions clause.
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40 The 2013 Act, however, approaches the matter more systematically. It introduces a new concept
41 termed 'related party transactions'. Section 2(76) defines 'related party' in terms of directors; key
42 managerial personnel; their relatives; firms and companies in which they or their relatives are
43 involved as partners, directors, members and so forth; and even persons on whose advice 'a director
44 or manager is accustomed to act'. Section 184 requires directors to reveal at the beginning of each
45 year all the firms and companies in which they are interested, and also their interest in any company
46 with which the board intends to enter into transactions. It is broadly analogous to Section 299 of the
47 old Act, but is much more precise in its wording. For example, cl 2(a) requires directors to reveal in
48 certain circumstances their interest in companies in which they hold more than 2% of the shares, or
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11 of which they are promoters, managers, or CEOs. Interestingly, cl (1) uses the phrase ‘concern or
12 interest’, which suggests that the two notions, namely ‘concern or interest’ and ‘related party’ are to
13 operate in parallel spheres, and that the second is not intended to replace the first.
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16 Section 188(1) specifies transactions that a company may enter into with a related party except
17 through the Board’s consent. Cl (2) requires related party transactions and their justifications to be
18 mentioned in the board’s report to shareholders. Clause (3), in the same manner as Section 297(5)
19 of the 1956 Act, makes unauthorised transactions voidable at the option of the board, and adds that
20 if circumstances so require, the concerned directors shall indemnify the company against any loss.
21 According to cl (4), the company may, without prejudice to anything contained in cl (3), seek
22 damages from the person responsible for the transaction in question. Cl (5) prescribes penal
23 liabilities in respect of unauthorised related party transactions.
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27 28 *IV.D Whistleblowers* 29

30 One area where the 2013 Act instantiates a radical departure from the 1956 legal position is in
31 respect of whistleblowers. The older legislation carries no mention of any such notion. The 57th
32 Report of the Parliamentary Standing Committee records a suggestion to incorporate provisions
33 relating to whistleblowing, and specifically to the legal protection of whistleblowers.⁵⁹ The Ministry
34 of Corporate Affairs responded by stating that provisions relating to ‘vigil mechanisms’, as they
35 termed it, had already been incorporated in cls 177(9) and (10) of the 2011 Bill.⁶⁰ Gurudas
36 Dasgupta’s dissenting note, however, contends that the Bill ‘fails to address squarely’ issues of
37 corporate delinquency, and that ‘Whistle-blowers, who expose such acts, should be protected by
38 law.’ From this, one may infer Dasgupta found extant provisions inadequate.⁶¹ Be that as it may, the
39 Statement of Objects and Reasons presented in the Report does assert that the Committee’s
40 revisions to the 2009 Bill includes moves towards enhanced accountability on the part of
41 companies, specifically ‘provisions in respect of vigil mechanism (whistle blowing) proposed to
42 enable a company to evolve a process to encourage ethical corporate behaviour, while rewarding
43 employees for their integrity and for providing valuable information to the management on deviant
44 practices.’ (emphasis added)⁶² The word ‘enable’ suggests an intention to make the matter only
45 optional at desire of the company, which appears to lend credence to Dasgupta’s apprehensions.
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52 ⁵⁹ 57th Report of the Parliamentary Standing Committee on the Companies Bill 2011, 78.

53 ⁶⁰ *Ibid.*

54 ⁶¹ *Ibid* 121.

55 ⁶² *Ibid* 746.
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13 The 2013 Act partially substantiates these apprehensions. Section 177(9) mandates compulsorily the
14 establishment of a vigil mechanism 'for directors and employees to report genuine concerns'. This
15 is followed by the phrase 'in such manner as may be prescribed'. But does this phrase qualify the
16 establishment of mechanisms or the reporting of concerns? Some ambiguity exists on this count,
17 though the latter does appear more likely. Cl (10) does not prescribe the manner in which the
18 mechanism is to be established. It merely specifies that such mechanism must be 'adequate', and
19 provide for 'direct access to the chairperson of the Audit Committee in appropriate or exceptional
20 cases. It also requires companies to specify on their respective websites and in the board's report
21 details of the mechanism chosen.
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24 25 *IV.E Corporate Social Responsibility* 26 27

28 The 2013 Act is notable also for its handling of CSR, or corporate social responsibility. Section 135
29 not only accords statutory recognition to the concept, but also makes it obligatory for companies
30 above a certain size to devote at least 2% of its net profits for this purpose. Cl (1) lays down several
31 criteria for determining inclusion into this category: they include a net worth of five billion Rupees;
32 a turnover of ten billion Rupees; or a net profit of fifty million Rupees within a financial year.
33 Commentators have pointed out that these threshold values create a sharp discontinuity, since 'a
34 minor change in net income leads to a discrete change (i.e., a discontinuity) in the application of
35 CSR rule.'⁶³
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39 The reason for referring to Section 135 is that this provision carries some bearing on the issue of
40 corporate governance. It requires companies to constitute a Corporate Social Responsibility
41 Committee comprising of three or more directors, at least one of whom is to be an independent one.
42 This committee is required to formulate and implement a CSR policy for the company, specifying
43 the activities the latter is to undertake. (Sch VII enumerates activities that a company may
44 legitimately pursue in this regard: instances include eradicating hunger and poverty; promoting
45 education; gender equality and women's empowerment, and so forth.) Clause (5) confers the
46 committee the responsibility to ensure the company spends on CSR at least 2% of its net profits; it
47 also specifies that if the company fails to do so, the Board shall in its report under S 134 (3)(o)
48 specify reasons for this failure.
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53 ⁶³ See Hariom Manchiraju, Shivaram Rajgopal, 'Does Corporate Social Responsibility (CSR) Create Shareholder
54 Value? Evidence from the Indian Companies Act 2013' (2017) 55 Journal of Accounting Research 1257, 1259.
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13 It is too early to say if this kind of legislative mandate will prove to be effective in the long run.
14 Case-law on the area is rather scant till date. In *Tata Power Company v. Maharashtra Electricity*
15 *Regulatory State Commission*,⁶⁴ the Appellate Tribunal for Electricity (New Delhi) held that the
16 appellant company could not pass CSR expenses onto consumers, since that would amount to the
17 consumers effectively sustaining the company's own social obligations. (Incidentally, though the
18 appellants explicitly invoked S. 135 of the 2013 Act, the issue here related to expenses incurred in
19 the years 2009-10 and 2010-11.)
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23 Secondary literature on the issue yields a diverse range of conclusions. Manchiraju and Rajgopal
24 referred to earlier conclude that mandatory CSR does not enhance shareholder value, but instead
25 has the effect of burdening the company at the expense of shareholders.⁶⁵ Kansal, Joshi and Batra
26 observed that on the whole, CSR declarations by Indian companies tended towards the 'low'.⁶⁶
27 Khan, Muttakin and Siddiqui's study of corporate governance and CSR disclosures (although
28 originally carried out in the context of the neighbouring Bangladesh) yields interesting conclusions:
29 High ownership concentration by managers (such as in family-owned companies, extremely
30 common in India as in Bangladesh) leads to a diminished involvement in social activities, and hence
31 a diminution in CSR disclosures as well. However, this does not hold true for export-oriented
32 concerns, even family-owned ones, which tend to make 'significantly more' CSR disclosures.
33 Further, measures such as independent directors have a beneficial effect on CSR disclosures: 'It
34 appears that despite the traditional settings, corporate governance mechanisms involving presence
35 of outsiders have significant impact on the extent of disclosures made by Bangladeshi companies,
36 possibly due to the legitimisation effects of such mechanisms.'⁶⁷ Mishra and Suar conclude
37 emphatically: 'A favourable CSR towards customers enhances firm profitability and NFP (*i.e.* non-
38 financial performance).'⁶⁸
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45 While the legislative focus on this part of the paper does reveal the degree and extent of evolution
46 of corporate governance norms in India, one still needs to look at the quantitative aspect in order to
47 gauge the extent to which such norms have had any measurable impact in the Indian corporate
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49 ⁶⁴ Manupatra citation MANU/ET/0150/2013.

50 ⁶⁵ Manchiraju, Rajgopal (n 57), 1296.

51 ⁶⁶ Monika Kansal, Mahesh Joshi, Gurdip Singh Batra, 'Determinants of Corporate Social Responsibility Disclosures:
52 Evidence from India' (2014) 30 *Advances in Accounting* 217.

53 ⁶⁷ Arifur Khan, Mohammad Badrul Muttakin, Javed Siddiqui, 'Corporate Governance and Corporate Social
54 Responsibility Disclosures: Evidence from an Emerging Economy' (2013) 114 *Journal of Business Ethics* 207, 220.

55 ⁶⁸ Supriti Mishra, Damodar Suar, 'Does Corporate Social Responsibility Influence Firm Performance of Indian
56 Companies?' (2010) 95 *Journal of Business Ethics* 571, 588.
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sector, something which will be discussed in the following part of this paper.

V: QUANTITATIVE ANALYSIS OF CHANGES IN CORPORATE GOVERNANCE IN INDIA

The authors now present the quantitative aspects of the evolution of the corporate governance regulation in India to complement the qualitative discussion above.

The authors have found that the probability of regime shift in Indian corporate governance development is very low throughout the period studied, this is due to the steady change in the updating of the corporate governance process in India. There are two very minor crests of probability 0.32, in year 5 and year 15. This corresponds to the years 1999/2000 around when the Report of the Kumar Mangalam Birla Committee on Corporate Governance (2000)⁶⁹ was accepted along with the publication of the Draft Report of the Kumar Mangalam Committee on Corporate Governance (1999)⁷⁰ and the Desirable Corporate Governance in India - A Code (1998)⁷¹ and the years 2008/09 which came in the implementation phase of Clause 49 (adopted in 2005)⁷² and the publication of the Corporate Governance Voluntary Guidelines (2009).⁷³

⁶⁹ SEBI, Report of the Kumar Mangalam Birla Committee on Corporate Governance (2000) <<http://www.ecgi.org/codes/documents/corpgov.pdf>>

⁷⁰ SEBI, Draft Report of the Kumar Mangalam Committee on Corporate Governance (1999) <http://www.ecgi.org/codes/documents/draft_report.pdf>

⁷¹ Desirable Corporate Governance in India - A Code (1998) <http://www.ecgi.org/codes/documents/desirable_corporate_governance240902.pdf>

⁷² Clause 49, SEBI Listing Regulation <<http://www.sebi.gov.in/commreport/clause49.html>> <http://indianboards.com/files/clause_49.pdf>

⁷³ Ministry of Corporate Affairs, Government of India, 'Corporate Governance Voluntary Guidelines' (2009) <http://www.ecgi.org/codes/documents/cg_voluntary_guidelines_2009_india_24dec2009_en.pdf>

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Similarly for the financial market index, the authors have found the following change-points.

The probability of a change point in the financial market development in India is highest for year 10 (probability of 0.61). This corresponds to the year 2005, which in turn corresponds with the time period of rapid financial growth, especially between 2005 to 2008 when the rate of growth averaged over 9%.⁷⁴

VI: IMPACT OF CHANGE IN CORPORATE GOVERNANCE ON FINANCIAL MARKET GROWTH IN INDIA

⁷⁴ Malayendu Saha, 'Indian Economy and Growth of Financial Market in the Contemporary Phase of Globalization Era' (2012) 1 International Journal of Developing Societies 1-10.

From the graph above, it can be summarised that corporate governance in India has shifted steadily towards a shareholder value model over the period of time studied under this research. The shift in corporate governance has coincided with growth in the financial market. However, the growth in the financial market also corresponds to economic (control 1) growth and an increase in R&D expenditure and high technology export (control 3). Prima facie control 1 and control 3 are more correlated to financial market development than change in corporate governance.

This is experimentally proven by the regression planes and scatter plot in the graphs above. However, the corporate governance regression coefficient for the Bayesian analysis differs significantly in comparison to frequentist analysis. The high density interval for the Bayesian analysis lies between 0.003676 and 0.120785, the frequentist coefficient of 0.140102 lies just beyond this area.

	CG	Control 1	Control 2	Control 3	Intercept
Mean Bayesian	0.062502	0.398711	0.057521	0.472082	-0.01918

Frequentist	0.140102	0.342849	0.021449	0.541839	-0.16607
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However, both the regression analyses show that the corporate governance regression coefficient is low in comparison to the mean control 1 and control 3 coefficient. Its impact is similar to control 2 for Bayesian analysis and seven times larger in frequentist analysis. The frequentist analysis also predicts that the corporate governance change in India has the second highest impact on financial market growth among the countries studied under this research, while Bayesian analysis puts India at eighth among the nineteen developing countries studied in this research. Thus there is a need for further qualitative study to explore the reason behind this apparent dissociation between the results predicted by Bayesian and frequentist methods.

A ratio analysis shows the impact as following.

Mean Bayesian		Frequentist	
CG:Ctrl1	CG:Ctrl3	CG:Ctrl1	CG:Ctrl3
1 : 6.3792	1 : 7.5531	1 : 2.447	1 : 3.868

It can thus be concluded that although changes in the corporate governance model in India may have some impact (based on frequentist analysis) on the growth of the Indian financial market, it is still several times lower than control 1 and control 3.

VII: CONCLUSION

In conclusion, the authors would like to posit that the present study in the course of this paper, both via qualitative as well as quantitative methodology, has presented the fact that India shows a significant correlation between the changes in its corporate governance regulations and its financial market growth. Even controlling for the macroeconomic growth and technological growth, at least in Frequentist or classical method, laws have had an undeniably major role to play. In Bayesian analysis, the role of law is, however, more muted. The authors would thus tend to agree with the 'law matters' group of legal scholars, at least in the view of this empirical research done in the context of Indian financial market growth.

The authors would hasten to add that there can of course be other hidden factors, which were not studied by this research, like enforcement, human development factors etc. The authors aim to add them to a multilevel model later. It is interesting to note that the G20/OECD Principles of Corporate Governance 2015 have also emphasised the regulatory and implementation aspects of corporate governance. Further studies are needed to find out if India which had eagerly adopted the

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11 shareholder primacy model espoused in the 2004 Principles, shows similar propensity towards
12 strengthening the regulatory systems as encouraged in the 2015 Principles.
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15 While it is difficult to exercise a radical influence on economic growth in a short space of time, it is
16 much easier to have a significant impact on R&D investment and encourage technology based
17 industries. The authors thus propose that in order to achieve sustainable growth in financial markets,
18 developing countries should adopt policies encouraging R&D and focussing on high technology-led
19 export industries. These policies could take the form of: favourable tax regulations for R&D
20 investments; incentives for high technology industries through conducive regulatory mechanisms
21 such as easier access to credit, simpler rules for doing business, fewer opportunities for regulatory
22 arbitrage, single window clearance whereby businesses are allowed to submit regulatory documents
23 to a single entity, tax credits etc.; and discouraging financial transactions which legitimise
24 unproductive rent-seeking behaviour, for example by imposing higher tax rates on buy backs of
25 shares, and rationalising capital gains tax rules, especially when they are being used as the primary
26 avenue to seek returns on investment etc.⁷⁵
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53 ⁷⁵ See generally William Lazonick, 'Stock Buybacks: From retain and reinvest to downsize and distribute' (2015)
54 Working paper Centre for Effective public management at Brookings
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Appendix A

Corporate governance variables

Shareholder rights index

- *Secure methods of ownership registration* - 2 if a central depository is available and shares are mandatorily held in an electronic dematerialised format in the central depositories, 1 if there is a central depository but it is optional to have shares in dematerialised format, 0 if there is no central depository.

The first step for a shareholder to claim these rights would be to prove himself a shareholder, with increasing cross-border holdings, registration often becomes the first hurdle. Thus a pro-shareholder corporate governance regime would insist on an easy process with dematerialised shares which allow for electronic transfer especially through a central clearing house to reduce frauds, transaction time etc.

- *Transfer of shares* – 2 if shares of listed/public companies which can be traded in the open market are fully transferable, 1 if there are restrictions at the discretion of companies and if a non-binding regulations call for full transferability of shares, 0 otherwise; 2 if foreign nationals are allowed to own and transfer shares and are treated on a par with the citizens of the host country, 1 if foreign nationals are allowed to own and transfer shares but with certain restrictions not placed on the citizens of the host country 0 if foreign nationals are not allowed to own or transfer shares.

The founding pillar of pro-shareholder corporate governance allows the shareholders a free choice to exit a company. Hence there is a need for an equity market, the shares need to be fully transferable and there should not be an onerous burden on the shareholder to transfer the shares. Some jurisdictions may have some restrictions on transfer such as a lock in period for promoters, restriction on preference shares, partially paid up equity shares etc. In the majority of such cases these non-transferable shares are not allowed to be traded on the open market (though sometimes trade is allowed in private markets). Therefore, to allow uniformity, only those shares which can be traded on the open market (like common equity shares) need to be fully transferable. Some jurisdictions place extra burden on foreign nationals and thus increase the cost of access to capital, a pro-shareholder policy would allow foreign funds entry to the financial market as it would give shareholders more choice and would lead to a more vibrant equity market.

- *Regular and timely information* – 2 if half yearly and annual reports are mandatorily sent to shareholders and a central registry, 1 if annual reports are sent to the central registry only and not to shareholders, 0 if no reports are sent or otherwise; 2 if it is statutorily mandated

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11 that an annual report includes at least five of the following: a. balance sheet, b. profit and
12 loss statement, c. cash flow statement, d. statement of changes in ownership equity, e. notes
13 on the financial statements and f. an audit report, 1 if it is recommended under a non-binding
14 code 0 if otherwise; 2 if financial reporting mandatorily is based on International Financial
15 Reporting Standards (IFRS) and International Standards on Auditing (ISA) 1 if it is
16 recommended under a non-binding code 0 if otherwise.

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19 Timely and regular information is key in order to make an informed choice. Shareholders always
20 suffer from an information gap, thus pro-shareholder corporate governance policies would always
21 insist on higher burdens on companies to share the maximum possible financial reports on more
22 than an annual basis. IFRS and ISA or comparable standards ensure that companies' financial
23 records comply with the globally accepted standards. This would allow easy comparisons across
24 companies and help in shareholder choice.

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26 • *Participate in shareholders meetings* – 2 if the law explicitly mandates that any class of
27 shareholders are allowed to attend the meeting and take part in discussion, 1 if it is a
28 common practice backed by a non-binding code 0 otherwise; 2 if a law mandates that a
29 proxy form to vote on the items on the agenda accompanies notice of the meeting or if
30 shareholders may vote by mail on the items on the agenda, 1 if it is recommended by a non-
31 binding code or is a general practice, 0 if under law/non-binding regulation/practice absent
32 shareholders vote (or shareholders who have not returned the proxy form/postal ballot) is
33 given to managers by default; 2 if cross-border proxy voting is allowed without any
34 restriction, 1 if it is allowed with some restriction or a non-binding governance code
35 recommends cross-border proxy voting without restriction, 0 otherwise.

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38 Although some classes of shareholders like those holding preference shares are barred from voting,
39 a policy which allows them to participate in the meeting (without voting) is more shareholder-
40 friendly than regulations which completely bar the participation of nonvoting shareholders from
41 general meetings. Further, in many highly dispersed companies it is not possible for the shareholder
42 to attend the meetings and personally cast votes and proxies are generally used. A system which
43 recognises shareholders as owners of the company would try to make it easier for more shareholder
44 participation rather than using regulatory loopholes. A further mark of a liberalised regime would
45 be to allow foreign nationals to use proxies to cast their votes as it otherwise might be financially
46 onerous on the foreign shareholder.

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48 • *Dividend* – 2 if shareholders can approve the amount of dividend to be paid with a simple
49 majority, 1 if it is recommended under a non-binding regulation or code, 0 otherwise;
50 Shareholder primacy corporate governance ensures shareholder wealth maximisation, timely
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11 and appropriate dividends is one way. In many common law jurisdictions the board of
12 directors decides the amount of dividend to be paid. Thus, shareholder approval by simple
13 majority on the amount of dividend paid would ensure that shareholders have an indirect say
14 on the amount of dividend rather than a situation where the board can itself decide and
15 approve the dividend amount.
16

- 17 • *Supermajority for extraordinary transaction* – 2 each if it is mandated by rule or statute that
18 75% or more shareholders need to agree for the following authorizing a) capital increases; b)
19 waiving pre-emptive rights; c) buying back shares; d) amending articles of association; e)
20 delisting; f) acquisitions, disposals, mergers and takeovers; g) changes to company business
21 or objectives; h) making loans and investments beyond limits prescribed under prospectus;
22 i) authorizing the board to: (i) sell or lease major assets; (ii) borrow money in excess of
23 paid-up capital and free reserves, and (iii) appoint sole selling agents and apply to the court
24 for the winding up of the company, 1 each if it is under a non-binding regulation with a
25 comply or explain architecture or if it is a common practice, 0 otherwise.
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28 Shareholders should retain control over the board in the case of an extraordinary transaction which
29 may affect the long term and short term viability and profitability of the company. Buy back of
30 shares, issuance of new shares and corporate restructuring generally lead to changes in the total paid
31 up share capital and directly impacts on share prices. Capital restructuring can also lead to the
32 consolidation of incumbent management in a widely held company. This provision can be misused
33 by majority shareholders who can issue new shares to themselves, waiving the pre-emptive rights of
34 first refusal of the minority, this leads to further dilution of minority held shares. Moreover, with an
35 increased number of shares the price of shares would generally fall thereby expropriating the share
36 value of the minority. Similarly, significant changes to the asset base of the company would also
37 impact on the prices of shares. Rights issues can also be used as a takeover defence. Some
38 jurisdictions allow for some of these powers to be exercised directly by the board, some require a
39 simple majority while others demand a supermajority. If a supermajority is required for these
40 transactions, shareholders are able to get full ex-ante information about aspects limiting their rights
41 that would normally be factored into the price of the security. This limitation on absolute board
42 power would also enable minority shareholders to protect themselves from self-dealing corporate
43 insider expropriation by dilution, to an extent.
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50 Anti-Managerial rights index

- 51 • *Performance related pay* - 2 if under law a minimum fixed portion of executive
52 remuneration is performance linked, 1 if it is a common practice or recommended under a
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11 non-binding corporate governance code, 0 otherwise; 2 if executive remuneration requires
12 shareholder approval, 1 if shareholder approval is only advisory, 0 otherwise; 2 if there are
13 statutory rules relating to stock option plans and stock linked pension funds exist, 1 if there
14 is a non-binding code or regulation, 0 otherwise.

15
16 One of the cornerstones of agency-based shareholder value maximisation of corporate governance
17 is to align the interests of the managers and the employees to the interest of the shareholders i.e. to
18 increase the price of shares on equity markets. This can be achieved if emphasis is placed on
19 encouraging executives to take a major portion of their remuneration in stock options. Like the
20 OECD principles of corporate governance which states that performance related pay should be
21 allowed to develop, most jurisdictions do not put in a fixed line as to how much executive
22 compensation should be linked to the performance of share prices. However, a jurisdiction which
23 wants to implement a performance-linked pay for executives will fix a minimum amount of
24 compensation which must be linked to share performance. Similarly for employees there can be
25 stock-linked pension funds or employees stock ownership plans (ESOPs). In many jurisdictions
26 these exist as general practice, however as it becomes more prevalent legislators tend to regulate it
27 by bringing rules. Thus the presence of guiding rules relating to ESOPs etc. acts as a proxy for the
28 fact that performance related pay for employees has been generally accepted. Executive
29 compensation is usually fixed by the remuneration committee, however, if shareholders need to
30 approve the quantum of compensation, it adds another layer of shareholder control over the
31 directors.

- 32 • *Proportionality of ownership of share and control* – 2 if ordinary equity shares that do not
33 carry a preference of any kind, neither for dividends nor for liquidation carry one vote per
34 share,⁷⁶ 1 when a non-binding code discourages the existence of methods of disproportional
35 control like multiple-voting and nonvoting ordinary shares, pyramid schemes or does not
36 allow firms to set a maximum number of votes per shareholder irrespective of the number of
37 shares owned, 0 otherwise

38 Each shareholder should be given proportional equity control to the amount invested. However over
39 the years, due to financial requirements, various forms of shares have evolved – preference shares
40 which have higher or fixed cash flow rights but sacrifice voting rights, golden shares which may
41 contribute little to equity but have disproportionate voting rights etc.⁷⁷ which are separate from
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51 ⁷⁶ Even with a strict imposition of one share one vote rule, which should in theory nullify golden shares, there would
52 be other ways like stock pyramids, cross-ownership structures and dual class equity structures which gives
53 disproportional control delinked from cash flow rights by careful manipulation of common equity shares.

54 ⁷⁷ See generally Milton Harris and Artur Raviv, 'Corporate governance: Voting rights and majority rules' (1988) 20
55 Journal of Financial Economics 203-235

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11 ordinary equity shares. The survey will limit itself to one vote per one ordinary share to ensure
12 proportionality of control across the ordinary equity class. Thus, for example, a jurisdiction which
13 does not have any regulation on disproportionate voting rights like golden shares, pyramid schemes
14 etc. would be scored 0.
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18 • *Markets for corporate control* - 2 if pre-offer takeover defences are statutorily banned, 1 if
19 there is a non-binding code which specifically discourages directors from using pre-offer
20 defences, 0 if there is no regulation; 2 if post-offer takeover defences are statutorily banned,
21 1 if there is a non-binding code which discourages directors from using post-offer defences,
22 0 if there is no regulation; 2 if at least 25% or more shares are to be with the public for listed
23 companies, 1 if there is a non-binding code for the same, 0 otherwise; 2 if a declaration to
24 the market by a shareholder holding 5% of share capital is necessary whenever their
25 shareholding changes by more than 1-5% of the total subscribed share capital within a given
26 period of time, 1 if the disclosure is recommended by a non-binding code, 0 otherwise;
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29 To ensure that the market for corporate control can function effectively, any pro-shareholder
30 corporate governance would try to restrict the powers of the incumbent managers to scupper
31 takeover attempts. Takeover defences can be divided into two categories based on the time when
32 they can be effected. Defences like the poison pill, automatic rights issue, golden parachute for
33 executives, staggered board etc. are arranged before a bid is made for the control of the company.
34 On the other hand, defences like targeted repurchase bids (coupled with white knight etc.), asset
35 restructuring (crown jewel defence, scorched earth policy etc.), capital restructuring (issue of new
36 shares to existing shareholders), greenmailing are usually set in motion once the takeover bid has
37 already been made. 'Poison pills provide their holders with special rights in the case of a triggering
38 event such as a hostile takeover bid. If a deal is approved by the board of directors, the poison pill
39 can be revoked, but if the deal is not approved and the bidder proceeds, the pill is triggered.
40 Similarly, golden parachutes are severance agreements that provide cash and non-cash
41 compensation to senior executives upon an event such as termination, demotion, or resignation
42 following a change in control.'⁷⁸ Rights issue (either contingent on takeover bid or post bid effected
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49 ⁷⁸ Paul Gompers, Joy Ishii and Andrew Metrick, 'Corporate governance and equity price' (2003) 118 (1) Quarterly
50 Journal of Economics 107 working paper available at < <http://www.boardoptions.com/governancearticle.pdf>>. In
51 their seminal paper they studied 24 firm level corporate governance factors for 1500 large corporations for the
52 period 1990-1999. The corporate governance provisions were divided into five thematic groups: tactics for delaying
53 hostile bidders, director/officer protection, voting rights, other takeover defences, and State/laws. Paul A. Gompers
54 et al. focussed on anti-shareholder provisions in the company's prospectus and other documents creating a 'G
55 index' where higher scores meant lower shareholder rights. They then concentrated on two extreme ends of the
56 index creating a 'Dictatorship Portfolio' of the firms with the weakest shareholder rights ($G \geq 14$), and a 'Democracy
57 Portfolio' of the firms with the strongest shareholder rights ($G \leq 5$).
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11 by incumbent management) allows for the issue of new shares to existing shareholders, this would
12 lead to an increase in the number of shares and make it expensive for the raider to get majority
13 control. As detailed in several pieces of research, takeover defences affect share prices and
14 earnings.⁷⁹ Thus, an ideal shareholder primacy corporate governance system would discourage
15 takeover defences. It is also necessary to differentiate between pre-bid and post-bid defences as
16 many jurisdictions allow some form of defence such as counter offers etc. which usually raises the
17 share prices and thus offers a better exit to shareholders. Therefore, if a jurisdiction bans the
18 incumbent management from executing pre-offer defences such as staggered board, poison pill,
19 golden parachute, supermajority (over 80%) to approve merger, dual class recapitalisation then the
20 jurisdiction would be coded 2, if some of them are banned and others are specifically discouraged
21 by a non-binding code then the country is coded 1, if there is no code or rule then it is coded 0.
22 Similarly, for post-bid defences the survey will look for laws and rules banning or discouraging
23 asset restructuring, liability restructuring, capital restructuring and targeted repurchase (not open
24 competitive bidding).

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29 In developing countries the share markets are generally illiquid and there is a high prevalence of
30 block-holder directors. This situation can be remedied by having a minimum amount of shares with
31 the public which may lead to more dispersed holding.⁸⁰ In India, which as per S&P is a leading
32 emerging market, only recently was it made mandatory that for listing at least 25% of the shares
33 should be with public. Therefore, to ensure that markets in developing countries move towards a
34 more open market it is imperative that shares become more dispersed, the first step towards this
35 would be a minimum of 25% free float.

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38 The disclosure rule for shareholders with 5% shareholding would nullify any attempts to effect a
39 creeping acquisition and allow for proper share valuation due to an expected increase in demand.

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41 • *Impediments to cross border voting* – 2 if American Depositary Receipt (ADR) and Global
42 depository receipt (GDR) with voting rights at par equity is allowed, 1 if ADR and GDR
43 have voting rights with some restriction, 0 otherwise.

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45 An investment bank can buy shares of companies listed at a share market in a developing country
46 and later issue a negotiable security linked to these issues at a stock exchange in a developed
47 country. These negotiable securities are referred to as depository receipts and their value varies
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50 ⁷⁹ See Richard S. Ruback, 'An Overview of Takeover Defenses' in Alan J. Auerbach, (ed.) *Mergers and Acquisitions*
51 (University of Chicago Press 1987) table 3.1 and 3.2; Pornsit Jiraporn, 'An empirical analysis of corporate takeover
52 defences and earnings management: evidence from the US' (2005) 15 (5) *Applied Financial Economics* 293-303.

53 ⁸⁰ Though Cheffins et al. 'Ownership Dispersion and the London Stock Exchange's 'Two-Thirds Rule': An Empirical
54 Test' (2012). University of Cambridge Faculty of Law Research Paper No. 17/2012. Available at
55 <<http://ssrn.com/abstract=2094538>> concludes that two-thirds rule of London stock exchange was not the catalyst
56 for dispersion of ownership and control that might have been expected.

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11 according to the price of the underlying share in the original host country. If depository receipts for
12 foreign companies are issued in the US market they are referred as ADR and if these depository
13 receipts are issued in the non US market⁸¹ it is commonly referred to as GDR. ADR and GDR
14 allows foreign capital to flow into the host country and at the same time ensures that the companies
15 adhere to the deposit agreements. Deposit agreements follow a strict set of disclosures, thus
16 jurisdictions which allow ADR and GDR automatically ensures that companies which choose to
17 issue ADR or GDR has to comply with strict standards. Whether the ADR/GDR purchaser would
18 be able to vote depends on the depository agreements, however from a pro-shareholder view any
19 equity investment should be able to exert proportionate control. Thus, shareholder primacy
20 corporate governance would allow default voting rights for depository receipts to be on a par with
21 domestic equity shares.
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- 2 if by law external auditors need to be changed after 1-5 years and some cooling off period,
23 1 if it is recommended under a non-binding code, 0 otherwise.

24
25 A regular change in the external auditor would ensure that management always remains at arms-
26 length from the auditors. A quick glance at major corporate fraud like the Enron scandal, Satyam
27 scandal⁸² would suggest that in many cases it was the willing oversight of the auditors which led to
28 the delayed discovery of fraud. Thus a pro-shareholder corporate governance policy would favour a
29 change of auditors at regular intervals so that the integrity of the financial information/disclosure is
30 maintained.
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- 2 each if it is mandatory for presence of audit committee, remuneration committee,
32 nomination committee with a majority of independent directors, 1 if it recommended by a
33 code, 0 otherwise.

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35 NEDs are supposed to act as an internal control mechanism looking at a long term view. Through
36 these committees they are supposed to keep watch on executive directors and managers, appoint
37 auditors, fix remuneration of the executives and maintain continuity with nominating executives for
38 the top positions. The majority rule has to be enforced by statutory binding regulation. Independent
39 directors are those directors who do not have any financial interest in the company and whose
40 remuneration is not linked with performance.
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- 2 if the country has legal protection for whistle-blowers, 1 if it is recommended in a non-
42 binding corporate governance code etc., 0 otherwise.

43 Minority shareholders rights index

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53 ⁸¹ For example in European stock exchanges like Frankfurt Stock Exchange, London Stock Exchange etc.

54 ⁸² Criminal prosecution of auditors is still on-going

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- *Ability to influence an electing member of board* – 2 if cumulative voting is allowed, 1 if it is recommended but discretionary, 0 otherwise.

Shareholders should be allowed to have effective control over the board by electing its members. Most jurisdictions offer shareholders the opportunity to elect members but in a shareholder primacy system cumulative voting would be allowed as minority shareholders would then be able to pool their votes for certain board candidates.

- *Prohibit abusive self-dealing* - A score of 0 if the board of directors, the supervisory board or shareholders must vote and the self-dealing majority shareholder is permitted to vote, 1 if it is recommended under a non-binding code that the board of directors or the supervisory board must vote and the self-dealing majority shareholder is not permitted to vote, 2 if it is mandatory that the self-dealing majority shareholder is not permitted to vote; 2 if shareholders must vote and the self-dealing majority shareholder is not permitted to vote, 1 if it is recommended, 0 otherwise. A score of 0 is assigned if no disclosure is required 1 if disclosure on the terms of the transaction is recommended, 2 if it is required; 2 if an external auditor is required to review the transaction before it takes place, 1 if it is recommended, 0 otherwise.

A majority shareholder who is also a member of the board is at a distinct advantage over minority shareholders in terms of insider information and control. This may also lead to the diversion of company's assets for personal gain and eventual expropriation. Therefore a shareholder wealth maximisation of corporate governance would call for strict regulations to limit any self-dealing, putting in place checks and balances like NEDs, external auditors and even approval in shareholder meetings.

- *Ability to take judicial recourse* - 2 if direct or derivative suits are available for 100 shareholders or shareholders holding a minimum of 5-10% of the share capital, 1 if more than 10% or more than 100 shareholders are required for a suit, 0 in other cases.

Business judgment rule prevents courts from interfering in the internal decision making process of a company, unless a sizeable number of shareholders approach the court. A pro-shareholder corporate governance policy would try to keep this threshold low so that even minority shareholders can approach the court to seek redressal in cases of oppression and mismanagement. Yet at the same time it should not be so low that the company has to always defend frivolous law suits.

Anti-Stakeholder rights index

- 0 if under a regulation stakeholder representation is found/encouraged in board, 1 if it is discouraged by a non-binding code or if there is no mention, 2 if it is prohibited by a binding regulation; 0 if under a regulation stakeholders or their representatives can be present/are

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11 encouraged to be present in shareholders meeting, 1 if it is discouraged by a non-binding
12 code 2 if it is prohibited by a binding regulation and only shareholders can be present; 2 in
13 the case of a unitary managing board where a majority of its members are directly elected by
14 shareholders or are selected with the concurrence of the elected members of the board, 1
15 where under a non-binding code it is encouraged, 0 otherwise; 0 if stakeholders find remedy
16 inside company law, 1 where there is a non-binding code under which stakeholders other
17 than shareholders are offered remedy outside of company law, 2 if the company code or the
18 listing agreements do not have any provision for stakeholder remedies except for
19 shareholders; 0 if the country has a code of ethics for directors which explicitly states that
20 stakeholder rights come before any other shareholder rights, 1 if it is recommended that
21 directors give due consideration to the rights of different stakeholders but does not state if
22 one group has a higher claim than another, 2 if there is a mandatory code which mentions
23 that shareholders have precedence over other stakeholders. Shareholder primacy corporate
24 governance demands that stakeholders like creditors, employees, suppliers and customers
25 are not represented at any stage of the decision making process. They should find remedies
26 outside the corporate law and corporate governance mechanism. Therefore a jurisdiction
27 which mandates dual board structure with stakeholder representation would score lower in
28 the overall assessment.
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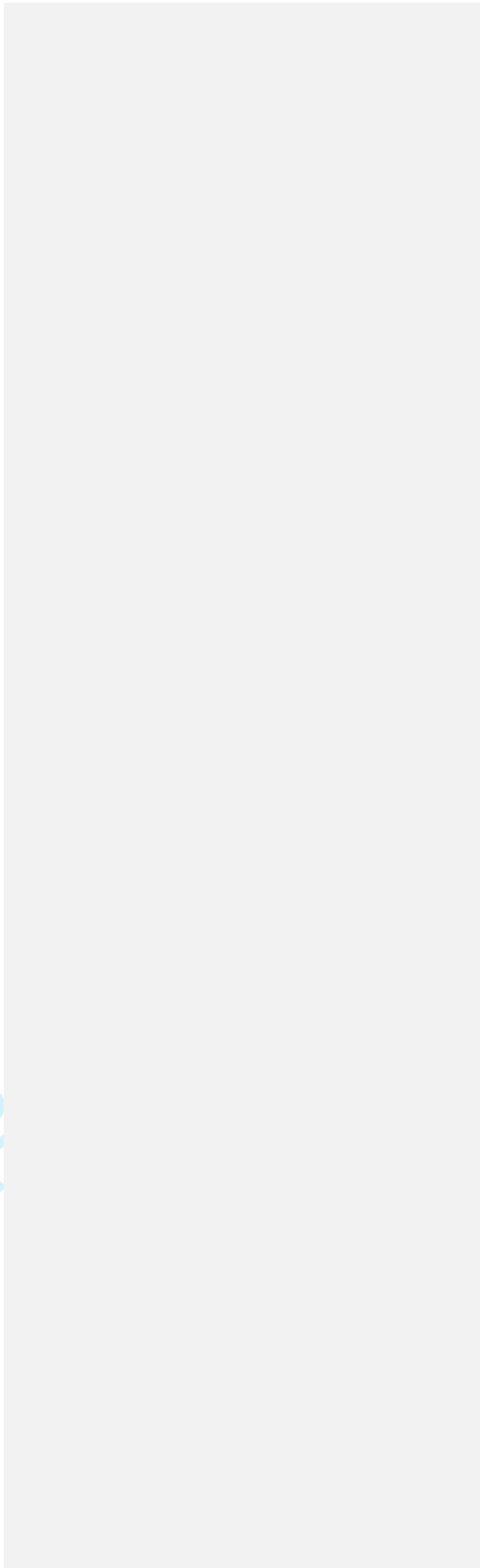
37 **Appendix D**

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Corporate Governance

Code snippet 1 for graded response model

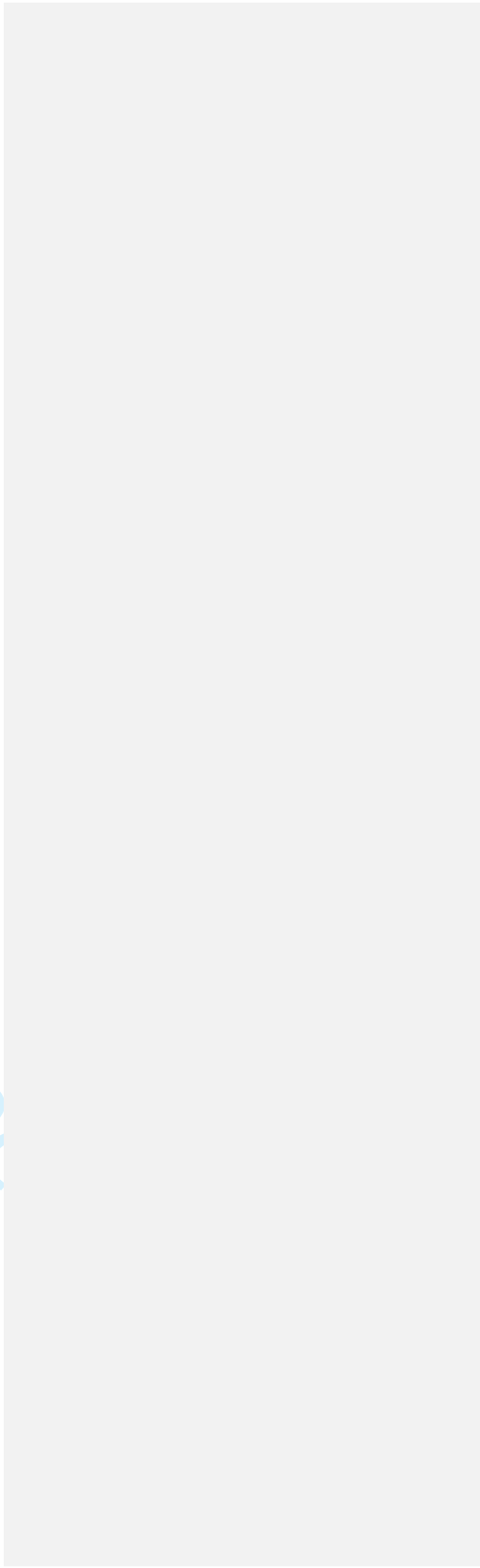


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Code snippet 2 for add on Kalman filter

Code snippet 3 for Bayesian factor analysis

Corporate Governance



Appendix B

Financial market development index

Foreign Direct Investment (FDI) – International Monetary Fund defines net FDI as ‘the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments.’ There is a wide array of literature which empirically connects improvement in corporate governance with an increase in FDI. The rationale is that a country which adopts a stronger corporate governance regime (which provides higher investor protections) gives a competitive advantage to that country as ‘Investors “cherry pick” the countries to which they allocate capital, based on the strength of investor protections. After countries undertake corporate governance reforms, they are more likely to draw in foreign investments.’ Fazio and Talamo investigated this transmission channel using a ‘two-stage version of the gravity model and investigate[d] the determinants of FDI flows with special reference to the institutional factors, after controlling for a number of traditional variables and potential incentives, such as wages and taxes.’ They found that robust corporate governance is an important factor in attracting FDI.

Market capitalisation of listed companies – Standard & Poor defines market capitalisation or market value as ‘the share price times the number of shares outstanding. Listed domestic companies are the domestically incorporated companies listed on the country's stock exchanges at the end of the year.’ The rationale behind linking shareholder primacy corporate governance with market capitalisation is the empirical evidence that ‘firms with stronger shareholder rights had higher firm value, higher profits, higher sales growth, lower capital expenditures, and made fewer corporate acquisitions’ this ‘enhances the investors’ optimism in the firm’s future cash-flow and growth prospects’ leading to higher share prices and therefore higher market capitalisation.

Number of IPOs – Initial public offering generally allows the shares of a company to be listed at a stock exchange and be bought and sold by the public. Given the long history of stock exchange scams where unsuspecting investors were lured into buying worthless shares, it is quite natural that strict corporate governance guidelines have been innovated to ensure continuing confidence amongst investors. Microeconomic firm-level evidence shows that ‘firms with stronger [corporate]

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11 governance structures have higher IPO valuations and better long term operating performance than
12 their peers.’ Thus, as Prof. Coffee posits, Anglo-American style shareholder primacy corporate
13 governance may be instrumental in assuring greater protections for minority shareholders and
14 increased financial transparency and thereby lead to an upsurge in the number of IPOs.
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18 Number of listed domestic companies - Listed domestic companies are the domestically
19 incorporated companies listed on the country’s stock exchanges at the end of the year. It is widely
20 used as a proxy for financial market development as a vibrant financial market governed by
21 adequate corporate governance regulation would induce private companies to seek equity funds and
22 relinquish control.
23

24 As there is high correlation between the number of firms and the number of IPOs, this survey uses
25 the total number of listed domestic companies as part of the dependent index.
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28 S&P global equity index - S&P Global Equity Indices measure the U.S. dollar price change in the
29 stock markets covered by the S&P/IFCI and S&P/Frontier BMI country indices. The theoretical
30 basis for linking the equity index with corporate governance lies in the doctrine of market for
31 corporate control, where it is hypothesised that if managers of a company are unable to produce the
32 desired results in the form of higher share prices then the shareholders would divest those shares,
33 resulting in the fall of share prices and thereby opening the entrenched management to the perils of
34 takeover and consequent loss of position. Thus, a shareholder oriented corporate governance is
35 theorised to positively impact stock market performance.
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39 Traded volume of stocks traded – Stocks traded refers to the total value of shares traded during the
40 period. It is controlled for foreign exchange price fluctuation. This variable provides a measure of
41 financial market depth, liquidity (consequently the fall in the cost of access to capital) and acts as
42 an indicator of market development and growing financialisation. All these factors are affected by
43 changes in corporate governance.
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46 47 **Appendix C**

48 49 Macroeconomic control

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51 **Log GDP** – this variable adjusts for the generally observed exponential growth of GDP and gives a
52 clearer picture about the actual growth rate of GDP. This also, to an extent, nullifies the
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11 autocorrelation in real GDP values.⁸³ Log GDP acts as a proxy for economic growth. It is an
12 accepted theory that there is a two way linkage between GDP and FDI, scholars like Hansen,⁸⁴ Basu
13 et al.,⁸⁵ Hsiao⁸⁶ etc. have clearly enumerated the long term relationship between FDI and GDP.
14 There is also an accepted relationship between GDP and the stock index,⁸⁷ as higher log GDP
15 usually translates into an increase in industrial output, which *pari passu* in turn should increase
16 share prices. The data will be sourced from WB WDI dataset.
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20 **Log GNP** – log GNP adjusts for the actual growth of GNP, it thus provides for the growth in
21 market value of all the goods and services produced in one year by labour and property supplied by
22 the citizens of a country. Therefore it can account for an increase in the industrial productions,
23 based on the investment made in a different country and consequently can supplement GDP values
24 which focus solely on the geographical location of production. Scholars like Cutler et al.,⁸⁸ Dhakal
25 et al.,⁸⁹ Mahdavi⁹⁰ etc. have shown that there is a causality between market variations and GNP.
26 The data will be sourced from WB WDI dataset. However owing to the high correlation between
27 log GDP and log GNP, we will not use log GNP.
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32 **Log PPP** – Purchasing power parity determines the relative value of different currencies, thus an
33 increase in PPP would allow researchers to estimate the economic growth especially when the real
34 GDP (which is pegged to a historic USD value) can fluctuate based on varying exchange rates.
35 Thus log PPP complements both log GDP and log GNP in proxying for macroeconomic growth by
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40 ⁸³ For advantages of using log GDP and its impact on health please refer to Aghion et al., 'The relationship between
41 health and growth: when Lucas meets Nelson-Phelps', (2010) National Bureau of Economic Research No. w15813
42 available at <http://scholar.harvard.edu/files/aghion/files/relationship_between_health.pdf>

43 ⁸⁴ Henrik Hansen and John Rand, 'On the causal links between FDI and growth in developing countries' (2006) 29
44 (1) *The World Economy* 21-41

45 ⁸⁵ Basu et al., 'Liberalization, FDI, and growth in developing countries: a panel cointegration approach' (2003) 41 (3)
46 *Economic Inquiry* 510-516.

47 ⁸⁶ Frank S.T. Hsiao and Mei-Chu W. Hsiao, 'FDI, exports, and GDP in East and Southeast Asia—Panel data versus
48 time-series causality analyses' (2006) 17 (6) *Journal of Asian Economics* 1082

49 ⁸⁷ See generally Holger Sandte, 'Stock Markets vs GDP Growth: A Complicated Mixture' (2012) WestLB Mellon
50 Asset Management Viewpoint 1 – 8 available at http://us.bnymellonam.com/core/library/documents/knowledge/AlphaTrends/Stock_Markets_vs_GDP.pdf; Lena Saeed Shiblee IV, 'The Impact of Inflation, GDP, Unemployment, and Money Supply On Stock Prices' (2009) available at <http://dx.doi.org/10.2139/ssrn.1529254>; N Groenewold Fraser, 'Share Prices and Macroeconomic Factors' (1997) 24 (9-10) *Journal of Business Finance & Accounting* 1367-1383

51 ⁸⁸ Cutler et al., 'What moves stock prices?' in Peter L. Bernstein and Frank L. Fabozzi (eds.), *Streetwise: The Best of the Journal of Portfolio Management* (Princeton University Press 1998) 56-63.

52 ⁸⁹ Dharmendra Dhakal et al., 'Causality between the money supply and share prices: a VAR investigation' (1993) *Quarterly Journal of Business and Economics* 52-74.

53 ⁹⁰ Saeid Mahdavi and Ahmad Sohrabian, 'The link between the rate of growth of stock prices and the rate of growth of GNP in the United States: a Granger causality test' (1991) *The American Economist* 41-48.
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11 stabilising inflationary forces.⁹¹ This connection between PPP, capital flow, exchange rates and
12 market growth has been explored by other researchers like Hung,⁹² Ammer,⁹³ Sarno,⁹⁴ etc. The data
13 will be sourced from the WB WDI dataset.
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16 **Balance of payment or Current a/c balance** – this records all the financial transactions between
17 the economy of the country and rest of the world, it can be crudely defined as the difference
18 between the cost of import and export of all goods and services. Balance of payment has a direct
19 effect on exchange rates,⁹⁵ exchange rate has direct impact on FDI.⁹⁶ Also if a country had suffered
20 a balance of payment crisis its financial market would have reacted adversely during that period,⁹⁷
21 controlling for balance of payment would allow for the negation of such variations. The data will be
22 sourced from the WB WDI dataset.
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27 **Deposit and lending interest rates** – The World Bank defines interest rate spread as the interest
28 rate charged by banks on loans to private sector customers minus the interest rate paid by
29 commercial or similar banks for demand, time, or savings deposits. The Central banks of countries
30 vary the interest rates and so stimulate or slow down economies by increasing or restricting the flow
31 of money and easy credit. Therefore the interest rates have a direct impact on the financial market.⁹⁸
32 Thus, interest rates can be used to control for monetary policy and structural shocks, inflationary
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36 ⁹¹ B Chowdhry et al., 'Extracting inflation from stock returns to test purchasing power parity' (2005) 95 (1)
37 American Economic Review 255-276

38 ⁹² Mao-Wei Hung and Yin-Ching Jan, 'Use of deviations of purchasing power parity and interest rate parity to clarify
39 the 1997 Asian financial crisis' (2002) 5 (2) Review of Pacific Basin financial markets and policies 195

40 ⁹³ J Ammer and JP Mei, 'Measuring international economic linkages with stock market data' (1996) 51 (5) Journal
41 Of Finance 1743-1763

42 ⁹⁴ Lucio Sarno and Giorgio Valente, 'Deviations from purchasing power parity under different exchange rate
43 regimes: Do they revert and, if so, how?' (2006) 30 (11) Journal of Banking & Finance 3147-3169; See also Akram
44 et al., 'Does the law of one price hold in international financial markets? Evidence from tick data' (2009) 33 (10)
45 Journal of Banking & Finance 1741-1754.

46 ⁹⁵ Magda Kandil, 'Exchange Rate Fluctuations and the Balance of Payments: Channels of Interaction in Developing
47 and Developed Countries' (2009) 24 (1) Journal of Economic Integration 191-174

48 ⁹⁶ See generally Michael W. Klein and Eric Rosengren, 'The real exchange rate and foreign direct investment in the
49 United States: relative wealth vs. relative wage effects' (1994) 36 (3) Journal of international Economics 373-389;
50 Kenneth A. Froot and Jeremy C. Stein, 'Exchange rates and foreign direct investment: an imperfect capital markets
51 approach' (1992) NBER Working Paper No. 2914; Bruce A. Blonigen, 'Firm-specific assets and the link between
52 exchange rates and foreign direct investment' (1997) The American Economic Review 447-465; Linda S.
53 Goldberg and Charles D. Kolstad, 'Foreign direct investment, exchange rate variability and demand uncertainty.'
54 (1994) NBER Research Working paper No. 4815 published at (1995) 36 (4) International Economic Review 855.

55 ⁹⁷ See generally Matthieu Bussière, 'Balance of payment crises in emerging markets: how early were the 'early'
56 warning signals?' (2013) 45 (12) Applied Economics 1601-1620

57 ⁹⁸ Md Mahmudul Alam and Md Gazi Salah Uddin, 'Relationship between interest rate and stock price: empirical
58 evidence from developed and developing countries.' (2009) 4 (3) International Journal of Business and
59 Management 43; Clive Coetzee, 'Monetary conditions and stock returns: a South African case study' (2002)
60 EconWPA working paper no. 0205002; Zivanemoyo Chinzara, 'Macroeconomic uncertainty and emerging market
stock market volatility: The case for South Africa' (2010) Economic Research Southern Africa Working paper 187.

pressure etc. and its effect on financial market.⁹⁹ The data will be sourced from the WB WDI dataset.

External debt – this is the public debt that is owed to foreign financial institutions.¹⁰⁰ International lenders keep an eye on the ratio of GDP to external rate to secure themselves against the risk of default.¹⁰¹ Thus when the foreign investment dries up smaller economies can fall into a growth trap where because of lower investment there is slower economic growth.¹⁰² Research has now clearly shown that higher external debts lead to ever increasing debt servicing burden, which has a negative effect on the productivity of labour and capital, leading to adverse effects on long term economic growth.¹⁰³ Hence, it is important to control for the negative impact of debt pressure and systemic shocks on financial growth especially in smaller emerging economies.¹⁰⁴

Financial and technological inclusion

Banks per capita – the number of banks per capita can be considered as a rough approximation of financial inclusion and the development of the banking sector. Financial inclusion plays a vital role in allowing marginal populations to directly or indirectly access capital and influence economic growth.¹⁰⁵ A robust banking sector is also an indicator of a vibrant stock market and long-term

⁹⁹ See generally Ronald Mangani, 'Monetary policy, structural breaks and JSE returns.' (2011) 73 *Investment Analysts Journal* 27-35; K. S. Mallick and M. R. Sousa, 'Inflationary pressures and monetary policy: evidence from BRICS economies.' (2011) *Quantitative and Qualitative Analysis in Social Sciences Conference* available at www.qass.org.uk/2011-May_Brunel-conference/Mallick.pdf; Michael Hewson and Lumengo Bonga-Bonga, 'The effects of monetary policy shocks on stock returns in South Africa: a structural vector error correction model' (2005) *Economic Society of South Africa Conference*, Durban.

¹⁰⁰ World Development Index defines external debt stock as 'Total external debt is debt owed to nonresidents repayable in currency, goods, or services. Total external debt is the sum of public, publicly guaranteed, and private nonguaranteed long-term debt, use of IMF credit, and short-term debt. Short-term debt includes all debt having an original maturity of one year or less and interest in arrears on long-term debt.' <http://data.worldbank.org/indicator/DT.DOD.DECT.CD?cid=GPD_31>

¹⁰¹ See generally Daniel Cohen and Jeffrey Sachs, 'Growth and external debt under risk of debt repudiation.' (1986) 30 (3) *European Economic Review* 529-560.

¹⁰² Pierre Villa, 'Financial constraint and growth in the developing countries' (1998) 49 (1) *Revue Economique* 103-117

¹⁰³ Hameed et al., 'External debt and its impact on economic and business growth in Pakistan.' (2008) 20 *International Research Journal of Finance and Economics* 132-140; See also Cristina Checherita-Westphal and Philipp Rother, 'The impact of high government debt on economic growth and its channels: An empirical investigation for the euro area.' (2012) 56 (7) *European Economic Review* 1392-1405; For a neoclassical economic perspective see Peter A. Diamond, 'National debt in a neoclassical growth model.' (1965) *The American Economic Review* 1126-1150.

¹⁰⁴ See generally Catherine A. Pattillo et al., 'External debt and growth' (2002) *International Monetary Fund working paper* No. 02/69; see also Benedict J. Clements et al., 'External debt, public investment, and growth in low-income countries.' (2003) *International Monetary Fund Working paper* no. 2249; Augustin Kwasi Fosu, 'The external debt burden and economic growth in the 1980s: evidence from sub-Saharan Africa.' (1999) 20 (2) *Canadian Journal of Development Studies* 307-318.

¹⁰⁵ See Levine and Zervos (n 83); See also Thorsten Beck and Ross Levine, 'Stock markets, banks, and growth: Panel evidence.' (2004) 28 (3) *Journal of Banking & Finance* 423-442.

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11 economic growth.¹⁰⁶ This phenomenon is however largely confined to economies with lower
12 financial inclusion (such as the majority of developing countries) where a large part of the
13 population does not have access to formal capital structures and have to depend on usurious loans
14 and thus have rippled negative economic effects.¹⁰⁷ Hence, to isolate the effects of corporate
15 governance on the overall financial market it is important from the context of developing countries
16 that we control for varying financial inclusion.
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20 **Access to ICT** - information and communication technology has led to the structural reorganisation
21 of the financial market through extending trade, reorganising capital and enhancing the availability
22 of information.¹⁰⁸ Easier access to ICT encourages SMEs and populations from weaker economic
23 areas to interact with the economic mainstream and can lead to economic growth, there have been
24 studies with panel data which have shown links between ICT use and the growth rate of GDP per
25 capita.¹⁰⁹ Therefore, information on inclusion measured by the number of internet users and the
26 number of mobile subscriptions per 1000 inhabitants provides a general control metric for its effect
27 on financial and economic growth.¹¹⁰
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32 **Access to electricity and power consumption per capita** – access to electricity and electricity
33 consumption per capita is a proxy for the level of industrialisation and therefore has a direct effect
34 on foreign direct investment and other financial market indicators.¹¹¹ It is thus believed that access
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37 ¹⁰⁶ Ross Levine, 'The legal environment, banks, and long-run economic growth.' (1998) *Journal of Money, Credit and*
38 *Banking* 596-613.

39 ¹⁰⁷ See Vigneswara Swamy, 'Financial Inclusion, Gender Dimension, and Economic Impact on Poor Households'
40 (2014) 56 *World Development* 1-15; Jake Kendall, 'Local financial development and growth' (2012) 36 (5) *Journal*
41 *of Banking and Finance* 1548-1562; Mohammad Shafi and Ali Hawi Medabesh, 'Financial Inclusion in Developing
42 Countries: Evidences from an Indian State' (2012) 5 (8) *International Business Research* 116; Panicos O.
43 Demetriades and Kul B. Luintel, 'Financial development, economic growth and banking sector controls: evidence
44 from India.' (1996) *The Economic Journal* 359-374; Mandira Sarma and Jesim Pais, 'Financial inclusion and
45 development.' (2011) 23 (5) *Journal of International Development* 613-628. For a developed country perspective
46 see Klaus Neusser and Maurice Kugler, 'Manufacturing growth and financial development: Evidence from OECD
47 countries.' (1998) 80 (4) *Review of Economics and Statistics* 638-646.

48 ¹⁰⁸ Maryam Farhadi et al., 'Information and Communication Technology Use and Economic Growth' (2012) 7 (11)
49 *PLoS ONE* available at <http://www.plosone.org/article/info%3Adoi%2F10.1371%2Fjournal.pone.0048903>

50 ¹⁰⁹ *ibid*

51 ¹¹⁰ See generally Sanjeev Dewan and Kenneth L. Kraemer, 'Information Technology and Productivity: Evidence from
52 Country-Level Data' (2000) 46 (4) *Management Science* 548-562; Sang-Yong Tom Lee et al., 'Time series analysis
53 in the assessment of ICT impact at the aggregate level – lessons and implications for the new economy' (2005) 42
54 (7) *Information & Management* 1009; Hwan-Joo Seo and Young Soo Lee, 'Contribution of information and
55 communication technology to total factor productivity and externalities effects' (2006) 12 (2) *Information*
56 *Technology for Development* 159-173; for a review of the literature see Erik Brynjolfsson and Shinkyu Yang,
57 'Information Technology and Productivity: A Review of the Literature' (1996) 43 *Advances in computer* 179-214;
58 for a developed country perspective see K Motohashi, 'ICT diffusion And Its Economic Impact In OECD
59 Countries.' (1997) 20 *STI Reviews* 13-45; J Jalava and M Pohjola, 'Economic growth in the new economy:
60 Evidence from advanced economies.' (2002) 14 (2) *Information Economics and Policy* 189-210.

61 ¹¹¹ Alice Shiu and Pun-Lee Lam, 'Electricity consumption and economic growth in China.' (2004) 32 (1) *Energy*

to electricity would become a part of access to resources and augment the classical growth theory.¹¹² Several researchers have shown bi-directional causality between economic growth and power consumption,¹¹³ therefore, it is imperative that access to electricity and power consumption per capita be used as a control variable to insulate the effects of corporate governance policies on the growth of the financial market.

Human development index – this ‘is a summary measure of average achievement in key dimensions of human development: a long and healthy life, being knowledgeable and have a decent standard of living. The HDI is the geometric mean of normalized indices for each of the three dimensions.’¹¹⁴ HDI can therefore act as a proxy for level of education, health and general standard of living.¹¹⁵ It is theorised that the improvement of HDI is concurrent and co-dependent on economic growth as a more educated long living population should foster more economic growth which in turn would increase spending on health and education leading to a virtuous cycle.¹¹⁶ Due to the relative stability of the variable over time, this variable is used as a country level control indicator.

policy 47-54; Jiahai Yuan et al., ‘Electricity consumption and economic growth in China: cointegration and co-feature analysis.’ (2007) 29 (6) *Energy Economics* 1179-1191; Sajal Ghosh, ‘Electricity consumption and economic growth in India.’ (2002) 30 (2) *Energy policy* 125-129; Nicholas Apergis and James E. Payne, ‘Energy consumption and economic growth in Central America: evidence from a panel cointegration and error correction model.’ (2009) 31 (2) *Energy Economics* 211-216; Yemane Wolde-Rufael, ‘Electricity consumption and economic growth: a time series experience for 17 African countries’ (2006) 34 (10) *Energy Policy* 1106-1114; Galip Altinay and Erdal Karagol, ‘Electricity consumption and economic growth: evidence from Turkey.’ (2005) 27 (6) *Energy Economics* 849-856; for a developed country perspective see S Smiech and M Papiez, ‘Energy consumption and economic growth in the light of meeting the targets of energy policy in the EU: The bootstrap panel Granger causality approach’ (2014) 71 *Energy Policy* 118-129; Jarawan Chontanawat et al., ‘Does energy consumption cause economic growth?: Evidence from a systematic study of over 100 countries’ (2008) 30 (2) *Journal of Policy Modeling* 209-220.

¹¹² Anis Omri and Bassem Kahouli, ‘Causal relationships between energy consumption, foreign direct investment and economic growth: Fresh evidence from dynamic simultaneous-equations models’ (2014) 67 *Energy Policy* 913-922

¹¹³ John Asafu-Adjaye, ‘The relationship between energy consumption, energy prices and economic growth: time series evidence from Asian developing countries’ (2000) 22 (6) *Energy economics* 615-625; Ugur Soytas and Ramazan Sari, ‘Energy consumption and GDP: causality relationship in G-7 countries and emerging markets’ (2003) 25 (1) *Energy economics* 33-37; for a counter opinion see Shyamal Paul and Rabindra N. Bhattacharya, ‘Causality between energy consumption and economic growth in India: a note on conflicting results’ (2004) 26 (6) *Energy Economics* 977-983.

¹¹⁴ United Nations Development Programme, *Human Development Report 2014*; for a more critical view see Mark McGillivray, ‘The human development index: yet another redundant composite development indicator?’ (1991) 19 (10) *World Development* 1461-1468; Ambuj D.Sagar and Adil Najam, ‘The human development index: a critical review’ (1998) 25 (3) *Ecological economics* 249-264; Jack Hou, ‘The dynamics of Human Development Index’ (2014) *The Social Science Journal* doi:10.1016/j.soscij.2014.07.003; Martin Ravallion, ‘Troubling tradeoffs in the Human Development Index’ (2012) 99 (2) *Journal of Development Economics* 201-209

¹¹⁵ See Technical notes in United Nations Development Programme, *Human Development Report 2014* available at http://hdr.undp.org/sites/default/files/hdr14_technical_notes.pdf

Gini coefficient – is an ad hoc measure for income inequality.¹¹⁷ It is theorised that a higher Gini coefficient denoting a higher income inequality would result in more conflicts, skewed political decisions favouring further accumulation of capital and lower spending on developing human capital¹¹⁸ leading to less sustainable economic growth.¹¹⁹ However this view has been challenged by numerous scholars who argue that in the short and medium term income inequality actually fosters higher economic growth.¹²⁰ However a different strand of scholarship finds a direct correlative link between ‘increases in wealth inequality and stock market participation, smaller increases in consumption inequality and the fraction of indebted households, and a decline in interest rates’¹²¹ especially in booming economies. Therefore, in spite of several shortcomings, Gini coefficient gives a proxy for poverty and inequality which is not adequately measured by HDI. Due to the relative stability of the variable over time, this variable is used as a country level control indicator.

Enforcement quality

Global Peace Index – this index attempts to calculate the relative peace in a country. It compiles around 22 individual qualitative and quantitative indicators under ‘three broad themes: the level of safety and security in society; the extent of domestic or international conflict; and the degree of militarisation.’¹²² Civil strife and conflicts have significant negative economic effects as they raise

¹¹⁶ Alejandro Ramirez et al., ‘Economic Growth and Human Development’ (1997) Yale University working paper no. 18; Gustav Ranis et al., ‘Economic growth and human development’ (2000) 28 (2) *World development* 197-219; Gustav Ranis and Frances Stewart, ‘Dynamic Links between the Economy and Human Development’ (2005) Department of Economics and Social Affairs (UN) Working Paper available at <http://economics.ouls.ox.ac.uk/12091/1/Ranis%2520%26%2520Stewart.pdf>; Sudhir Anand and Amartya Sen, ‘The income component of the human development index’ (2000) 1 (1) *Journal of human development* 83-106; Ghulam Akhmat et al., ‘Impact of financial development on SAARC’S human development’ (2013) *Quality and Quantity* 1-16.

¹¹⁷ Robert Dorfman, ‘A formula for the Gini coefficient’ (1979) *The Review of Economics and Statistics* 146.

¹¹⁸ See generally Amparo Castelló and Rafael Doménech, ‘Human capital inequality and economic growth: some new evidence’ (2002) 112 (478) *The economic journal* C187-C200.

¹¹⁹ Torsten Persson and Guido Tabellini, ‘Is Inequality Harmful for Growth? Theory and Evidence’ (1991) University of California at Berkley working paper no. 91-155; Alberto Alesina and Dani Rodrik, ‘Distributive politics and economic growth’ (1991) National Bureau of Economic Research working paper no. 3668 available at <<http://www.nber.org/papers/w3668>> published at (1994) 109 (2) *The Quarterly Journal of Economics* 465.

¹²⁰ See Kristin J. Forbes, ‘A Reassessment of the Relationship between Inequality and Growth’ (2000) *American economic review* 869-887; Hongyi Li and Heng-fu Zou, ‘Income Inequality is not Harmful for Growth: Theory and Evidence’ (1998) 2 (3) *Review of Development Economics* 318-334; Robert J. Barro, ‘Inequality and Growth in a Panel of Countries’ (2000) 5 (1) *Journal of economic growth* 5-32; see also Simon Kuznets, ‘Economic growth and income inequality’ (1955) *The American Economic Review* 1-28.

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¹²² Institute of Economics & Peace, *Global Peace Index: Measuring peace and assessing country risk* (2014) available online at <http://www.visionofhumanity.org/sites/default/files/2014%20Global%20Peace%20Index%20REPORT.pdf>

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11 expenditure on violence containment thereby increasing the cost of business etc. Most developing
12 countries score lower on the peace index and are theorised to lose between 5%-10% of their GDP
13 on violence containment.¹²³ The link between conflicts and economic growth seems quite clear,
14 conflicts lead to diversion of resources from economically useful ventures to more security oriented
15 sectors with less economic return.¹²⁴ The peace index can also stand as a proxy for political
16 stability.¹²⁵ In recent years terrorism has led to short lived but major distortions in financial
17 markets.¹²⁶ The peace index is available only from 2007 onwards. The unavailability of data for the
18 major part of the time period studied in this research, along with the probable relative stability of
19 the variable over time, this variable is best used as a country level indicator.
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24 **Rule of law** – the index is sourced from the World Justice Project, it comprises of ‘47 indicators
25 organized around 8 themes: constraints on government powers, absence of corruption, open
26 government, fundamental rights, order and security, regulatory enforcement, civil justice, and
27 criminal justice.’¹²⁷ Rule of law is important for economic and financial growth at several levels - it
28 repudiates crony capitalism leading to fair allocation of resources, reduces incidences of corruption
29 like bribery etc.; a vibrant judicial system can control excesses of executive and legislature and
30 provide a safety net for foreign investors, a perception of higher rule of law along with confidence
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61 ¹²⁷ World Justice Project, WJP Rule of Law Index 2014 at <http://worldjusticeproject.org/rule-of-law-index>

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11 in judicial integrity and impartial market regulators would thus allow for a growth in inflow of
12 capital and more robust capital market.¹²⁸ Therefore a country with better rule of law would have
13 higher economic development and market growth.¹²⁹ Rule of law can also act as a proxy for
14 political stability along with judicial and administrative independence.¹³⁰ The WJP rule of law index
15 is available only from 2007 onwards. The unavailability of data for the major part of the time period
16 studied in this research, along with the probable relative stability of the variable over time, this
17 variable is best used as a country level indicator.

21 Industrial value addition through R&D

22 **High technology export** – WB defines high-technology exports as products with high R&D
23 intensity, such as in aerospace, computers, pharmaceuticals, scientific instruments, and electrical
24 machinery.¹³¹ It can act as a proxy for the level of industrialisation in a society, as per the theories
25 of comparative and competitive advantages of international trade, it is the ultimate goal of societies
26 to move from low value addition to high technology exports through lowering the costs of
27 manufacture.¹³² Thus we would expect to find mature developing countries to have higher
28 technological exports and be recipients of higher technology transfer.¹³³ These exports also

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56 ¹³⁰ See Lars P. Feld and Stefan Voigt, 'Economic Growth and Judicial Independence: Cross Country Evidence Using
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58 published at (2003) 19 (3) European Journal of Political Economy 497; Kenneth W. Dam, 'The Judiciary and
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60 <<http://dx.doi.org/10.2139/ssrn.892030>>; Paul H. Rubin, 'Legal Systems as Frameworks for Market Exchanges'
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11 influence the inflow of FDI¹³⁴ and have a bidirectional positive effect on the financial market and
12 economic growth.¹³⁵

13 **Number of patent and trademark applications** –acts as a proxy for investment in R&D, level of
14 industrialisation and as an indicator of technological activities.¹³⁶ There is an established link
15 between R&D and economic growth,¹³⁷ however its effect on the financial market is uncertain.
16 Some commentators and researchers show a negative link between increased R&D expenditure and
17 stock prices, arguing shareholder short-termism¹³⁸ while other scholars argue for positive long term
18 impact.¹³⁹ There is yet another branch of research which links R&D and capital expenditure to
19 corporate governance and tries to explain that the transmission channel for the effects of R&D on
20 the financial market runs through the emergence and pre-eminence of Anglo-American corporate
21 governance which may focus on short term turnovers.¹⁴⁰ Thus R&D stands in a unique position
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11 among the variables studied in that it behaves as a control variable (it affects economic growth and
12 the financial market) and at the same time also shows characteristics of interdependent variable (it
13 is directly affected by the type of corporate governance policies chosen by the polity).
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