FOREIGN OWNERSHIP AND CORPORATE GOVERNANCE PRACTICES: A STUDY OF SELECT INDIAN COMPANIES

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CANDIDATE'S DECLARATION

I, hereby certify that the thesis titled **"Foreign Ownership and Corporate Governance Practices: A Study of Select Indian Companies"** and submitted in fulfilment of the requirements for the award of the degree of Doctor of Philosophy is an authentic record of my research work carried out under the guidance of Dr. Archana Singh. Any material borrowed or referred to is duly acknowledged.

The matter presented in this thesis has not been submitted elsewhere in part or fully to any other University or Institute for the award of any degree.

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SUPERVISOR'S CERTIFICATE

This is to certify that the thesis titled **"Foreign Ownership and Corporate Governance Practices: A Study of Select Indian Companies"**, submitted in fulfilment of the requirements for the award of the degree of Doctor of Philosophy is an original research work carried out by Ms. Ruchi Kansil under my supervision. The matter presented in this thesis has not been submitted elsewhere in part or fully to any other University or Institute for the award of any degree, to the best of our knowledge.

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EXECUTIVE SUMMARY

The concept of Corporate Governance (CG) involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. It encompasses within itself: Transparency, Disclosure, Fairness, Accountability and Responsibility. This thesis adopts the stakeholder value focus of CG in which "CG deals with mechanisms by which stakeholders of a corporation exercise control over corporate insiders and management such that their interests are protected. The stakeholders of a corporation include equity holders, creditors and other claimants who supply capital, as well as other stakeholders such as employees, consumers, suppliers, and the government" (John and Senbet, 1998).

It is widely argued that foreign investment is a mechanism for improving CG in emerging markets and the form of foreign investment matters. Foreign capital inflows need well developed capital markets, sound legislative, regulatory and structural reforms and most importantly strong CG infrastructure. An examination of the same especially those concerning ownership structures and performance could yield important insights into the topic and provide a fresh perspective on what has become an increasingly international debate. In the light of the above, the present study explores the structure and trend of foreign equity shareholdings in the sample companies for a nine year period (2008-2016).

Foreign capital inflows are dependent upon financial and non-financial considerations which include return on investment, macroeconomic policy framework, investment climate and infrastructure in the host country. Further, such investments require broader and deeper financial markets with strong investor protection, market discipline and market transparency. The investments by foreign investors in the equity of a company would be based on their own firm specific risk and reward assessments as well as various firm specific financial characteristics namely, value, performance, profitability to name a few. The present study is an attempt to address and examine whether there exists a relationship between foreign equity shareholdings and firm characteristics in the Indian context. Further, the study is taken up to assess the

stakeholders' perception towards current corporate governance regime and identify the related issues, barriers and challenges for improvements in future.

For the purpose of the study both secondary and primary data sources are used. The study employs various statistical techniques on a sample of 449 non-financial companies selected from S&P BSE 500 and NSE NIFTY 500 indices of India over the period 2008-2016. The data is analyzed using SPSS (version 22), STATA (version 13) and Eviews8. The analysis elucidates the motivation for shareholder activism, management responsibility and regulators enforcement.

The empirical findings put forth by the study highlights the role of foreign investors in enhancing CG practices in emerging market economies. Further, the study has reinstated the importance of activism of foreign shareholders that will lead to emergence of a more activist engagement for the long term benefit of both investors and investees. Consequently, Indian policy makers must permit more and more foreign investment and let India procure the entire performance benefits of ownership of foreign investors. The study enhances knowledge of the firm's financial characteristics that influence foreign capital inflows which in turn would help Indian firms to act accordingly and tap more and more foreign capital. Thus, the thesis adds to the CG literature which can be beneficial to governance practitioners, policy makers, regulators, stock exchanges, think tanks, investors, corporates as well as researchers.

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LIST OF ABBREVIATIONS

AMC	Asset Management Companies
ANOVA	Analysis of Variance
BSE	Bombay Stock Exchange
CDGS	Consumer Discretionary Goods & Services
CEO	Chief Executive Officer
CFO	Chief Finance Officer
CG	Corporate Governance
CGR	Corporate Governance Rating
CLSA	Credit Lyonnais Securities Asia
CMIE	Centre for Monitoring the Indian Economy
CRISIL	Credit Rating Information Services of India Limited
CRSP	The Centre for Research in Security Prices
CS	Controlling Stake
ESG	Bloomberg Environment, Social and Governance
FES	Foreign Equity Shareholdings
FGLS	Feasible Generalized Least Squares
FMCG	Fast Moving Consumer Goods
FO	Foreign Ownership
GOVSC	Governance Score
GROW	Growth of the firm
GVC	Governance and Value Creation
ICRA	Investment Information and Credit Rating Agency of India Limited
IDP	Investment Development Path
LEV	Leverage of the Firm
LLS	Rafael LaPorta, Florencio Lopez-de-Silanes, Andrei Shleifer

LLSV	Rafael LaPorta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert Ward Vishny
MCAP	Market Capitalization of the firm
NCS	Non-controlling Stake
NSE	National Stock Exchange
OECD	Organization for Economic Co-operation and Development
ROTA	Return on Total Assets of the firm
S&P	Standard and Poor
SEBI	The Securities and Exchange Board of India

Chapter 1
Introduction

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INTRODUCTION

1.1 Background

During the recent years, inflows and outflows of capital by entities, funds, and individuals outside the host countries is quite prevailing all around the world. The external capital inflow is a supplement to domestic savings and stimulates economic growth of the recipient economy. The external capital providers, that is, foreign investors, however, achieve international portfolio diversification and gain through higher returns. Moreover, this enables host economies to counterbalance fluctuations in income and attain even consumption streams only if that leads to reducing the gap between boom time and bust time consumption. However, this is not the case with developing countries like India wherein the gap between boom-time and bust-time consumption actually widened and not narrowed during the reform period (Sikdar, 2006).

External capital flows into India since the post-liberalization period (post-1991) increased. At the same time, gradual shifts away from debt components to equity flows have been witnessed. This has been broadly in line with international developments. However, a steady and continuous inflow of external capital needs a matching absorptive capacity of the economy which could not be sustained over the last decades due to continuing slowdown of industrial activity in some sectors while industrial activity not up to the required level in some others. Hence, sincere and serious efforts should be made to remove this hindrance of the slowdown of industrial activity to tap the merits of external capital.

The enormous economic resources and their utilization is been handled by the board of the respective entity for the greater benefit of all stakeholders'. The board is the controller of capital and not the capital provider. The capital providers are the owners of that entity. Thus, there emerges a distinction between the board and the owners. This distinction, in turn, infuses policies and rules for running and controlling the entity. Also, it demands the maintenance of cohesiveness of an organization. Corporate governance (CG) is meant to achieve the same. CG eliminates financial, legal and ethical pitfalls for a firm and at the same time holding it accountable. As business enterprises extend their scope towards international markets, it becomes indispensable for them to meet the expectations of their international counterparts.

The case of India is no different. The external capital inflows due to liberalization and globalization initiatives since 1990 have led to foreign equity stakes in Indian listed firms. It is an established fact that foreign investors who invest outside the home economies would have their own risk-return objectives and would do their own risk-return assessments. Here, a question arises:

- What firm-specific characteristics foreign investors evaluate?
- What is the impact of firm-specific characteristics on foreign ownership (FO)?

Another related aspect is that foreign investors who own stakes outside the home economies may or may not actively and effectively run, monitor or control the firm or management. At times, they may force the management to run the business within the ambit of good governance. They may pressurize management to become more responsible, transparent and accountable. They may demand customer-friendly policies, protection of social groups and the environment. This has led to appropriate changes in

the Boards as well as the governance practices of some of the Indian firms. The issues that follow are:

- How is ownership – equity stakes of various shareholders groups related to CG?
- Does the impact of different owners differ?
- What is the impact of the foreign owner on CG?
- How has increasing foreign ownership affected CG regime in listed firms?

The present study is an attempt to answer some of the issues raised above. This chapter highlights the emergence of the managerial firm, corporate theory and its convergence with CG followed by explanation of the concept of CG in section 1.3. The next section 1.4 explains the evolution of CG followed by the theoretical framework of CG in section 1.5. The background to corporate ownership and the interlinkage between FO and CG is explained in section 1.6 and 1.7 respectively. The motivation of the research is presented in section 1.8. Section 1.9 lists the objectives of the study. The last two sections of the chapter, section 1.10 and 1.11 provide the scope of the study and structure of the thesis respectively.

1.2 The Emergence of the Managerial Firm, Corporate Theory, and Corporate Governance Convergence

In the eighteenth and the nineteenth century, businesses were owned and controlled by individuals and were called 'traditional enterprise' with an exception of few large companies created to promote foreign trade (Dignam & Galanis, 2013). Later, during the nineteenth century incorporated entities began to emerge with integrated ownership and control. By the end of the nineteenth century during the second industrial revolution, big large ventures emerged which needed huge capital, expertise, knowledge, and power to

administer. These ventures could not be controlled and managed by the owner oneself and thus emerged 'the managerial control of companies' (Chandler, 1977). These companies are modern business entities with managerial competence, know-how, and control. During the late nineteenth and early twentieth century, tremendous growth opportunities resulting from industrial growth and emergence of large integrated markets all over the world led to a new organizational structure where the owners were not the managers (Burnham, 1941). This separation called "separation of ownership and control" (Berle & Means, 1932) gradually emerged all over the world depending upon respective countries institutional setup and historical events. The "separation of ownership and control" of companies also called "agency theory" has led to two distinct corporate structures:

- The shareholdings are widely dispersed that it prevents them from exercising control over management - OUTSIDER SYSTEM.

  The outsider system would have significant securities market with highly dispersed shareholders at arm's length investing for financial returns (TYPE I Agency Problem).
- The shareholdings are large and concentrated which have a great incentive to control. This further incentivizes expropriation of the minority. The concentrated shareholders are controllers and may act as managers or control managers- INSIDER SYSTEM.

  The concentrated shareholdings could be of the state, banks, big business families and/or others (TYPE II Agency Problem).

The corporate structures emerging from corporate theories in law and economics are same despite that the corporate theories differ. The first is based on moral principles

and sociological arguments and the second relies on the standard rule of efficiency. The theories correspond to two basic underlying concepts namely, shareholder supremacy and managerialism (Dignam & Galanis, 2013). The *shareholder supremacy* also called shareholder approach considers the present shareholders as the owners and the legitimate controllers of the firm. This is similar to the "agency theory of the firm" where the alignment of shareholders' interests with the managerial decision making is the concern. *Managerialism*, on the contrary, requires the alignment of managerial decision making with the interests of all the stakeholders' (Aoki, 1984). This is called the "stakeholder theory of the firm".

The emergence of the managerial firm encompassing the outsider and the insider system, and the shareholder and the stakeholder theory (discussed in detail in section 1.5) of the firm received tremendous attention since 1980's. It is believed that the insider system of CG encompasses financial development and growth (LLSV, 1998). Furthermore, the insider system of CG is unsustainable due to increasing demands of capital and globalization. This would further lead to convergence of these two alternative systems of CG. By the early 1990's most of the lawyers, economists and academicians confessed that this convergence has begun and would occur (Fukuyama, 1992; Gilson & Roe, 1993). On the contrary, Huntington (1996) claimed that the insider systems are well coordinated between institutions in the economy leading to pressure on non-convergence with outsider systems. Later, by the late 1990's LLSV (1998, 1999) and LLS (2000) works on legal protection of shareholders headed this debate towards legal protection of shareholders. Here, two scenarios emerge:

- Strong legal protection of shareholders leading to dispersed shareholdings. This is similar to outsider system of CG.
- Weak legal protection of shareholders leading to concentrated shareholdings. This is similar to insider system of CG.

The undoubted dominance of insider system of United States led to claims that the convergence of insider system of CG to outsider system of CG is pre-decided. Yet, here it is important to understand that this movement or convergence is dependent on the institutional setting of the respective economies.

1.2.1 Institutional Setting with respect to India

Institutional setting with respect to an economy refers to the corporate law, the financial system and the industrial relations system (Dignam & Galanis, 2013). The institutional setting with respect to India encompasses within itself:

Stock Exchanges

The stock exchanges play three important functions in the enhancement and development of CG, namely, *a remunerating function, counseling and educating function and lastly a disciplinary function* (Naciri, 2009).

Remunerating Function: The theory of finance works on the risk-return trade off. The higher the risk, the higher would be the return and vice versa. Investors in the market require less return from less risky investments and this means lower cost of capital for them. The firms in turn to decrease their risk and the cost of capital should put in place internal control systems along with risk management systems which mean good CG

system. Thus, good CG and higher corporate valuation will reduce the cost of capital of the firm.

Counseling and Educating Function: Stock exchanges counseling and monitoring of the board of directors by imposing CG norms leads to improved management performance.

Disciplinary Function: Listed companies are subject to mandatory rules and regulations imposed by law and the regulators. Further, the stock exchange is a platform for disciplining the incumbent management by the threat of takeovers and acquisitions. The more the threat of job loss, displacement or reduction of power, the more likely is the action of management towards shareholder's interests and returns.

The Companies Act, 2013

Companies Act is the legislation for firms in India which encompasses various functional aspects of companies. The 2013 Act introduced various significant provisions relating to CG, e-management, compliance, enforcement, and disclosure. Various specific provisions relating to CG were incorporated especially dealing with the independence of the board of directors and audit committees. The role of independent directors is established as that of a watchdog of CG wherein they must ensure proper checks and balances. Further, it emphasized that the extensive powers of independent directors should be employed in a rational, responsible and accountable manner.

Further, audit committees are held responsible for various key functions including assisting the board, issuing approval of related party transactions to name a few. These changes are a step towards enhancing CG and further ensuring that the companies are managed and led in the best interest of all its stakeholders'. The steps are expected to improve the manner in which businesses are run in India.

Securities and Exchange Board of India (SEBI)

SEBI, the market regulator in India played a significant role in CG landscape. Out of various reforms undertaken, Clause 49 of the Listing Agreement is the key document for governance and disclosures practices of listed companies. Clause 49 is considered as a defining point in the evolution of Indian CG practices. The principles on the basis of which Clause 49 operate are: "Rights of shareholders, Role of stakeholders' in CG, Disclosure, and transparency and lastly, Duties and responsibilities of the Board".

An amendment to Clause 49 in 2003 led to the mandatory signing of the Listing Agreement for every listed public company. Since then, Clause 49 has been revised in 2004 and 2014. On 17th April 2014 SEBI amended the said clause, effective from 1st October 2014, to synchronize it with Companies Act, 2013.

Accounting Standards

Good CG ensures that companies perform better and have a better relationship with its stakeholders'. Accounting standards are a means of reporting required by corporations that would enhance managers' concern for their stakeholders'. The proper disclosure of affairs of the firm through the practice of accounting standards is crucial, as it leads to good CG.

It is believed that there is a need for strict and uniform standards that are, widely practiced by all. Also, there is a need for harmonization of related standards or laws towards international accounting practices. The accounting standards practiced in India are harmonized with International Financial Reporting Standards. However, at times, the accounting standards do not seem to be beneficial especially when they mandate one respective policy and hence merits attached to every other accounting policy are sacrificed. Lastly, the practice of window dressing of financial statements is a major obstacle in responsible disclosures by the company.

1.3 Corporate Governance

The role of the financial market is to act as a mediator for transfer of savings to investors and establish relative prices of their investment. These prices depend upon the decisions taken by the investors themselves or by company management appointed by them to act on their behalf. There exist formal and informal rules for their working that is, the CG system. CG is defined by many authors, academicians, and researchers. The most important and relevant definitions of CG are:

> *"The system by which companies are directed and controlled (Cadbury 1992)".*

The Shareholder Value Focus

> *"The set of mechanisms – both institutional and market based – that induce the self-interested controllers of a company (those that make decisions regarding how the company will be operated) to make decisions that maximize the value of the company to its owners (the suppliers of capital)" (Denis & McConnell, 2003).*

The Stakeholder Value Focus

> *"Corporate governance deals with mechanisms by which stakeholders of a corporation exercise control over corporate insiders and management such that their interests are protected. The stakeholders of a corporation include equity holders, creditors and other claimants who supply capital, as well as other stakeholders such as employees, consumers, suppliers, and the government" (John & Senbet, 1998)*
>
> *"Corporate governance is a key element in improving the economic efficiency of a firm. Good corporate governance also helps ensure that corporations take into account the interests of a wide range of constituencies, as well as of the communities within which they operate. Further, it ensures that their Boards are accountable to the shareholders. This, in turn, helps assure that corporations operate for the benefit of the society as a whole. While large*

> *profits can be made taking advantage of the asymmetry between stakeholders, in the short run, balancing the interests of all stakeholders alone will ensure survival and growth in the long run. This includes, for instance, taking into account societal concerns about labor and the environment" (Murthy, 2003).*

The above-cited definitions of CG relate to the corporate structures discussed in section 1.2. It can be concluded that CG is a concept that can only be dealt with in a holistic manner. CG includes a set of relationships between various stakeholders' of the firm, namely, shareholders, board of directors, management, employees, debtors and others. It encloses transparency, disclosure, fairness, accountability as well as responsibility within itself. The agency problem, expropriation of the minority shareholders and need to run the businesses for the long-term survival and sustainability of businesses creates the demand for CG structures. The ways to deal with these are referred to as the mechanisms of CG. These mechanisms ensure that manager's actions are monitored and managers are held responsible and accountable. Further, minority shareholders rights are not seized and the firms are run in the best interests of all its stakeholders'. These mechanisms are split into two broad classifications: Internal Mechanisms and External Mechanisms.

The studies on CG talk about various mechanisms in an overlapping internal and external classification. The different mechanisms as mentioned have distinct significance because their hierarchy varies with the type of company (Fama, 1980). According to Fama (1980), the large public corporations are valued by the market on the basis of market reputation impacting the market for managers. The dominating mechanism is the market for managers. Shleifer and Vishny (1989) pointed to the entrenchment strategies implemented by the managers. These managers take up manager-specific investments turning out to be expensive for shareholders to replace

them. In such a scenario, the shareholders land up continuing the appropriation of rents by the managers in the form of higher salaries and perquisites.

The basics of internal governance include board of directors, the company management, who decides where to invest and how to raise further capital if required. Here, "The Board of Directors, at the apex of internal control systems, is charged with advising and monitoring management and has the responsibility to hire, fire, and compensate the senior management team" (Jensen, 1993).

The main CG mechanisms include "*Ownership Structure, Board of Directors, Executive Compensation, and Market for Corporate Control".* Ownership and control of the firm are actually overlapping because the controllers do have some equity stake in the firms they control while some owners have virtual control over the firms by virtue of the stake of their equity holdings. More the overlap of owners and controllers, the higher would be the value of the firm. Thus, ownership structure is an important mechanism of CG with two separate aspects- Composition (type) and Concentration (size). Large (block) shareholdings often referred to as *concentrated ownership* generally incentivizes close monitoring of the management because these large stakes create the value of all the time, effort and costs spent. They generally capture seats on the Board which increases their ability and effectiveness to monitor. A large stake 51 percent or more ownership will have outright control of the firm and management. A minority stake of 10 or 20 percent can also be instrumental in putting pressure on the management. This depends on the large shareholder's involvement in dealing with the affairs of the firm and the management. The large stakes, on the contrary, often lead to expropriation of the minority by redistributing wealth from small investors to concentrated shareholders. Small investors in the absence of legal protection cannot be

effective even if they join together and form large minority groups. These alliances can be easily broken down by the power of the managers and become ineffective. Thus, the benefits of large shareholdings of directors, their relatives, big family houses, corporate bodies, financial institutions outweigh its costs and lead to mitigating the agency problem in the absence of strong legal protection of the minority.

It is established that large dominant shareholders would monitor more than the small dispersed shareholders. Dispersed ownership in absence of large (block) shareholders is subject to the classical free rider problem. In such cases, institutional shareholders particularly, do not monitor because they reduce their risks by holding large diversified portfolios. Large dominant shareholders are better informed than small dispersed shareholders, called information asymmetries among shareholders. They may provide high compensation to managers which may or may not be directly related to the performance of the firms. Thus, managerial compensation or incentives is a function of information asymmetries as well as risk appetite of investors and managers.

Another aspect of concentrated ownership is disciplining the incumbent management to act in line with the interests of the firm as a whole, i.e. stakeholders' perspective. They need to align their personals goals with that of the organization. Weak control by owners deviates their behavior from shareholder/stakeholder maximization. Active owners should exercise "voice" and force poorly performing management to "exit". Thus, a relationship runs from different aspects of ownership towards disciplining and monitoring of firms through board representation, discipline, monitoring as well as incentives.

The third mechanism of CG, namely, executive compensation (managerial compensation) relates to salary, bonuses, stock options, equity ownership, pensions, perquisites etc.

provided to the managerial staff, executives and board of directors. Executive decisions are complex and non-routine and incentives may or may not be aligned with outcomes. Top managers see an opportunity to improve or increase incentives with an increase in the long-term value of their firms. Thus, this mechanism is expected to align managerial behavior with the stakeholder theory and would create companies which are more valuable for all its stakeholders'. The economics of this mechanism works on the structure of managerial compensation that will affect managerial behavior towards achieving the long-term value creation for firm's stakeholders'. Practically, the shift in pay packages towards options (equity) has led to some unexpected consequences in the favor of managerial decision making in pursuit of short-term gains. As a result, some stock prices have turned out to be overvalued.

At times, needy and desired decisions are not taken because they would reduce current earnings and have an immediate effect on share prices. The idea of aligning pay with performance within the broader context of aligning incentives and interests of all corporate stakeholders' seems lost. As an extremely important mechanism of CG, executive compensation must be such that it strives to put in line the incentives of key management personnel and other executives of the firm with stakeholders' and increases long-term value of the firm.

The market for corporate control refers to the transaction whereby the control of an asset/firm is moved from one person to another. In corporate literature, it refers to mergers, acquisitions, spin-offs, and divestiture. It would be little less effective as a governance mechanism to address the "agency problem" especially between controlling and minority shareholders.

Inefficient firms face the risk of takeover, whether hostile or not, resulting in ownership concentration. The dispersed shareholders sell their equity to the bidder who will replace or control management. Previous researchers have established the fact that takeovers solve governance problems and lead to a distribution of profits to investors over time (Jensen, 1988). Bidders target poor performing firms, remove managers so as to increase the combined value of the firm after the takeover and in an expectation of increased profits (Morck, et al. 1988). Takeovers are a critical CG mechanism so as to control managerial discretion effectively. Yet, the takeover is extremely expensive because the bidder has to pay to the target firms shareholders the expected increase in profits without which they would not part with their shares.

In the absence of protection of minority rights, the bidder may be at a slight advantage and still have to surrender much of the gains of the acquisition (Grossman & Hart, 1980). Bidders would overpay for acquisitions for private benefits of control leading to further increase in agency problem (Shleifer & Vishny, 1986). Jensen (1993) rightly pointed to the disciplining of the takeover activity to reap its entire benefit as a governance mechanism. A prerequisite of takeovers is the liquid capital market making the whole process accessible for small investors and bidders.

India has a deep and liquid stock market. The regulator, SEBI has enacted specific takeover regulations in line with India's unique characteristics and fundamental differences with the other developed nations, especially with respect to differences in ownership structure. The focus of the same is on the protection of shareholders and management against attackers/ bidders. In case of change of control, the minority is given an equal treatment by an exit option. However, the concentrated ownership structure of Indian corporates has not led to many hostile takeovers in India (Varottil, 2015).

1.4 Evolution of Corporate Governance

Previous studies have traced the evolution of CG and linked it to the values, institutional setup and legislative framework of their respective economies. Figure 1.1 traces the evolution of CG vis evolution of different forms of business ownership.

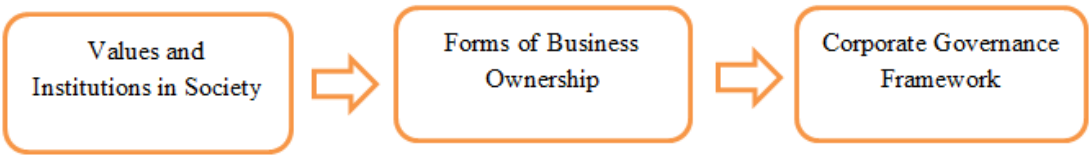

Figure 1.1: Evolution of Corporate Governance

The organizations with different forms of ownership act differently to same environmental challenges. A single institutional system that supports diverse forms of ownership or diverse forms of firm's own CG systems within a common institutional system can be achieved. It is believed that family ownership has an inbuilt governance challenge due to its unprofessional management practices. Mallin (2004) suggested that such firms if adopting an effective governance structure will benefit from the knowledge, abilities etc of independent people appointed on the board and thus can expand and grow. The family business groups can easily evade institutional lacunas due to their family and community relationships. However, few professionally run firms overcame the same limitations through self-governance and cheaper finance from foreign investors.

Claessens et al. (2006) assert that the evolution of CG in an emerging economy surfaced due to its effect on economic development. The most important ingredients for the same are law enforcement and institutional framework. The emerging economies lacked in both and therefore CG has been perceived as a luxury for developed economies. The scenario

has changed more so since last two decades. It is well established that CG would lead to the improved business management and administrative governance would be a viable alternative to legal governance in such economies (Pistor & Xu, 2005).

Bebchuk and Roe (1999) pointed out that CG problem in every country is unique and is related to its path dependence. This refers to the initial ownership structures that impact the present ownership structures as well as the legal rules governing the relationship between the corporations with its related parties called stakeholders'. The same applies to India because of Indian business models and structures of the past.

Gollakota and Gupta (2006) analyzed these historical trends and found that the result is a fusion of diverse co-existing ownership forms with more balanced values than before. The business forms include family-owned businesses, government-owned businesses, professional owned businesses and foreign-owned businesses, each of these has their respective governance implications. The evolution of CG in India and the value system associated with business enterprises during four periods are mentioned as below:

"Phase I: Pre-independence (until 1947) – eco-centrism and family ownership.

Phase II: The License Raj (1947-1981) – social altruism and public enterprises.

Phase III: Knowledge professionalism (1981-1991) – social justice and professional ownership.

Phase IV: Liberalization (1991 onwards) – eco-centrism and foreign ownership".

In the pre-independence period (until 1947), family firms were dominant in India probably due to lack of confidence in British government's rule. Such firms were lower risk businesses managed by the members of the family with conservatism, values, and resources. These family businesses had an outstanding advantage of internal fund

generation with the absence of developed external markets due to high saving rate and being economical with money. Family businesses were controlled and managed by owners or shareholders, which were a family, irrespective of the equity stake held by them. At times, the control of a firm by family members exists even if they do not own a substantial equity (Short, 1994). This exists due to lower equity base of the firms and higher debt financing (Goswami, 2000).

In the second phase, the license raj period emerged with stress on public sector and establishment of financial institutions for financial credit. The strong and influential family businesses managed to survive by taking over some businesses from existing British firms and encashing political ties and connections. The political protection made them stronger by growing their businesses and strengthening their brand names. The family houses had nexus with lending financial institutions (government) that were inactive as well as non-accountable for their own investments. The family group expropriated the profits, irrespective of the quantum of profits and thus the minority was deprived of the same. This further created barriers to entry for others which are unleashed later during the period 1981-1991 with the information technology boom.

Till 1970's the business model was a 'managing agency model' in which Indian business houses had control of the business enterprises without having a controlling stake. Here the business controllers had disproportional voting rights. Later, the Indian business families moved towards "business house model" in which the families still control the firm even with their minority stakes. The ownership till then vested with the well-established business families, a new set of entrepreneurs and the government itself which owned numerous public sector companies. In the 1990's, 'business house model' of governance existed with a mixture of governance mechanisms across varied

ownership structures in Indian listed companies. These governance mechanisms vary across firms and arise in a path-dependent fashion (Machold & Vasudevan, 2004).

During the third phase, the techno professionally owned firms emerged and introduced the model of social justice with the participation of some employees in corporate decision making, equity options, and capital appreciation. This was the seed for CG initiatives and reforms which the government is taking majorly since the year 2000. The government's policy reforms called LPG- liberalization, privatization, and globalization initiated 1991 onwards was the end of the license raj and the beginning of deregulated, liberalized global economy with an inflow of foreign capital and dominance of private sector enterprises. Further, a lot of initiatives are taken to develop capital markets and an era of regulatory compliance was unfolded. The process of internationalization started with big Indian business houses listing abroad and foreign firms investing in India.

While there is no consensus on classifying the distinctive periods of different CG systems among the researchers, there seems to be an agreement that the Indian CG is moving towards the Anglo-Saxon model. On the contrary, Varma (1997) proclaimed that the issue of CG in India is not the same as that of the Anglo Saxon system. In the Anglo Saxon system of the US or the UK, the issue is mainly to discipline management who has ceased to be accountable to its owners. The Indian corporate sector has been a mix of both public sector and private sector and therefore, Varma (1997) reiterated that disciplining the dominant shareholder and protecting the minority shareholders from their expropriation has been the main issue in the Indian corporate sector, which can be solved only by external forces. Two such forces—the regulator and the capital market are suggested.

In case of government-owned businesses wherein the government is the agent of the citizens who are so dispersed it is unlikely that there would be any incentive for them to

monitor and thus principal agent governance problem exists due to extremely dispersed stakes (Andrews & Dowling, 1998). These issues arising from family owned and government-owned firms started resolving due to various self-governance initiatives of professionally managed firms which realized the benefits of good governance such as access to cheaper financing (Claessens & Fan, 2002). Chakrabarti (2005) stated that CG failures are a major concern, particularly for developing economies since it is crucial to financial and economic development. India has been working together with socialistic policies of the pre-reform era. Good CG structure is in place. In an emerging economy like India, however, the bigger challenge is the proper implementation of the norms and guidelines at the ground level. It is believed that foreign stock markets and outside agencies like analysts influence the actions of managers, the most, especially in the leading companies of the country. Furthermore, ensuring adequate CG in an average Indian company is another area of concern.

The above-cited developments led towards convergence of shareholders' interests. But today, this is by far reached towards convergence of stakeholders' interests (Mallin, 2004).

1.5 Theoretical Framework of Corporate Governance

This section reviews the theories related to CG, corporate ownership and corporate performance with a view to understanding how they relate to each other. These theories attempt to highlight the objective of the firm for various stakeholders' and the interlinkages within the firm. The corporate management manages the firm and is responsible for meeting these objectives and should be held responsible and accountable. The owners, together with other stakeholders', need to monitor and control them.

The theories of CG framework provide the basis for the linkages between owners, managers and other stakeholders' in relation to CG. These theories have laid the foundation of alternative forms of CG systems all around the globe. The firms have departed from the sole objective of maximizing the wealth of its shareholders and operate for other objectives like sales maximization, satisfying behavior, increasing market share, survival, and others. In this competitive world, firms have secured shareholders' wealth through internal corporate control practices, various financial market forces outside the firm as well as institutional investors' reactions. But, legal protection needs to be given to them. Governments around the globe had to endorse to its influences and supremacy. The ultimate theories in CG started with the agency theory, later extended and evolved into stewardship theory, stakeholder theory, ownership structure theory, and bankruptcy theory.

The role that institutional investors play in CG is established on the fact that these owners can be instrumental in affecting the management performance and activities of the firm both directly and indirectly. The direct effect would be through the rights of ownership and the indirect effect would be through right and ability to buy and sell the shares (Gillan & Starks, 2003). Moreover, they can be active monitors of their firms and act as communicators to other shareholders. Their role can be seen as similar to a monitoring device which would reduce bankruptcy costs and signal superior performance of the firms these investors have invested in. Many researchers have contributed to the literature providing newer evidence through various theories to explain this monitoring phenomenon of institutional investors wherein they would minimize bankruptcy costs and signal good performance of the firms they have invested in.

Figure 1.2 depicts the flowchart about the theoretical framework of CG further divided into

- theories related to CG, corporate ownership, and corporate performance
- theories related to the role of institutional investors

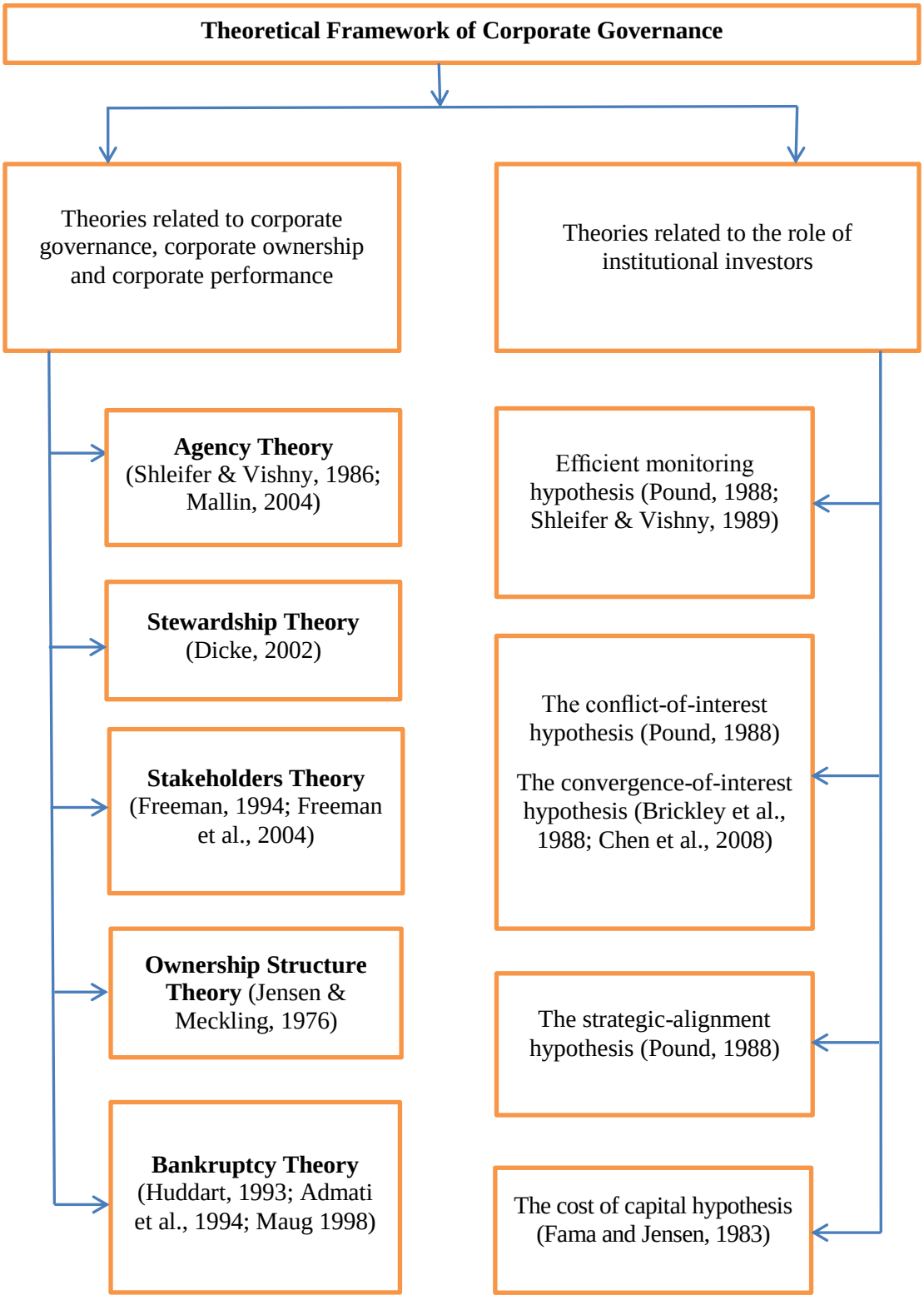

Figure 1.2: Theoretical Framework of Corporate Governance

1.5.1 Agency Theory (Principal-agent Theory)

Agency theory is the starting point of the CG debate. In modern corporations, due to widely held share ownership, owners cannot (due to lack of skills or expertise or otherwise) or do not wish to manage the firms. There exists the separation of owners and managers where managers are the agents of capital providers, the owners/ shareholders. The interests of both the parties do not align. Managers who are the decision makers depart from shareholder wealth maximization actions or decisions (Mallin, 2004). They take such decisions which are not in the best interests of capital providers. Many times, owner's money is expropriated or invested and wasted in unviable projects. The governance mechanisms are to be such that they lead to maximization of the shareholder value forcing the managers to act accordingly, in other words, disciplining the managers. Shleifer and Vishny (1986) defined this as the "separation of ownership and control". The merit of this separation is the freedom of owners to sell shares leading to change in share ownership and the ability to hire skilled and specialized managers (Jensen & Meckling, 1976).

A different type of separation called "separation of ownership and responsibility" has emerged due to the distinct theories of CG leading to hostile takeovers (Margotta, 1989). This shift witnesses ownership concentration in the hands of institutional investors and responsibility of managers. This separation arises when the investor is not responsible yet influences corporate decisions and events. In the present modern day firms, ownership rests with individuals and institutional shareholders with control by institutional shareholders rather indirectly through outcomes of tender offers, proxy fights and other forms of corporate control. Here the responsibility vests with the non-owner manager.

With the growing shareholdings of financial institutions, managers are successful due to being responsible and closer to reality than other officers of financial institutions. The corporate management has to balance out with institutional investors and take crucial financial and management decisions within the constraint of shared partnership with them. Managers today are found to be in constant communication with their utmost influential shareholders and take actions in response to shareholders desires. Further, they are aware that job security lies in the hands of these investors (Connelly et al., 2010). At the same time, institutional investment, if being short-term in nature cannot be relied upon for any supportive and cooperative behavior.

The "agency theory" expresses the subject of corporate ownership structure. Institutional investors can act as external monitoring systems and thus decrease the need for capital markets to act as external monitoring systems (Al-Najjar, 2010). Maug (1998), Admati et al. (1994) and Huddart (1993) documented that institutional owners can be instrumental in curtailing the agency conflicts by monitoring the managerial performance or even taking control of the firm itself.

1.5.2 Stewardship Theory

Agency theory highlighted the divergence of owners and managers interests and values. Stewardship theory proposed an alternative to agency theory suggesting the convergence of owners and managers interests and values by internal control methods. This would lead to responsible behavior of managers (Dicke, 2002).

1.5.3 Stakeholder Theory

Freeman (1994) coined the stakeholder theory recognizing the fact that an organization is a combination of numerous diverse systems, each requiring equal attention and strategic

thinking. The diverse systems represent the various interest groups namely, shareholders, employees, creditors, lenders, customers, suppliers, public interest groups, government agencies and bodies etc. having a stake in the growth and well-being of the organization (Ansoff, 1987). The value of the organization is created and enhanced through interaction between these systems called "the shared sense of the value".

The stakeholder value model focusses on the sharing of rent (profits) amongst all the stakeholders' in their series of contracts. The incentive of rent sharing leads to the contribution of all stakeholder's towards the creation of value of the firm (Grossman & Hart, 1986). Charreaux (2004) calls it a governance system wherein loss in value of the firm would be reduced. The theme of this theory of CG is the role played by different CG structures in association with all the related parties of the corporation, the stakeholder view.

In such a scenario the firms would generate superior performance and firm value. The organization has to strive for the fulfillment of economic interests of all the interest groups. The theory of shareholder wealth maximization has been replaced by stakeholder theory.

It is further believed that most of the times the economic interests of various stake groups would not align and in such a scenario the mechanism of natural selection "survival of the fittest" would prevail. The managers would decide how they wanted to do business and the kind of relationships they would create with their stakeholders'. Freeman et al. (2004) propounded the stakeholder theory further aiming at balancing the interests of various stakeholders' of the firm and their satisfaction. It all rests on the identification of the purpose of the firm which would drive all its actions and decisions.

The stakeholder view changed and broadened the concept of responsibility of the firm. As per the stakeholder view, the firm is responsible towards all its stakeholders' and thus the managers would first identify their relationships with all the stakeholders' and try to act in the best interests. Ansoff (1987) did not agree with the broader stakeholder view and argued that the shareholders have their entire investment at risk and therefore should be the primary, if not sole, recipients of superior firm performance. The other stakeholders' enjoy added protection due to the presence of shareholders and thus should be the secondary recipients of benefits of firm performance.

1.5.4 Ownership Structure Theory

Jensen and Meckling (1976) developed the theory of ownership structure by integrating agency theory, property rights, and finance. In the corporate form of organization, the personal wealth of millions of individuals is voluntarily handed over to the managers to be taken care of. There exists a complex set of contracting relationships between managers and owners (individuals and others) leading to the agency costs. The agency costs depend upon company's ownership structure, statutory law, common law and the ways human mind influence human behavior.

The ownership structure may be diffused or concentrated. When it is diffuse, managers own a considerable amount of equity leading to an alignment of their own monetary incentives and other equity owners. The conflict vests between owner-managers and outside shareholders. On the contrary, when ownership is concentrated, the controlling owner (usually the manager) would have effective control of the firm. The conflict vest between the manager (shareholder) and minority shareholders.

In all cases, the owners would have strong incentives to minimize agency costs. Since its inception, the corporate form survived despite all its shortcomings and alternative forms available.

1.5.5 Bankruptcy Theory

The inability of firms in meeting its fixed obligations leads to bankruptcy. A bankrupt firm would undergo a change in ownership and/or restructuring involving various costs like costs of legal and accounting charges, opportunity costs from disruption in firms business and business relations with suppliers and customers. The higher the business risk, the more are the chances of bankruptcy and henceforth more agency problems. Such firms need added exhaustive monitoring by institutional investors. Institutional investors can play the crucial role in reducing agency problems leading to minimizing bankruptcy costs (Maug, 1998; Admati et al., 1994, Huddart, 1993).

The risky investments would have higher or positive net present values and thus shareholders would prefer risky investments (Jensen & Meckling, 1976). Furthermore, risky firms can optimize by diversification. Hence, it can be argued that institutional investors will invest in firms with high business risk for higher firm valuation.

1.5.6 The Efficient Monitoring Hypothesis

Shleifer and Vishny (1989) and Pound (1988) suggest that the institutional owners would actively monitor the board of the investee companies due to the consideration of their own risks. They are efficient and possess greater expertise and power at doing so as compared to the dispersed small investors. The larger the institutional ownership, the more efficient the monitoring exerted by these shareholders through various mechanisms which could be formal and informal such as voting power, shareholder

activism, and election of board members. Pound (1988) further argued that marginal benefits of such intervention would be much more than the marginal costs. Thus, the more the institutional ownership the higher would be the firm performance (McConnell & Servaes, 1990).

On the contrary, Usman and Yero (2012), Ghabdian et al., (2012), Siregar and Sidharta (2008), Wang (2006) witnessed efficient monitoring hypothesis and suggested that in family-owned firms these large shareholders have a strong incentive to actively monitor and influence management so as to protect their significant investments. Therefore, the study emphasized that monitoring can reduce agency costs and alleviate the free-rider problem. As a result, the study of monitoring managerial behavior actions reduces the scope of managerial opportunism to engage in earnings management. Further, the controlling shareholders focus more on the long-term leading to lesser burden on management to meet short-term earnings expectations. Thus, ownership concentration limits manager's discretionary behavior as per the efficient monitoring hypothesis (Ali et al., 2007).

1.5.7 The Conflict-of-Interest Hypothesis

Pound (1988) predicted that greater institutional ownership would lead to deterioration of firm performance due to such investors reluctant to intervene with the management or are persuaded to vote their shares with management. These investors would maintain present strategic alliances or would have future ties or profitable business relationships with the management which they would not like to forego or strain. When institutional shareholders collude with firm managers against their own fiduciary duty to their clients, the firm value would ultimately decrease (Woidtke, 2002).

1.5.8 The Strategic-Alignment Hypothesis

Pound (1988) worked on the principle of mutual gains, cooperation and agreement. Both institutional investors and management find it mutually advantageous to cooperate. Mutual benefits are promoted, and disagreements and conflicts are avoided. This cooperation destroys the positive effects of monitoring by institutional investors. Thus, more the institutional ownership lesser would be the firm performance or firm value.

Both the conflict-of-interest and strategic-alignment hypothesis foresee an inverse relationship between institutional ownership and the performance/value of the firm.

1.5.9 The Convergence-of-Interest Hypothesis

The convergence of interest hypothesis works on the premise that the positive effects of monitoring by institutional investors would not last forever. The institutional investor's ownership would decrease firm value once their ownership reaches a certain threshold level. Therefore, the more the ownership by institutional investors, the more are the chances of sub-optimal decisions by the firm that could be harmful to the firm value (Chen et al., 2008; Brickley et al., 1988). Likewise, Lin and Chang (2010) determined non-linear relation of institutional ownership with financial performance in case of family firms.

1.5.10 The Cost of Capital Hypothesis

Under the cost of capital hypothesis (Fama & Jensen, 1983), increased institutional ownership increases the firm's cost of capital due to reduced market liquidity and lessened diversification opportunities of the investor. Thus, it predicts a direct relationship between institutional ownership and cost of capital.

The various theories have conceptualized the relationship between CG, corporate ownership and corporate performance. The next section throws light on corporate ownership.

1.6 Corporate Ownership

> *"Ownership is a combination of rights and responsibilities with respect to a specific property (Monks & Minow, 2008)".*

Shareholders or stockholders of a company are deemed to be the owners of the company in which they invest in but the assets of the company they own against those shares or stock are not specified. This corporate model has important features.

Firstly, the liability of the shareholders is limited which do not bring any threat to their personal assets in case of substantial liabilities of the company. They may lose what they have invested but are not liable beyond their investment. Every investment decision is based on certain considerations. Fernando (2014) has talked about the following key factors, in the order of their importance, to be taken into consideration for an investment decision:

i. **Financial Results and Solvency:** A rise in earnings per share, profits, a healthy cash flow and a reasonable dividend is the first and the foremost consideration of any investment decision. Moreover, the present market price and the trend in share prices would lead to the final decision.

ii. **Disclosure:** The disclosure practices relating to company's policies, strategies, and financial results together with the quality of disclosures is the next most important factor in making investment decisions.

iii. **Convergence to International Practices for Preparation of Financial Statements:** The preparation of financial statements as per the international practices, norms, procedures, and rules is another important consideration. This facilitates comparison of financial statements across countries.

iv. **Transparency:** The extent of disclosure beyond mandatory norms and procedures is another area of concern. This additional information if being prompt and timely ensures fair treatment of all shareholders.

v. **Corporate Governance Practices:** Investors do consider CG practices followed by the target company as another important consideration before investing. This encompasses within itself various internal and external mechanisms of CG like a board of directors, audit committees, whistleblower policy to name a few. The companies with good CG have better performance and enhanced valuations as against those with bad CG records.

vi. **Corporate Image:** The corporate image of the company considered for any investment is another important consideration as no investor would like to invest in a company perceived to be bad. The lenders would extend loans only if a particular company enjoys a good reputation in the market.

Secondly, the investors do not run or manage the company on their own instead they employ the management or board of directors to do so. Thus, there exists the separation of ownership and control (Berle & Means, 1932). The management would at times take many large risks in order to generate high and quick returns for their investors or other personal gains leading to business bankruptcy and failures. The impact of this hits the society at large including all stakeholders' i.e. many individuals, employees, creditors, lenders, customers, suppliers, community, government.

It is believed that all the stakeholder's bear the costs of such actions leading to the continuing problem of how to run businesses which are technically called "*corporate governance*". The legendary function of shareholders (Hurst, 1970) to monitor has collapsed and the obligation of significant ownership to act as involved owners (Charkham & Simpson, 1999) based on public policy is been reiterated again and again. The modern owner is a passive provider of capital and therefore his rights from such passive investment should not be equal to the rights of those who are actively engaged in the corporate affairs (Monks, 2012). With the passive shareholders, the entire corporate system loses its energizing foundation and a very significant risk arises from the relative absence of the effective monitoring and supervising energy that those with 'ownership' interests are more likely to provide.

The participation of shareholder or owner would depend on various factors like type of owner, stake of ownership, motive of investment. An owner can be an individual or a family(s) or a corporate body(s), a bank(s), an institutional investor(s) or a non-financial corporation(s). The owners can be further divided into domestic and foreign.

1.7 Foreign Ownership and Corporate Governance Practices - An Interlinkage

Firm-level governance is an important attribute in firm financing. Such firms command high firm valuation and firm performance. Firms which are committed to investors and practice good governance structures even in countries with weak legal systems still manage to raise funds externally from abroad (Klapper & Love, 2004). In weak governance systems, foreign investors with majority stakes might also act as insiders and exploit minority shareholders.

Foreign investors became a significant, if not majority shareholder in equity markets across the globe in the later part of the twentieth century. Assets held by these investors have grown in response to liberalization, privatization and globalization initiatives as well as deepening of the capital markets. These investors can influence management activities or monitor firms directly by their ownership stake and indirectly by trading their shares despite costs involved in doing so. Practically, these costs are incurred only by large shareholders within their own personal investment constraints, investment objectives and preferences for liquidity. It is believed that investment by institutional investment and trading of equity shares in stock markets would lead to increased liquidity, information symmetries, and volatility in stock markets. The overall market infrastructure would improve facilitating efficient use of capital.

Ownership is the most important CG mechanism. Ownership by foreign investors and/ or institutional investors is a recent phenomenon. It is proclaimed that foreign ownership (FO) is a vehicle for improving CG in developing markets and the type (composition) of foreign investment matters. Foreign investment is in two forms: Foreign institutional investment and foreign direct investment. Foreign institutional investors often drive CG changes and foreign institutional investment comes and increases in response to government actions and regulations (Gillan & Starks, 2003). The foreign direct investment would bring technology, create jobs, and lead to productivity spillovers along with transferring managerial and CG structures. Therefore, foreign investments could be considered to be a cause of the development of certain structures of CG of the countries in which they invest in. This also depends on the industry structure of the country.

The role of foreign investors in governance initiatives is a continuing debate. They may exercise their voice or exit or be loyal and do nothing. The voice can be raised by direct intervention in the managerial affairs or through group intervention. These investors when join together as a group can exert strong influences leading to lesser investments in a firm, fall in stock prices, bad market reputation and/or increasing the cost of capital. The intervention is dependent upon the choice of other institutions to act or not similarly, investment policies of foreign investors, costs of intervention and legal rights and restrictions vis a vis their equity stakes. However, collective intervention is practically very difficult to establish.

The empirical research on the behavior of financing policies of foreign investors and the role of foreign parties in the development of CG climate is relatively limited (Fernando, 2014). The cause and effect of the relationship between foreign equity stake and governance are difficult to establish since it is believed that on one hand, better or good governance attracts foreign equity and on the other hand, the increased foreign investment would enforce positive governance changes. This direction of causality becomes imperative in an emerging economy like India where domestic savings cannot meet the demands of capital and hence external capital is much needed.

1.8 Motivation of the Research

Recent cases of accounting malpractice, outright fraud and subsequent revelations of poor governance have highlighted the importance of transparency in the global corporate sector. The importance of transparency would store confidence in the capital markets. Fundamentally, disclosure and transparency are crucial elements of good CG which bestows the foundation needed for a strong and robust capital market. Over the last few

decades, governance and transparency have been very much the focus of attention across all markets worldwide. CG and transparency is the result of many elements. It is crucial to talk about related elements, namely sound regulation and enforcement, shareholder activism, and professional, integrity based ethical management.

In addition, need for CG arose from the conflicts of interests between various stakeholders' due to their varied goals and preferences i.e., non-alignment of interests of various stakeholders'. Market imperfections often lead to information asymmetries leading to pursuing self-interests by the managers and executives. The rise of global competition for long-term capital together with the growth of private sector and capital markets is another reason for the increased focus on CG in economies all over the world. This was further fueled by the financial crisis of 1997 in Asia.

Corporate owners play a significant role in maximizing shareholders wealth and monitoring managers (Jensen, 2000). Also, owners play a significant role in determining board of directors and objectives of the firm that affect company performance (Yammeesri & Lodh, 2004). Thus, owners play a significant role in CG. No effective CG system leads to operational risk to all its stakeholders'. The inherent risks of an investment in a company can be understood by exploring the quality of company's CG practices. Weak CG systems pose accounting risk, asset risk, liability risk and strategic policy risk. These risks are in turn affected by changes in management, the composition of the board, the company's competitive and market conditions or mergers and acquisitions in important ways and hence continuous monitoring of a company's practices is a must. The continuous monitoring is to be done by the company's owners or equity shareholders. The emphasis is given on activists rather than passive financiers.

Previous studies relating to advanced capital markets and economies have observed that changes in CG structures (Davis & Thompson, 1994), and the behavior and performance of the firm (Dalton et al., 1998) occur due to changes in corporate ownership. The issue of CG has evolved to be more serious, significant as well as important in developing economies. The dearth of knowledge and research about CG in these developing economies is an important concern due to the fact that foreign investment flows have actually increased significantly in these economies during the past decade.

Corporations seek external capital. Foreign capital is an increasingly important source of finance (Leuz et al., 2008). Equity capital providers become owners and are entitled to rights and responsibilities of ownership. Ownership [1] has two important aspects: Composition and Concentration. Composition refers to who are the owners, domestic or foreign, promoter or non-promoter, individuals, corporate bodies or institutions. Concentration refers to the level of equity stake so as to influence or control the company.

Foreign investments have various spillover effects, positive and negative.

- Positive Effects
    1. Technology, managerial skills, training and intangibles promoting efficiency (Ananchotikul, 2006)
    2. Foreign investors may have significant effects on monitoring and controlling of the firms leading to a reduction of agency problems (Aggarwal et al., 2011; Leuz et al., 2008). Foreign investors bring scarce monitoring skills from advanced capital markets (Khanna & Palepu, 1999)

[1] "Ownership is defined as a combination of rights and responsibilities with respect to a specific property (Monks and Minow, 2008)".

- Negative Effects
    1. Foreign firms may take demand away from domestic firms and damage their sales and profitability (Aitken & Harrison, 1999)
    2. Foreign shareholders may act as insiders and exploit minority (Ananchotikul, 2006)

Previous studies exhibit that foreign investors could play a significant role in strengthening CG and improving the performance of the firms they invest in. The relation between foreign ownership (FO) and CG is still unclear. In other words, does FO lead to better CG or better CG attract FO? If FO is a necessary cause of good CG then the presence of good CG implies more FO. However, if FO is a sufficient cause of good CG then the presence of FO implies good CG, besides many other causes of good CG. Thus, the relation between FO and CG is an empirical question which is not explored in the Indian context.

Since the economic reforms starting 1980's, the growth rate of India has been amongst the highest in the world. Market infrastructure, foreign inflows, and CG regime progressed much faster than many other developing economies. This growth urges critical need to understand the changes, direction, and advancements of CG regime within an international context.

An inquiry into current CG regime as well as the relation between ownership, governance and firm characteristics could provide important revelations and a fresh perspective on the topic. Every country is unique in its environment as well as social and business institutions and therefore changes in CG should take place in that context itself. Prior empirical findings are divergent and conflicting and therefore, provide an opportunity for future research in this area.

1.9 Objectives of the Research

CG policies and structures are important for holding a company accountable to its shareholders by avoiding financial, legal and ethical pitfalls. Its effectiveness depends upon what role does its equity shareholders play in shaping them. Equity shareholders investments, in turn, depend upon the various firm-specific characteristics. It is pertinent, therefore, to study the relation of equity ownership with CG and firm characteristics.

The primary objective of the present study is to explore as well as analyze the relationship among CG, corporate ownership, and firm characteristics. The specific objectives of the study are:

1. *To analyze foreign equity shareholdings in sample Indian companies*
2. *To examine the relation between foreign equity shareholdings and firm characteristics*
3. *To examine the impact of foreign equity shareholdings on corporate governance*
4. *To assess the stakeholders' perception of the current corporate governance regime*

The specific objective 2 stated above further seeks to enhance the understanding of the variability explained in FES and its relationship with firm characteristics. It would determine the relation of firm characteristics with equity group membership of FES as well as various levels of FES stake.

Hence, the focus of the present study is to analyze and examine the issues pertaining to CG, FO, and firm characteristics as they provide a systematic procedure to achieve better governance by strengthening internal mechanism of CG.

1.10 Scope of the Research

The present study is exploratory and empirical in nature and attempts to focus on the dynamism of CG in the listed companies. The non-financial companies are selected from "S&P BSE 500 Index of the Bombay Stock Exchange and Nifty 500 Index of the National Stock Exchange of India" of India. Within the limited range of the next few pages, the present study attempts to present a snapshot of:

- the foreign investors who have invested in India and the level of their equity stakes.
- the firm characteristics that impact the flow of foreign investments in the listed companies. In the exploratory phase of research, the possible firm characteristics namely, market capitalization, debt structure, growth opportunities, profitability, size, and age have been identified.
- the basis on which investment decisions about optimal equity stakes in a particular firm can be taken by the foreign investor.
- the role of foreign investors in corporate management to strengthen the governance practices. Over a period of time, the activism of foreign institutional investors especially is seen as an integral part of corporate management.
- the impact of FES on CG and the threshold level, if any, at which the impact varies.
- assessment of stakeholders' perception of current CG regime through primary data from different stakeholder groups related to listed companies. Employees, independent analyst's, auditors, accountants, representatives of stock exchanges, capital markets, and centers of governance, professors, researchers, bankers, and investors have been the respondents.

1.11 Structure of the Thesis

The present study is divided into eight chapters. Figure 1.2 presents the structure of the thesis. The present chapter, which is of introductory nature, explains the central idea of the present study in brief. The chapter unfolds the emergence of the managerial firm, corporate theory and CG convergence, which are central to the study in a concise manner. The chapter offers an interlinkage between FO and CG practices after explaining about CG and corporate ownership. The theories of CG are also discussed. The motivation of the research, objectives of the research, scope of the research and the structure of the present study is also mentioned.

Chapter two presents the review of the literature with respect to studies on corporate ownership, FO and firm characteristics, the relevance of CG and measuring CG. The relation between CG and ownership, the relation between CG and FO, the relation between CG and institutional ownership, the relation between CG and concentrated ownership is also discussed. Later, the literature on stakeholder's perception of current CG practices is discussed. Theories and hypothesis relating to the above relationships are delineated on the basis of literature survey in this regard. The research gap originated from the literature review and lastly, the relevance of the study is mentioned.

Chapter three throws light on research methodology adopted for qualitative assessment of current CG regime and the quantitative assessment to find out the relation between FES and firm characteristics along with the relation between FES and CG for the sample firms. The chapter covers objectives of the study, hypotheses, data and their sources, selection of the sample, period of the study, techniques of data analysis and method of investigation for data analysis.

Chapter four to seven discuss the empirical results of the study.

Chapter four provides a holistic view of the analysis of FES in Indian listed companies over the period of study, viz 2007-2008 to 2015-2016. Further, it seeks to identify who are the major providers of foreign capital amongst the two foreign groups. A detailed analysis of FES across different levels of equity stakes and difference in FES on the basis of the sector, market capitalization, age, and size are also presented.

Chapter five presents the results of empirical examination of the relation between FES and firm characteristics of sample Indian companies over the period of study (i.e. the financial year 2007-2008 to the financial year 2015-2016). Here the results of multiple linear panel regression, binary logistic regression, and multinomial logistic regression techniques are presented.

Chapter six presents the results of the impact of FES on CG. Here, the results of multiple linear instrumental variable panel regression are presented for understanding the relationship between FES and CG. Evaluation of FES at various threshold levels is studied through spline specification regression and sensitivity analysis.

Chapter seven presents the results of the stakeholders' perception of the current CG regime. Here, the results of questionnaire survey obtained through factor analysis, ANOVA and post hoc analysis are described and discussed in detail.

Chapter eight summarizes the conclusions of the study and identifies the recommendations and implications that can be derived therefrom. It also explores the scope for future research possibilities and presents the limitations of the study in the last.

The present study heavily relies on many small pieces of literature on CG (Shleifer & Vishny, 1986) (Ananchotikul, 2006), foreign shareholdings (Alfaraih et al., 2012), institutional shareholdings (Sarkar & Sarkar, 2000) (Anderson et al., 2001) and firm characteristics (Ko et al., 2007). In fact, the theoretical framework of the study on CG, corporate ownership, and firm characteristics is based on the inputs from such contributions published in the form of research papers and reports. This leads to the necessity of extensive literature review, discussed in the next chapter.

Chapter 2

Review of Literature

CHAPTER 2
REVIEW OF LITERATURE

2.1 Introduction

Every study is undertaken after a thorough literature review. The review of literature besides providing information about the subject under study also identifies and articulates the relationships between the present literature and the present area of research. It is essential as well as mandatory to look through the present literature so as to identify and find out how the proposed research is related to prior research. It also manifests the originality as well as the relevance of the research problem.

The objectives and basic principles of corporate governance (CG) practices are similar for different countries. However, the countries differ in the ways and methods by which CG is practiced and regulated. Several studies have been undertaken in the past to understand the concept of CG, its related issues, its impact and the various mechanisms employed to deal with it. This chapter starts with a discussion of previous studies on corporate ownership, and on foreign ownership (FO) and firm characteristics. Further, it summarizes previous studies on the basis of evolution, relevance as well as quantifying CG. Later, it provides literature on the relationship between CG and ownership structures considering different types of ownership. This is followed by a review of studies on stakeholders' perception of current CG regimes.

Figure 2.1 depicts the flowchart of classification of the literature review. In section 2.11, the research gap identified through literature review is presented and lastly, the relevance of the study is presented in section 2.12.

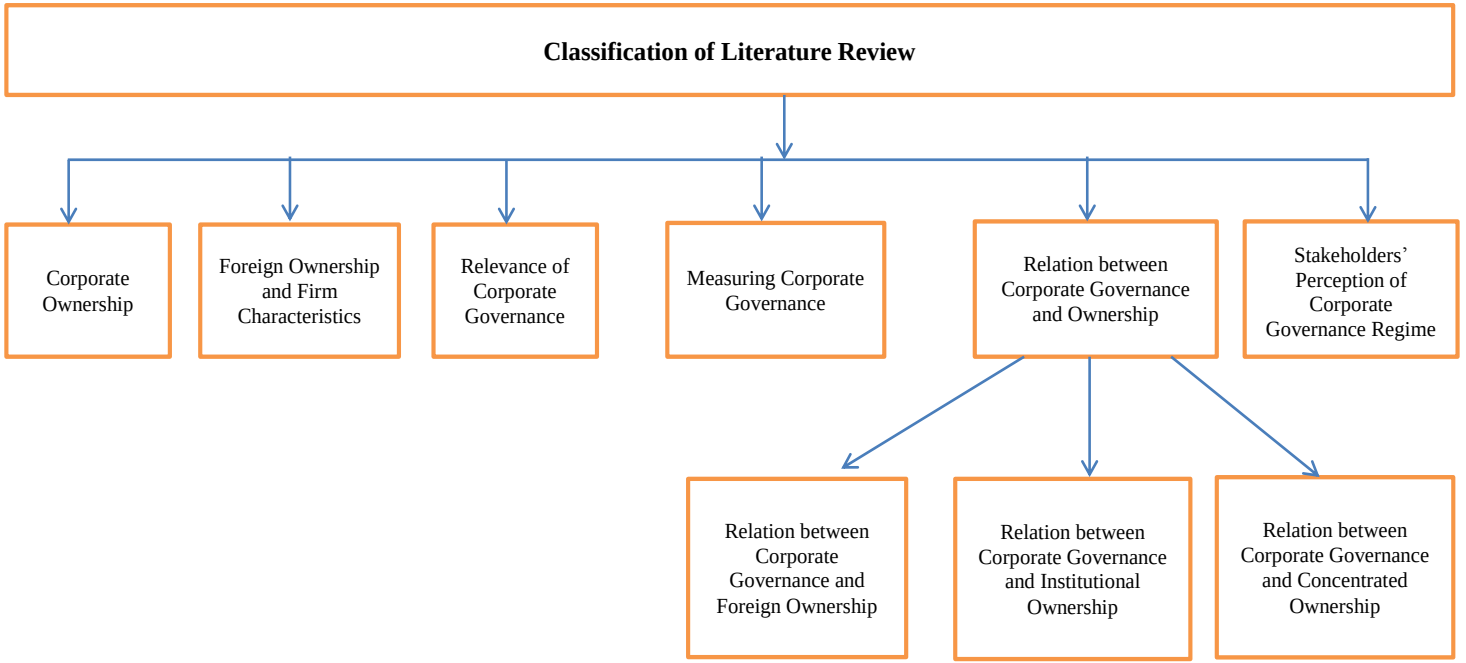

Figure 2.1: Classification of Literature Review

2.2 Studies on Corporate Ownership

Previous studies on corporate ownership discusses the ownership structure vis a vis its composition (type) and concentration (size). The ownership pyramids and participation in management give power to controlling shareholders in excess of their cash flow rights. Also, concentrated ownership prevails due to inefficiencies in markets (Khanna & Palepu, 2005). LLSV (1999) found that equity control by financial institutions is quite less in twenty-seven economies of the world. Outside blockholders do not have controlling stakes nor do they have the ability to act as a countervailing force against insiders (Sarkar, 2010). With respect to India, it is found that insider control is widespread. Equity ownership by promoters is significant yet foreign institutional investors are consolidating their holdings (Kaur & Gill, 2008). Further, it is found that corporate ownership structure varies with value maximization (Demsetz & Lehn, 1985). Further, firm size and profits impact ownership structure

2.3 Foreign Ownership and Firm Characteristics

Corporate ownership, the various advantages that a firm enjoys as well as government's policy frameworks are interrelated was propounded by Nayak and Choudhury (2014) as well as Dunning (1988). The firm-specific advantages relate to firm's owners, its structures, processes, advanced technologies as well as managerial effectiveness. Various firm-specific characteristics impact investment in firms by investors. The importance of firm-specific characteristics differs from investor to investor. Different investors take these firm attributes differently. Only a firm which is perceived valuable by investors would attract outside investors.

Previous studies have examined the relation of FO with firm characteristics, firm value or firm performance and given mixed results. Huang and Shiu (2009) found the positive relation of FO with firm performance probably due to their ability to invest globally by choosing different stocks and thus diversifying their portfolios. These investors possess knowledge and capabilities which help them to influence the management of recipient firms. A significant correlation was found between firm size and FO (Choi et al., 2014) and an inverse relation was found between firm size and long-term leverage (Gurunlu & Gursoy, 2010). Less leverage implies more equity. Further, Ko et al. (2007) concluded that foreign investors invest in large cap stocks which have low book to market ratio with high return on equity. Another study by Kulchina (2017) explored that managing foreign entrepreneurs significantly improve firm performance. It pointed out that foreign owner-managers reduce operating costs but have no effect on the firm's productivity and growth.

Fu and Wu (2013) reported a very interesting finding. The profitability and growth of firms increase after a small initial foreign investment but would decrease if in case foreign investments are large. Thus, the relation of profitability and growth with foreign investment is an inverted U shape which would vary with the foreign investments. The probable reason for the same could be that foreign firms are expected to have strong associations with the countries they come from. They would ignore social causes related to the recipient country and would be interested in their private gains only (Gollakota & Gupta, 2006). Thus, the positive impact of foreign investments vanishes beyond a point. On the contrary, it is observed that FO diffuses specific asset, knowledge, and culture, along with governance practices, which is induced by institutional context of the host country (Chevalier et al., 2006). As a

result, firm profitability increases with foreign equity. It can be concluded that foreign equity would have both positive and negative effects which need to be empirically explored in each context.

2.4 Relevance of Corporate Governance

The governance and ownership environment varies across nations. Different governance and ownership environments would lead to different governance – performance relationships. The present literature on the relationship between CG and firm performance has been reviewed by Mishra and Kapil (2016). The study found that CG is related to corporate performance and availability of legal recourse ensures effective working of CG mechanisms. Klapper and Love (2004) found contradictory results wherein better CG is highly related to better operating performance and market valuation. This relationship is stronger in countries with weaker legal systems and inefficient judiciary. This makes sense whereby one can resolve governance conflicts without recourse of legal systems. At the same time, it is asserted that firm-level CG is not at all a substitute of country-level legal and judicial systems rather firm's CG systems would enhance investor protection and investor confidence. Legal rules and norms are a check as well as a guide for effective implementation of good governance. It places an obligation on administrators to apply the laws and at the same time, an obligation on courts to ensure the enforcement of these laws.

Over the last few decades, some important legal and regulatory reforms have been enforced in India which has improved the CG regime. In this context, board practices and transparency have been heightened, the level of insiders' responsibility and accountability have been hardened, fair treatment of minority shareholders have been boosted. Dwivedi

and Jain (2005) confirmed that the CG code or norms are followed by most of the companies in India and abroad. However, this compliance is just trying to comply with the mandatory requirements that is, in letter and not in spirit. In order to address the same, the directors need to be made personally liable for corporate misconducts.

Many previous studies have postulated the governance effects on the firm. Better CG practices endorse higher market valuation of firms was witnessed by Durnev and Kim (2005), Bai et al. (2004) as well as Bhagat and Black (2002). Good governance has a positive impact on firm performance also (Gompers et al., 2003; Gibson 2003). Bhagat and Bolton (2008) found that better governance is significantly positively related to the subsequent operating performance but board independence is negatively related to subsequent operating performance. Further, no governance measures were found related to future stock market performance.

Mukherjee and Ghosh (2004) found their results disappointing as the CG was at a nascent stage and decision making by management was not optimized and scientific. The capital markets could not implement better governance on the part of directors and managers. Strenger (2006) studied the performance effect for institutions and found that good governance matters for company performance. Klein et al., (2005) could not find any relationship between governance and performance in Canadian firms and Alves and Mendes (2004) found that compliance improves firm performance in Portuguese firms. In one paper, Picou and Rubach (2006) found that after the announcements of the enactment of CG guidelines by the firms, the stock prices increased. The individual shareholders are the last and the institutional investors and other analysts are the first to catch all the benefits of this firm-specific CG compliance.

A survey conducted by Demirbas and Yukhanaev (2011) concluded that the board of directors is an important mechanism for the conduct of efficient and good CG practices. Moreover, employee representation on the board would enhance board size and composition. Bordean (2012) investigated the perceptions of future managers i.e. business students towards CG and addresses the need to think and formulate CG courses in the business studies curriculum. This would instate CG values and principles in the future managers. Hardi and Buti (2012) stressed the significance of an organized review of national level macro factors, both internal and external that influence CG practices. A report (Institute of International Finance, Inc. 2006) offers an appraisal of the investment environment in India relative to that of other members of the IIF Equity Advisory Group. It is found that weak surveillance and enforcement practices have dropped the pace of improvements in the CG policy framework which was above average and moving in the right direction. It is believed that further refinement in CG practices and significant actions of regulators are needed to enhance enforcement and surveillance functions.

Thus, the governance effects on the firm's move in both the directions. At the same time, it has been accepted worldwide that there exist positive performance effects as a result of better CG and all economies around the globe should try to enhance the positive effects and reduce the negative effects, if any. Despite some of the remaining challenges, CG reforms have led to increasing pressure on institutional investors to fulfill their core responsibility as a shareholder and to provide good returns to their clients'.

Cornelius (2005) suggested that legal institutions, politics, cultural and historical roots together play a key role in CG. There are instances where some companies on an

average are found to follow practices superior to those that their legal and regulatory environments would suggest. Leblanc and Gillies (2006) answered this by undertaking a survey of various stakeholders' of CG spread over a period of five years and asserted that there exists a causal relationship between CG and firm performance. The superior performance has been accounted for due to the competencies and behavioral characteristics of individual directors. The corporations which are well run generate profits for all its stakeholders' on a level playing field within fair and efficient capital market structure and administration.

It is important to understand first the model of the organizations (where a firm is considered as an organization) which will answer what organizations are really made out of and who is really working in the firm (Yvon & Salma, 2005). The stakeholder value model focusses on the sharing of rent (profits) amongst all the stakeholders' in their series of contracts with board of directors and management managing the firms. In this context, Ernest (2003) mentioned that the main CG problem is inward looking management and scattered shareholders with weak shareholders rights. Kumar (2004) pointed out that the subject of CG mainly revolves around the question of ethical behavior on the part of management in the day to day management functions. Despite the existence of various other attributes of CG, the real-life problem is that of the ethical dilemmas faced by management pressing the need for values and ethics in all their working. Adams et al. (2010) undertook a large survey to find out the role of outside directors as advisors and monitors of management. It was found that the directors who principally monitor management would generally not participate in boardroom discussion than other members of the board. Further, the chief executive officer would take their advice.

Lazarides and Drimpetas (2010) argued that the legal and regulating isomorphism leads to the fundamental differences of the CG systems across nations. The CG system of a particular country would depend upon and is affected by foreign capital inflows and outflows of that particular country. Talamo (2011) confirmed the economic theory that less open countries have stronger ownership restrictions along with weak CG mechanism whereas open market countries and investment regimes are strong enough to attract foreign investors in general and foreign direct investment in particular.

The eventual convergence of global CG systems over the period of reforms is controversial with some researchers agreeing to the same and some not. This is due to the fact that there exist significant cross-country variations in the evolution of CG systems.

2.5 Measuring Corporate Governance

Any qualitative assessment is actually difficult and needs well-defined assessment criteria, score or index based on all related parameters. The assessment of CG of a firm is done in many previous studies based on CG score or index or scorecard. This CG assessment is a tool for all stakeholders' to evaluate the company's fulfillment towards mandatory norms and codes as well as the quality of CG practices. It provides relevant information to investors, that is readily comparable vis-à-vis other companies, industry, years. The investors can evaluate present portfolios and new/future investment opportunities.

The scorecard is customized to the particular environment in which the company operates, including a country's CG framework and priorities. There is no one size fits all for a scorecards content and structure, because local adaptation is the key to the tool's overall effectiveness. In most countries, scorecards are voluntary, but in some cases, the

regulators opt to make them mandatory for listed companies to further improve disclosure of CG practices. In Montenegro, the Securities and Exchange Commission believes that completing the scorecard should be mandatory for all companies under its jurisdiction. A similar approach was adopted in Bulgaria, and the Macedonian Securities and Exchange Commission is also considering this option.

Escrig-Olmedo et al. (2010) in a study had overviewed the various criteria's of evaluation used by sustainability indices and Environment, Social and Governance (ESG) agencies. The study expressed that the importance of these indices has increased in order to encourage the implementation of responsible corporate policies. In order to build a score, Krishnamurti (2010) categorizes CG into seven key components, which are "Discipline, Transparency, Independence, Accountability, Responsibility, Fairness, and lastly Social Awareness". The weighted aggregate score was arrived at by taking 15% weight for the first six components and 10% weight for the last component. It was found that regulation escalates CG at the firm level and sooner or later, all corporates within a country converge to similar practices. Another aspect that is studied in the study is competition. It is found that competition is inversely related to CG and reduces within country convergence. Further, the interactive effect of both regulation and competition is also inversely related to CG.

A high score indicates good or better governance and a low score indicate poor governance. An improvement in CG index or scores depicts an improvement in CG as well as a growing trend of better implementation of CG policies and norms (Sarkar & Sarkar, 2014). Various firm characteristics would impact CG. Better governed firms are found to be less leveraged and have a higher market valuation, interest coverage ratios,

return on net worth and return on capital employed. Further, such firms have stable profit margins and higher Price-Earnings Ratio (P/E) and yield as against their counterparts.

Khanchel (2007) investigated the determinants of CG that is, the firm characteristics that impact governance in the US firms and found firm size, investment opportunities, intangible assets and external financing needs to be significant. However, growth opportunities and performance did not impact governance quality. The study constructed indices on board of directors, board committees, audit committee, and an overall index. Another study by Banerjee et al. (2012) observed a positive and significant relationship between CG score and corporate performance after taking into account many firm-specific and time-specific factors. Doidge et al. (2007) found the contrary where the firm characteristics, namely investment opportunities, asset size, ownership, and cash holdings, do not explain any variation in Credit Lyonnais Securities Asia (CLSA) scores. The study developed and tested a model of how country-specific characteristics, such as legal protection of minority investors, level of economic and financial development, influence a particular firm's costs and benefits in taking measures to improve its own governance and transparency. Furthermore, firm-specific characteristics have been more successful in explaining variation in Standard & Poor's scores, wherein their explanatory power will be reduced with the explanatory power of country characteristics.

For a given level of country specific investor protection, a country's financial and economic development provides incentives to adopt better governance practices at the firm level. The adherence of Organization for Economic Co-operation and

Development (OECD) principles of CG in Indian companies was examined with the help of a scorecard based on five OECD basic principles of CG (Sharma et al., 2013). The analysis revealed that disclosure practices followed by Indian firms as per Clause – 49 meet the OECD principles of CG to a certain extent. "Role of Stakeholders'" in CG framework is paramount. Further, despite Indian firms making fair disclosures, responsibilities of the board of directors, disclosure and transparency at the firm level are to be looked upon for global level effective CG practices.

2.6 Relation between Corporate Governance and Ownership

Various aspects of CG that are most crucial for investors would vary across firm ownership. Owners would always prefer policies that align manager and owner interests, rules and laws that provide stronger shareholder rights and a regulatory framework that provides open and transparent disclosure mechanisms. In case of family firms, governance effects differ. These firms differ across many dimensions that impact governance such as ownership, culture, managerial policies and experience (Klein et al., 2005). Another important consideration is that in these firms managers generally act as stewards who provide services and advice to the controllers of the firm rather than their own role of monitoring and control. Thus in these firms, the stewardship theory of CG applies more so than the agency theory (Muth & Donaldson, 1998).

Ownership concentration is perceived as a solution to the free rider problem. Free rider problem emerges from dispersed ownership. Hence, dispersed ownership is not suggested to be a remedy for the inefficiencies in the state ownership in China and rather a diversification of state ownership by large block holders and institutional owners is suggested by the study (Xu & Wang, 1999).

Foreign investment is dependent on various variables relating to a particular country and relating to particular country's trade and foreign investment policies. Foreign investment is also dependent on various variables relating to a particular company is advanced by the eclectic theory of Dunning (1988). This theory was criticized on the ground that it considers too many factors and hence lacks practicality. As a result, a new theory was propounded called The Investment Development Path (IDP) which linked a country's policy framework to its foreign inflows and outflows (Nayak & Choudhury, 2014).

Along with this line of thought, it can be surmised that corporate ownership along with firm-specific privileges and country's policy framework are interrelated. Hence, various firm-specific characteristics impact foreign investments and firm's which are perceived as valuable by them would attract more of external capital. The firm-specific characteristics that are perceived important by investors would vary depending on the type of investor. Mishra and Kapil (2016) along with Imam and Malik (2007) examined both the practice of CG through ownership structure and the influence of ownership structures on firm performance and dividend payout policy. The firm performance, measured in terms of holding period returns of the firm and Tobin's Q was found to be positively and significantly related to FO. Further, it is found that firms with high institutional ownership pay high dividends and firms with concentrated ownership pay lesser dividends. In case of insider-dominated firms, firm performance does not improve due to concentrated insider ownerships (Han et al., 1999). However, Goud (2002) witnessed that firm performance is significant in various regressions ran on various types of ownership. Further, newer and bigger firms outperform older and smaller firms. Thus, different ownership structures have varying effects on CG and firm characteristics.

2.7 Relation between Corporate Governance and Foreign Ownership

Many research studies have focused on the behavior of foreign firms in the CG of the firms they invest in and many others have examined the differences between FO and domestic ownership. Few research studies have focused on the behavior of foreign firms in light of the reasons for their investment abroad and few others have studied the determinants of foreign investment at the economy level considering various variables impacting the macro environment (Patro & Wald, 2005; Bekaert et al., 2003; Mukherjee et al., 2002; Henry, 2000; Rajan & Zingales, 1995).

Vo (2016) confirmed the long-term buy and hold strategy of foreign investors in Vietnam stock market leading to lesser liquidity in the market for equity shares. Farooque and Yarram (2010) found that ownership by different owners has a positive effect on CG and negative effect on FDI. Ananchotikul (2006) proclaimed that FO is a vital instrument for augmenting CG in developing economies. The study created a firm-specific index of the quality of CG and explored the relation between foreign investment and CG. A positive effect of foreign investment on CG was found using econometric methods. The results also indicated that the form of FO matters. Large stakes of foreign industrial companies do not improve CG. These large owners exploit minority shareholders while acting as insiders, thus they favor weak CG. On the contrary, foreign institutional investors' minority stakes do improve CG. Further, the country of foreign owner matters. If the large foreign owner comes from a country with relatively poor governance then CG would be poorer for firms in which they have invested.

The impact of newly established outside director system of South Korea on firm ownership structure is studied by Bowman and Min (2012). The results indicated that foreign investors give significant importance and value to the appointment of independent directors. An increase in FO was accompanied by improvements in the CG system which occurred after controlling for home bias and firm size.

An improvement and furtherance in the CG systems can facilitate capital mobility across countries happen to be the findings of globalization. These are especially relevant for an emerging economy because the variation in capital costs of domestic markets and that of international markets exists. Further, these findings are particularly relevant and important for developing economies where investor protection is especially weak and foreign capital investment is particularly significant. Chevalier et al. (2006) questioned whether foreign owner's participation leads to better CG practices in emerging countries with a focus on the capital invested in the firms for examining the CG practice. It is found that multinationals companies in Indonesia are essentially more prudent in their financing policies. Thus, the role of MNC in developing countries is supposed to be an important factor in installing better institution of business and economic environment.

Few studies compared ownership effects of foreign institutional investments and domestic institutional investments. Khanna (2003) found that foreign institutional investment provides significant monitoring benefits as against the domestic institutional ownership. Firm performance has a direct and positive relationship with the ownership of foreign institutions and an inverse relation with the ownership of domestic institutions.

2.8 Relation between Corporate Governance and Institutional Ownership

With the internationalization of cross-border holdings and the need of capital due to the financial crisis in many countries across the globe, the equity stake of institutional investors has increased in almost all parts of the globe, especially in the last few decades. Institutional investors own a considerable amount of equity in many countries across the globe and thus by virtue of their size, become an important mechanism of CG of companies. The three reports of UK namely, "the Cadbury Report (1992), the Greenbury Report (1995) and the Hampel Report (1998)" strongly emphasized the role that institutional investors play in CG. It has been observed that the institutional investors do examine the CG structures of the recipient companies before investing. Mallin (2004) reports that activism of institutional investors of US has led to a great impact on both institutional investors and companies of UK. Conversely, if they do not then some countries are emphasizing their role in CG and trying to ensure their activism in corporate affairs of investee companies through various rules, guidelines etc. Kara et al. (2007) studied the investment behavior of shareholdings of institutional investors in Japan. The study found that the financial investors – institutional investors and banks – held more than 60% of the equity share capital of the firms listed at the two stock exchanges of Tokyo and Osaka which is in high-tech manufacturing, traditional manufacturing, and communications industries. Banks are the largest group of these financial investors. The study presented the case that FO plays a pivotal role in the system of CG in Japan. Short and Keasey (1997) found that presence of large institutional shareholders has a positive influence on corporate performance. This relationship further affects the relationship of other shareholders and performance. The

presence of institutional shareholders also strengthens the direct relation of directors' ownership and firm performance by restraining management discretion.

The mechanism of institutional investor activism works through the active participation in the 'core' investee companies. This could be by engaging in a dialogue with the investee company, apart from merely discharging the voting rights (Annuar, 2015; Mizuno, 2014). Mokhtari and Makerani (2013) pointed out that the institutional owners can act as watchdogs against manager's opportunistic behavior and earnings manipulation which would further increase firm valuation. In another study, Su et al. (2013) found that the institutionality matters by restraining ultimate owners' expropriation behavior. Also, regional institutional development is inversely related to capital structure. The regions with better-developed institutionality have a smaller positive effect on the separation of control and cash flow rights. Thus, previous studies confirm that there is a positive and significant relationship between CG and institutional ownership, further suggesting that firms should be able to attract and maintain their institutional investors (Saleh et al. 2010). Strenger (2006) emphasized that the exercise of voting rights by the institutional investors would set an example for others. They need to develop and disclose voting policies as encouraged by the regulators. The annual disclosure of voting records should be done.

The studies that focus on the role of institutional investors as corporate monitors found that their large stakes provide the opportunity, resources, and ability to monitor, discipline, and influence managers (Grossman & Hart, 1980; Shleifer & Vishny, 1986). A study by Du et al. (2014) found a positive relationship between the ownership concentration and firm value, the managerial ownership and firm value, and the director compensation and firm

performance but the director compensation and firm value, and the debt financing and firm value are negatively related. Further, the group with the highest increase of institutional investor's ownership during the period showed better performance than other groups, implying that institutional investors' decision of selecting firms for investment was based on the expected performance of return on equity (Mizuno, 2014).

Bedo and Acs (2007) discussed another related aspect called collective action problem between the largest block holder and the next largest block holder. The cost of ownership concentration was present if the largest block holder was able to influence management by itself both in highly concentrated and in dispersed environments. In practice, the largest block holder needs to be non-dominant for creating the benefits of efficient monitoring along with the coalition of block holders. Dedoussis and Papadaki (2010) found that the nationality of ownership, whether domestic or foreign (multinational) affects the investment behavior and is related to the specific information problems of the Greece firms.

Different types of owners impact firm performance differently. Some owners enhance performance while others worsen performance (Alfaraih et al., 2012). Institutional ownership is positively associated with the financial performance which encourages companies to adopt good CG practices and protect the interests of the shareholders (Tahir, 2015; Tornyeva & Wereko, 2012; Chen et al., 2008; Cornett et al., 2007). Kumar (2004) provided evidence that the shareholding by institutional investors and managers affect firm performance non-linearly. However, foreign and corporate shareholders equity ownership does not influence firm performance. The ownership of institutional investors could be further divided into government and non-governmental, domestic and foreign,

financial institutional ownership - mutual funds, insurance companies, venture capital funds, banks, securities investment trust funds and other institutional ownership. The ownership by government institutions and incorporated companies have a significant negative correlation with firm performance but securities investment trust funds and corporate performance is positively correlated was found by Shin-Ping and Tsung-Hsien (2009). Fauzi and Musallam (2015) found that the government-linked investment companies ownership is positively and significantly related to company performance with an inverted U-shaped relationship, while board ownership is negatively and significantly related to company performance with a U-shaped relationship. This suggests that the government-linked ownership improves whereas board ownership destroys company performance. Thanatawee (2014) indicated that domestic institutional equity ownership has a positive impact on firm value whereas higher foreign institutional equity ownership has a negative impact on corporate value.

Previous studies have analyzed the relationship among firms' capital structure, ownership structure, and firm valuation and found the differential effect of ownership structure on firms' value in civil law and common law environments. Moreover, the ownership structure is found to be affected by the value of the firm and by the capital structure. Further, firms' corporate finance decisions are conditional on its valuation and taken simultaneously with other mechanisms of CG (Lopez-Iturriaga & Rodriguez-Sanz, 2012). Al-Najjar (2010) concluded that Jordanian institutional investors consider firms' capital structure as well as various firm attributes while taking their investment decisions. The study suggested investing in services firms rather than manufacturing firms. However, no significant relationship between firms' dividend policy and institutional investors was found.

Another study by Al-Najjar and Taylor (2008) observed that assets tangibility, size of the firm, growth opportunities and business risk jointly determine firms' ownership structure as well as its capital structure. The shareholdings of institutional owners is found to be determined by asset structure, business risk, growth opportunities and size of the firm whereas the determinants of capital structure are profitability, size of the firm, its growth rate, market-to-book ratio, asset structure, and liquidity, which are similar to the ones for developed economies. Among the two categories of institutional investors, the foreign investors are mostly invariable in stock picking as against the domestic one's whose performance is sporadic and volatile (Mukherjee & Ghosh, 2004).

2.9 Relation between Corporate Governance and Concentrated Ownership

It is seen that owners by virtue of their size impact CG. The large (block) shareholder group may be a family group, institutional investor or any other. The results of the previous studies are mixed. Zeckhauser and Pound (1990) reported that large shareholders monitoring depends on the technical nature of the industry the firm is in. Holderness and Sheehan (1988) did not discern significant relation of large shareholdings with firm performance. McConnell and Servaes, (1990) found significant relation of large shareholdings with director's ownership. Gibson (2003) concluded that CG is not effective in emerging market economies due to the presence of large domestic shareholders.

Some other studies have reported the impact of large or concentrated shareholdings on firm characteristics. An inverse relation of large FO with stock price volatility was found by Li et al. (2011) in a study relating to thirty-one emerging economies including

India. It is stated that strong commitment of large foreign owners and their potential monitoring role would bring stability of foreign inflows in the emerging economies where the fear of reverse flow of foreign capital is quite persistent. Many factors like improper capital market infrastructure, laws, and regulations contribute towards the same. Large shareholdings are found to be more or less long-term as well as stable investments (Stiglitz, 1999). Also, concentrated shareholdings would augment foreign shareholdings whereas dispersed shareholdings would decrease foreign shareholding (Choi et al., 2014)

Sarkar and Sarkar (2000) revealed the role of large block shareholders in monitoring company value for India. The picture of large block shareholder monitoring that emerges from India is a mixed one. The findings are similar to many of the existing studies that block holdings by directors do increase company value after a certain level of holdings. There was no evidence that institutional investors, typically mutual funds, are active in governance. The study suggests that the monitoring by lending institutions occur effectively once they have substantial equity stakes in the company. This monitoring is further reinforced when these lending institutions also have debt holdings. The study also highlights the beneficial effect of foreign equity ownership on company value.

Kang and Kim (2010) compared the governance role of foreign block acquirers and that of domestic block acquirers in U.S. targets. The engagement in post-acquisition governance activities is less of foreign block acquirers as against that of domestic block acquirers. From amongst the foreign block acquirers, those who share a common language and a common legal origin with the U.S. are more likely to engage in post-acquisition governance activities. The post-acquisition governance activities would

include replacement of poorly performing target management in two cases. Firstly when the target company is located geographically closer to their acquirers and secondly when their acquirers have more acquisition experience in the U.S. These results highlight the importance of information asymmetries in determining the governance role that foreign acquirers play in domestic targets.

2.10 Stakeholders' Perception of Corporate Governance Regime

There are different theories pertaining to CG put forth in the literature, one of which stresses the role and importance of stakeholders'. Kay and Silberston (1995) claimed that there is no justification for the fact that the interests of shareholders do or should enjoy precedence over the interests of other stakeholders'. Cook and Deakin (1999) compare the stakeholder and shareholder approaches to CG. While the shareholder model considers only the financial performance as the sole measure of firm's long-term success, the stakeholder model encompasses both quantitative financial and market share measures as well as qualitative aspects of performance involving trust and commitment. It is not that the interests of shareholders and stakeholders' are disconnected (Charkham & Simpson, 1999). The pension funds, insurance companies, mutual funds and others are a large group of shareholders whose assets are drawn from the savings of the individuals, working class, pension plans etc. These groups are part of society at large and hence stakeholders' become shareholders.

Bhasa (2003) studied the shareholder theory and found that companies focus only on shareholder wealth maximization and all other stakeholders' are ignored. On the contrary, companies should strive for maximizing stakeholder's wealth instead of only focusing on shareholders wealth because all the stakeholders' who are either directly or

indirectly related to the company must be compensated either in monetary or non-monetary terms. Companies would do well by optimizing the interest of stakeholders' which is the result of pursuing maximizing the wealth of shareholders' (Panchali & Baid, 2002). Thus the acceptance of the principle of shareholder wealth leads to optimize the interests of other stakeholders'. It is believed that priority of shareholders' interests over other stakeholders' would damage the survival and success of the businesses in the long term. The interests of various stakeholders' need to be optimized by striking a balance among the interests of all of them. Mahajan (2003) asserted that a company is a social institution that is accountable to the members of the society. The legitimacy of a company comes from its potential as well as covets to fulfill the needs of the society. Over the years, regulators namely, SEBI and Stock Exchanges have put a major emphasis on ethical behavior, transparency and voluntary disclosures of the company.

In a study by Nam and Nam (2004) the respondents, of all the four countries under study, agreed on companies pursuing the interests of all its stakeholders'. Out of the total respondents, 52-62 percent supported that companies have the goal of enhancing stakeholder wellbeing together with that of shareholders as against only 7-29 percent had the opinion that companies have the only goal of shareholders wealth maximization. It is seen that stakeholder's are moving from non-participation to co-decision making (Spitzeck & Hansen, 2017). Further, current malignancies recognized and complete change in governance structures and attitudes is needed (Chanda et al., 2017).

Firm owners should look forward to many mechanisms to govern the company effectively across time (Rediker & Seth, 1995). It is only through the effective and

proper use of these available ways that the owners would be able to govern and manage the firm that would optimize strategic competitiveness as well as financial value of the firm. Varma (1997) witnessed a silent revolution in Indian CG with managements woken up to the power of minority shareholder and are voluntarily accepting tougher accounting standards. Hellwig (2000) asserted that an important strategy to increase accessibility to external finance is to establish such a regime that is more sensitive towards outside investors. Bazerman et al. (2002) found that, at times, the ineffectiveness of CG system is due to the subjective nature of accounting and tight relationships between accounting firms and their clients. The unconscious bias of the most honest and meticulous auditors in misleading various stakeholders' is the real problem. They unintentionally distort the numbers in such a way that it puts a veil on the company's true financial status.

Thus it is seen that, in the corporate form of businesses, the firms are led and managed by the board of directors and management on the owner's behalf. If in case the interests of both do not align, it is not in the favor of long-term sustainability of firms. CG systems would ensure the long-term sustainability of firms wherein it is asserted that owners have to actively participate in running and monitoring of the firms. Thus, ownership is an important mechanism for augmenting CG.

The corporate ownership provides right to receive their share of profits, along with certain other rights of ownership, to owners. They are responsible to ensure that firms are running and functioning in the best interests of all its stakeholders. In other words, they need to exercise control over corporate insiders and management so as to ensure that their interests are protected. Ownership varies across firms and in turn effects as

well as is affected by firm-specific characteristics. To explain, owners would always want high profits and a profitable firm would attract more and more investors. Who the owners are (type) and what is the level of their stake (concentration) plays the most pivotal role here? Foreign owners are one of the corporate owners and their decision to invest or not as well as the level of investment (equity stakes) would also depend on firm-specific characteristics. Once the foreign investors invest, the resultant impacts could be both positive as well as negative.

Thus, it is sensical to explore and examine the type and concentration of foreign ownership along with its relationship with CG and firm characteristics in the Indian context.

2.11 Research Gap

A number of studies have been conducted on ownership structure, CG and firm value/performance across the globe which has been encapsulated in the previous section. The literature review revealed the following research gaps:

- CG has generated considerable academic interest in the last few decades in the West, and it is the limited corresponding literature from developing countries like India, that warrants an investigation into the relation between FO and CG.
- The comprehensive characteristics of this study are not found in the prior literature.
- There is relatively limited research on the equity shareholdings by foreign investors in India which would assess their ability to manage, control and run the firm(s) which in turn depends on the composition (type) and concentration (size) of their shareholdings.

- There is a dearth of literature on firm-specific characteristics which affect the investments by foreign investors in the equity of a company, particularly from India.
- Very few research studies have focused on the cause and effect relationship between FO and CG, particularly in the CG reform period which further accelerated CG reforms.
- There is a need for assessment of the stakeholder's perception about various developments and reforms in the CG regime of developing economies like India which affect all of them.

2.12 Relevance of the Study

The review of the literature and the consequent research gap identifies the need to study the relationship between governance-ownership-firm characteristics in Indian business context. The findings of the present study would be extremely useful to corporates, practitioners, academia, investors, policymakers, think tanks and the regulators.

Based on previous studies, both theoretical and empirical, it has become increasingly evident that CG structures and their specific design and development would have important ramifications on a country's growth and development and further establishing its relative competitiveness in the global market (Morck et al., 2005; Carlin & Mayer, 2003; Emmons & Schmid, 1999). Various dissimilarities in governance structures exist across countries, both at the firm level and the country level, that lead to dissimilarities in the development of financial structures, industries, and firms. Many corporate failures, scandals and financial crisis of the past decade, culminated importance of sound CG structures. The 1997 East Asian crisis endangered economic collapse of several countries and further disclosed serious weaknesses in their governance

structures (Claessens & Fan, 2002; Sachs et al., 2000; Lange et al., 2000). The same was captured furthermore due to accounting scandals and corporate failures involving some of the World's largest firms (Maddaloni & Pain, 2004; Holmstrom & Kaplan, 2003; Healy & Palepu, 2003).

At the same time, previous studies have provided ample empirical evidence of changes in ownership structures leading to changes in CG structure (Davis & Thompson, 1994) and in firm behavior and firm performance (Dalton et al., 1998). Some studies have shown that few dimensions of business like the legal environment and industry regulations, may influence CG and corporate performance (Luoma & Goodstein, 1999). Despite these existing studies, the impact of ownership structures on CG and impact of firm characteristics on ownership structures still remain unresolved. Due to the unique environment of India in the context of its social and business institutions, it is claimed that changes in its CG regime should occur within its unique context only. Relevant previous empirical findings from India highlight opportunities for future research in this area.

Indian market infrastructure and CG has advanced a lot, since its economic reforms, as against most developing economies of the world. It is believed that Indian CG regime has advanced the most than many other developing market economies. This advancement, especially in the context of foreign flow of funds, bring with it greater need to understand the dynamics of CG. A study of various dynamics of CG especially those relating to ownership and firm characteristics could yield valuable insights into the topic and provide a fresh perspective for further advancements in the years to come in the whole international context. This is one of the contributions of the present study.

Also, the present vast literature on CG is related to advanced market economies with sophisticated capital markets. But the problem of CG is acute and more serious in transitional and emerging economies particularly since foreign investments have risen significantly during the past decade.

Thus, the literature presented clarifies that there are many questions relating to the relationship between FO and firm characteristics which remains unresolved. These issues are important in the discussion that follows the role of foreign owners in developing CG climate in developing countries. The empirical research on the behavior of financing policies of foreign investors and the role of foreign parties in the development of CG climate is relatively limited. The present study contributes towards the same. The study intends to fill this gap by examining FO, CG and firm characteristics. In the present study valuable insights into the behavior of foreign investors and the relationship between FO, CG and firm characteristics are provided.

In order to improvise and implement any new structures and processes, it is imperative to first understand and thoroughly evaluate the same. Further, it is equally important to know the perception of the stakeholders' regarding the current regime so as to decide upon further improvements, structures and processes. In light of the above, the present study also assesses the stakeholders' perception towards current CG regime in India.

2.13 Conclusions

This chapter provided a didactic account of the present literature on ownership and CG. Ownership and CG depend upon various firm characteristics. The review of the literature suggests that both ownership and CG are multidimensional and the numerous factors are intermingled. From the aforesaid discussion, it can be easily seen that the

issue involved is empirical in nature. No conclusions or categorical statement can be made unless an empirical evaluation of the relationships is done. It helped to establish why the relationship between FO, CG and firm characteristics should be researched in the Indian context. The present study is qualitative as well as quantitative in nature makes a modest attempt at analyzing FO, CG and firm characteristic of Indian corporate sector. Any detailed analysis can be carried out if the study is based on appropriate research design and methodology, which is discussed in the next chapter.

Chapter 3

Research Design and Methodology

CHAPTER 3

RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

A good research design is a prerequisite for research to arrive at desired results. For the purpose of any study, a proper research design is a prerequisite and it must also be ensured that all statistically relevant prerequisites are met. The prerequisite of survey method is a good sampling technique together with a proper selection of sample and sample size in order to effectively study the population. The secondary data analysis requires the appropriate variables, relevant hypotheses and specific statistical tools for arriving at inferences from the data. Further, the research should be comprehensive such that it includes all the relevant aspects of the subject under study.

In this chapter, the research objectives and the research methodology of the present study stating the procedures pertaining to the qualitative and quantitative research techniques are described. Hypothesis formulation, the sources of data, sample selection, the period of the study and the techniques used to meet the specific objectives of the study are set in this chapter. The last section provides a detailed explanation of model formulation for various regression analysis.

The chapter is organized as follows. Section 3.2 deals with research design and section 3.3 deals with the objectives of the study. Besides, the primary objective, the specific objectives are also described. To carry out these objectives various hypotheses are formulated which are described in section 3.4. Section 3.5 describes the various sources of data collection. Section 3.6 gives the sample selection followed by the period of the

study in section 3.7. Sections 3.8 discuss various techniques of investigation to fulfill the objectives. The method of investigation for the data analysis is explained in the last section 3.9.

3.2 Research Design

The present study is an exploratory and empirical one which provides a qualitative assessment of current corporate governance (CG) regime and a quantitative assessment to find out the relation between foreign equity shareholdings (FES) and firm characteristics, and FES and CG for the sample firms. Table 3.1 shows the research method applied to fulfill the objectives of the study (section 1.9).

Table 3.1: Research Method

Data Source	Primary Source	Secondary Source • Prowess • Bloomberg ESG score
Instrument	Structured Questionnaire	
Sampling Technique	Purposive Sampling Technique	
Sample Size	215 respondents	449 companies
Time Period		Nine year time period – 2008 to 2016, starting of the second phase of corporate governance reforms

The qualitative method of questionnaire survey has been found suitable to assess the perception of different stakeholders' regarding current CG regime. The complexity of the study lies in the fact that the respondents belong to different groups namely, representatives of regulatory authorities, capital markets, centers of governance, corporate employees, professionals namely, independent analysts, auditors, accountants,

and researchers, professors, bankers, and investors. The quantitative study has a large sample of companies, selected on a particular basis.

The results of primary and secondary data analysis are being supplemented by interviews of ten eminent fund managers and corporate top management personnel actively engaged in financial investment decisions. This study attempts to triangulate the findings across chapters and research methods to provide a more holistic view of CG in India, which can be of use to various stakeholders'.

3.3 Objectives of the Study

As discussed in the literature review (chapter 2), many authors have dealt with CG and its relation to ownership and firm characteristics in different ways. The present study aims to fill the various research gaps identified in section 2.11. The study presses the need for shareholder activism (equity shareholders participation and intervention in the corporate firms) so as to ensure best CG practices at the firm level. The primary objective of the study is to understand and analyze the relationship among CG, corporate ownership, and firm characteristics, so as to achieve better governance in Indian companies. Specifically, it deals with the following issues:

- **Foreign Ownership and Firm Characteristics:** The study identifies the firm characteristics that impact foreign investments in Indian listed companies. Also, the study investigates the impact of various firm characteristics in determining the stake of foreign equity ownership in Indian listed companies. Large equity stake provides an incentive to monitor efficiently and effectively whereas dispersed

equity ownership badly suffers from free rider problem. Further, more at times, large equity stake may act as an incentive to exploit minority. The equity stake should be governance oriented and it should be enough incentive to shareholder activism (equity shareholders participation and intervention in the corporate firms) so as to ensure best CG practices at the firm level.

- **Corporate Governance and Foreign Ownership**: The present study makes an attempt to examine the impact of FES on CG. The study primarily addresses the issue relating to shareholders activism that emanates in changing the CG practices. An attempt has been made to have a comprehensive view of foreign equity investments in India by adopting a systematic approach by first analyzing the trends and pattern of FES in Indian listed companies.
- **Stakeholders' Perception of Current Corporate Governance Regime:** Any structure can be strengthened and improved after knowing and analyzing its current regime which includes components, practices, status, strategies, major issues etc. CG regime has its wide impact on the flow of funds in an economy, whether from internal sources or external sources. It should be such that it encourages ample investments in the corporate sector. Good CG has been recently included in the list of likely benefits of foreign investment in emerging markets. In the light of the above, the study investigates the perception of various stakeholders' about the current CG regime in India so as to suggest areas for further improvement, inclusions, and consideration. Further, it assesses the difference in perception of various stakeholder groups.

The specific objectives of the study are:

1. *To analyze foreign equity shareholdings in sample Indian companies*
2. *To examine the relation between foreign equity shareholdings and firm characteristics*
3. *To examine the impact of foreign equity shareholdings on corporate governance*
4. *To assess the stakeholders' perception of the current corporate governance regime*

The specific objective 2 stated above further seeks to enhance the understanding of the variability explained in FES and its relationship with firm characteristics. It would determine the relation of firm characteristics with equity group membership of FES as well as various levels of FES stake.

3.4 Hypotheses

The following hypotheses are constructed in order to meet the above-stated objectives. These hypotheses are based on the extensive literature review which has been discussed in the previous chapter of the present study. These hypotheses are further divided into sub-hypothesis according to the need of fulfillment of the objectives.

Objective 1: To analyze foreign equity shareholdings in sample Indian companies

$H_{a1.1}$: *There is significant difference in mean equity shareholdings across years*

$H_{a1.2}$: *There is significant difference in mean equity foreign promoters shareholdings, foreign non-promoters shareholdings and total foreign shareholdings.*

$H_{a1.3}$: *There is significant difference in mean equity shareholdings across sectors*

$H_{a1.4}$: *There is significant difference in mean equity shareholdings across market capitalization*

$H_{a1.5}$: *There is significant difference in mean equity shareholdings across size*

$H_{a1.6}$: *There is significant difference in mean equity shareholdings across age*

Objective 2: To examine the relation between foreign equity shareholdings and firm characteristics

$H_{a.2.1}$: *There is significant relationship between foreign equity shareholdings and firm characteristics**

**firm characteristics are a function of market capitalization, return on total assets, leverage, growth, size, and age*

Objective 2 (a): To determine the relation between firm characteristics and probability of foreign equity controlling stake

$H_{a.2.2}$: *There is significant relationship between firm characteristics and equity group membership of foreign equity shareholdings*

Objective 2 (b): To determine the relation between firm characteristics and various levels of foreign equity shareholdings stake

$H_{a2.3}$: *There is significant relationship between firm characteristics and various levels of foreign equity shareholdings stake*

Objective 3: To examine the impact of foreign equity shareholdings on corporate governance

$H_{a3.1}$: *There is significant impact of foreign equity shareholdings on corporate governance*

Further, to examine the impact of concentrated foreign equity stakes on the quality of CG of select Indian companies

$H_{a3.2}$: *There is significant impact of concentrated* foreign equity shareholdings on corporate governance*

**Concentrated foreign equity shareholdings is studied at various threshold levels, namely 5%, 10%, 15%, 20%, 25% similar to Kumar (2004), Sarkar and Sarkar (2000), La Porta et al (1997).*

Objective 4: To assess the stakeholders' perception of the current corporate governance regime. Further, to assess the difference in perception of various stakeholders' towards current CG regime

$H_{a4.1}$: *There is significant difference in perception of various stakeholders' towards current corporate governance regime*

3.5 Data and their Sources

The study employs a two-fold approach to data collected from both primary and secondary sources. An assessment of the stakeholder's perception of current CG regime is done through primary data. Besides the rich source of primary data, secondary data (cross-sectional time series data called panel data) has been collected dealing with all the sectors of the economy for a time span of nine-years covering the period of CG reforms.

The primary data of the study is sought through a structured questionnaire. A large sample is taken for finding out the results. Responses were gathered through electronic correspondence and some respondents who did not respond to the questionnaire through electronic mode were either contacted in person or through telephonic calls.

The panel data facilitates the examination of the relationship between FO and firm characteristics, and FO and CG. This data is obtained from Prowess, a database provided by the "Centre for Monitoring the Indian Economy (CMIE)" for Indian companies. Prowess is the principal source of financial information for Indian firms, comparable to a combination of Compustat and "The Centre for research in Security Prices (CRSP)" for U.S. firms (Balasubramanian et al., 2008).

The reports of various committees, commissions, RBI reports are used together with other financial books, periodicals, and journals. Data is also obtained from the website of "Bombay Stock Exchange (BSE) and National Stock Exchange (NSE)" and sample companies. The data obtained from these sources is used by previous studies Balasubramanian et al. (2008) and Kumar (2004) and is considered reliable and valid and can be generalized to the problem that is being dealt in the present research.

The CG practices are being evaluated through various scores or indices by many rating agencies and others like "Investment Information and Credit Rating Agency of India Limited (ICRA)" Corporate Governance Rating (CGR), "Credit Rating Information Services of India Limited (CRISIL)" Governance and Value Creation (GVC) ratings, Bloomberg Environment, Social and Governance (ESG) Score. These are meant to evaluate and indicate the relative level of acceptance and follow up of the codes and guidelines of CG practices. For the purpose of the study, relative CG quality of corporates has been obtained from Governance Score which is a part of ESG Score (Banerjee et al., 2012), computed after considering various dimensions of CG, namely, shareholder capital, shareholder rights, board and management information, board and management remuneration, committees information, etc.

3.6 Sample Selection

The following two subsections 3.6.1 and 3.6.2 deal with the methodology to select the sample for the present study, which is carried out through both primary as well as secondary sources respectively. Section 3.6.1 first explains the development of measurement scale for the questionnaire and later the selection of respondents for the questionnaire survey. Section 3.6.2 explains the sample selection using secondary sources over the nine-year period of study.

3.6.1 Primary Data and Survey Instrument

The stakeholders' perception of the current CG regime, objective 4 of the present study is studied through a structured questionnaire where an extensive section of respondents was covered through an online source. The questionnaire collected primary information from the stakeholders' about their perception of various aspects of CG like the current status of CG, major issues in CG, CG practices, players of CG etc. The procedure for development of measurement scale for the structured questionnaire is shown in Figure 3.1.

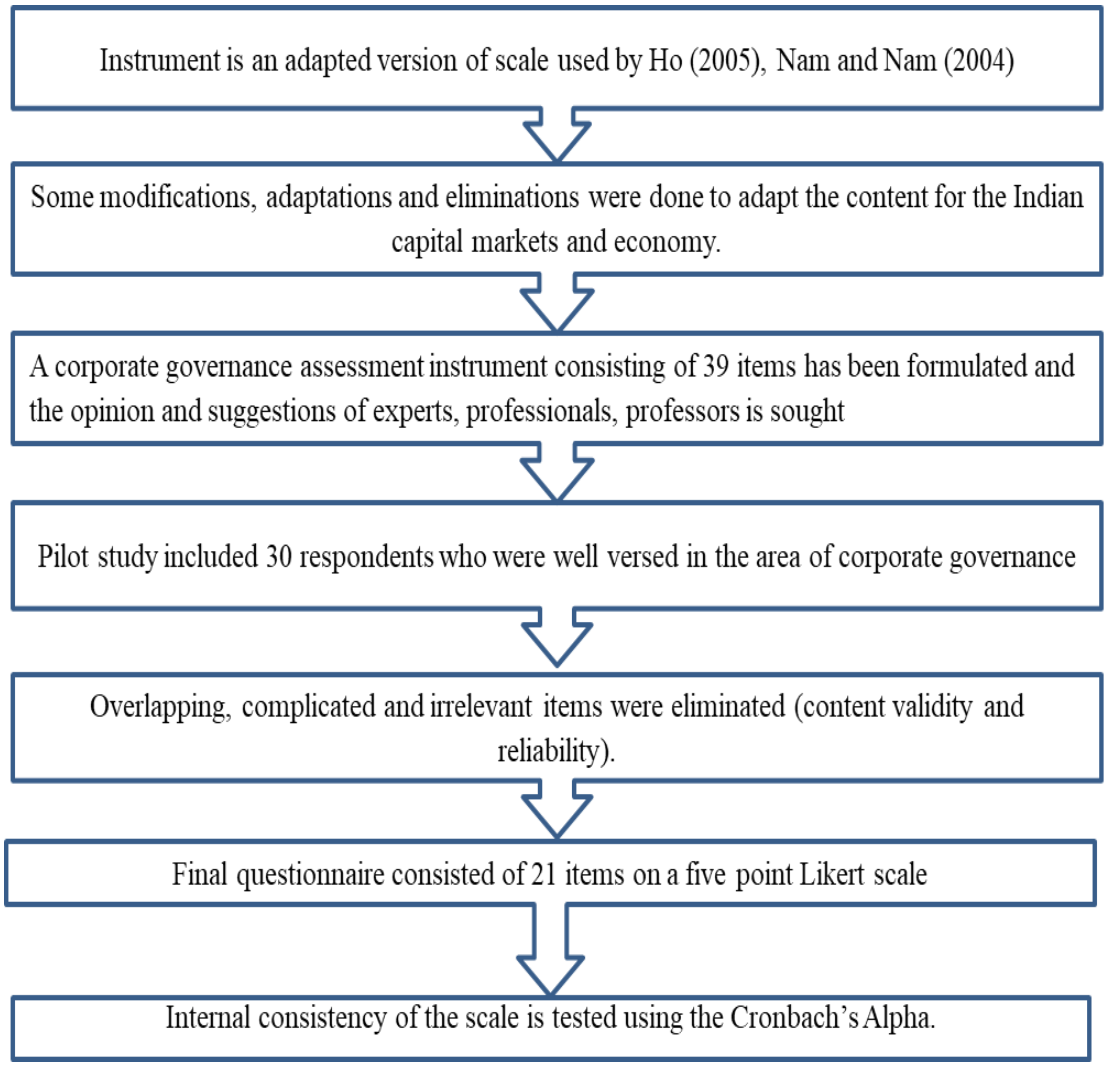

Figure 3.1: Development of Measurement Scale

The final version of the instrument can be considered as an adapted version of the scale used by Ho (2005), Nam and Nam (2004) to determine the factors constituting CG regime. Some modifications, adaptations, and eliminations were done to adapt the content for the Indian capital markets and economy. A CG assessment instrument consisting of 39 items has been formulated and the opinions and suggestions of experts, professionals, and professors (n=30) was sought. Overlapping, complicated and irrelevant items have been eliminated. The final modified scale consisting of 21 items measured on the 5-point Likert scale has been used for the purpose of the present study.

The respondents were the stakeholders' in the governance of the company divided into three groups, namely,

Group One: **Employees**- Government or private- Executives, Directors, CEO, CFO;

Group Two: **Independent** - analysts, auditors, accountants and representatives of regulatory authorities, capital market, centers of research;

Group Three: **Others**- researchers, professors, bankers, investors.

Nearly all the respondents could fall into more than one group, which was personally monitored and administered. Special care has been taken as to in which capacity the respondent is answering. The respondents were chosen from all over using purposive sampling technique.

3.6.2 Secondary Data

In order to fulfill the objective 1, 2, and 3, secondary data has been used wherein the sample companies are the listed companies on "Bombay Stock Exchange (BSE) and National Stock Exchange (NSE)".

The Clause 49 of the Listing Agreement which incorporates various CG norms was introduced by the Securities and Exchange Board of India (SEBI) on February 21, 2000, with the objective to improve the standards of CG in India, is applicable to the listed companies. All the listed companies in India are required to follow the norms set by the market regulator (SEBI) with respect to CG and accounting disclosures. Publicly listed stock companies provide a unique opportunity for the study since they allow us to quantify the equity held by foreign investors and various firm-specific characteristics. The evaluation of CG practices can also be done through various indices or scores.

The companies included in S&P BSE 500 Index of the "Bombay Stock Exchange" and Nifty 500 Index of the "National Stock Exchange of India" as on March 31, 2016 has been the basis of sample selection. The BSE indices are the benchmark indices with wide acceptance among institutional investors, foreign investors, fund managers, and individual investors. The BSE has the second largest number of firms listed in the world. The S&P BSE 500 Index calculated as per free-float market capitalization represents nearly 93 percent of the total market capitalization on BSE, which cover all major industries of the economy and therefore is widely accepted and used as an indicator to describe the overall market, and compare and assess the performance and return on investments. The indices comprised of banking and financial services companies regulated by Banking Regulation Act, 1942. Swarup (2011), and Arun and Turner (2004) highlighted that these entities have certain features specific to them and are governed by a specialized set of norms for CG and hence are excluded for the sample selection.

Table 3.2 provides the details of the sample. 466 firms were common firms included in both the indices. After deleting those 466, 82 financial firms and 3 others whose data were not complete and could not be found were also excluded (Kumar, 2004). The final sample consists of 449 companies (Table 3.2 Part A) observed over a nine-year period 2008-2016. Amongst the sample companies, the governance score is available only for 201 companies for both the years under study that is, 2007-2008 and 2015-2016 (explained in detail in section 6.2). Therefore, the sample to examine the impact of FES on CG (objective 3) is reduced to 201 companies (Table 3.2 Part B).

Table 3.2: Details of Sample

Sample Selection		**Number of Companies**
S&P BSE 500 Index of the Bombay Stock Exchange		500
Nifty 500 Index of the National Stock Exchange		500
Number of Companies		1000
Less:		
Common firms in both indices	466	(551)
Banking and Financial Services Companies	82	
Merged company and non-availability of data	03	
Final Sample		449
Part B		
Governance Score for the end of FY 2008 and 2016		201

Further, the selected companies represent all the major industrial activities. The sample companies are further divided into eight sectors namely, "Basic Materials, Consumer Discretionary Goods & Services (CDGS), Diversified, Energy, Fast Moving Consumer Goods (FMCG), Healthcare, Industrials and Utilities, and Information Technology and Telecom" (Table 3.3). Table 3.3 shows that the diversity lies within the sample with respect to sectors. The number of companies selected in each sector amongst 449 companies and 201 companies is listed in column 3 and column 4 of Table 3.3 respectively.

Table 3.3: Number of Sample Firms by Sector

S.No.	Sector	Number of Companies	
		Column 3	Column 4
1	Basic Materials	75	29
2	Consumer Discretionary Goods & Services (CDGS)	121	47
3	Diversified	12	3
4	Energy	14	8
5	Fast Moving Consumer Goods (FMCG)	40	17
6	Healthcare	44	22
7	Industrials and Utilities	107	54
8	Information Technology and Telecom	36	21
	Total	**449**	**201**

The sample is represented by all the sectors of the Indian economy as shown with 75 companies from Basic Materials, 121 from Consumer Discretionary Goods & Services (CDGS), 12 from Diversified, 14 from Energy, 40 from Fast Moving Consumer Goods (FMCG), 44 from Healthcare, 107 from Industrials and Utilities and the balance 36 from Information Technology and Telecom.

3.7 Period of the Study

The following subsections 3.7.1 and 3.7.2 state the period of the present study for primary and secondary analysis respectively.

3.7.1 Period of Survey

The survey to assess the perception of various stakeholders' regarding the current CG regime has been done in second half of the year 2015. Nearly 600 respondents were contacted and 235 responses were received after a repeated follow up and reminders on a weekly basis. After a thorough data cleaning exercise, only 215 responses has been finally taken for data analysis giving a response rate of 35.83 percent.

3.7.2 Period of Secondary Data

The period of the present study for secondary analysis is from 2007-2008 to 2015-2016. The financial year ending 2008 marked the end of the first phase (starting from 1990's) and the beginning of the second phase of the CG reforms in India (Afsharipour, 2011).

The first phase started with the formation of SEBI, India's securities market regulator in 1992. The regulator has been instrumental in advocating for and drafting CG guidelines. During this phase, the corporates had started thinking, knowing and practicing CG. This phase stressed upon the independence of boards and audit committees together with shareholders participation in monitoring management. By the end of the financial year 2008, India had an adequate system of CG in place. This year witnessed the amendment of the Listing Agreement by SEBI. Satyam scandal in the financial year 2009 led to further amendments in guidelines of CG and corporate laws. Thus, key developments in the year 2008 guided the choice of this year as the starting point of the study period. The data has been collected till the financial year 2015-2016.

3.8 Techniques of Data Analysis

In order to fulfill the objectives of the present study, different techniques have been used. The broad categorization of these can be done on the basis of data used for analysis. Table 3.4 provides an objective wise summary of the same.

The secondary data information is first categorized and later statistical techniques like descriptive statistics, t-test, ANOVA, correlation, various forms of regression and sensitivity analysis have been performed. Profiling of the sample companies on the basis of the sector, market capitalization, size, and age has been employed and studied in order to understand the behavior and rationale behind foreign investment inflows.

Table 3.4: Objective wise Summary

Objective	Data Source	Sample	Techniques
To analyze foreign equity shareholdings	Secondary	449 companies	Descriptive statistics, t-test, ANOVA
To examine the relation between foreign equity shareholdings and firm characteristics	Secondary	449 companies	Descriptive statistics, Correlation, Multiple linear panel regression, Binary logistic regression and Multinomial logistic regression
To examine the impact of foreign equity shareholdings on corporate governance	Secondary	201 companies	Descriptive statistics, Correlation, Multiple linear instrumental variable panel regression, Spline specification regression, Sensitivity analysis
To assess the stakeholders' perception of the current corporate governance regime	Primary	215 respondents	Factor Analysis, ANOVA, Post hoc analysis

Software's used for analysis: SPSS 22, STATA 13 and EVIEWS 8.

The data collected through the structured questionnaire has been analyzed using Exploratory Factor Analysis to assess the perception of various stakeholder groups towards CG regime. ANOVA has been employed to test significant difference between the mean factor scores of extracted factors for the three respondent groups. Lastly, Post hoc test has been performed to find out which groups differ across extracted factors, if any.

3.9 Method of Investigation

This section consists of three subsections. Each subsection relates to the method of investigation for objectives 1 to 3. In the first subsection 3.9.1, the method to analyze FES in sample Indian companies has been presented whereas, in the second subsection 3.9.2, the method to examine the relation between FES and firm characteristics is mentioned. The last subsection 3.9.3 states the method to examine the impact of FES on CG.

3.9.1 Foreign Equity Shareholdings

Foreign Ownership (FO) or foreign equity shareholdings (FES) refers to the percentage of equity share capital held by a foreign shareholder out of the total equity share capital of a company (Figure 3.2). FO/FES is the sum of equity shareholdings of Foreign Promoters and Foreign Non-promoters. A promoter when comes from outside the recipient country is a foreign promoter and a non-promoter when comes from outside the recipient country is a foreign non-promoter.

A promoter[2] is a person who has the right to exercise control over the board.

> *"SEBI's-Re-classification of Promoters as Public defines promoters as who are in control of the company, directly or indirectly, whether as a shareholder, director or otherwise; or named as promoters in any document disclosed by the company under the provisions of the Listing Agreement."*

Non-promoter is a person who has the right to monitor, control or run the firm through various direct and indirect means e.g. exercise of voting rights, a seat on board, class action suits, threatening to sell shares etc.

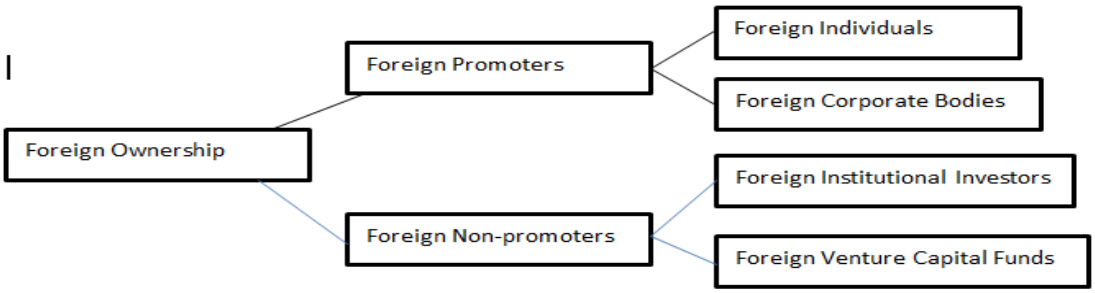

Figure 3.2: Types of Foreign Ownership

[2] "*As per Section 2(69) of Companies Act, 2013 the term Promoters is defined as: - who has been named as such in a prospectus or is identified by the Company in the annual return referred to in section 92; or who has control over the affairs of the Company, directly or indirectly whether as a shareholder, director or otherwise; or in accordance with whose advice, directions or instructions the Board of Directors of the Company is accustomed to act" (Ministry of Corporate Affairs [MCA], 2013).*

"This sub-clause uses the word – Control which is defined in 2(27) of the Act: control shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner."

Foreign promoters include foreign individuals and foreign corporate bodies. Foreign non-promoters include foreign institutional investors and foreign venture capital funds. The data is analyzed using Descriptive statistics, t-test, ANOVA.

3.9.2 Foreign Equity Shareholdings and Firm Characteristics

Investors have their own risk-return objectives. Investors do their own risk-return assessments which are based on various firm-specific characteristics. Firm characteristics refer to the firm-specific attributes that determine firm's ability to access foreign capital as well as its quality of governance (Bokpin & Isshaq, 2009; Al-Najjar & Taylor, 2008; Khanchel, 2007; Mangena & Tauringana, 2007; Ananchotikul, 2006; Anderson et al., 2001; Kang & Stulz, 1997).

There are a number of firm-specific characteristics that may affect the FES (Fauzi & Musallam, 2015; Al-Najjar & Taylor, 2008; Demsetz & Villalonga, 2001; Rajan & Zingales, 1995). The various firm-specific characteristics included in the study as predictors (called control variables) that impact FES are market capitalization, profitability, leverage, growth, firm size and firm age (Ho et al., 2013; Bokpin & Isshaq, 2009; Mangena & Tauringana, 2007; Grossman & Hart, 1980). The relation between FES and firm characteristics of select Indian companies has been examined through descriptive statistics, correlation and multiple linear panel regression.

Model Formulation

The following regression function has been employed to examine hypothesis 2.1:

$$FES = f\ (MCAP,\ ROTA,\ LEV, GROW, SIZE,\ AGE)$$

where

FES = foreign equity shareholdings in a firm

MCAP = market capitalization

ROTA = return on total assets

LEV = leverage

GROW = growth of the firm

SIZE = size of the firm

AGE = age of the firm

The definition and the significance of the variables is discussed later in detail in Chapter 5 Subsection 5.2.1.1.

3.9.2.1 Equity Group Membership and Firm Characteristics

The level of equity shareholdings of FES would also depend on firm characteristics. In order to study the same, FES is further divided into two groups, namely, Non-Controlling Stake (NCS) shareholding group and Controlling Stake (CS) shareholding group. The equity group membership would depend on and is a function of firm characteristics. The relation between firm characteristics and the probability of foreign equity controlling stake has been studied through binary logistic regression. The basis of the aforesaid analysis suggests a classification system for determining group membership. It predicts specific percentage of increase in probability of a given dependent variable due to existence of a predictor variable.

The binary logistic regression does not require the assumptions of ordinary least square multiple regression. It does not require any specific distributional form of predictors.

Moreover, logistic regression does not require linear relationships between the predictors and the outcome variable. Also, the assumption of homoscedasticity becomes nonsensical (Hair et al., 2015).

Model Formulation

The following regression function is employed to examine hypothesis 2.2:

$$Pr\,(Y = 1 \mid X) \;=\; F\,(\beta_0 \;+\; \beta_1\, X_1 \;+\; \beta_2\, X_2 \;+ \cdots .. + \beta_k\, X_k)$$

The dependent variable *Y* is a dichotomous variable with value 0 and 1 which represents two groups of equity membership of FES.

For CS* companies Y=1 and for NCS** companies Y=0.

The independent variables $X_1,\ X_2,\ \ldots.\ X_k$ include *market capitalization, profitability, leverage, growth, firm size and, firm age.*

*CS refers to the equity stake of foreign shareholdings being more than or equal to the average foreign shareholdings of 9.85 percent.

**NCS refers to the equity stake of foreign shareholdings being less than the average foreign shareholdings of 9.85 percent.

3.9.2.2 Levels of Equity Shareholdings and Firm Characteristics

The impact of firm characteristics on FES may change significantly at various levels of equity stakes. The relation between firm characteristics and various levels of FES stake is studied through multinomial logistic regression. Figure 3.3 depicts the various levels of equity stakes at which impact of firm characteristics is studied (LLSV, 1999). The objective is to model the odds of choice of equity shareholding stake as a function of

the firm characteristics and to explain the results in terms of the odds ratio for the choice of different levels of an equity stake.

The sample data is further divided into six categories, as per figure 3.3, and multinomial regression analysis is done.

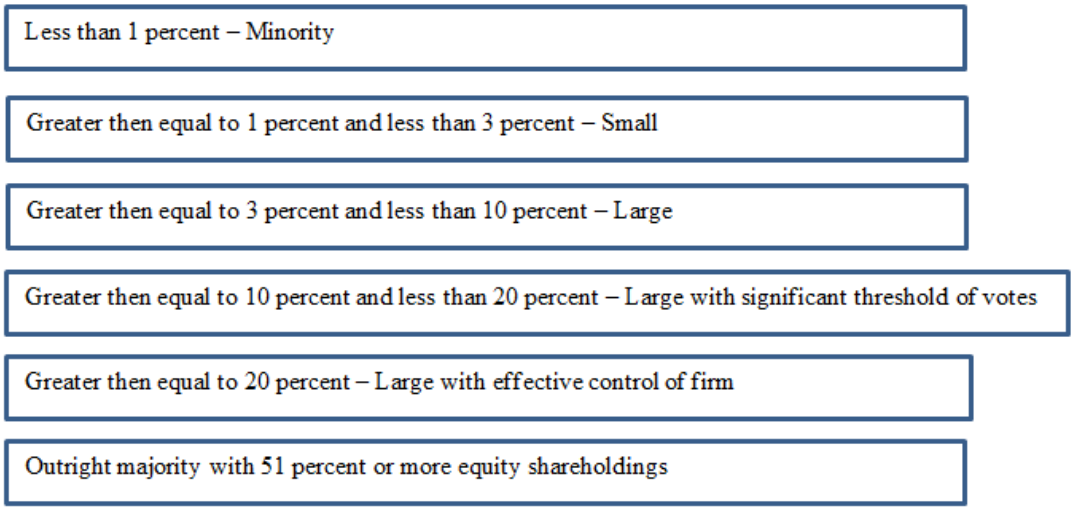

Figure 3.3: Levels of Equity Stakes (LLSV, 1999)

3.9.3 Foreign Equity Shareholdings and Corporate Governance

It is believed that CG of the firms will improve if the firm's owners act as focused monitors of management. Thus, ownership impacts governance. Cook and Deakin (1999) posited that foreign large investors act as outside block holders and have an ability and incentive to monitor incumbent management. Moreover, they bring in superior corporate practices of their countries to the countries they invest in. Thus, governance score depends on and is a function of FES. Also, various firm-specific characteristics may affect the quality of CG (Thanatawee, 2014). The relation between CG, FES and firm characteristics of select Indian companies has been studied through descriptive statistics, correlation, and multiple linear instrumental variable panel regression.

A thorough assessment of the quality of CG of a firm would need an assessment over a period of time. For this purpose, governance score of a firm for the financial year 2007-2008 and 2015-2016 is chosen.

Previous similar studies document the problem of endogeneity while dealing with the relationship between CG and ownership. It can be argued that while ownership may influence governance, governance can affect ownership too. Potential endogeneity problem is straightforwardly tackled using an instrumental variables approach in which FES stake is employed as an instrument for actual FES.

Model Formulation

The following regression function is employed to examine hypothesis 3.1:

$$\boldsymbol{GOVSC = f\ (FES,\ MCAP,\ ROTA,\ LEV, GROW, SIZE,\ AGE)}$$

where the dependent variable is the Governance Score (*GOVSC*) taken from Bloomberg ESG Score measuring the quality of CG of the firm, *FES* is an independent variable depicting the ownership structure, and control variables include six variables, namely, market capitalization, profitability, leverage, the growth of the firm, firm size and firm age.

The definition and the significance of the variables is discussed later in detail in Chapter 6 Subsection 6.2.1.

3.9.3.1 Threshold Levels of Foreign Equity Shareholdings and Corporate Governance

The large ownership stake of foreign owners may act as outside block holders and have an ability and incentive to monitor incumbent management leading to good governance (Ananchotikul, 2006). On the contrary, large ownership stake of foreign owners may act as an incentive, similar to other insiders, to exploit minority leading to poor governance (Ananchotikul, 2006; Kumar, 2004).

Sarkar and Sarkar (2000) have studied the effect of equity shareholdings at various threshold points. Thus, governance score depends on and is a function of equity stake of foreign shareholders.

The conflicting effects of concentrated ownership* indicate that shareholder incentives and behavior would depend on the level of shareholdings. A non-linear relationship between concentrated foreign shareholdings and CG is expected. The ordinary least squares regression equation model with spline specification is studied to find out whether concentrated foreign equity ownership stake matters or not.

*Concentrated FES is studied at various threshold levels, namely 5%, 10%, 15%, 20%, 25% similar to Kumar (2004), Sarkar and Sarkar (2000), LLSV (1997).

Model Formulation

The following regression function is employed to examine hypothesis 3.3:

$$GOVSC_{it} = \beta_0 + \beta_1 Foreign1_{it} + \beta_2 Foreign2_{it} + \beta_3 MCAP_{it} + \beta_4 ROTA_{it} + \beta_5 LEV_{it} + \beta_6 GROW_{it} + \beta_7 SIZE_{it} + \beta_8 AGE_{it} + Sector\ Dummy + Time\ dummy + €_{it}$$

where the dependent variable is the governance score (*GOVSC*) taken from Bloomberg ESG Score measuring the quality of CG of the firm, Foreign1 and Foreign2 are the two spline knots at a particular threshold level studied at 5 percent, 10 percent, 15 percent, 20 percent and 25 percent, and control variables include a set of six variables, namely, market capitalization, profitability, leverage, growth of the firm, firm size and firm age.

The definition and the significance of the spline knots are discussed later in detail in Chapter 6 Subsection 6.2.5.4.

3.10 Conclusions

This chapter introduced the research design and methodology adopted in meeting the research objectives formulated after identifying the research gap from the literature review of the previous chapter. The research design is both qualitative and quantitative in nature. The empirical evaluation of CG practices of a company is a qualitative assessment and the relation between FES and firm characteristics, and CG and FES are quantitative in nature. Data is collected from both primary and secondary sources. The chapter also outlined the process of development of measurement scale along with the procedure of sample selection and data collection. The period of study is nine-years 2008-2016. The statistical techniques used are exploratory factor analysis, ANOVA, post hoc analysis, t-test and various forms of regression. Regression functions are built and stated as model formulation. The next four chapters would outline the main findings from the research starting with chapter 4 on analysis of FES.

Chapter 4

Foreign Equity Shareholdings in India

CHAPTER 4

FOREIGN EQUITY SHAREHOLDINGS IN INDIA

4.1 Introduction

The equity shareholders of a firm own its equity shares and hence are called "its owners". The equity share ownership bestows right to control the firm which follows democratic principles wherein the more the shareholding the more will be the control. Thus, the incentive to control depends on the stakes, i.e., level of equity held in the firm.

An owner can be an individual or a family(s) or a corporate body(s), a bank(s), an institutional investor(s) or a non-financial corporation(s). The owners can be further divided into Indian and foreign. Foreign owners/investors may be foreign individuals, foreign corporate bodies, foreign institutions and/or foreign venture capital funds who invest in Indian firms. These owners are further subdivided into two categories, namely, promoters and non-promoters (defined in section 3.9.1).

The promoters are the capital providers who are in direct or indirect control of the company. On the other hand, non-promoters are capital providers yet investors who are more likely to be interested in achieving their own investment objectives, which may or may not include control of the firm. Most likely, non-promoter shareholdings act as an obstacle to non-value enhancing as well as value threatening activities of the promoters.

To summarize, the promoter is a person who has the right to exercise control over the board. Non-Promoter is a person who has the right to monitor, control or run the firm

through various direct and indirect means e.g. exercise of voting rights, a seat on board, class action suits, threatening to sell shares etc.

The incentive to control over the board or firm depends upon the level of an equity stake. More stakes are categorized as concentrated shareholdings or block shareholdings or large shareholdings. Shleifer and Vishny (1997) define concentrated shareholdings as when shareholder(s) hold sufficient amount of equity shares that they are able to influence the affairs or control the company through direct or indirect ways. Less than one percent stake is termed as 'minority stake'. More than equal to one percent and less than three percent is termed as 'small stake'. More than equal to three percent and less than ten percent is termed as 'large stake'. More than equal to ten percent and less than twenty percent is termed as 'large with a significant threshold of votes'. More than equal to twenty percent is termed as 'large with effective control of the firm'. Further, more than equal to fifty-one percent is 'outright majority' (LLSV, 1999).

Thus, control of the firm depends upon composition (type of shareholder) and concentration (level of stake) of equity shareholdings.

The objective of this chapter is to analyze FES of sample Indian companies. This analysis aims to identify

- the major providers of foreign capital in the Indian listed firms
- the trend in foreign equity shareholdings
- the concentration of foreign equity shareholdings.

Further, the analysis aims to establish an average level of equity shareholdings of foreign promoters, foreign non-promoters, and total foreign shareholders according to sector affiliation, market capitalization, size and age of the firm.

The rest of the chapter is organized as follows. Section 4.2 seeks to identify who are the foreign equity shareholders in India and further to analyze the trend of FES. The first being the trends in the two components of total FES and the second being the trend towards consolidation or divestment of two components of total FES over the period of study, that is, 2008-2016. The next section 4.3 identifies the concentration, if any, of the two components of total FES. Later, in the last section 4.4, distribution of FES as per sector, market capitalization, size and age of the company is examined. At the end of the chapter, the findings are summed in section 4.5.

4.2 Trends in Foreign Equity Shareholdings

The FES in a firm is further divided into two groups, namely, foreign promoters and foreign non-promoters. The foreign promoters include foreign individuals, foreign corporate bodies, and foreign institutional investors. Marginal foreign promoter's shareholding includes shareholding by foreign individuals and foreign institutional investors. Accordingly, foreign promoter shareholdings are essentially shareholdings of foreign corporate bodies, that is, inter corporate equity ownership amongst non-financial firms. The foreign non-promoters shareholdings include foreign institutional shareholdings as well as foreign venture capital fund shareholdings. The share of foreign venture capital funds is marginal and hence most foreign non-promoters shareholdings are foreign institutional investments.

The FES of Indian firms is examined using the equity shareholding of 449 companies listed on "Bombay Stock Exchange (BSE) and National Stock Exchange (NSE)" over a nine-year period 2008-2016.

4.2.1 Trend Analysis for Changes in Foreign Equity Shareholdings

Two aspects of foreign equity shareholding trends have been analyzed. The first being the trends in the two components of total FES and the second being the trend towards consolidation or divestment of two components of total FES over the period of study. The final sample being 449 firms as discussed in chapter 3 section 3.6 subsection 3.6.2.

4.2.1.1 Trends in Foreign Equity Shareholdings

Table 4.1 shows the total FES of the sample companies and further splits into the two stated categories of FES for the period of study, 2008-2016.

Table 4.1: Foreign Equity Shareholdings N=449 (as of the end of FY, the percentage of shares held)

Year	Foreign promoter equity shareholdings	Foreign non-promoter equity shareholdings	Total foreign equity shareholdings
2008	10.38	8.50	20.61
2009	10.54	6.86	20.16
2010	10.55	8.10	20.40
2011	10.47	9.34	20.16
2012	10.28	9.60	20.10
2013	10.04	10.47	19.89
2014	10.28	11.35	19.98
2015	10.41	11.82	20.65
2016	10.84	12.32	20.55
Average	10.42	9.86	20.28

The average equity shareholding of foreign shareholders has been 20.28 percent of the total equity shareholdings from 2008 to 2016. The average equity shareholding of foreign promoters and foreign non-promoters has been 10.42 percent and 9.86 percent respectively of the total outstanding shares from 2008 to 2016 respectively.

Average equity stake of foreign shareholders (20.28 percent) is quite enough to exert a significant degree of control of the firm. Similarly, the average equity stake of foreign non-promoters (9.86 percent) though not very large, yet it is enough to exert a significant degree of monitoring and control of the firm. Foreign promoter(s) could control the board with the average equity stake of 10.42 percent, being fair enough.

The average share of foreign promoters remained within 10.04 percent to 10.84 percent during the period of study. Although the equity shareholdings of foreign promoters do not exhibit a marked variation, there is certainly a marked variation in the equity shareholdings of foreign non-promoters. In the case of foreign non-promoters, there has been an increase of 45 percent from the mean share of 8.50 percent for financial year 2007- 2008 to 12.32 percent for the financial year 2015-2016.

The foreign non-promoters shareholdings have risen since 2008 till 2016 with the exception of the year 2009 due to the impact of Global Financial Crisis. The crisis of 2008 happened because of banks that created too much money, too quickly. It led to pushing up the prices of housing sector and speculation of financial markets. Several major financial institutions across the globe were absorbed by other financial institutions or received government bailouts or received outright crash as a corrective mechanism.

Further, on a close scrutiny of the data of FES, it is observed that out of 449 firms, 259 firms are such that there are no foreign promoter equity shareholdings over the entire period of study yet there is no such firm for foreign non-promoters shareholdings. The balance 190 firms have foreign promoter equity investments, though not for all the nine years of study. Table 4.2 reveals that (for 190 firms) average equity shareholding of

foreign shareholders has been 36.75 percent of the total equity shares from 2008 to 2016. The average equity shareholdings of foreign promoters and foreign non-promoters have been 25.70 percent and 11.05 percent respectively of the total outstanding shares from 2008 to 2016 respectively. These results confirm that if in case foreign promoters invest then the average equity shareholding is 25.70 percent, which is substantial enough to control the board.

Table 4.2: Foreign Equity Shareholdings for 190 Companies (as of the end of FY, the percentage of shares held)

Year	Foreign promoter equity shareholdings	Foreign non-promoter equity shareholdings	Total foreign equity shareholdings
2008	27.80	9.38	40.29
2009	27.40	7.42	37.73
2010	26.62	9.55	38.17
2011	26.05	10.72	36.83
2012	25.18	10.91	36.17
2013	24.34	11.92	35.89
2014	24.44	12.55	35.06
2015	24.60	12.53	35.60
2016	25.50	13.52	35.91
Average	25.70	11.05	36.75

The analysis of the firm data reveals that in the early phases of economic reforms, foreign promoters' inflows to India remained sluggish probably due to lesser access to different sectors of the economy, various hardships in starting businesses, stricter norms of owning equity and repatriation of dividends and profits. Walsh and Yu (2010) endorsed that the institutional and governance quality is a determinant of

foreign inflows for developing economies. The pickups of investments by foreign non-promoters' have led to an overall rise in equity holdings. As may be observed from Figure 4.1, compared to foreign promoters, the investments by foreign non-promoters have exhibited a smooth trend implying that foreign inflows are smoothening in the Indian context.

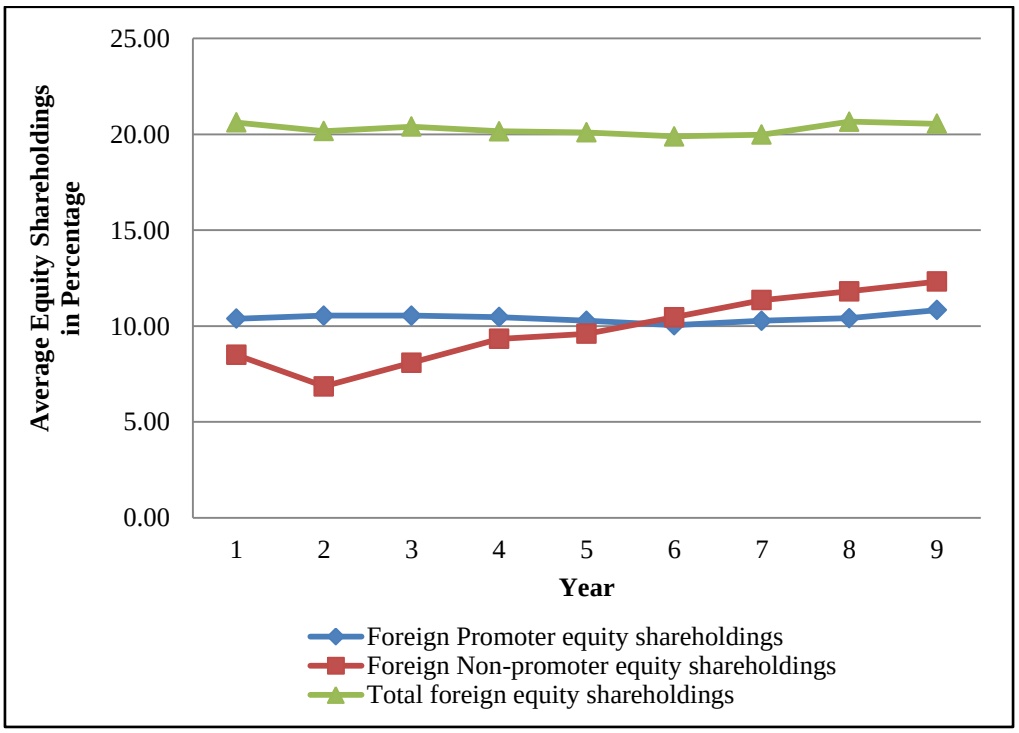

Figure 4.1: Trend in Foreign Equity Shareholdings during 2008-2016

The trend in the FES has been further studied year wise by t-test (Kumar, 2004).

$H_{a1.1}$: There is significant difference in mean equity shareholdings across years

This hypothesis would relate to foreign promoters equity shareholdings, foreign non-promoters equity shareholdings, and total foreign equity shareholdings.

Table 4.3 depicts the results of the t-test for the change in FES during the period of study.

Table 4.3: t-test for Change in Foreign Equity Shareholdings (for the sample period 2008 to 2016, the average percentage of shares) (N=449)

Year-end	Foreign promoter equity shareholdings	Foreign non-promoter equity shareholdings	Total foreign equity shareholdings
2008-2009	-0.104 (0.917)	2.619 (0.009)***	0.277 (0.782)
2009-2010	-0.004 (0.997)	-2.042 (0.041)**	-0.143 (0.886)
2010-2011	0.053 (0.958)	-1.918 (0.055) *	0.145 (0.885)
2011-2012	0.122 (0.903)	-0.400 (0.690)	0.037 (0.970)
2012-2013	0.156 (0.876)	-1.263 (0.020) **	0.133 (0.891)
2013-2014	-0.156 (0.876)	-1.256 (0.020)**	-0.060 (0.095)*
2014-2015	-0.086 (0.931)	-0.664 (0.050)*	-0.423 (0.0672)*
2015-2016	-0.288 (0.774)	-0.733 (0.046)**	0.067 (0.094)*
2008-2016	-0.302 (0.763)	-5.566 (0.000)***	1.042 (0.096)*

*Significant at the 0.10 level (2-tailed).
**Significant at the 0.05 level (2-tailed).
***Significant at the 0.01 level (2-tailed).
(p-value in parentheses)

Overall, the FES in the sample firms changed significantly (at 10 percent level of significance) over time with t stat 1.042. The t statistic for the change in total FES has been significant for last three years of study. Thus, the total FES have shown significant change over time i.e. the period of study but respectively only for the last three years of the study.

The results from the t-test provided evidence that the change in foreign non-promoters equity shareholdings has been significant for the respective years of study (except one)

as well as for the entire period of study. Taking 2008-2009 as an example, the p-value for t-test has been significant implying that foreign non-promoters equity shareholdings significantly changed between the year-end 2008 and year-end 2009. Therefore, the results depict that change in foreign non-promoters equity shareholdings is significant for all the respective years as well as over the whole period of study. It can be concluded that the dominance of foreign non-promoters equity shareholdings in the data drives the result for total FES.

The t statistic for foreign promoter shareholding has not been significant for the respective years of study as well as for the entire period of study. Hence, the equity shareholdings of foreign promoters do not significantly vary for sample companies during the period of study. (Similar results are obtained when only 190 companies foreign promoter's shareholdings have been taken).

The null hypothesis for total FES and foreign non-promoters equity shareholdings is not accepted while null hypothesis for foreign promoter's equity shareholdings is accepted. This supports the use of panel data regression for further analysis.

The variation in the FES has been further studied across groups by ANOVA test.

$H_{a1.2}$: There is significant difference in mean equity foreign promoters shareholdings, foreign non-promoters shareholdings and total foreign shareholdings

The results for the change in foreign promoter's shareholding, foreign non-promoters shareholdings, and total foreign shareholdings during the period of study can be observed from Table 4.4.

Table 4.4: ANOVA Table for Difference of Means across Groups

Type of Shareholder	F	Sig.
Foreign promoter	.043	0.991
Foreign non-promoter	14.879	0.00*
Total foreign equity shareholdings	.062	0.08**

* Significant at the 0.01 level (2-tailed)
**Significant at the 0.10 level (2-tailed)

As may be observed from the results of Table 4.4 the difference in means in foreign promoter's equity shareholdings across the nine-year period of study is insignificant. However, the difference in means in foreign non-promoters equity shareholdings is significant at 1 percent level of significance. The total FES mean difference has also been significant but at 10 percent level of significance. The alternate hypothesis for total FES and foreign non-promoters equity shareholdings is accepted while alternate hypothesis for foreign promoter's equity shareholdings is not accepted.

4.2.1.2 Trends towards Consolidation or Divestment in FES

A closer examination of FES has been done in order to dig out the firm-specific trend within sample firms. The examination of Table 4.5 reveals that

- More than half of sample firms (52.32%) have higher total FES in 2016 as compared to their 2008 levels.
- A higher percentage of firms (67.89%) have more of foreign non-promoters shareholdings in 2016 as compared to their 2008 levels while only 18% of the sample firms witness an increase in foreign promoter's equity shareholdings.
- Both the percentage of firms undergoing divestment as well as the average extent of divestment is lower for foreign promoter share (14.11% and 9.69%,

respectively) as compared to foreign non-promoters shareholdings (29.2% and 7.05%, respectively).

- Only 5.83 % of the sample firms have witnessed no change in total foreign shareholdings. However, the same for promoter's shareholdings is quite high (67.89%). Thus, nearly 97% of the sample firms has a change in foreign non-promoters shareholdings.
- In the sample firms, none of the firms witness persistent consolidation or persistent divestment over the nine-year period of study. The shareholdings of foreign promoters as well as foreign non-promoters increased decreased or witness no change but the change or no change has not been continuous from one year to another during the entire period of study.

Table 4.5: Trends and Pattern of Consolidation/Divestment of Foreign Equity Shareholdings in Indian Listed Companies (2008 and 2016)

Change in Foreign Shareholdings between 2008 and 2016			
	Foreign promoter equity shareholdings	**Foreign non-promoters equity shareholdings**	**Total foreign equity shareholdings**
(1) Increase in ownership			
Number (%) of firms	74 (18.00)	279 (67.89)	215 (52.32)
Median (mean) increase	8.61 (13.05)	6.65 (9.15)	7.33 (4.22)
(2) Decrease in ownership			
Number (%) of firms	58 (14.11)	120 (29.20)	172 (41.85)
Median (mean) decrease	4.72 (9.69)	4.5 (7.05)	4.37 (7.04)
(3) No change in ownership			
Number (%) of firms	279 (67.89)	12 (2.91)	24 (5.83)

The results reinstate the fact that foreign non-promoters equity shareholdings are a dominant group which drives the result for total FES. The equity shareholdings of foreign non-promoters have a high financial significance and hence obtained an important and significant position in equity shareholdings of Indian listed companies as against those of foreign promoter's equity shareholdings (Kara et al, 2007).

4.3 Concentration of Foreign Equity Shareholdings

The concentration of FES would provide a further detailed analysis of FES of Indian listed companies. Turning to the levels of shareholdings (LLSV, 1999) (refer to figure 3.3 of subsection 3.9.2.2 of chapter 3), 59.05 percent of total FES is large and 18.15 percent of foreign shareholdings are minority shareholdings (Table 4.6). This shows clearly a high concentration of FES. The concentration of FES is due to the fact that 66.49 percent of foreign non-promoters shareholdings are large as against only 12.05 percent is foreign promoters shareholdings. The foreign promoters largely own (74.81 percent) minority stake (mean 0.01 percent). The results indicate the prevalence of concentrated FES with the dominance of foreign non-promoters.

Table 4.6: Mean Equity Shareholdings and Percentage of Total Shareholdings according to Levels of Shareholdings

Levels of shareholdings	Foreign promoter equity shareholdings		Foreign non-promoter equity shareholdings		Total foreign equity shareholdings	
	Mean shareholdings (in percentage)	Percentage of total	Mean shareholdings (in percentage)	Percentage of total	Mean shareholdings (in percentage)	Percentage of total
Less than 1 percent	0.01	74.81	0.17	22.21	0.13	18.15
> = 1 percent < 3 percent	1.79	1.58	1.94	11.23	1.93	8.45
> = 3 percent < 10 percent	5.78	3.47	6.21	26.67	6.24	20.87
> = 10 percent < 20 percent	16.04	2.09	14.59	24.37	14.64	19.35
> = 20 percent < 51 percent	34.17	6.48	28.16	15.44	30.92	18.84
> = 51 percent	66.00	11.56	53.83	0.08	70.64	14.34
Total		100		100		100

4.4 Distribution of Foreign Equity Shareholdings

Investment in listed companies is the outcome of the interplay of various complex factors, both micro and macro, that impact the risks and returns on the investments. In this context, it is essential to understand firm-specific characteristics of the sample companies that would impact the investment decisions of foreign investors in these companies. Therefore, profiling of the sample companies is done to better understand the behavior and rationale behind FES.

For the purpose of analysis, the sample has been classified into various categories. The basis of classification has been: sector (as per CMIE sector classification), market capitalization, size of firm and age of firm (on the basis of number of years since incorporation) of the company.

4.4.1 Distribution of Foreign Equity Shareholdings by Sector

The sample companies have been classified into eight sectors, namely "Basic Materials, Consumer Discretionary Goods & Services (CDGS), Diversified, Energy, Fast Moving Consumer Goods (FMCG), Healthcare, Industrials and Utilities and lastly, Information Technology and Telecom" as per the sector classification used by CMIE in the prowess database. The number of companies in each sector and average equity shareholdings is given in Table 4.7.

Out of the total sample of 449 companies, the highest number of companies (121) belonged to Consumer Discretionary Goods & Services (CDGS). The next highest number of companies (107) belonged to Industrials and Utilities. Rest of the sectors namely, Fast Moving Consumer Goods (FMCG), Healthcare, and Information Technology and Telecom has more or less same number of companies 40, 44, 36

respectively. Diversified and Energy sector has 12 and 14 companies only. 75 companies belong to Basic Materials sector. Thus, the sample represented evenly all the sectors of the Indian economy.

Table 4.7: Distribution of Foreign Equity Shareholdings by Sector (for the sample period 2008 to 2016, the average percentage of shares)

Sector	**Number of firms**	**Foreign promoter equity shareholdings**	**Foreign non-promoters equity shareholdings**	**Total foreign equity shareholdings**
Column 1	**Column 2**	**Column 3**	**Column 4**	**Column 5**
Basic Materials	75	7.71	8.63	16.35
Consumer Discretionary Goods & Services (CDGS)	121	7.90	9.97	17.87
Diversified	12	19.21	6.89	26.09
Energy	14	1.15	8.54	9.68
Fast Moving Consumer Goods (FMCG)	40	18.06	11.78	29.83
Healthcare	44	12.04	9.63	21.67
Industrials and Utilities	107	11.88	9.08	20.97
Information Technology and Telecom	36	10.43	14.14	24.56
Grand Total	449	10.42	9.86	20.28
F statistic		14.017	13.447	13.208
p-value		0.000*	0.000*	0.000*

* Significant at the 0.01 level (2-tailed)

The average FES, foreign promoters as well as foreign non-promoters shareholdings of the sample companies for the period of study, 2008 to 2016, sector-wise is shown in Columns 3 to 5 of Table 4.7. It is found that there is a difference in the equity shareholdings of foreign promoters and foreign non-promoters in different sectors.

While the share of foreign promoters holding has been highest in Diversified (19.20 percent) and Fast Moving Consumer Goods (FMCG) (18.05 percent), it has been lowest in Energy sector amounting to 1.145 percent.

The foreign non-promoters have the highest average equity shareholdings in the Information Technology and Telecom sector (14.14 percent) with the share for the Fast Moving Consumer Goods (FMCG) sector touching 11.78 percent. However, the average equity shareholding of foreign non-promoters has been significantly less for the Diversified at 6.89 percent. In the case of Consumer Discretionary Goods and Services sector (CDGS), Healthcare, and Industrials and Utilities, the holding of foreign non-promoters has been almost the same around 9.5 percent.

Thus, the results showed that foreign average equity shareholdings in total in the Energy sector have been lowest (9.69 percent) due to lowest investment by foreign promoters despite reasonable investment by foreign non-promoters. Similarly, foreign average equity shareholdings in total in Information Technology and Telecom sector has been third highest (24.56 percent) due to highest investment by foreign non-promoters but near average investment by foreign promoters. The total foreign average equity shareholdings have been highest in the diversified sector due to highest investment by foreign promoters.

$H_{a1.3}$: There is significant difference in mean equity shareholdings across sectors

The variation in the FES has been further studied sector wise by ANOVA test.

This hypothesis would relate to foreign promoters equity shareholdings, foreign non-promoters equity shareholdings, and total foreign equity shareholdings.

As may be observed from the last row of Table 4.7, the difference in means across sectors in foreign promoter's shareholdings, foreign non-promoters shareholdings and total foreign shareholdings over the nine-year period of study has been significant at 1 percent level of significance. This indicates that foreign inflows differ across various sectors in the Indian context. Only four out of eight sectors with 132 firms (29.39 percent mean shareholdings) are preferred by foreign shareholders. Foreign investors do not favor remaining sectors for investments.

4.4.2 Distribution of Foreign Equity Shareholdings by Market Capitalization

The sample companies are also been classified into three groups according to market capitalization, namely small-cap, mid-cap and large-cap companies. The market capitalization as on the last day of last year of the period of study, 2016 has been the basis. The companies having a market capitalization of less than Rs. 20000 million are classified as small-cap companies, those with a market capitalization of Rs. 20000 million or more but less than 740000 million are classified as mid-cap companies and those with a market capitalization of Rs. 740000 million and above are classified as large-cap companies. The number of companies that fall into each category is given in Table 4.8.

Out of the total 449 sample companies, 173 companies (38.6 percent) are small-cap companies, 124 companies (27.6 percent) are mid-cap companies and 152 companies (33.8 percent) are large-cap companies. The sample represented all the three groups of market cap companies.

The equity shareholding of foreign promoters has been highest in mid-cap companies and lowest in small-cap companies. The equity shareholding of foreign non-promoters has been similar for mid-cap and large-cap companies. Thus, it appears that all foreign investor's

invest in mid and large market capitalization companies. Market capitalization is considered as a basis to evaluate the relative size of one company versus another. It is a measure of company's value in the vulnerable equity market, and also the market's perception of its future projections because it reflects what investors are keen to pay for its stock.

Table 4.8: Distribution of Foreign Equity Shareholdings by Market Capitalization (for the sample period 2008 to 2016, in Rs. million)

Market Capitalisation (Amount in Rs. Million)	Number of companies	Percentage	Foreign promoter equity shareholdings	Foreign non-promoters equity shareholdings	Total foreign equity shareholdings
Small-cap companies (0 - less than 20000)	173	38.54	8.78	7.39	15.38
Mid-cap companies (20000 and above - less than 740000)	124	27.61	13.02	11.23	25.45
Large-cap companies (740000 and above)	152	33.85	10.21	11.64	21.79
Total	449	100	10.42	9.86	20.28
F statistic			1.685	124.093	172.505
p-value			0.186	0.000*	0.000*

* Significant at the 0.01 level (2-tailed)

The variation in the FES has been further studied on the basis of market capitalization by ANOVA test.

$H_{a1.4}$: There is significant difference in mean equity shareholdings across market capitalization

This hypothesis would relate to foreign promoters equity shareholdings, foreign non-promoters equity shareholdings, and total foreign equity shareholdings.

The results of the same for the change in foreign promoter's equity shareholdings, foreign non-promoters equity shareholdings, and total FES during the period of study can be observed from the last row of Table 4.8.

The difference in means across market capitalization in foreign non-promoters equity shareholdings and total FES across the nine-year period of study has been significant at 1 percent level of significance. This indicates that foreign non-promoters equity shareholdings differ across three groups of companies across market capitalization in the Indian context. Foreign investors would consider market capitalization of firms in taking investment decisions.

4.4.3 Distribution of Foreign Equity Shareholdings by Size

The sample companies have been categorized into three groups on the basis of size, namely small, medium and large. The basis of classification has been size as given in the Prowess database on the basis of the three-year average of the total income and total assets of a company which is:

Size = 3 year average (total income + total assets)

The size of companies less than Rs. 11000 million are classified as small companies, size being Rs. 11000 million or more but less than 45000 million are classified as medium companies and size being 45000 million and above are classified as large companies. The number of companies that fall into the mentioned category is given in Table 4.9.

Table 4.9: Distribution of Foreign Equity Shareholdings by Size (for the sample period 2008 to 2016, in Rs. million)

Size (Amount in Rs. Million)	Number of companies	Percentage	Foreign promoter equity shareholdings	Foreign Non-promoters equity shareholdings	Total foreign equity shareholdings
Small companies (0 - less than 11000)	188	41.88	10.48	7.40	17.25
Medium companies (11000 and above - less than 45000)	156	34.74	12.13	10.28	22.71
Large companies (45000 and above)	105	23.38	7.76	13.53	21.95
Total	449	100	10.42	9.86	20.28
F statistic			5.794	70.635	28.305
p-value			0.003*	0.000*	0.000*

* Significant at the 0.01 level (2-tailed)

Out of the total 449 sample companies, 188 companies (41.88 percent) are small companies, 156 companies (34.74 percent) are medium companies and 105 companies (23.38 percent) are large companies. The sample represented evenly all the age groups for the sample firms.

The average equity holdings of foreign promoters are highest in medium-sized companies and lowest in large companies. The average foreign non-promoters equity shareholdings depict an increasing trend wherein lowest is invested in small companies and highest is invested in large companies. This investment behavior of foreign non-promoters depicts apparent disinterest in small firms with least average shareholdings. Thus, it appears that foreign non-promoters invest in larger companies. Consequently, total FES has increased for medium-sized companies as against smaller ones and fall marginally for larger ones as against medium-sized companies.

The variation in the FES has been further studied size wise by ANOVA test.

$H_{a1.5}$: There is significant difference in mean equity shareholdings across size

This hypothesis would relate to foreign promoters equity shareholdings, foreign non-promoters equity shareholdings, and total foreign equity shareholdings.

As may be observed from the results of Table 4.9 that difference in means across size of firms in foreign promoter's equity shareholdings, foreign non-promoters equity shareholdings and total FES across the nine-year period of study has been significant at 1 percent level of significance. This indicates that foreign inflows differ across various firm sizes in the Indian context. Thus, foreign investors would consider firm sizes in taking investment decisions.

4.4.4 Distribution of Foreign Equity Shareholdings by Age

The sample companies have been categorized into three groups on the basis of age, namely young, middle-aged and old. The age is calculated by subtracting the end of each reporting year from the year of incorporation. The companies operating since last 24 years are classified as young companies, those operating for last 25 years but less than 47 years are classified as middle-aged companies and those operating for last 47 years and above are classified as old companies.

Table 4.10: Distribution of Foreign Equity Shareholdings by Age (for the sample period 2008 to 2016)

Type of company	Number of companies	Percentage	Foreign promoter equity shareholdings	Foreign non-promoter equity shareholdings	Total foreign equity shareholdings
Young companies (up to 24 years)	153	34.07	6.83	9.63	16.57
Middle-aged companies (25-46 years)	159	35.41	8.63	10.59	19.12
Old companies (47 and above)	137	30.52	17.21	9.48	26.62
Total	449	100	10.42	9.86	20.28
F statistic			46.969	6.987	16.637
p-value			0.000*	0.001*	0.000*

* Significant at the 0.01 level (2-tailed)

The number of companies that fall in the mentioned category is given in the Table 4.10. Out of the total 449 sample companies, 153 companies (34.07 percent) are young companies, 159 companies (35.41 percent) are middle-aged companies and 137 companies (30.52 percent) are old companies. The sample represented evenly all the age groups.

An age-wise analysis of FES shows an increasing trend for foreign promoters and total FES. Foreign promoter's equity shareholdings as well as total FES increase as the

company matures. For old companies, the total foreign shareholdings are 26.62 percent and that of young companies has been 16.57 percent. This shows the lesser confidence of foreign shareholders in the younger Indian firms probably due to political considerations, the presence of corruption, poor infrastructure, inadequate government policies and rigid labor laws. On the other hand, older and mature firms are perceived as stable, visible, reputed and legitimate similar to Li et al. (2010). Foreign non-promoters equity shareholdings marginally increase for middle-aged firms and marginally fall for old firms.

The variation in the FES has been further studied age-wise by ANOVA test.

$H_{a1.6}$: There is significant difference in mean equity shareholdings across age

This hypothesis would relate to foreign promoters equity shareholdings, foreign non-promoters equity shareholdings, and total foreign equity shareholdings.

As may be observed from the results of the last row of Table 4.10 that difference in means in foreign promoter's equity shareholdings, foreign non-promoters equity shareholdings and total FES across the nine-year period of study is significant at 1 percent level of significance. This indicates that foreign inflows differ across various age groups of sample companies in the Indian context where more is invested in older and mature firms by foreign investors.

4.5 Conclusions

In this chapter, foreign promoter's equity shareholdings, foreign non-promoters equity shareholdings, and total FES have been studied for the purpose of analyzing the investment behavior of foreign investors in Indian listed firms over the period of study.

The average foreign equity shareholding in the sample Indian firms for the period of study has been 20.28 percent. The average foreign promoter's equity shareholding has been 10.42 percent and that of foreign non-promoters is 9.86 percent. The trend analysis instates the fact that foreign non-promoters' equity shareholdings are a dominant group which drives the result for total FES. The equity shareholdings of foreign non-promoters have a high financial significance and hence obtained an important and significant position in equity shareholdings of Indian listed companies as against those of foreign promoter's equity shareholdings (Kara et al, 2007).

The average equity stake of foreign promoters' is 25.70 percent (considering only those firms which have foreign promoters' investments) which implies that if in case foreign promoters' invest, they have a substantial stake to control the board. Change in foreign non-promoters equity shareholdings is significant over the period of study which derives the results of total FES. None of the firms witness persistent consolidation or persistent divestment over the period of study. This implies that foreign investors consistently shift within the firms.

Further, total foreign equity stakes and foreign non-promoters equity stakes are large but foreign promoters are minority shareholders. Thus, foreign investors, being large can exert a significant degree of control over Indian firms. Foreign investors would consider sector, market capitalization, firm sizes and firm age while taking investment decisions.

To sum up, it can be inferred from the above that total foreign equity participation has increased and these investors have large stakes in the Indian companies. The dominance of non-promoters is particularly significant. The government's initiatives to abandon the

restrictions and caps on foreign investments in India since the beginning of 1990's have shown some favorable results. Now, these investors can become a rather crucial characteristic of CG in India.

Another, important aspect to be considered here is when foreign investors invest; they have their own risk-return objectives. Investors do their own risk-return assessments depending upon various firm-specific characteristics and also on CG infrastructure. This persuades further examination of firm characteristics that impact investments by foreign investors in the listed firms in India. The same will be discussed in the next chapter.

Chapter 5

Relation between Foreign Equity Shareholdings and Firm Characteristics

CHAPTER 5

RELATION BETWEEN FOREIGN EQUITY SHAREHOLDINGS AND FIRM CHARACTERISTICS

5.1 Introduction

This chapter examines the relationship between foreign equity shareholdings (FES) and firm characteristics of Indian companies over the period of study (i.e. the financial year 2007-2008 to the financial year 2015-2016). An attempt has been made to determine empirically whether or not firm characteristics influence FES in the Indian context. In order to check the influence, various research techniques namely, descriptive statistics, correlation, ordinary least squares regression, multiple linear panel regression, binary logistic regression and multinomial logistic regression techniques are used.

The chapter is bifurcated into sections. The first section 5.2 discusses the effect of firm characteristics on FES. In the following subsections 5.2.2 and 5.2.3 respectively, the detailed analysis as per the two research propositions namely, the effect of firm-specific characteristics on foreign equity group membership, namely, controlling stake and non-controlling stake and secondly, whether or not different firm characteristics influence various levels of FES stakes differently is presented. Later in the last section 5.3, the findings of the empirical analysis of the sample companies are summarized.

5.2 Foreign Equity Shareholding and Firm Characteristics

Since the enunciation of Indian government's New Industrial Policy 1991, favoring LPG - liberalization, privatization, and globalization, the cross-border movement of funds started picking up. The investors all over the world have their own risk-return

objectives for which they do risk-return assessments. The foreign equity investments depend on various firm-specific criteria's, namely market capitalization of the company, profitability of the company, leverage, growth prospects of the company, size, age of the firm etc. The study attempts to identify the firm characteristics that impact FES in Indian listed firms.

5.2.1 Impact of Firm Characteristics on Foreign Equity Shareholdings

For the purpose of examining the relation between FES and firm characteristics of select Indian companies, the following hypothesis is tested:

$H_{a2.1}$: There is significant relationship between foreign equity shareholdings and firm characteristics

The foreign equity shareholding (*FES*) is the sum of the shareholding of foreign promoters and foreign non-promoters. Firm characteristics is a function of market capitalization, profitability, leverage, growth, size, and age of the firm.

5.2.1.1 Definition and Significance of Variables under Study

The factors potentially affecting FES are referred to as firm characteristics. Previous studies have found mixed results for the relation between various firm characteristics and various types of ownership. The present study relates to FES in which foreign institutional investors have a dominant and significant share. Therefore, Table 5.1 and 5.2 summarizes the results of previous studies with respect to various firm characteristics and foreign shareholdings, and firm characteristics and institutional shareholdings separately. No previous study similar to the present study is found. The construction and significance of the various firm characteristics is explained as under:

Market Capitalization (*MCAP*)

Market capitalization can be proxy for two things (Liljeblom & Loflund, 2005). Firstly, it may capture the effect of information asymmetries. Investors are less likely to face information asymmetries for high market cap firms. Secondly, transaction costs are likely to be lesser for high market cap firms. All previous studies have found the positive relation of market capitalization with foreign shareholdings as well as institutional shareholdings. A positive relationship is expected between FES and market capitalization.

"Market Capitalisation in Rs. million is calculated by multiplying the number of shares outstanding with the closing price of the stock as on the last day of the financial year". Number of shares outstanding is the total number of equity shares held by the company. This is the total free-float market capitalization of the company which is included in the computation of "Bombay Stock Exchange (BSE) and National Stock Exchange (NSE)" index. "Free-float market capitalization is defined as that proportion of total shares issued by the company, which are readily available for trading in the market, other than any kind of locked-in shares, which will not come to the market for trading in the normal course".

Profitability (*ROTA*)

The investment by an owner would be for returns or profits on the investments. It is expected that foreign investors will favor spending in profitable firms because of the lesser probability of default and of bankruptcy. Therefore, a positive relationship is expected between profitability and FES.

Previous studies have taken varied measures of firm profitability namely, return on total assets, return on net worth, return on equity, return on capital employed and the results

are mixed. Return on total assets *(ROTA)* is a pure measure of operating efficiency of a firm in generating returns without being affected by management financing decisions. In the study, the return on total assets is used as a proxy for firm profitability.

"Return on total assets (percentage) is net profit divided by total assets. Net profit is the net profit of the company after tax. It is the residual after all revenue expenses are deducted from the sum of the total income and the change in stocks".

Leverage (*LEV*)

Leverage is a long-term measure of financial distress and foreign investors are less likely to invest in leveraged firms (Liljeblom & Loflund, 2005. Therefore a negative relationship between leverage and FES is expected.

Leverage is debt-to-equity ratio which measures the relative proportion of shareholders' equity and debt employed to finance a company's assets. In other words, it refers to the ratio of borrowed funds to own funds. The debt to equity ratio is computed by dividing the company's total debt by shareholder's equity. Total debt is the total of all forms of borrowings, debt and debentures, long-term as well as short-term, secured and unsecured. It also includes funds raised by way of preference shares as preference capital is a kind of borrowing. Shareholder's equity includes equity capital and reserves.

Firm Growth (*GROW*)

The foreign investors would favor high growth firms as they are expected to bring more capital gains and high future performance similar to Al-Najjar and Taylor (2008). Previous studies have shown mixed results with respect to growth and foreign

shareholdings and only positive results with respect to institutional shareholdings. A positive relation between growth and FES is expected.

Growth is measured in terms of change in sales because of change in net fixed assets (times). This change in sales is the one that can be attributed to the change in net fixed assets, assuming that the efficiency in the utilization of net fixed assets has remained unchanged.

Firm Size (*SIZE*)

Firm size reflects likely entry barriers that might be an outcome of economies of scale, the degree of the market power of a firm, firm's ability to raise funds internally as well as firm's ability to raise funds through issue of new equity (Sarkar & Sarkar, 2000). Majority of the previous studies have found that investors closely follow large firms and hence a positive relation is expected between firm size and FES.

Firm size is Rs. million is the three year average of the total income and total assets of a company which is:

Size = 3 year average (total income + total assets)

Firm Age (*AGE*)

Firm age controls for lifecycle effects (Sarkar & Sarkar, 2000). Older and mature firms enjoy reputation building due to their experience based learning efforts. Further, older firms are prone to inertia and face rigidities in change (Kumar, 1999). Li et al. (2010) consider age as a good indicator of stability, visibility, reputation, and legitimacy. Previous studies have reported positive relation of age of the firm with foreign

shareholdings as well as institutional shareholdings. A positive relationship is expected between FES and age of the firm.

Firm age is the total number of years since the year of inception of the firm calculated as the difference between each of the end of the financial year of study and the year of incorporation of the company.

Table 5.1: Relation with Foreign Shareholdings

Variable	**Previous Results**		
	Positive	**Negative**	**Ambiguous**
Market capitalization	Liljeblom and Loflund (2005), Kang and Stulz (1997), Bokpin and Isshaq (2009), Mangena and Tauringana (2007), Ko et al. (2007)		
Profitability	LLSV (1998), Liljeblom and Loflund (2005), Fu and Wu (2013), Choi et al. (2014), Kang and Stulz (1997), Mangena and Tauringana (2007)	Shleifer and Vishny (1997)	Kumar (2004), Bokpin and Isshaq (2009)
Leverage	Wahab et al. (2008), Liljeblom and Loflund (2005)	Huang and Song (2006), Anderson et al. (2001), Kang and Stulz (1997), Rajan and Zingales (1995), Titman and Wessels (1988), Jensen and Meckling (1976)	
Growth	Hovakimian et al. (2004), Choi et al. (2014), Kang and Stulz (1997), Bokpin and Isshaq (2009)	Bokpin and Isshaq (2009), Ko et al. (2007)	Liljeblom and Loflund (2005), Thanatawee (2014)
Firm's size	Choi et al. (2014), Bokpin and Isshaq (2009) , Ko et al. (2007), Mangena and Tauringana (2007), Liljeblom and Loflund (2005), Tong and Ning (2004), Huang et al. (2004), Anderson et al (2001), O'Brien and Bhushan (1990)		Anderson et al. (2001)
Firm's age	Fauzi and Musallam (2014)		
Sector dummy	Fu and Wu (2013)	Anderson et al. (2001)	

Table 5.2: Relation with Institutional Shareholdings

Variable	Previous Results		
	Positive	**Negative**	**Ambiguous**
Market capitalization	Ferreira and Matos (2008)		
Profitability	Thanatawee (2014), Yang and Wang (2008), Kumar (2004), Chaganti and Damanpour (1991)	Tong and Ning (2004), Ho (2003)	Al-Najjar and Taylor (2008), Liang et al. (2011)
Leverage	Wahab et al. (2008), Thanatawee (2014)	Oak and Dalbor (2010), Al-Najjar and Taylor (2008), Huang and Song (2006), Rajan and Zingales (1995), Chaganti and Damanpour (1991), Titman and Wessels (1988), Jensen and Meckling (1976)	Tong and Ning (2004)
Growth	Hovakimian et al. (2004), Ko et al. (2007), Oak and Dalbor (2010), Al-Najjar and Taylor (2008)		
Firm's size	Thanatawee (2014), Al-Najjar and Taylor (2008), Ko et al. (2007), Tong and Ning (2004), O'Brien and Bhushan (1990)	Oak and Dalbor (2010), Liang et al. (2011)	
Firm's age	Fauzi and Musallam (2014)		

Certain Qualitative Remarks

Before embarking upon the empirical evaluation of the proposed analysis, certain qualitative remarks are indeed essential. In a study, it is not possible to exhaust the sources of variation in the dependent variable, especially in the context of FES as it is guided by several economic and non-economic considerations both at the micro and macro levels. These considerations could be related to home country of the foreign investor or the country where investments are to be made. Again, some of the known sources of variation cannot be incorporated into the specification either due to non-availability of data or due to the nonquantifiability of variables. Another factor, which

cannot be easily isolated, is the influence of government intervention and policies on the inflows and outflows of funds in our country.

Multiple Linear Panel Regression Function

To test hypotheses about the relationship between firm characteristics and FES, a simple cross-sectional OLS regression function is specified as:

$$FES_{it} = f\ (MCAP_{it}, ROTA_{it}, LEV_{it}, GROW_{it}, SIZE_{it}, AGE_{it}\ )$$

Where

FES_{it} = foreign equity shareholdings in an firm

$MCAP_{it}$ = market capitalization

$ROTA_{it}$ = return on total assets

LEV_{it} = leverage

$GROW_{it}$ = growth of the firm

$SIZE_{it}$ = size of the firm

AGE_{it} = age of the firm

The subscript *i* is used to denote individual firms and subscript *t* is used to denote time.

To control for sector and time, both sector and time dummy variables are included.

Sector is a categorical variable and seven sector dummies are employed referring to the sector to which the firm belongs to out of the total eight sectors, namely "*Basic Materials, Consumer Discretionary Goods and Services (CDGS), Diversified, Energy, Fast Moving Consumer Goods (FMCG), Healthcare, Industrials and Utilities, Information Technology and Telecom"*.

Time is another categorical variable with eight dummies referring to the period of study which is nine years, 2008- 2016.

While examining the impact of explanatory variables on the dependent variable, the statistical techniques that have been employed are descriptive statistics (minimum, maximum, mean, standard deviation) and multiple linear panel regression (pooled ordinary least square, fixed effect, random effect, feasible generalized least squares).

Pooled OLS regression assumes all companies are same, that is, it neglects heterogeneity that exists among sample companies. On the contrary, the panel data analysis, namely, fixed effect model and random effect model considers heterogeneity that exists among sample firms. The fixed effect model allows for heterogeneity among sample companies. The intercept varies across the company but does not vary over time. The random effect model incorporates the variability of sample firms across time. Thus, the panel data analysis allows controlling for variables which cannot be observed or measured across companies, for example, cultural factors across companies and variables that change over time but not across companies, for example, national policies, government regulations, international agreements etc.

The multiple linear panel regression equation that has been estimated to measure the combined effects of explanatory variables on the dependent variable is:

$$FES_{it} = \beta_0 + \beta_1 MCAP_{it} + \beta_2 ROTA_{it} + \beta_3 LEV_{it} + \beta_4 GROW_{it} + \beta_5 SIZE_{it} + \beta_6 AGE_{it} + sector\ dummy + time\ dummy + €_{it}$$

The descriptive statistics describe the basic features of the data in the study.

The statistical significance of regression coefficients has been worked out and tested by applying t-test. The coefficient of determination R squared (R^2) is also computed to determine the percentage variation in the dependent variable explained by all the independent variables.

The model fit is examined by F value. The multicollinearity is detected by variance inflation factors and the autocorrelation by Durbin Watson statistics. *rho*- is the share of the estimated variance of the overall error accounted for by the individual effect u_i.

5.2.1.2 Major Findings

The following subsections provide the descriptives and correlation of the variables of the study followed by the findings of the regression equation.

5.2.1.2.1 Descriptive Statistics

The descriptive statistics of dependent and independent variables for the period of study from 2008 to 2016 are given in Table 5.3. The inspection of the table reveals that the mean FES for the sample companies has been 20.28 percent with a standard deviation of 23.77 percent which is much higher than 1.701 percent ownership by institutional investors (both foreign and domestic) as reported by Kumar (2004). The minimum and the maximum equity percentage held by foreign shareholders have been 0.00 percent and 94.92 percent respectively.

Table 5.3: Descriptive Statistics for the Sample

Variable	Minimum	Maximum	Mean	Std. Deviation
FES	0.00	94.92	20.28	23.77
MCAP	8.29	4988978.10	122183.74	323167.73
ROTA	-331.51	131.04	7.48	13.15
LEV	0.00	39.93	0.99	2.00
GROW	-391389.56	1026626.68	9273.18	42391.95
SIZE	0.00	3759651.60	66423.28	228497.88
AGE	1.0	153	35.76	24.40

The variation in an equity stake of foreign shareholdings is apparent. The t-test for change in FES during the sample period provides evidence that change in FES is significant as

discussed in detail in chapter 4 (Table 4.3). The FES does significantly change over sectors, market capitalization, size, and age as discussed in a detailed manner in chapter 4 (Table 4.7 to Table 4.10), thus panel data regression analysis has been used.

Further, there is wide variation within the sample. The sample included large as well as the small cap, high profit as well as low profit, less leveraged as well as highly leveraged, high growth as well as low growth, large as well as small, old as well as new firms.

The minimum value of market capitalization has been 8.29 and the maximum value has been 4988978.10. The high market capitalization with a mean of 122183.74 and standard deviation of 323167.73 showed the volatility in share prices in the stock exchanges.

The returns on total assets varied between negative 331.51 percent and 131.04 percent. The mean *ROTA* has been 7.48 percent which is much higher than Indonesia's mean profitability of 1.18 percent (Chevalier et al., 2006), of China 6.6 percent (Qi et al., 2000), of Thailand 7.18 percent (Wiwattanakantang, 2001). The standard deviation of *ROTA* (13.15) showed variability in the profits of sample firms.

Leverage varied between 0.00 to 39.93, with the mean 0.99 and standard deviation 1.99. The sample firms has nearly 40 percent of the total finance from debt sources.

On an average, the firm grows 9273.1779. The growth in terms of change in sales of the sample firms varied between -39189.56 to 1026626.68 with a standard deviation of 42391.95. This depicts variation in growth opportunities for the sample firms.

The size of the sample firms ranged between 0.00 to 3759651.60 with the mean 66423.28 and standard deviation 228497.88. The sample has included both small and large firms.

The age of the sample firms ranged between 1 to 153 years with an average of 36 years (standard deviation 24.40). The data included a varied sample of new and old firms.

5.2.1.2.2 Correlation Matrix

Correlation matrix for sample companies over the period of study is given in Table 5.2. The correlation matrix is drawn between independent variables (market capitalization, profitability, leverage, growth, size, age) and the dependent variable (FES).

Table 5.4 shows that market capitalization, return on total assets and age are significantly positively correlated to FES at 1 percent level of significance while leverage is significantly negatively correlated to FES at 1 percent level of significance. The correlation between growth and FES as well as size and FES is insignificant.

Table 5.4: Correlation of Variables used in the Study

	FES	MCAP	ROTA	LEV	GROW	SIZE	AGE
FES	1						
MCAP	.042** (0.009)	1					
ROTA	.127** (0.000)	.111** (0.000)	1				
LEV	-.048** (0.003)	-.037* (0.020)	-.137** (0.000)	1			
GROW	-.007 (0.681)	.351** (0.000)	-.003 (0.855)	.013 (0.418)	1		
SIZE	-.027 (0.090)	.559** (0.000)	-.023 (0.146)	.029 (0.071)	.614** (0.000)	1	
AGE	.158** (0.000)	.047** (0.003)	.043** (0.007)	-.035* (0.026)	.051** (0.001)	.079** (0.000)	1

** Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.05 level (2-tailed).
p-values in parentheses

Market capitalization is positively significantly correlated to return on total assets, growth, size, and age at 1 percent level of significance and negatively correlated to leverage at 5 percent level of significance.

Return on total assets has a significant positive correlation with market capitalization and age (at 1 percent level of significance) and significant negative correlation with leverage (at 1 percent level of significance).

Leverage has a negative significant correlation with market capitalization (at 5 percent level of significance), ROTA (at 1 percent level of significance) and age of the firm (at 5 percent level of significance). Leveraged is not significantly correlated with growth and size of the firm.

Market capitalization, size, and age are positively significantly correlated with growth at 1 percent level of significance. Size is positively significantly correlated to market capitalization, growth, and age at 1 percent level of significance.

5.2.1.2.3 Multiple Linear Panel Regression Analysis

Multiple linear panel regression (ordinary least square, fixed effect, and random effect) results are drawn from independent and dependent variables for sample firms. The results are shown in Table 5.5.

Column 2 of Table 5.5 displays the results of pooled OLS regression for FES with control variables. Variance inflation factors ranged between 1.006 and 1.159 depicting no multicollinearity amongst the independent variables. Durbin Watson statistics 0.291 signified absence of autocorrelation in the residuals. The coefficient of determination R squared (R^2), has shown that 11.85 percent variation in FES is explained by all

independent variables at 1 percent level of significance (F statistic- 24.95, p-value 0.00). F statistic is significant at 1 percent level of significance indicates model fit.

Table 5.5: Multiple Linear Panel Regression Results

Variables	**Pooled Regression**	**Panel Regression**		
		Fixed Effect	**Random Effect**	**FGLS**
Column 1	**Column 2**	**Column 3**	**Column 4**	**Column 5**
MCAP	0.2428 (0.000)***	0.2407 (0.000)***	0.2386 (0.000)***	0.2428 (0.000)***
ROTA	0.781 (0.011)**	0.1899 (0.352)	0.255 (0.21)	0.781 (0.011)**
LEV	-0.0581 (0.002)***	-0.0093 (0.525)	-0.0125 (0.38)	-0.0581 (0.002)***
GROW	-0.0859 (0.435)	-0.0138 (0.830)	-0.0169 (0.79)	-0.0859 -0.434
SIZE	0.0199 (0.014)	0.0186 (0.070)*	0.00196 (0.043)**	0.0199 (0.014)**
AGE	0.3825 (0.000)***	-0.0657 (0.566)	0.2828 (0.000)***	0.3825 (0.000)***
SECTOR DUMMY	yes	yes	yes	yes
TIME DUMMY	yes	yes	yes	yes
CONSTANT	-4.9565 (0.031)**	-1.2506 -0.417	17.567 0.000***	-4.956 (0.030)**
R squared	0.08	within = 0.0551 between = 0.0236 overall = 0.0414	within = 0.0525 between = 0.1383 overall = 0.1146	
F Stat / Wald	11.85 (0.000)***	13.43 (0.000)***	260.4 (0.000)***	526.95 (0.000)***
Durbin-Watson	0.291			
rho		0.7363	0.6985	

*Significant at the 0.10 level (2-tailed).
**Significant at the 0.05 level (2-tailed).
***Significant at the 0.01 level (2-tailed).
p-values in parentheses

Column 2 of Table 5.5 determines that β_i of market capitalization, leverage, and age is highly significant at 1 percent level of significance while ROTA is significant at 5 percent level of significance. The coefficient of growth and size are insignificant in determining FES as per the pooled OLS model.

F test of joint significance of fixed effects intercepts is significant at 1 percent level of significance with p-value 0.000 and stat 21.75. This suggests using fixed-effect model. Also, Breusch and Pagan Lagrange multiplier test for random effects appeared significant (chibar2(01) = 7532.00, p-value = 0.000) implying that OLS should not be used.

Column 2 and column 3 of Table 5.3 show the results of fixed effect and random effect panel regression. The Hausman test chi-square statistic is 28.86 (p-value 0.0168) signify the appropriateness of fixed effect model. The results of fixed effect model column 2 of Table 5.5 have been discussed in detail.

The results of fixed effect model show that market capitalization is highly significant at 1 percent level of significance while size is significant at 10 percent level of significance. Other control variables namely return on total assets, leverage, growth, and age are insignificant.

The β_i of market capitalization and size is positive. The coefficient of determination, R squared (R^2) has shown that 5.51 percent within variation in FES is explained by all independent variables with a significant (1percent) wald statistic (13.43, p-value 0.00). Since wald statistic is significant at 1 percent level of significance hence firm characteristics impact FES.

Wooldridge test for autocorrelation in fixed panel data model exhibits no first-order autocorrelation with F(1, 446) = 0.005, p-value 0.009. Further, Breusch-Pagan / Cook-Weisberg test for heteroscedasticity is significant at 1 percent level of significance with p-value 0.000 (chi2(6) = 152.11) exhibiting heteroscedasticity. Feasible generalized least squares (FGLS) regression is preferred under heteroscedasticity or serial correlation. The results of the same are estimated and presented in column 5 of Table 5.5.

Since wald statistic is significant at 1 percent level of significance (526.95, 0.000) hence firm characteristics impact FES. The alternate hypothesis 2.1 is accepted. Hence, there is a significant effect of firm characteristics on FES.

The results of FGLS regression exhibit that market capitalization, leverage, and age are significant at 1 percent level of significance. ROTA and size are significant at 5 percent level of significance. The impact of market capitalization, ROTA, size, and age are positive while that of leverage has been negative. Growth remains insignificant.

The positive and significant impact of market capitalization ($\beta_i = 0.2428$), ROTA ($\beta_i = 0.781$), size ($\beta_i = 0.0199$) and age ($\beta_i = 0.3825$) imply that foreign investors do consider these firm characteristics in taking the investment decisions. Out of these four, the impact of ROTA is highest and that of size is lowest. The negative and significant impact of leverage ($\beta_i = 0.0581$) implies that lower leveraged firms would have higher FES.

5.2.2 Impact of Firm Characteristics on Equity Group Membership of FES

Bebchuk and Hamdani (2009) point out that kind of agency problem, the contestability of control of the firm, the ability of a majority of shareholders to exercise their formal power, and the main ways in which opportunism benefits insiders differ for different

equity stakes of investors. The de facto control in a non-controlling equity stake of a particular investor rests with management as against with controller or majority shareholder in large or controlling stake of a particular investor. In the first category, the focus is on the manager-shareholder relationship (Type I agency problem) while the focus shifts to majority shareholder and minority shareholder relationship in the second category (Type II agency problem).

For the purpose of identifying the firm characteristics that impact equity group membership of FES of select Indian companies, the following hypothesis is tested:

$H_{a2.2}$: There is significant relationship between firm characteristics and equity group membership of foreign equity shareholdings

The equity group membership (*EGM*) of FES refers to the non-controlling stake (*NCS*) equity ownership group and controlling stake (*CS*) equity ownership group of FES. NCS equity ownership group refers to the sample companies with FES being less than the average FES of 20.28 percent. The CS equity ownership group of FES refers to the sample companies with FES being more than or equal to the average FES of 20.28 percent. In the total sample of 3918 observations, 2636 observations are of NCS and 1282 observations are of CS.

To test hypotheses 2.2 binary logistic regression function is specified as:

$$EGM_{it} = f\ (MCAP_{it}, ROTA_{it}, LEV_{it}, GROW_{it}, SIZE_{it}, AGE_{it}\ )$$

Where

EGM_{it} = equity group membership of FES

$MCAP_{it}$ = market capitalization

$ROTA_{it}$ = return on total assets

LEV_{it} = leverage

$GROW_{it}$ = growth of the firm

$SIZE_{it}$ = size of the firm

AGE_{it} = age of the firm

The subscript *i* is used to denote individual firms and subscript *t* is used to denote time.

Binary logistic regression estimates the probability that a character is present, referred to as the probability of "success". The observation would fall into one of two categories of a dichotomous dependent variable based on one or more independent variables that can be either continuous or categorical. It is a special case of the generalized linear regression and thus similar to linear regression.

The binary logistic regression model $logit\ (\pi) = \beta_0 + \beta_k$ does assume a linear relation between the logit of the response and the explanatory variables. The model does not assume a linear relationship between the dependent variable and the independent variables.

Thus, "no exact linear dependencies should exist among control variables (*X*) across the years under study and that the relationship between dependent variable (*Y's*) and *X's* should be nonlinear or logistic (Hair et al., 2015) (i.e. $P(Y = 1|X) = exp\ (\Sigma\beta_k\ X_k)\ /\ [1 + exp\ (\Sigma\beta_k\ X_k)]$)".

Where

Y = binary response variable, taken as,

Y_i = 1; if the trait is present in observation *i*

Y_i = 0; if the trait is NOT present in observation *i*

X = (X_1, X_2, ..., X_k) be a set of explanatory variables

This relationship is checked for all the eight control variables as mentioned in table 5.5.

The goodness of fit statistics of the model is: "change in *-2 Log likelihood* statistics or the difference between the two *-2 log likelihood* values denoted by chi-square". The results gave significant chi-square p values for the control variables namely, market capitalization, return on total assets (*ROTA*), leverage, size, and age together with sector and year. The results of chi-square statistics and p values are shown in Table 5.6.

Table 5.6: Chi Square Statistics and p-values of Control Variables

Variables	**Chi square**	**p value**
Market capitalization	119.471	0.000*
Return on total assets (ROTA)	17.086	0.000*
Leverage	14.269	0.000*
Growth	0.051	0.821
Size	25.022	0.000*
Age	11.154	0.001*
Sector	75.874	0.000*
Year	37.658	0.000*

*Significant at the 0.01 level (2-tailed).

The control variables except growth are significant at 1 percent level of significance. These seven variables are considered meaningful and nonlinear ones. Thus, our final logistic regression function is:

$$Pr\ (Y = 1|X)\ =\ F\ (\beta_0\ +\ \beta_1\ X_1\ +\ \beta_2\ X_2\ +\ldots..+\ \beta_k X_k)$$

The dependent variable *Y* is a dichotomous variable with value 0 and 1 which represents two groups of equity membership of FES. For CS companies Y=1 and for NCS companies Y=0.

The independent variables X_1, X_2,... X_K include market capitalization, return on total assets (*ROTA*), leverage, size, age, sector and year.

$$Pr\,(EGM) = \beta_0 + \beta_1\, MCAP_{it} + \beta_2\, ROTA_{it} + \beta_3\, LEV_{it} + \beta_4\, SIZE + \beta_5\, AGE_{it} + sector\ dummy + time\ dummy + €_{it}$$

In order to reveal the differences in two equity ownership groups of foreign equity, an independent sample t-test has been performed on the control variables. Table 5.7 summarizes the results of the same.

Table 5.7: Summary Statistics for CS and NCS Firms

Variable	NCS firms (N= 2636)		CS firms (N=1282)		t statistics	Sig.
	Mean	Std. Deviation	Mean	Std. Deviation		
Market capitalization	78885.328	203424.500	186254.431	436973.477	-10.339	0.000*
Return on total assets (ROTA)	6.812	14.463	8.459	10.843	-3.856	0.000*
Leverage	1.091	2.133	0.858	1.775	3.591	0.000*
Size	51643.094	212427.889	88294.209	248856.194	-4.940	0.000*
Age	34.682	24.235	37.344	24.568	-3.354	0.000*

*Significant at the 0.01 level (2-tailed).

The p-value of all the variables is statistically significant indicating a distinguishable difference in the two groups. The CS firms, on an average, are less leveraged (average leverage 0.858) as compared to the NCS companies (average leverage 1.091). On the contrary, the CS firms have higher market capitalization, ROTA, size, and age compared with NCS companies. This indicates that relatively profitable, larger and older companies tend to have CS of FES. The higher market capitalization of CS firms indicates that the firms with CS of FES tend to have higher market value than those with NCS of FES.

5.2.2.1 Major Findings

The binary logistic regression works with two models, namely the null model and the full model. The null model is also called the first model or zero model and the full model is also called the second model. The null model has an intercept and no predictors whereas the full model includes the predictor(s).

“Both the models predict the percentage of cases for which the dependent variable has been correctly predicted by the model which is called the overall percentage”.

The most common assessment of overall model fit in logistic regression is the goodness-of-fit test (G), based on the overall percentage, which is simply the chi-square difference between the null model (i.e., with the constant only) and the model containing one or more predictors.

“If in case the overall percentage increases for the full model as against the null model than the model is a good fit for the data. Thus, it is an assessment of the improvement of fit between the predicted and observed values on dependent variable Y by adding the predictor(s)”.

The overall percentage of the null model is 67.3 percent which increased to 70.8 percent for the full model proposed for the study. Hence, the proposed full model is a good fit for the existing data to predict the probability of equity group membership of FES.

The alternate hypothesis is accepted. Hence, there is a significant effect of firm characteristics on equity group membership of FES.

In logistic regression, there is no true R squared value as there is in OLS regression. There are two modified versions of this basic idea, one developed by Cox & Snell and

the other developed by Nagelkerke. The Cox and Snell R Square is 7.1 percent and Nagelkerke R Square is 9.9 percent. It can be concluded that the model explains 7.1 percent to 9.9 percent of the variation in FES.

The Wald chi-square statistic assesses the contribution of individual predictors in a given model. The Wald statistic, is similar to the t-test in linear regression, is used to assess the significance of coefficients. The Wald statistic is the ratio of the square of the regression coefficient to the square of the standard error of the coefficient and is asymptotically distributed as a chi-square distribution.

The results of binary logistic regression for the equity group membership of FES are given in Table 5.8. On the inspection of the table, it is revealed that wald statistic is significant for ROTA, size, and age. This indicates that profitability, size, and age are significantly related to the probability of CS equity group membership of FES. Size impact CS of equity group membership in the positive direction. As the size of the firm increases, the predicted probability will increase, thus increasing the likelihood that the equity group membership of FES would be a CS. ROTA and age impact CS of equity group membership in the negative direction. As the profitability of the firm decreases or if in case the firm is younger, the predicted probability will increase, thus increasing the likelihood that the equity group membership of FES would be a CS.

However, the impact of size has been the highest with coefficient 0.022. The impact of age is the second most important predictor of CS equity group membership of foreign equity investors with coefficient as 0.021.

Table 5.8: Results of Binary Logistic Regression

Variable	Coefficient	Wald	p-value	Exp (B)
MCAP	.018	.250	.617	1.121
ROTA	-.016	18.397	0.000***	.985
LEV	.002	.017	.896	1.002
SIZE	.022	4.698	0.030**	1.000
AGE	-.021	140.093	0.000***	.979
Sector				
sector (1)	-.279	3.369	0.066*	.757
sector (2)	.165	1.427	.232	1.180
sector (3)	-.089	.114	.736	.915
sector (4)	-1.914	26.647	0.000***	.148
sector (5)	.118	.479	.489	1.125
sector (6)	-.094	.324	.569	.910
sector (7)	-.323	5.205	0.022**	.724
Year				
year (1)	-.339	4.972	0.025**	.713
year (2)	-.304	4.077	0.043**	.738
year (3)	-.236	2.507	.113	.790
year (4)	-.193	1.701	.192	.824
year (5)	-.170	1.316	.251	.844
year (6)	-.133	.785	.376	.875
year (7)	-.061	.176	.675	.941
year (8)	-.032	.048	.826	.969
Constant	.343	4.418	.036**	1.409

*Significant at the 0.10 level (2-tailed).
**Significant at the 0.05 level (2-tailed).
***Significant at the 0.01 level (2-tailed).

The effect of market capitalization and leverage is not significant. This indicates the fact that CS equity group membership of FES would not be dependent upon market capitalization and leverage. Moreover, the equity group membership of FES varies across sectors and years (with few coefficients significant) as depicted by the Wald statistic.

The odds ratio in the binary logistic regression compare the relative odds of the occurrence of the outcome of interest (CS equity group membership of FES), given exposure to the variables of interest (firm characteristics, namely market capitalization, return on total assets (*ROTA*), leverage, size, age together with sector and year).

The odds ratio can also be used to determine whether a particular exposure is a risk factor or a protective factor for a particular outcome. Further, the magnitude of various risk factors for that outcome can also be compared. The odds ratio higher than one signifies a particular exposure is a risk factor and the odds ratio less than one signifies a particular exposure is a protective factor.

The odds ratio more than one indicates that the probability of CS equity group membership of FES with a unit increase in market capitalization and leverage is more likely to occur than the probability of NCS equity group membership of FES at the prior values of market capitalization and leverage. This probability is highest for market capitalization (1.121) and for leverage (1.002). The profitable and older companies have 2 percent and 3 percent respectively, less likely chance to have a CS equity group membership of FES.

The highly significant negative effect of sector indicates decreasing impact of that sector with increased odds of achieving CS equity group membership of FES. The results determine that the probability of CS equity group membership of FES for a firm decreases if operating in economic sector except for Diversified and Healthcare in relation to the basic materials sector, which is considered as the reference category.

Further, the odds ratio reveal that firms in the diversified sector are 18 percent more likely than those from reference category (basic materials) to achieve CS of FES. Another significant result that emerged is that the association between year and CS of FES has varied after controlling for other control variables. The overall association has remained significant for almost all the years. The size of coefficients and their associated odds ratio has changed substantially. The statistic is significant for the year ended 2009 and 2010 only. The odds ratio being less than one indicates that the probability of CS equity group membership of FES occurring for each following year is less than the probability of NCS equity group membership of FES of the year 2008. However, less likely chance to have a CS equity group membership of FES has fallen from 29 percent to only 4 percent. Thus, as the investment by FES would increase in the future years, the equity stakes of FES would move from NCS to CS equity group membership and significantly influence the management, performance, and valuations of these firms (Jensen & Meckling, 1976).

5.2.3 Impact of Firm Characteristics at different Levels of FES Stake

The stocks in which FES is high are perceived as favored stock and will command high market prices due to demand by small retail investors. Stocks with lower stakes of FES could then prove less volatile. If FES increases, it is considered positive as foreign investors invest funds only when they are totally optimistic and confident about the future of the company. On the contrary, if foreign investors sell their shares due to any reason, whether due to economic or political changes or legal problems in their home country or moving out of a short-term investment, then it would not necessarily mean that the company is not doing well. If foreign investors sell their stock, a fall in stock

prices is noticed which is representative of the various firm, market, and economy specific factors.

The comparison of stakes over years and beyond the thresholds will be a meaningful exercise as only beyond certain levels, the impact of firm characteristics on FES would change and be meaningful similar to Sarkar and Sarkar (2000), McConnell and Servaes (1990). Further, a significant and large variation in FES both across sectors and time has been noticed in the dataset.

The total number of observations is divided into six levels of equity stakes (dividing the data into six subparts) for FES similar to the equity levels suggested by LLSV (1999). The levels and the corresponding number of observations from the dataset is mentioned below:

Minority Stake – less than 1 percent (712 observations),

Small Stake – more than equal to 1 percent and less than 3 percent (331 observations),

Large Stake – more than equal to 3 percent and less than 10 percent (818 observations),

Large with Significant Threshold of Votes – more than equal to 10 percent and less than 20 percent (758 observations),

Large with Effective Control – more than equal to 20 percent and less than 51 percent (738 observations),

Outright Majority – more than equal to 51 percent (561 observations).

For the purpose of examining the relation between the various levels of equity stakes of foreign shareholdings and firm characteristics of select Indian companies, the following hypotheses have been tested.

$H_{a2.3}$: There is significant relationship between firm characteristics* and various levels** of foreign equity shareholdings stake

*firm characteristics are a function of market capitalization, profitability, leverage, growth, size, and age

**as defined above as per LLSV (1999).

When a dependent variable has various categories (more than two) and the values of each category have a meaningful sequential order where a value is indeed 'higher' than the previous one, then ordinal logit model is used.

The ordered logit model is estimated which failed the test of proportional odds (chi-square 252.561, p-value 0.000) and hence the multinomial logit model is estimated.

5.2.3.1 Major Findings

The likelihood ratio test is significant at 1 percent level of significance with chi-square 990.746 and the corresponding p-value 0.000. Hence, the proposed model is a good fit for the existing data to find out the effect of firm characteristics on various levels of equity stakes of foreign shareholdings. It can be concluded that there exists significant effect of firm characteristics on various threshold levels of equity stakes of foreign shareholdings.

The Cox and Snell R Square is 22.3 percent and Nagelkerke R Square is 23.0 percent. It can be concluded that the model explains 22.3 percent to 23.0 percent of the variation in various threshold levels of equity stakes of foreign shareholdings.

The estimates are shown in Table 5.9. Minority equity stake of FES is the reference category for multinomial logistic regression.

For small equity stake of FES, that is, more than equal to 1 percent to less than 3 percent equity stake of FES, market capitalization, size, and age are significant at 1 percent level of significance. This can be interpreted as for a unit change in market capitalization for small equity stake of FES relative to minority equity stake of FES, given other predictors in the model held constant, the multinomial log odds of preferring small equity stake of FES to minority equity stake of FES would be expected to decrease by 0.129 units. It implies that the relative probability of small equity stake rather than minority stake is 13 percent (exp value of 0.129 is 1.364) lower for market capitalization. However, the positive impact of size is 9 percent and that of age is more than double. The impact of market capitalization has been rising (from 0.016 to 0.338 units) till large with effective equity stakes of FES.

Profitability is not significant firm characteristics up to large equity stakes but its impact is quite high for an outright majority. Size and age are the firm characteristics that impact all levels of equity stakes of FES at 1 percent level of significance. This implies that size and age of the firm are the most influential firm characteristics to induce foreign shareholders to increase their equity stakes.

Growth remains insignificant for all levels of FES. The main difference lies in the impact of leverage which is negative and only beyond large equity stakes of FES implying that foreign investors invest lesser with high debt firms.

Industrials and Utilities sector is significant for all levels (except small) of equity stakes of FES. The time dummy is insignificant for all levels of equity stakes of FES except for the year 2014 for large with significant threshold of vote's stakes of FES.

Table 5.9: Results of Multinomial Logistic Regression (with reference category - minority equity stake of FES)

Stakes / Variable	Small equity stake of FES		Large equity stake of FES		Large with significant threshold of votes		Large with effective control		Outright majority	
	Coefficient	**p value**	**Coefficient**	**p value**	**Coefficient**	**p value**	**Coefficient**	**p value**	**Coefficient**	**p value**
MCAP	0.129	(0.004)*	0.016	-0.64	0.295	(0.000)*	0.338	(0.000)*	0.233	(0.000)*
ROTA	0.376	-0.792	1.796	-0.206	1.194	-0.322	1.551	-0.273	13.68	(0.000)*
LEV	0.007	-0.896	-0.073	(0.081)***	-0.177	(0.000)*	-0.107	(0.012)**	-0.083	(0.076)***
GROW	-0.108	-0.922	0.584	-0.48	-0.387	-0.598	0.021	-0.982	-0.805	-0.538
SIZE	0.087	(0.000)*	0.079	(0.000)*	0.076	(0.000)*	0.086	(0.000)*	0.054	(0.003)*
AGE	0.715	(0.000)*	0.49	(0.000)*	0.58	(0.000)*	0.67	(0.000)*	1.298	(0.000)*
Constant	-3.395	-0.837	-19.931	-0.146	-7.515	-0.526	-14.73	-0.301	-76.467	(0.000)*
Sector Dummy****	Energy		Diversified, FMCG, Healthcare, Industrials and Utilities		Industrials and Utilities		All sectors significant		CDGS, Diversified, Industrials and Utilities	
Time Dummy	All insignificant		All insignificant		All insignificant except 2014		All insignificant		All insignificant	

Note: **** Only significant sectors are mentioned, ***, ** and * denote the statistical significance at the 10%, 5%, and 1% levels respectively.

Robustness of the Results: Similar results are obtained if only 3331 number of observations are taken (deleting 587 observations with FES up to 0.10 percent. Applying "Thumb rule 2" (Bowerman et al., 2013) six equity levels (dividing the data into six subparts) of FES are used in the model:

Extremely low equity stake of FES - more than 0.15 percent to 2.5 percent (629 observations),

Very low equity stake of FES - more than 2.5 percent to 5 percent (467 observations),

Low equity stake of FES - more than 5 percent to 10 percent (675 observations),

Average equity stake of FES - more than 10 percent to 15 percent (533 observations),

High equity stake of FES - more than 15 percent to 20 percent (421 observations), and

Very high equity stake of FES - above 20 percent and up to 55.64 percent (606 observations)

5.3 Conclusions

In this chapter, the empirical results of the relation between FES and firm characteristics of Indian companies over the period of study (i.e. the financial year 2007-2008 to the financial year 2015-2016) are discussed. The results of the analysis indicate that firm characteristics (market capitalization, ROTA, leverage, size, and age) significantly impact FES. Firm characteristics (ROTA, size, and age) significantly predict the probability of equity group membership of FES. Firm characteristics (market capitalization, size, and age) significantly impact various levels of FES stake. This is largely true in real life as equity investment decisions in a particular firm's equity would encompass the thorough assessment of its firm-specific characteristics. The impact of FES on CG is explored in the next chapter to evaluate whether FES could contribute to the larger cause of CG.

Chapter 6

Relation between Foreign Equity Shareholdings and Corporate Governance

CHAPTER 6

RELATION BETWEEN FOREIGN EQUITY SHAREHOLDINGS AND CORPORATE GOVERNANCE

6.1 Introduction

During the last few decades, with the advent of LPG - liberalization, privatization, and globalization, the cross-border movement of funds picked up. By the year 2000, it was felt that foreign investments would need best corporate practices and policies termed as "Corporate Governance". All over the world, various initiatives reforming the corporate practices and policies called CG initiatives were undertaken to guide the corporate sector in playing its role in increasing foreign capital inflows and to steer the foreign investors' confidence in the host companies. Governance is one of the important criteria amongst many others, for foreign investors to decide on which company to invest in. This chapter examines the relation between foreign equity shareholdings (FES) and CG of Indian companies over the period of study (i.e. the financial year 2007-2008 to the financial year 2015-2016). An attempt has been made to determine empirically whether or not FES influence the quality of CG in the Indian context. The instrumental variable regression, multiple regressions – pooled ordinary least squares, OLS with spline specification and sensitivity analysis techniques is used.

The chapter is bifurcated into sections. The first section 6.2, presents the regression function and its related issues to study the effect of FES on CG score after dealing with endogeneity. The findings of the empirical analysis of the sample companies are discussed in subsection 6.2.5. This subsection also finds the nature of the relationship between concentrated foreign shareholdings and CG through spline specification

technique in subsection 6.2.5.4. Later in the last section 6.3, the empirical results are summarized.

6.2 Foreign Equity Shareholdings and Corporate Governance

Foreign shareholdings are a crucial characteristic of the system of CG. Foreign shareholdings in any form, whether institutional or not, can lead to effective monitoring and hence bring in significant monitoring benefits for the recipient companies. In order to study the effect of foreign equity stakes on the quality of CG of select Indian companies, the following hypothesis is tested:

$H_{a3.1}$: There is significant impact of foreign equity shareholdings on corporate governance

The foreign equity shareholding *(FES)* is the sum of equity shareholdings of Foreign Promoters and Foreign non-promoters which is taken as a proxy for FES.

In this analysis, CG is a dependent variable taken as the CG score (*GOVSC*) of the sample company for the respective year of study. *GOVSC* is Bloomberg Environment, Social and Governance (ESG) Score taken from Bloomberg database.

The effect of foreign equity stakes on the quality of CG can be studied over a time period since governance reforms and initiatives would take some time to happen and provide visible results. The end of 2008 and end of 2016 have been the starting and ending years of the nine-year period of study. Hence, 2008 and 2016 has been the two years over which the quality of CG is been studied.

Out of the total sample of 449 companies as discussed in section 3.5 of chapter 3, governance score is available for 201 companies for both the years of study that is 2008 and 2016. The sample is thus reduced to 201 companies.

The following function has been employed to examine hypothesis 3.1 (stated in section 3.4 of chapter 3):

$$GOVSC = f\ (FES, MCAP\ , ROTA, LEV, GROW, SIZE, AGE)$$

where *GOVSC* is quality of CG of the firm, *FES* is a foreign ownership variable, and control variables include a set of six variables. The firm-specific characteristics, namely, market capitalization, profitability, leverage, growth, firm size and firm age are included as control variables similar to Ananchotikul (2006).

6.2.1 Definition and Significance of Variables under Study

Various firm-specific characteristics affecting CG are identified by the previous studies (Fauzi & Musallam, 2015; Fu & Wu, 2013, Li et al., 2010; Khanchel, 2007; Ananchotikul, 2006; Brown & Caylor, 2006; Ananchotikul, 2006; Kumar, 2004; Sarkar & Sarkar, 2000). Table 6.1 summarizes the results of previous studies with respect to the relation of foreign shareholdings, institutional shareholdings and various firm characteristics with CG. The definition and the construction of the variables is explained in subsection 5.2.1.1 of chapter 5. The significance of the various firm characteristics with respect to CG is explained as under:

Market Capitalization (*MCAP*)

Inefficient governance directly causes additional agency costs, which might get reflected in market prices. Good governance actually generates high market valuations hence a positive relation is expected between market capitalization and CG.

Profitability (*ROTA*)

Profitable firms have strong governance practices because they are safer and have very little chances of bankruptcy. In such cases, expropriation of shareholders wealth is less likely

even if legal systems are imperfect (LLSV, 1999). If in case profits fall, high profits motivate management to misstate financial statements leading to poor governance. Further, poor profits often instigate management to place undue emphasis on reported profits (Loebbecke, 1989). Therefore, a positive relation is likely between profitability and CG.

Leverage (*LEV*)

Good governance in the form of greater investor protection increases the availability of external finance at lower costs (LLSV, 1998). Thus, a positive relation between leverage and governance is expected.

Firm Growth (*GROW*)

Better growth opportunities imply the greater need of external capital and growing firms may have better governance practices (Durnev & Kim, 2005; Himmelberg et al., 2002; LLSV, 1999). Thus, a positive relationship between growth and governance is expected.

Firm Size (*SIZE*)

Large firms are difficult to monitor due to increased complexities. Also, large firms have significant resources to invest in good CG practices (Ananchotikul, 2006). Larger the firm, better the governance practices.

Firm Age (*AGE*)

Older companies are prone to managerial entrenchment and lack of ability to respond to changes in the environment (Sarkar & Sarkar, 2000). Newer and smaller firms take away market share in spite of disadvantages like lack of capital and reputation (Sorensen & Stuart, 2000). Old firms may or may not have poor governance practices than new firms. The relation between age of the firm and CG seems ambiguous.

Table 6.1: Relation with Governance

Variable	Previous Results		
	Positive	**Negative**	**Ambiguous**
Foreign shareholdings	Shleifer and Vishny (1997), Xu et al (2005), Aggarwal et al (2011), Mangena and Tauringana (2007)	Ananchotikul (2006), Bokpin and Isshaq (2009)	
Institutional shareholdings	Khanchel (2007), Yang and Wang (2008), Al-Najjar and Taylor (2008)	Thanatawee (2014)	
Market capitalization	Durnev and Kim (2004), Klapper and Love (2004), Bokpin and Isshaq (2009), Ragothaman and Gollakota (2009)		
Profitability	Ragothaman and Gollakota (2009), Anderson et al (2001), Aksu and Kosedag (2006)	Shleifer and Vishny (1997), Phung and Le (2013), Cheung (2005)	
Leverage	Ragothaman and Gollakota (2009), Khanchel (2007), Phung and Le (2013)	Rahman (2002)	
Growth	Banerjee et al (2012)		
Firm's size	Khanchel (2007), Ananchotikul (2006), Tsamenyi et al (2007)		
Firm's age	Kumar (2004), Fu and Wu (2013), Li et al., (2010), Brown and Caylor (2006), Ananchotikul (2006), Sarkar and Sarkar (2000), Fauzi and Musallam (2015)		
Sector dummy	Ananchotikul (2006)		Anderson et al (2001)

6.2.2 Addressing Endogeneity

In the course of the extensive literature review on the relationships between *CG, ownership structure and firm characteristics, a vexing issue, namely endogeneity* has emerged. Hence, various challenges exist in the econometric analysis of the data when explaining the causes and effects of CG and its related mechanisms.

To illustrate, treating CG as an *independent variable (X)* affecting *corporate ownership (Y)* (Morck et al., 1989); positive results would provide that CG positively effects corporate ownership. In other words, better CG would attract corporate investors. However, causality also labeled as 'simultaneous causality' may run in both directions, i.e. it runs from X to Y and from Y to X (Farooque & Yarram, 2010).

To illustrate further, treating corporate ownership as an independent variable (X) affecting CG (Y), corporate owners lead to firms practicing good CG (Bowman & Min, 2012).

Thus, it can be argued that while ownership may influence governance, governance can impact ownership too. In other words, the unanswered issue remains: Does CG attract corporate investors or corporate investors provide better CG practices? (Chevalier et al., 2006). If corporate ownership is necessary cause of CG then the presence of good CG practices implies demand of corporate ownership by investors. Further, investors would be willing to pay a premium for good CG practices. However, if corporate ownership is a sufficient cause of CG then the presence of active corporate owners implies good CG practices, besides many other causes of better/good CG practices. However, the presence of CG does not imply the presence of active/ large corporate ownership.

The archival research in the area has suggested measures to deal with endogeneity. It follows that any study that unreasonably ignores the possibility of endogeneity, but makes a causal argument that, say, better CG attracts more corporate ownership, is at the very least incomplete. Unidirectional regression analysis may no longer be the most suitable ones to test the relation between CG and corporate ownership. Moreover, the sign of this relationship is not clear with some authors claiming a negative relation

whereas other authors support a positive relation. Another problem that exists in such analysis is that of "unobserved heterogeneity" where the identified relationships are symptoms of some unobservable factor(s) that drive both *X* and *Y* (Brown et al., 2011). Therefore, in these cases, the explanatory variable(s) will be endogenous and correlated with the residuals '*e*' in the regression equation. Ordinary least squares regression is biased and inconsistent. Therefore, instrumental variable regression analysis has been applied to address the issue of endogeneity.

6.2.3 Instrumental Variable Regression

The instrumental variable regression equation that has been selected to measure the reverse cause and effect relationship between CG and ownership (Kumar, 2004; Sarkar & Sarkar, 2000) is:

$$GOVSC_{it} = \beta_0 + \beta_1 FES_{it} + \beta_2 MCAP_{it} + \beta_3 ROTA_{it} + \beta_4 LEV_{it} + \beta_5 GROW_{it} + \beta_6 SIZE_{it} + \beta_7 AGE_{it} + sector\ dummy + time\ dummy + €_{it}$$

where

$GOVSC_{it}$ = corporate governance score of the firm

FES_{it} = foreign equity shareholdings in a firm

$MCAP_{it}$ = market capitalization

$ROTA_{it}$ = return on total assets

LEV_{it} = leverage

$GROW_{it}$ = growth of the firm

$SIZE_{it}$ = size of the firm

AGE_{it} = age of the firm

The subscript *i* is used to denote individual firms and subscript *t* is used to denote time.

To control for sector and time, sector dummy variables and time dummy variable have been included. The sector is a categorical variable depicting the sector to which the firm belongs out of the total eight sectors, namely "*Basic Materials, Consumer Discretionary Goods and Services (CDGS), Diversified, Energy, Fast Moving Consumer Goods (FMCG), Healthcare, Industrials and Utilities, Information Technology and Telecom"*. Time is a dichotomous variable referring to the two periods of study. Time dummy is zero if the observation belonged to the financial year 2007- 2008, otherwise, time dummy is one.

There is no prior theory that determines suitable instrument for FES. The best instrument would be one that is related to control rights and cash flow rights leading to corporate control. This is because incentive of investment by foreign shareholders is highly related to firm's control.

For instrumental variable regression, a set of valid instruments for CG are to be identified and the equation is to be estimated consistently using two-stage least squares (2SLS). The 2SLS requires at least as many instruments as there are suspect endogenous variables to identify the parameters in the model (Murray, 2006). In other words, when there are multiple endogenous variables, some additional parameters are to be identified in the model.

The instrumental variable *(IV)* regression equation specified above has one endogenous variable, namely, *FES*. Therefore, one instrument *(IV)*, a dummy variable depicting the size of FES is identified. The instrument – dummy variable, *IV* is a dichotomous variable with value 0 and 1 representing the two groups, *IV* equal to zero

(*X=0*) and *IV* equal to one (*X=1*) based on the equity ownership stake of foreign shareholders.

The two groups, *IV* equal to zero (*X=0*) and *IV* equal to one (*X=1*) are identified after considering the average foreign equity stake in the sample companies. The average foreign equity stake in the sample companies is 20.28 percent.

IV equal to zero (*X=0*) represented 255 observations being less than the average foreign shareholdings of 20.28 percent, out of total 402 observations of 201 sample companies for the two years of study.

Similarly, *IV* equal to one (*X=1*) represented 147 observations being more than and equal to the average foreign shareholdings of 20.28 percent, out of total 402 observations of 201 sample companies for the two years of study based on the equity ownership stake of foreign shareholders.

The basic idea behind this instrument is that more equity stakes of foreign investors would amount to no or less deviation of control and cash flow rights, which brings more incentives for controlling shareholders to expropriate (LSS, 1999) and might encourage foreign shareholdings. This instrument is unlikely to have a direct influence on firms current CG score as when foreign investors invest they would certainly take time and incur costs to influence governance quality of the firm.

The 2SLS estimator is a special type of *IV* estimator which involves two successive applications of the ordinary least squares estimator in a two-stage procedure. In the first stage, *FES* is regressed on *IV* and the set of control variables, whereas in the second stage, GOVSC is regressed on *FES*, the control variables and the residuals from the first stage regression.

The 2SLS instrumental variable regression equation employed is:

First Stage

$$FES_{it} = \beta_0 + \beta_1 IV_{it} + \beta_2 MCAP_{it} + \beta_3 ROTA_{it} + \beta_4 LEV_{it} + \beta_5 GROW_{it} + \beta_6 SIZE_{it} + \beta_7 AGE_{it} + sector\ dummy + time\ dummy + €_{it}$$

Second Stage

$$GOVSC_{it} = \beta_0 + \beta_1 FES_{it} + \beta_2 MCAP_{it} + \beta_3 ROTA_{it} + \beta_4 LEV_{it} + \beta_5 GROW_{it} + \beta_6 SIZE_{it} + \beta_7 AGE_{it} + sector\ dummy + time\ dummy + €_{it}$$

where

FES_{it} = foreign equity shareholdings in an firm

IV_{it} = instrument for foreign equity shareholdings

$GOVSC_{it}$ = corporate governance score of the firm

$MCAP_{it}$ = market capitalization

$ROTA_{it}$ = return on total assets

LEV_{it} = leverage

$GROW_{it}$ = growth of the firm

$SIZE_{it}$ = size of the firm

AGE_{it} = age of the firm

The subscript '*i'* is used to denote individual firms and subscript '*t'* is used to denote time.

Henceforth, the two simultaneous equations are estimated by 2SLS system estimation in order to mitigate the potential bias, if any, from separate single equations similar to Lopez-Iturriaga and Rodriguez-Sanz (2012), Liang et al., (2011), Oak and Dalbor (2010), and Ferreira and Matos (2008).

The descriptive statistics describe the basic features of the data in the study. The multicollinearity is checked by variance inflation factors.

The statistical significance of regression coefficients is worked out and tested by applying t-test. The coefficient of determination R squared (R^2) is computed to determine the percentage variation in the dependent variable explained by all the independent variables.

The model fit is checked by wald statistics for 2SLS instrumental regression.

6.2.4 Justifying the Endogeneity and Validity of the Instrument

Various specification tests are to be performed for checking the endogeneity and validity of the instrument employed in instrumental variable regression analysis.

Durbin-Wu-Hausman test and weak instrument F test are to be performed to test the endogeneity and the validity of the instrument respectively (Oak & Dalbor, 2010). Further, the validity of the instrument is checked by its correlation with the endogenous variable and the residuals.

6.2.4.1 Test for Endogeneity

Durbin-Wu-Hausman test is to be applied to test for endogeneity. Durbin (score) chi2 (1) 0.382715, p = 0.5362 is insignificant at 10 percent level of significance and Wu-Hausman F (1,384) 0.366879, p = 0.5451 is insignificant at 10 percent level of significance.

The results of Durbin-Wu-Hausman test reveal that the p values are not significant. Thus, it can be interpreted that the variables, *GOVSC* and *FES* are exogenous. This provided evidence of *IV* being uncorrelated with the error 'u_{it}'.

6.2.4.2 Checking Instrument Strength

A weak instrument F test is to be performed to check the strength (relevance) of the instrument. *F stat* greater than 10 indicates that the instrument is not weak.

The weak instrument test for *IV* has an F stat 215.062 with p-value 0.0000 significant at 1 percent level of significance. This indicated that the instrument *IV* is not weak.

6.2.4.3 Checking the Validity of the Instrument

The validity of any instrument in instrumental variable regression analysis is formally checked by satisfying the following two conditions.

To illustrate, a variable z is called an instrument or instrumental variable for the regressor x in the scalar regression of $y = x + u$ if

(1) Exogeneity: z is uncorrelated with the error u; and

(2) Relevance: z is correlated with the regressor x

For the above stated instrumental variable regression, *IV (z)* is the instrument for foreign shareholdings (x).

Henceforth, instrument (*IV*) has to satisfy two conditions to be a valid instrument for the regression analysis. The correlation between *IV* and the residuals from regression should be zero. Secondly, the correlation between *IV* and *FES* should not be zero.

The correlation between *IV* and the residuals from the regression is zero and the correlation between *IV* and *FES* is 0.7886. Hence, the validity of *IV* as an instrument is confirmed.

6.2.5 Major Findings

After identifying the instrument, *IV* regression has been applied. This section deals with the findings obtained and interpretation that follows from the regression analysis. In the first two subsections, descriptive statistics and correlation matrix are stated.

6.2.5.1 Descriptive Statistics

The descriptive statistics of dependent and independent variables are given in Table 6.2. The inspection of the table reveals that there is a wide disparity in the quality of CG and FES in the sample companies. The overall CG score range from 17.86 to 85.64 with a mean score of 45.05 which is on a scale of 0 to 100 with a larger score indicating better CG.

Table 6.2: Descriptive Statistics for the Sample

Variable	Minimum	Maximum	Mean	Std. Deviation
GOVSC	17.86	85.64	45.05	7.669
FES	0	94.92	19.728	19.551
MCAP	255.34	4957695	169180.4	450452.6
ROTA	-39.52	70.84	8.692	10.02
LEV	0	9.84	0.692	1.042
GROW	-12584.8	1026627	16910.18	71137.3
SIZE	257.9	3737640	112787.1	339700.8
AGE	1	153	37.515	25.289

The minimum and maximum governance score for the financial year 2007- 2008 has been 17.86 and 64.28 respectively. Similarly, the minimum and maximum governance score for the financial year 2015 - 2016 has been 35.86 and 85.64 respectively. The data exhibit a wide variation in the minimum score and lesser variation in the maximum score over the period under study. This indicates that companies have tried to improve their governance score as lowest governance score has almost doubled (raised from

17.85 to 35.86) during the nine-year period. This is the result of regulatory changes aimed at strengthening CG in the Indian context.

The average *FES* is 19.73 percent with a minimum of 0.00 percent and maximum 94.92 percent for 402 observations of 201 sample companies. The minimum FES of 0.00 percent belongs to companies who had no foreign shareholdings in the year 2008 and later in the year 2016 has FES. The reverse also holds true. Thus, the period 2008 to 2016 witnessed major reforms in CG as well as an increase in FES.

The minimum value of market capitalization is Rs. 255.340 million and the maximum value is Rs. 4957695.220 million. The high market capitalization with a mean of 169180.359 and standard deviation of 450452.607 showed the volatility in market prices of the equity shares of the sample companies.

The returns on total assets varied between negative 39.52 percent and 70.84 percent. The mean *ROTA* is 8.692 which is much higher than reported in some previous studies (Chevalier et al., 2006; Wiwattanakantang, 2001; Qi et al., 2000). However, the standard deviation of *ROTA* depicted variability of profits of sample companies.

Leverage varied between 0.00 to 9.840, with the mean 0.692 and standard deviation 1.042. The sample firms has on an average 69 percent of the total finance from debt sources.

The growth of the firms depicted variations while ranging from a minimum of 12584.750 times (negative) to 1026626.680 times with a mean of 16910.175 and standard deviation of 71137.295. The sample companies included both inefficient and efficient firms in terms of utilization of net fixed assets.

The size of the sample firms ranged between Rs. 257.90 million to Rs. 3737640 million with the mean 112787.081 and standard deviation 339700.835. The sample has included both small and large firms.

The age of the sample firms ranged between 1 year to 153 years with an average of 38 (standard deviation 25.289). The data included a varied sample of new and old firms.

6.2.5.2 Correlation Matrix

Table 6.3 depicts the correlation matrix of the variables under study. A very low correlation (insignificant) is found between CG score and FES. This implies that good CG practices are not associated with foreign equity ownership in the Indian context. However, significant but low correlation is found between CG and market capitalization, growth and size of the firm.

Table 6.3: Correlation Table of Variables used in the Study

Variable	GOVSC	FES	MCAP	ROTA	LEV	GROW	SIZE	AGE
GOVSC	1							
FES	0.031 (0.540)	1						
MCAP	.341** (0.000)	0.027 (0.589)	1					
ROTA	0.051 (0.310)	.102* (0.041)	.162** (0.001)	1				
LEV	-0.025 (0.623)	-0.004 (0.940)	-.101* (0.044)	-.350** (0.000)	1			
GROW	.248** (0.000)	-0.034 (0.493)	.363** (0.000)	-0.002 (0.973)	0.029 (0.563)	1		
SIZE	.343** 0.000	-0.052 (0.297)	.588** 0.000	-0.058 (0.243)	0.019 (0.704)	.778** (0.000)	1	
AGE	0.054 (0.281)	-0.012 (0.811)	0.004 (0.939)	-0.044 (0.379)	0.049 (0.324)	0.04 (0.418)	0.071 (0.158)	1

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).
p-value in parentheses

The FES has not been correlated to any of the other control variables except ROTA. Further, Table 6.3 reveals that other correlations, if any, are again very low. This indicates that there could be no multicollinearity in the data. Further, variance inflation factor values, which range from 1.11 to 4.71 with a mean score of 2.129, proves that control variables are not correlated.

6.2.5.3 Instrumental Variable Regression Analysis

An instrumental variable regression result has been drawn from independent and dependent variables for sample firms. The results are shown in Table 6.4.

Column 2 of Table 6.4 displayed the first stage regression summary statistics while Column 3 of Table 6.4 displayed the second stage regression summary statistics.

The Wald statistic for first stage regression is significant at 1 percent level of significance with p-value 0.000. The Wald statistic for second stage regression is also significant at 1 percent level of significance being 79.97 with p-value 0.000.

Since wald statistic is significant at 1 percent level of significance hence independent variables (*FES, MCAP, ROTA, LEV, GROW, SIZE and AGE*) together significantly explain the variability of CG score yet FES is not found as significant.

Column 2 of Table 6.4 reported β_i and p values of first stage regression. *IV* has a positive coefficient of 1.95 with p-value 0.000 significant at 1 percent level of significance. Size of the firm is significant at 5 percent level of significance with β_i and p-value 0.1651, 0.014 respectively. Further, the age of the firm is significant at 10 percent level of significance with β_i and p-value 0.1712, 0.078 respectively. Surprisingly, the coefficients of market capitalization, return on total assets, leverage,

growth and time dummy are not significant in determining FES. Out of seven sector dummies, only four are significant.

Table 6.4: Instrumental Variable Regression Results

	Dependent variable	
Column 1	**Column 2**	**Column 3**
Variables	**FES (First Stage)**	**GOVSC (Second Stage)**
IV	1.95 (0.000)***	
FES		0.0059 (0.483)
MCAP	-0.0234 (0.692)	0.0172 (0.017)**
ROTA	0.2286 (0.483)	-0.0216 (0.590)
LEV	-0.0463 (0.377)	-0.0047 (0.462)
GROW	0.001 (0.819)	0.0112 (0.070)*
SIZE	0.1651 (0.014)**	0.0214 (0.011)**
AGE	0.1712 (0.078)*	0.0048 (0.686)
SECTOR DUMMY	Yes	Yes
TIME DUMMY	0.0285 (0.838)	0.0448 (0.009)***
CONSTANT	-1.013 (0.456)	3.443 (0.000)***
R Squared		within = 0.0283 between = 0.3431 overall = 0.1770
Wald	293 (0.000)***	79.97 (0.000)***

*Significant at the 0.10 level (2-tailed)
**Significant at the 0.05 level (2-tailed)
***Significant at the 0.01 level (2-tailed)
p-value in parentheses

The results of second stage instrumental variable regression are presented in Column 3 of Table 6.4. The beta coefficients of market capitalization (0.0172 p-value 0.017) and growth (0.0112 p-value 0.070) are positive and significant at 5 percent level of significance and 10 percent level of significance respectively. Size of the firm also significantly impact GOVSC with a beta coefficient of 0.0214 (p-value 0.011) at 5 percent level of significance.

Hence, market capitalization, growth and size impact CG score of the sample companies. This suggests that high market capitalization would lead to better governance. At the same time, growing companies would also practice better governance. Further, the larger firms would ensure practicing good CG practices than the smaller ones. Time dummy is significant (beta coefficient 0.0448, p-value 0.009) whereas all sector dummies are insignificant. The significance of time dummy implies that governance score improves over time.

Furthermore, the result of second stage instrumental variable regression has shown that FES does not impact GOVSC. The beta coefficient is insignificant (0.0059 p-value 0.483). The hypothesis 3.1 that there is the impact of FES on CG is rejected. This indicates that the relation between FES and GOVSC may be non-linear. A similar work is done by Kumar (2004), Sarkar and Sarkar (2000), McConnell and Servaes (1990), Morck et al., (1989) with respect to the relation between institutional and directors ownership and firm value. Thus, in order to check the existence of a non-linear relation between the FES and CG, spline specification analysis has been applied in the next subsection 6.2.5.4.

6.2.5.4 Spline Specification Analysis

The insignificance of FES in the above analysis presses on the need to further find out the nature of the relationship between FES and CG.

Previous literature stresses on the fact that concentration of ownership is another important determinant of corporate owners actions and activism (Kumar, 2004; Sarkar & Sarkar, 2000). The positive effect of concentrated ownership is that these large shareholdings would act as an incentive to monitor management leading to better governance practices. Also, such shareholders with large stakes would have the ability to monitor (Shleifer & Vishny, 1986). On the contrary, the negative effect of concentrated ownership is that these large shareholdings may act as an incentive, as another insider, to exploit minority thus, further reiterating poor governance practices (Ananchotikul, 2006).

The conflicting effects of concentrated ownership indicate that shareholder incentives and behavior would depend on the extent of shareholding. A non-linear relationship between concentrated FES and CG is expected.

Thus, governance score depends on and is a function of the concentration of FES. To examine the impact of concentrated FES, it is imperative to know how they impact CG score. The following hypothesis is tested:

$H_{a3.2}$: There is significant impact of concentrated* foreign equity shareholdings on corporate governance

**Concentrated foreign equity shareholdings is studied at various threshold levels, namely 5%, 10%, 15%, 20%, 25% similar to Kumar (2004), Sarkar and Sarkar (2000), LLSV(1997).*

A spline specification technique which allows for the piecewise linear relation between two variables is adopted to estimate the relationship between concentrated FES and CG similar to Kumar (2004), Sarkar and Sarkar (2000), McConnell and Servaes (1990), Morck et al., (1989). The effect of FES would change at a specific threshold point known as spline node. The regression line would be continuous before and beyond the spline node.

To illustrate, if in case the relation between *y* and *x* is piecewise linear, with the linear relation changing at one knot say x_1. Then, two spline variables (the number of spline variables is always one more than the number of knots) are added as independent variables (together with other control variables) to run a linear regression.

The ordinary least squares regression equation which has been studied to find out whether concentrated FES stake matters or not is:

$$GOVSC_{it} = \beta_0 + \beta_1 Foreign1_{it} + \beta_2 Foreign2_{it} + \beta_3 MCAP_{it} + \beta_4 ROTA_{it} + \beta_5 LEV_{it} + \beta_6 GROW_{it} + \beta_7 SIZE_{it} + \beta_8 AGE_{it} + Sector\ Dummy + Time\ dummy + €_{it}$$

where Foreign 1, Foreign 2 are two piecewise linear terms for FES at various threshold points.

The estimated threshold point at around 25% for foreign investors has been taken by Kumar (2004) while for the institutional investors it has been at 15%. The threshold level or spline knot for foreign shareholdings in the sample companies is studied at 10 percent, 15 percent, 20 percent and 25 percent. Hence, two piecewise linear terms of FES are included for estimating the spline specification in the regression analysis. The results of the regression with spline specifications are reported in Table 6.5, Column 2 to 6.

Specifically, for spline knot at 15 percent;

Foreign 1 = FES if FES < 15;

otherwise 15 everywhere else;

Foreign 2 = 0 if FES < 15;

otherwise (FES minus 15) if FES >= 15.

Table 6.5: OLS Regression Results with Spline Specification

	Dependent variable - GOVSC			
Column 1	**Column 2**	**Column 3**	**Column 4**	**Column 5**
Variables	**Threshold 10%**	**Threshold 15%**	**Threshold 20%**	**Threshold 25%**
Foreign 1	0.1444 (0.000)***	0.291 (0.000)***	0.214 (0.000)***	0.168 (0.000)***
Foreign 2	-0.034 (0.135)	-0.05 (0.048)**	-0.066 (0.020)**	-0.081 (0.010)**
MCAP	0.004818 (0.001)**	0.005 (0.001)**	0.005 (0.001)**	0.0055 (0.001)**
ROTA	-0.38 (0.452)	-0.039 (0.446)	-0.037 (0.468)	-0.036 (0.473)
RONW	0.013 (0.275)	0.013 (0.278)	0.0133 (0.291)	0.013 (0.29)
LEV	-0.1118 (0.758)	-0.106 (0.769)	-0.085 (0.813)	-0.079 (0.827)
CHAN	0.005 (0.815)	0.001 (0.806)	0.001 (0.761)	0.0005 (0.783)
SIZE	0.000515 (0.067)*	0.001 (0.067)*	0.002 (0.079)*	0.00016 (0.074)*
AGE	0.012 (0.405)	0.012 (0.393)	0.013 (0.372)	0.014 (0.326)
TIME DUMMY	-0.581 (0.437)	-0.584 (0.485)	-0.588 (0.431)	-0.567 (0.448)
CONSTANT	41.276 (0.000)***	41.889 (0.314)	42.223 (0.000)***	42.413 (0.000)***
R squared	0.206	0.2071	0.2074	0.2069
F Stat	285.694 (0.000)***	287.263 (0.000)***	287.703 (0.000)***	286.986 (0.000)***

*Significant at the 0.10 level (2-tailed)
**Significant at the 0.05 level (2-tailed)
***Significant at the 0.01 level (2-tailed)
p-value in parentheses

Column 2 of Table 6.5 reported the results of first spline specification with threshold point of 10%. The estimates showed that governance score significantly (at 1% level of significance) increases by 0.144 for every unit increase in FES before 10% and decreases by 0.034 for every unit increase in FES after 10% but that decrease is insignificant. Further, from column 3 to 5 of Table 6.5 it is clear that threshold points of 15%, 20%, and 25% do not alter the results but the after threshold level beta coefficient is also significant.

Therefore, these results suggested that the relationship between governance score and FES is non-linear. The FES influence the governance of the firm up to a certain level. FES before 15% equity stake would improve governance system but not beyond. After the threshold level of 15% foreign investors enjoy the rights and benefits of concentrated ownership and thus the incentives of good governance are lost.

To do some more robustness test, spline regression is run for a threshold level of 14% and 16% also, which gives the same results. The results of other control variables indicate that market capitalization and size are significant at all threshold levels.

6.2.5.5 Sensitivity Analysis for Coefficients of Spline Variables

The sensitivity analysis of coefficients of *Foreign 1* and *Foreign 2* has been performed for various threshold levels, in order to determine the threshold level in the Indian scenario. In order to do the same (threshold level of 5 percent and 30 percent is added to previous results), both the coefficients must be significant and also their magnitude must be maximum simultaneously. The interval gap between the two threshold levels is taken as 5%. The coefficients and their respective p-values are stated in Table 6.5. The pictorial presentation of *Foreign 1* and *Foreign 2 in* Figure 6.2 depict that *Foreign 1* shows a non-linear trend with its peak at 15%.

It can be observed that at 15% threshold level both coefficients are significant (at 1% level of significance) and also their magnitude (0.291, -0.05) maximum simultaneously. Hence, 15% threshold level can be taken as the threshold level of concentrated FES in the Indian scenario.

Table 6.6: Sensitivity Analysis for Coefficients of Foreign 1 and Foreign 2

Spline Knot	Threshold 5%	Threshold 10%	Threshold 15%	Threshold 20%	Threshold 25%	Threshold 30%
Foreign 1	0.067	0.1444	0.291	0.214	0.168	0.119
	(0.000)*	(0.000)*	(0.000)*	(0.000)*	(0.000)*	(0.000)*
Foreign 2	-0.020	-0.034	-0.05	-0.066	-0.081	-0.082
	(0.200)	(0.135)	(0.048)**	(0.020)**	(0.010)**	(0.002)*

*Significant at the 0.01 level (2-tailed)
**Significant at the 0.05 level (2-tailed)
p-value in parentheses

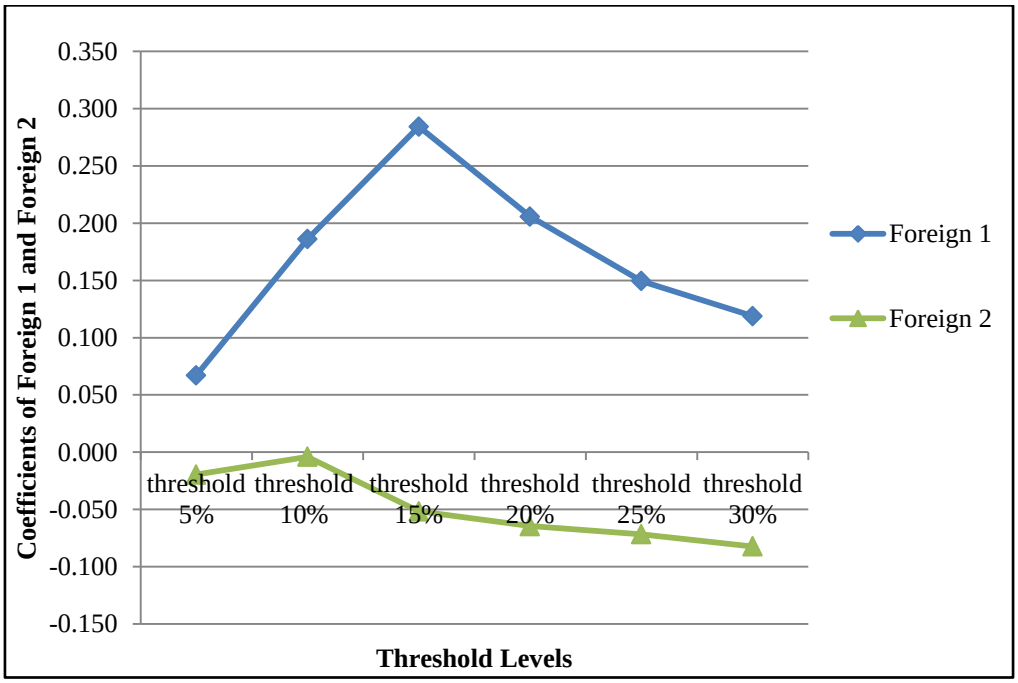

Figure 6.1: Sensitivity Analysis for Coefficients of Foreign 1 and Foreign 2

6.3 Conclusions

In this chapter, the empirical results of the relation between the equity stakes of foreign shareholders and governance score of Indian companies for 2008 to 2016 are established. The instrumental variable regression equation is estimated in order to address the potential endogeneity in the relationship between FES and CG with a dummy variable depicting the size of FES as an instrument for FES. The results of the analysis indicated that FES does not linearly impact governance of the sample companies under study. Further, the impact of concentrated shareholdings of foreign shareholders on CG is assessed through spline specifications. It is found that the relationship between governance score and FES is non-linear. It is positive for threshold level before 15% and not later. The next chapter would study the stakeholders' perception of current CG regime so as to meet the fourth objective of the study.

Chapter 7

Stakeholders' Perception of Current Corporate Governance Regime

CHAPTER 7

STAKEHOLDERS' PERCEPTION OF CURRENT CORPORATE GOVERNANCE REGIME

7.1 Introduction

This chapter provides the details of analysis done on the data collected through a structured questionnaire and the interpretations arrived therefrom with respect to the stakeholders' perception of current CG regime. The chapter is divided into various sections. The first section 7.2 describes the primary study. Section 7.3 explains the sampling technique and sample for the questionnaire survey. Profile of respondents is discussed in section 7.4. Findings of exploratory factor analysis are presented in section 7.5. The succeeding section 7.6 presents the test of homogeneity of variances amongst respondent groups. Later, results of post hoc analysis of differences across respondent groups are presented in section 7.7. The conclusions of the chapter are presented in the last section 7.8.

7.2 Stakeholders' Perception

A questionnaire survey is conducted in order to capture detailed information regarding the perception of various stakeholders' about the current CG regime. The study encompasses various aspects relating to CG regime, namely, its components, various performance implications, current status, major issues, the impact of certain issues on CG system, the importance of various strategies adopted and key players of CG.

Thus, for the purpose of assessing the stakeholders' perception of the current CG regime, an exploratory factor analysis (EFA) is done to extract underlying factors that

would define the key issues of CG regime. EFA as a data summarization tool would provide the key issues of CG regime at a more generalized level where individual variables are grouped and then viewed collectively as a concept.

Instrument

From the literature review based on Indian and international studies, items are borrowed from different countries with slight modifications to fit the specific context of CG regime in India. The final version of the instrument can be considered as an adapted version of the scale used by Ho (2005), Nam and Nam (2004) to determine the factors constituting CG regime. Some modifications, adaptations, and eliminations were done to adapt the content to the Indian capital markets and economy. A CG assessment instrument consisting of 39 items was formulated and the opinion and suggestions of experts were sought. During the pilot study phase, respondents raised questions regarding certain items. Overlapping, complicated and irrelevant items were eliminated. The original instrument was modified and the final questionnaire consisted of 21 items on a five-point Likert scale. Table 7.1 presents the list of items in the final questionnaire.

The respondents were required to provide their responses at values ranging from ‘Strongly disagree: 1’ to ‘strongly agree: 5’; ‘extremely unimportant: 1’ to ‘extremely important: 5’; extremely bad: 1’ to ‘extremely good: 5 and extremely unlikely: 1’ to ‘extremely likely 5’; extremely low: 1’ to ‘extremely high The respondents were also required to provide the information related to their demographic profiles for the purpose of classification.

Table 7.1 List of Items Selected for Final Questionnaire

Items		
1.	In your opinion, how important is the company's internal management that is its board of directors in CG regime?	V1
2.	How will you rate the importance of legal framework of India with respect to CG?	V2
3.	Do you feel that regulatory framework including monitoring institutions play an important role in CG regime?	V3
4.	Do you feel that the owners, who are the holders of equity share capital, are major caretakers of CG in a company?	V4
5.	CG is nothing but a set of rules, procedures, and practices to be followed.	V5
6.	It is only the inhibit culture and value system of the society that will build the CG regime?	V6
7.	Do you expect improvement in firm's ability to generate equity share capital because of improvement in CG?	V7
8.	Do you agree that improved CG regime would improve Corporate Social Responsibility?	V8
9.	Do you believe that improved CG practices would attract more investors at a reduced cost of capital?	V9
10.	Do you think that the improved CG practices improve the firm's market capitalization?	V10
11.	What do you think about Indian CG regime as against the CG regime of other developed countries?	V11
12.	Do you believe that the existing CG regulations are fair enough to ensure good CG climate?	V12
13.	Do you find that the existing CG regulations are being implemented by most listed companies?	V13
14.	Do you find there is any need for more rigorous CG rules to be framed by legal and regulatory authorities?	V14
15.	Do you find companies voluntarily taking measures to strengthen CG practices?	V15
16.	How will you rate the presence of integrity and ethics amongst Indian Board of Directors?	V16
17.	Do you believe that further measures should be taken for minority shareholder protection?	V17
18.	Do you believe that most of the time, there exists disagreement on important issues among Indian Board of Directors?	V18
19.	Do you believe that independence is an arbitrary term? No board member can be independent in decision making.	V19
20.	Do you believe that artificially controlling share prices by directors is a common phenomenon?	V20
21.	Do you believe that the CG regime is being hampered due to drain off of funds amongst associates and subsidiaries?	V21

Internal consistency of the scale is tested using the Cronbach's Alpha (0.684) and therefore the data did not suffer from sampling bias.

7.3 Sampling Technique and Sample

The responses are gathered through both online and offline sources. An extensive section of respondents was covered through an online source. Some respondents who did not respond to the questionnaire through electronic mode were contacted in person or through telephonic calls.

Given the dynamic and evolving CG scenario, purposive sampling technique is employed. The technique is based on characteristics of a population and the objective of the study. Special care has been taken as to in which capacity the respondent is answering. The responses of the respondents who could fall into more than one group were cross-checked and analyzed. While collecting data from the respondents, it has been avoided that no field is left unanswered by the respondent. Personal monitoring is done to avoid the same. Further, appropriate steps were taken to avoid discrepancies due to incomplete responses and outliers in data. This also ensured the data to be free from any coding errors. In the questionnaire, three statements were reverse coded.

Nearly 600 respondents were contacted and 235 responses were received after a repeated follow up and reminders on a weekly basis. After a thorough data cleaning exercise, only 215 responses were finally taken for data analysis giving a response rate of 35.83 percent. The overall response rate has been favorable as to previous studies, (Balasubramanian et al., 2008; Ho, 2005; Nam & Nam, 2004) due to a combination of

methods used for collecting responses. The sample size followed the Rule of 10 for factor analysis which specifies that there should be at least 10 cases for each item in the instrument being used (Garson, 2008; Kline, 1998).

7.4 Profile of Respondents

The respondents represented nearly all the sectors and industries of the economy. The respondents were dispersed all over India. Both male and female investors were approached, irrespective of their age, educational qualifications, and designation. A special care has been taken to ensure that each of the research subjects who responded to the questionnaire had basic understanding and knowledge relating to various aspects of current CG regime.

Table 7.2 presents the characteristics of the survey respondents. Most of the respondents were male (84.65 percent) as compared to 15.35 percent of females. With regard to age, the data showed that most of the respondents were 50 years of age and over with a nearly equal number of respondents were of age 30-39 and 40-49. With respect to qualification, nearly half (48 percent) of the respondents had a professional degree while 30 percent had done post-graduation and rest 20 percent were graduates. Out of the total responses received 62 (28 percent) were received from employees (top-level management and middle-level management), 85 (39 percent) were from independents (analysts, auditors, company secretaries and chartered accountants practicing, representatives of regulatory authorities, capital markets, rating agencies, stock exchanges, centers of governance and others 68 (31 percent) were researchers, professors, bankers, and investors.

Table 7.2: Characteristics of Respondents

	Number	Percentage
Gender		
Male	182	84.65
Female	33	15.35
Age		
20-29	38	17.67
30-39	51	23.72
40-49	54	25.12
50 and over	72	33.49
Qualification		
Graduate	45	20.93
Post Graduate	65	30.23
Professional	105	48.84
Designation/Occupation		
Employees	62	28.84
Independents	85	39.53
Others	68	31.63

7.5 Exploratory Factor Analysis

The data collected through the structured questionnaire is summarized using exploratory factor analysis so as to define a small number of factors (variates) that would adequately represent the original set of variables. These factors could be identified as the key issues of current CG regime.

7.5.1 Assumptions in Exploratory Factor Analysis

Two assumptions are to be tested for factor analysis (Hair et al., 2015). First, Bartlett's test of sphericity indicating that sufficient correlations exist among the variables.

Second, measure of sampling adequacy (MSA) for both overall test and each individual variable.

Bartlett's test of sphericity statistic (1029.627 p-value 0.000) is significant at 1 percent level of significance indicating the presence of correlations among the variables.

Table 7.3 showed the correlation matrix for 21 variables. Inspection of the table revealed 108 correlations (out of 210 correlations, that is, 51%) as significant at 1 percent level of significance.

"This is an adequate basis for proceeding to an empirical examination of adequacy for factor analysis on both overall basis and for each variable" (Hair et al., 2015). The number of significant correlations is highest (8) for $V_{11,}$ $V_{14,}$ $V_{15,}$ V_{16} and V_{18} and lowest (0) for V_6 respectively. The value of the overall test for MSA is 0.729. On examination of MSA values of each variable from the anti-image matrix, it is found that V_4 (0.460) and V_6 (0.401) has MSA less than 0.50. V_6 is deleted since V_6 has lowest MSA. MSA values were then recalculated. After recalculating the MSA values, overall test MSA is 0.735. On examination of MSA values of each variable from the anti-image matrix, it is found that V_4 (0.461) has MSA still less than 0.50. V_4 is deleted. Table 7.4 presents the correlation matrix for remaining variables (after deleting V_4 and V_6) along with their measure of sampling adequacy.

None of the partial correlation value is greater than 0.50 indicating that the strength of interrelationships among the remaining variables. Each variable in the set of remaining variables met the necessary threshold of sampling adequacy (MSA above 0.5) with overall MSA value of 0.745. Hence, the remaining set of variables met the basic assumptions needed for factor analysis (Hair et al., 2015).

Table 7.3: Correlations among Variables

	V1	V2	V3	V4	V5	V6	V7	V8	V9	V10	V11	V12	V13	V14	V15	V16	V17	V18	V19	V20	V21	Significant at 1 percent
V1	1	.185**	.188**	-.061	.002	-.059	.338**	-.042	.039	-.283**	-.236**	-.289**	-.310**	-.079	-.077	.133	.011	-.076	.109	.134	.116	7
V2		1	.226**	.084	.080	.100	.075	.120	.108	.039	.063	.017	-.002	.037	-.091	.163*	.022	-.029	-.087	.040	.164*	2
V3			1	.211**	.344**	-.144*	.138*	.196**	.133	-.107	.023	-.067	-.140*	-.022	.073	.115	-.009	.061	-.066	.101	.115	5
V4				1	.186**	.023	.033	-.006	-.059	-.050	.030	.022	.002	-.016	.101	.072	-.010	-.019	-.102	.087	.145*	2
V5					1	-.067	-.027	.192**	.127	-.039	-.045	-.034	-.083	-.070	-.009	.017	-.112	.065	-.056	.013	-.082	3
V6						1	.011	-.034	-.061	.016	.084	.008	-.047	.023	-.057	.093	.001	-.004	-.065	.033	-.039	
V7							1	.075	.217**	-.293**	-.052	-.123	-.160*	.104	.016	.200**	.051	-.046	.046	.172*	.147*	4
V8								1	.112	.042	.071	.060	-.018	.010	-.032	-.018	-.077	.038	-.003	.076	.181**	3
V9									1	-.064	.035	.013	.025	.129	.127	.028	.072	-.024	.065	.088	.124	1
V10										1	.413**	.550**	.481**	.220**	.147*	.070	-.049	.044	-.010	-.053	-.019	6
V11											1	.490**	.431**	.354**	.352**	.201**	.146*	.191**	-.031	.015	.035	8
V12												1	.558**	.377**	.297**	.085	.104	.118	.069	-.037	.081	6
V13													1	.441**	.357**	.108	.022	.135*	.062	.022	-.011	6
V14														1	.520**	.288**	.153*	.229**	.312**	.133	.072	8
V15															1	.259**	.096	.186**	.237**	.189**	.066	8
V16																1	.388**	.338**	.193**	.342**	.155*	8
V17																	1	.493**	.366**	.381**	.251**	5
V18																		1	.508**	.395**	.271**	8
V19																			1	.366**	.309**	7
V20																				1	.352**	6
V21																					1	5

*Significant at the 0.10 level (2-tailed)
**Significant at the 0.05 level (2-tailed)

Table 7.4: Measures of Sampling Adequacy and Partial Correlations

Variables	V1	V2	V3	V5	V7	V8	V9	V10	V11	V12	V13	V14	V15	V16	V17	V18	V19	V20	V21
V1	.746[a]																		
V2	-.167	.554[a]																	
V3	-.129	-.151	.646[a]																
V5	.034	-.025	-.295	.513[a]															
V7	-.228	.058	-.037	.073	.627[a]														
V8	.094	-.054	-.110	-.136	-.064	.602[a]													
V9	.052	-.082	-.044	-.136	-.181	-.054	.596[a]												
V10	.045	-.038	.035	.021	.244	-.027	.021	.763[a]											
V11	.070	-.051	-.044	.060	-.060	-.068	-.004	-.188	.817[a]										
V12	.085	.004	-.001	-.057	-.057	-.038	.038	-.339	-.190	.798[a]									
V13	.122	-.040	.097	.050	.059	.050	-.040	-.179	-.087	-.273	.843[a]								
V14	.016	-.084	.024	.052	-.145	-.021	-.060	.008	-.085	-.108	-.213	.795[a]							
V15	.000	.173	-.130	.003	.085	.080	-.091	.105	-.194	-.066	-.112	-.325	.743[a]						
V16	-.104	-.143	-.023	-.051	-.174	.043	.087	-.120	-.044	.073	-.003	-.122	-.139	.758[a]					
V17	.044	-.004	.021	.139	.061	.120	-.110	.147	-.108	-.141	.095	.023	.114	-.254	.726[a]				
V18	.127	.052	-.077	-.138	.098	-.019	.119	.050	-.147	.048	-.064	-.020	.051	-.141	-.273	.740[a]			
V19	-.164	.103	.128	.013	.033	-.008	-.042	-.047	.208	-.022	.049	-.233	-.113	.086	-.121	-.369	.699[a]		
V20	-.047	.016	-.023	-.028	-.101	-.064	-.009	-.044	.066	.118	-.068	.057	-.124	-.140	-.174	-.140	-.109	.816[a]	
V21	-.033	-.150	-.072	.159	-.064	-.158	-.073	.012	.012	-.116	.039	.078	.002	.028	-.044	-.089	-.163	-.198	.739[a]

a. Measures of Sampling Adequacy (MSA)

Bartlett's test of sphericity statistic (987.277 p-value 0.000) is significant at 1 percent level for the reduced set of variables to be further analyzed.

Exploratory factor analysis is performed to extract the possible factors by the *principal component method of extraction.* These factors would be a lesser number than the original variables under study. Further, these factors when extracted and interpreted would provide unique dimensions for the CG regime without any overlapping of the original individual variables under study.

Communalities exhibits the amount of variance of a particular variable that is accounted for by all the factors taken together. Stevens (2002) point out that the acceptable communalities for sample size 500 -1000 would be greater than 0.4 and for sample size 100 - 200 would be greater than 0.5. Given the 19 variables to be analyzed, Table 7.5 contains the information regarding communalities of 19 variables and its relative variance that is extracted by the factor solution.

The communalities varied from 0.315 to 0.700 for the sample size of 215. The communality figure of 0.315 for variable V_9 indicated that it has less in common with other variables. Hence, variable V_9 is deleted and rotation of the factor matrix is done by Promax rotation. The component transformation matrix has correlations higher than 0.3 and thus Promax rotation is used.

Applying the latent root criterion of retaining factors with eigenvalues greater than 1, five factors are retained. The five-factor solution extracted 66.88% of the total variance.

Table 7.5: Communalities

Variables	Initial	Extraction	Variables	Initial	Extraction
V1	1.000	.526	V13	1.000	.631
V2	1.000	.617	V14	1.000	.652
V3	1.000	.545	V15	1.000	.644
V5	1.000	.660	V16	1.000	.432
V7	1.000	.579	V17	1.000	.557
V8	1.000	.399	V18	1.000	.700
V9	1.000	.315	V19	1.000	.580
V10	1.000	.625	V20	1.000	.515
V11	1.000	.547	V21	1.000	.452
V12	1.000	.645			

The cutoff point for factor loadings is kept as 0.45. The final grouping of 17 items (deleting V_{16}) in the extracted factors is shown in Table 7.6 with the respective eigenvalues and percentage of variance explained.

Table 7.6 exhibits five factors with a minimum factor loading of 0.467 and maximum factor loading of 0.850 which are extracted and named (Kuhndt et al., 2004) based on the significance of variables with significant loadings. Thus, the structures within which CG regime can be explained and studied are as follows:

Factor 1: Substance – refers to appropriate content and coverage of CG. It encompasses within itself the present status of CG.

Factor 2: Inclusiveness – refers to the active participation of stakeholders' in the affairs of the company. Owners must participate actively and exercise their ownership rights. Further, owners must ensure minority shareholder protection and independence of board is not compromised. The working of the board members should be such that there exists agreement on critical and crucial issues.

Table 7.6: Grouping of Factors

	Factor loading	Eigen value	Percentage of variance explained
Factor 1 Substance		**3.557**	**22.764**
Do you agree that improved CG regime would improve Corporate Social Responsibility?	0.696		
What do you think about Indian CG regime as against the CG regime of other developed countries?	0.754		
Do you believe that the existing CG regulations are fair enough to ensure good CG climate?	0.796		
Do you find that the existing CG regulations are being implemented by most listed companies?	0.787		
Do you find there is any need for more rigorous CG rules to be framed by legal and regulatory authorities?	0.647		
Do you find companies voluntarily taking measures to strengthen CG practices?	0.543		
Factor 2 Inclusiveness		**2.747**	**18.261**
Do you believe that further measures should be taken for minority shareholder protection?	0.754		
Do you believe that most of the time, there exists disagreement on important issues among Indian BOD?	0.842		
Do you believe that independence is an arbitrary term? No board member can be independent in decision making.	-0.753		
Do you believe that artificially controlling share prices by directors is a common phenomenon?	-0.681		
Factor 3 Credibility		**1.696**	**11.425**
In your opinion, how important is the company's internal management that is its board of directors in CG regime?	0.702		
Do you expect improvement in firm's ability to generate equity share capital because of improvement in CG?	0.783		
Factor 4 Accountability		**1.325**	**8.361**
CG is nothing but a set of rules, procedures, and practices to be followed.	0.850		
Do you feel that regulatory framework including monitoring institutions play an important role in CG regime?	0.696		
Do you think that the improved CG practices improve the firm's market capitalization?	0.467		
Factor 5 Integration		**1.150**	**7.387**
How will you rate the importance of legal framework of India with respect to CG?	0.736		
Do you believe that the CG regime is being hampered due to drain off of funds amongst associates and subsidiaries?	0.527		

Factor 3: Credibility – refers to trustworthiness and dependability of internal management leading to more access to equity finance. Here, the issues related to the working of management are highlighted.

Factor 4: Accountability – refers to rules and regulatory mechanisms enforcing best practices leading to increased firm valuation. CG regulatory mechanism plays a pivotal role in the implementation of CG practices.

Factor 5: Integration – refers to coordination amongst regulators and judiciary. Also, to incorporate desired values and culture amongst all related parties. Thus, in a way institutional framework of CG must be integrated into one unified whole for the benefit and gains of all stakeholders'.

With regard to "**Substance**", the majority of respondents indicated that Indian CG regime is fair enough as against that of other developed countries. Further, the existing regulations are appropriate to ensure good CG climate and no more rigorous CG rules are required. The respondents do not want more rigorous rules and regulations. Further, they believe that the existing CG rules are being implemented by most of the listed companies. At the same time, companies do not take any measures voluntarily to strengthen CG. Balasubramanian et al. (2008) suggested that compliance with India's governance rules amongst the responding firms of the survey has been fairly good despite room for improvement. Based on the findings, one may surmise that India has laws and regulatory frameworks to ensure good governance which are followed since last decade or so. At the same time, the stakeholders' perceive them to be ineffective probably because the system of CG is actually not followed in spirit.

With respect to "**Inclusiveness**", the respondents agree that the minority shareholder protection and disagreement between the board of directors are the major concerns for the owners. Further, the independence of the board of directors seemed questionable. Independence of the board of directors is perceived as an arbitrary term. It is perceived that directors do actually artificially control share prices. This has actually hampered the CG regime. These results are consistent with Maheshwari (2002) wherein the study stressed on the company internal management, that is, independent board of directors, audit committees and accountability can win shareholder confidence.

These results are consistent with the findings of Varma (1997) where it is recognized that disciplining the dominant shareholder and protecting the minority shareholders from their expropriation has been the main issue in the Indian corporate sector, which can be solved only by external forces. Two such forces—the regulator and the capital market are suggested.

There is a serious shortcoming on the part of the capital market, directors and managers not being able to enforce better governance. Such issues need to be carefully checked and addressed by owners as also reported by previous studies. As per Patibandla (2001), misuse of savings of small investors operated both in primary and secondary equity markets which is further facilitated by public sector financial institutions. Further, another study by Mukherjee and Ghosh (2004) have reported that director's shareholding as a factor to enhance shareholders activism and alertness of the board of directors is ineffectual in India.

Further, the respondents feel that internal management, that is, the board of directors is the most important part of CG regime. The well-governed companies would increase

their ability to generate more equity share capital, this will be favored by investors. Also, these results are consistent with Okpara (2011) where it is found that the lack of commitment on the part of board members is the key challenge in CG development. The results reconfirm the results of Monga (2004) from a survey that the chief executive officer should demonstrate a commitment to the organizational beliefs and values by own actions and high standards of personal integrity.

Another important aspect which is revealed from the results "**Accountability**" is that CG is perceived as a set of rules, procedures, and practices to be followed wherein regulatory framework including monitoring institutions of the country play a significant role. A study by Balasubramanian et al. (2008) found out that in India, government enforcement through the powers of monitoring institutions are rarely exercised. In terms of regulatory framework, weak monitoring and enforcement make them ineffective. This reasserts the fact that monitoring institutions in India need to exercise their power aggressively. Good governance would lead to improved market capitalization of the firms and hence impacting the investment in equity shares by the investors.

In the Indian context, it is found by Phani et al. (2005) that family business work through the business community networks. The access to funds both nationally and internationally is based on their reputation and networks. This suggests that corporates following good governance practices for access to funds at lower costs are probably not the case in India. But, since the last decade, it is found that investors do pay a premium for good governance and that leads to good reputation and much better access to funds at lower costs. It has been witnessed by Saibaba and Srinivasan (2013) that the practices beyond mandatory compliance lend to credence to the governance process and investors accord premium valuations for it.

Furthermore, with respect to "**Integration**" of CG, the respondents agree that the legal system of the country and drain off funds amongst associates and subsidiaries are the main issues in the Indian context. This is also asserted by Balasubramanian et al. (2008) that related party transactions are quite common at Indian firms and their approval requirements are fairly weak.

7.6 Test of Homogeneity of Variances

Further, to assess the difference in perception of various stakeholder groups regarding the current CG regime, the following hypothesis is tested:

$H_{a4.1}$: There is significant difference in perception of various stakeholders' towards current corporate governance regime

The levene statistics for homogeneity of variance is not significant for all the five factors. Hence, the assumption of homogeneity of variance is violated. One way ANOVA has been conducted to test hypothesis 4.1 in order to compare the perception of various stakeholder groups towards the mean scores of various factors governing the CG regime. The results infer that out of the five extracted factors, the significant difference of opinion exists for only one factor "**Accountability**". The three groups of respondents agree on rest of the four factors as shown in Table 7.7.

Table 7.7: Test of Homogeneity of Variances

Factors	Levene Statistic	Significance	F Statistic	Significance
Factor 1 : Substance	.533	.587	1.422	.243
Factor 2 : Inclusiveness	1.155	.317	.292	.747
Factor 3 : Credibility	.326	.722	1.729	.180
Factor 4 : Accountability	.374	.688	13.280	.000*
Factor 5 : Integration	.392	.676	.054	.948

*Significant at 1 percent level of significance

The alternate hypothesis 4.1 that there is significant difference in perception of various stakeholders' towards current CG regime is accepted. There exist significant differences in perception of three stakeholder groups towards "accountability" with respect to current CG regime.

7.7 Post hoc Analysis

Further, to identify which groups differ in their perception on the above, a Tukey's Post hoc test is been conducted. The mean differences of Tukey's Post hoc test are tabulated in Table 7.8.

Table 7.8: Multiple Comparisons

Dependent Variable				**Mean Difference (I-J)**	**Std. Error**	**Significance**
Factor 4 : Accountability	Tukey HSD	1	2	-.55924354*	.15815102	**.001***
			3	.19317995	.16620551	.477
		2	1	.55924354*	.15815102	.001
			3	.75242349*	.15333869	**.000***
		3	1	-.19317995	.16620551	.477
			2	-.75242349*	.15333869	.000

**Significant at 1 percent level of significance

The mean differences are statistically significant for all the three groups of respondent's - employees, independents, and others. The employees believe that present set of rules, procedures, and practices are fair and appropriate, independent and representatives believe monitoring is perfectly managed while, others believe that a lot more is to be done.

7.8 Conclusions

In this chapter, the results of the assessment of stakeholders' perception of current CG regime are discussed. The results of the analysis indicate that there exists positive perception of stakeholders' for current CG regime. Further, stakeholders' differ in perception towards current CG regime only with respect to one factor "Accountability". The next chapter would conclude and make recommendations on the basis of empirical findings discussed in the previous chapters.

Chapter 8

Conclusions and Recommendations

CHAPTER 8

CONCLUSIONS AND RECOMMENDATIONS

8.1 Introduction

The study on foreign equity shareholdings (FES) and corporate governance (CG) practices of select Indian listed companies is undertaken with the primary objective of understanding and analyzing the relationship between CG, corporate ownership, and firm characteristics. The study began with the investigation of the relation between FES, CG, and firm characteristics and later evaluated the stakeholders' perception of the current CG regime. Different types of investors behave differently and so the pattern in which FES exists within the sample firms is studied first which is followed by the examination of the impact of firm characteristics on FES considering ownership as a CG variable. The impact of FES on CG in the Indian context is also studied.

The study uses a twofold approach in its research design. Both primary data (questionnaire-based), as well as secondary data, has been collected. The data collected therefrom is analyzed using various statistical tools and results are arrived at. The chapter is divided into various sections. Conclusions relating to each objective are discussed in section 8.2 which is supplemented by insights from interviews. Section 8.3 outlines recommendations of the study followed by implications of the research in section 8.4. Scope for further future research and limitations of the study are presented in the last two sections 8.5 and 8.6 respectively.

8.2 Conclusions of the Study

The following sections provide objective wise conclusions arrived at after an analysis of data collected through primary and secondary sources using various data analysis

techniques. The study has empirically analyzed FES, examined impact of firm characteristics on FES as well as the impact of FES on CG. The study has been limited to the companies that comprise the "Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) 500" Index for nine financial years, year-ending 2007-2008 and year-ending 2015-2016. From a questionnaire survey of 215 respondents, the study critically evaluated the perception of various stakeholders' regarding current CG regime. Figure 8.1 provides a flowchart of explaining the connection between the objectives and the findings of the study. After analyzing the data statistically, the following conclusions emerge from the findings.

8.2.1 Foreign Equity Shareholdings

Since the embarking on the path of development, Indian economy faced the problem of inadequacy of domestic capital and underdeveloped capital market. The capital requirements are thus to be met by foreign funds. The prerequisite of foreign capital is legislative, regulatory and structural reforms in order to build up a strong CG infrastructure. The institutional and governance quality is considered as a determinant of foreign inflows for developing economies (Walsh & Yu, 2010). Hence, foreign capital inflows and CG are interrelated. With the opening up of the Indian economy, post-1991 reforms, foreign shareholders hold substantial equity stakes in the listed firms in India.

In the early phases of economic reforms, foreign promoters inflows to India remained sluggish due to lesser access to different sectors of the economy, various hardships in starting businesses, stricter norms of owning equity and repatriation of dividends and profits. The pickups of investments by foreign non-promoters have led to an overall rise in equity holdings.

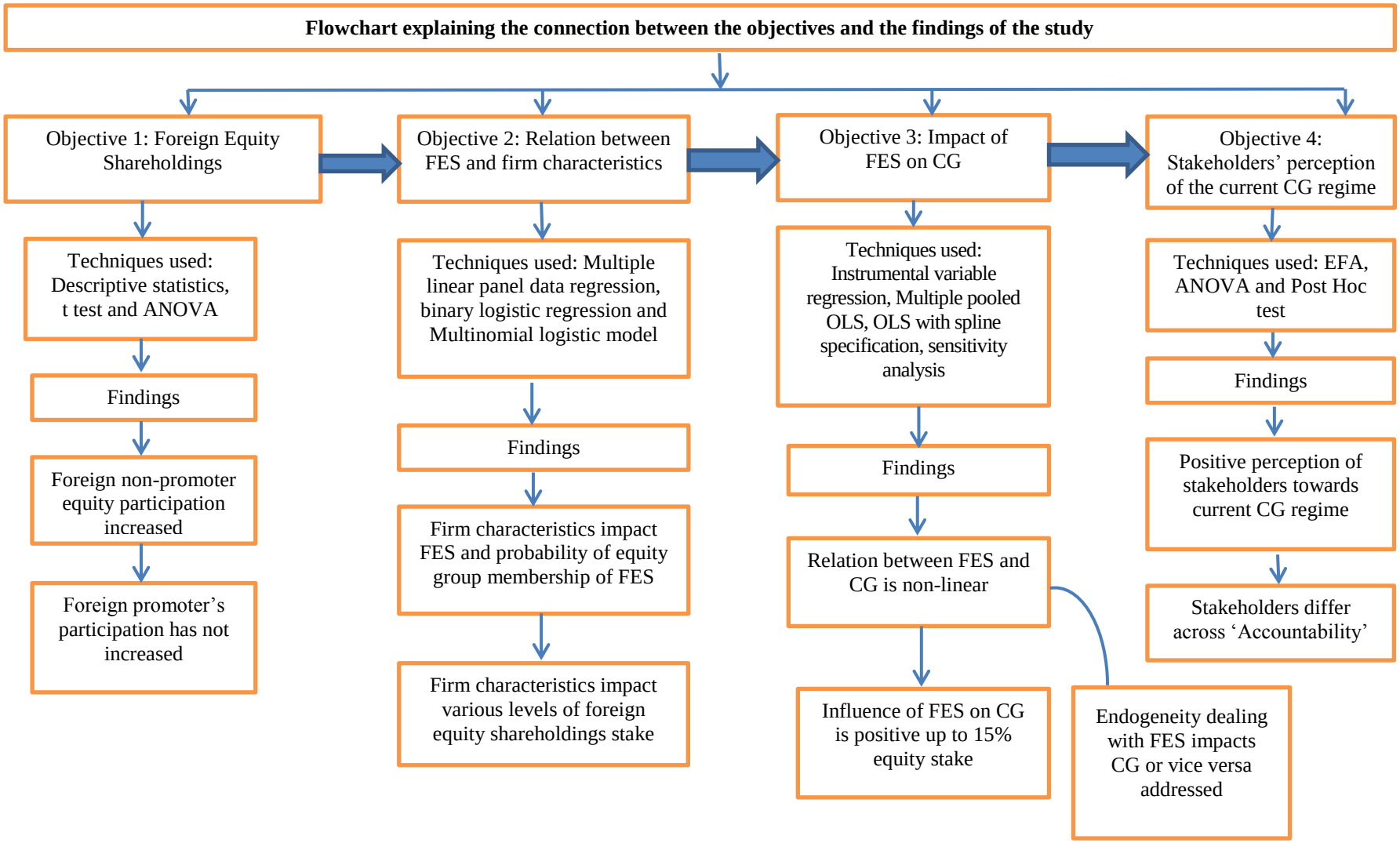

Figure 8.1: Flowchart explaining the Connection between the Objectives and the Findings of the Study

The analysis of FES reveals a rising trend of foreign non-promoters shareholdings as against that of foreign promoter's shareholdings. The increase has been taking place in a smooth manner except for the year 2009 due to the global financial crisis. Further, the largest increase in FES is more than 5 percentage points despite the regulatory restrictions and the restrictions on large shareholdings. However, there have been gradual relaxations in the caps on foreign investments. The results of the present study are consistent with the study of Kaur and Gill (2008) which reported a considerable increase in foreign shareholdings in India.

Further, the analysis of change in FES over time shows that there is a significant change in foreign non-promoters shareholdings for sub-periods as well as over time. However, the ownership of foreign promoters did not significantly change. The dominance of foreign non-promoters equity shareholdings in the data drives the result for total FES.

The average equity stake of foreign shareholders (20.28 percent) is quite enough to exert a significant degree of control of the firm. Similarly, the average equity stake of foreign non-promoters (9.86 percent) though not very large, yet it is enough to exert significant degree of monitoring and control of the firm. Foreign promoter(s) could control the board with the average equity stake of 10.42 percent, being fair enough.

The results indicate the prevalence of concentrated FES with the dominance of foreign non-promoters. 66.49 percent of foreign non-promoters shareholdings are large as against only 12.05 percent of foreign promoters' shareholdings. The foreign promoters largely own (74.81 percent) minority stake (mean 0.01 percent).

It can be concluded that the equity shareholdings of foreign non-promoters have a high financial significance and hence have obtained an important and significant position in

equity shareholdings of Indian listed companies as against those of foreign promoter's equity shareholdings (Kara et al, 2007).

Foreign inflows differ across various sectors in the Indian context. Only four out of eight sectors with 132 firms (29.39 percent mean shareholdings) are preferred by foreign shareholders. Foreign investors do not favor remaining sectors for investments.

All foreign investor's invest in mid and large-cap companies. The average equity holdings of foreign promoters are highest in mid cap, small sized and older companies. Foreign promoters favor older firms and small-sized companies whereas foreign non-promoters favor middle-aged and medium-sized companies. This shows lesser confidence of foreign investors vis a vis promoters shareholdings in the younger Indian firms probably due to political considerations, presence of corruption, poor infrastructure, inadequate government policies and rigid labor laws.

The investment behavior of foreign non-promoters depicts apparent disinterest in large firms with least average shareholdings. Thus, it appears that foreign non-promoters invest in medium and small-sized, and middle-aged companies probably due to lesser monitoring and control needed for a secure return on their investments. This is in line with conflict of interest and strategic alignment hypothesis wherein the principle of mutual gains, cooperation and agreement operate between institutional investors[3] and management. Both find it mutually advantageous to cooperate. They would promote areas of mutual benefits and avoid disagreements and conflicts. However, this

[3] The foreign non-promoters shareholdings include foreign institutional shareholdings as well as foreign venture capital fund shareholdings. The share of foreign venture capital funds is marginal and hence most foreign non-promoters shareholdings are foreign institutional investments.

cooperation destroys the positive effects of monitoring by institutional investors leading to poor governance.

It can be concluded that foreign inflows differ across various sectors, market capitalization, size, and age and hence these are important firm characteristics that impact FES.

Presently, with the Indian government's initiatives to abandon the restrictions and caps, foreign investment would further increase drastically. As a matter of fact, foreign investment depends on the sectoral caps under India's foreign investment policy. Although liberalized over time, caps on foreign investments in select sectors with sub-limits for specific types of foreign investment such as foreign portfolio investment (FPI) and foreign direct investment (FDI) have been a hallmark of India's foreign investment policy. In order to address this, the government has headed towards the abolition of sub-limits on different categories of investment and the creation of overall caps for foreign investment. Further, SEBI came up with a new class of foreign investors known as Foreign Portfolio Investors (FPI) in the year 2014. This class has merged all the existing classes of investors and simplified the overall mechanism of foreign investments in India. It is expected to boost foreign investment in India.

It is also worth noting that increase in foreign capital would lead to active monitoring of the investee companies. This is in line with efficient monitoring hypothesis (Shleifer & Vishny, 1989; Pound, 1988) which suggests that the institutional owners would actively monitor the board of the investee companies due to the consideration of their own risks. They are efficient and possess greater expertise and power at doing so as compared to the dispersed small investors. The larger the institutional ownership, the more efficient the

monitoring exerted by these shareholders through various available ways such as shareholder voting rights, shareholder activism and/or electing the members of the board. Pound (1988) further argued that the marginal benefits of such intervention would be much more than the marginal costs. This would further result in higher firm performance (McConnell & Servaes, 1990). Thus, it can be inferred that ownership is one of the mechanisms, among many others leading to good governance.

8.2.2 Foreign Equity Shareholding and Firm Characteristics

Foreign capital is an important source of external capital in Indian listed firms. It is worth finding out the key considerations on the basis of which the investment by foreign investors would depend. Prior studies deduce that foreign investments would depend upon various firm-specific financial characteristics. The results indicate that market capitalization, return on total assets, leverage, size, and age are the most impacting firm characteristics for FES in the Indian context. High market capitalization, high profit, less levered, big and old firms are preferred by foreign investors.

Foreign investors have considerable knowledge, skills, and ability to select high market cap stocks because they are safe and have lesser restrictions. These stocks provide easy exit routes to these investors. This would destroy the positive effects of monitoring by FES. Hence, in such a case conflict of interest and strategic alignment hypothesis would hold true.

The regression results also indicate a positive relationship between profitability and FES (Kang & Stulz, 1997). Hence, foreign investors favor firms with higher profitability ratios. This result counters the significant negative relationship found by Tong and Ning (2004) whereas confirms the results found by Barucci and Falini (2005).

These results point towards foreign investors being more oriented toward safe assets which ensure at least present profitability.

Bigger the size of the firm, higher will be the foreign investment is observed in the Indian context similar to Garavito et al. (2014). At the same time, foreign investors invest in older and large companies probably due to lesser risk for secure return on their investments. At times, such firms have export sales or depository receipts abroad and therefore are well known internationally. Gillan and Starks (2003) identified the role of institutional investors in communicating information to other investors of the financial markets. Thus, the presence of institutional owners or large shareholders reduces the need for various other signals of good performance. Institutional ownership would actually minimize the need for dividends to signal good performance (Short et al., 2002). However, this theory needs to be applied with caution since false signals about the poor expected performance of the firms should not be imitated and transmitted to the market.

Furthermore, positive relationship of firm profitability, size, and age is found with the probability of control by FES. The probability that FES would control the firm increases with firm profitability, size, and age. This is largely true in real life as equity investment decisions in a particular firm's equity would encompass the thorough assessment of its firm-specific characteristics. Firm size is the most influential firm characteristics to induce FES to gain control over the firms.

The study presents the case that foreign investments in the Indian context depend on market capitalization, profitability, size, and age of the firm. The stock which has a less market value, is less profitable belonging to small and medium-sized young firms are

less likely to be controlled by foreign investors. Foreign investors prefer profitable, volatile stocks of bigger and older firms. These investors are supported by their internal or external strong technical teams who take due diligence and care. They work really hard to realize their investment objectives which could be short-termism or long-term sustainable growth.

The results are in congruence with agency theory which states that investors prefer low levered firms (Al-Najjar, 2010). Further, the result is in line with the results of the study by Huddart (1993) and Maug (1998) where it is documented that institutional owners play a significant role in monitoring management leading to reduction of agency conflicts. The results confirm the role of foreign investors as a monitoring mechanism to minimize agency as well as bankruptcy costs. This would address the Type I agency problem but only up to a certain threshold level as discussed in the next subsection.

8.2.3 Foreign Equity Shareholdings and Corporate Governance

The results indicate that effect of ownership on governance and the simultaneous effect of governance on ownership persist. Thus, governance is one of the criteria, among many others for foreign investors to decide which company to invest in. This result is in congruence with the ownership structure theory (Jensen & Meckling, 1976). The theory argues that in all cases, owners would have strong incentives to minimize agency costs. Within the corporate form, agency costs emerge due to the fact that personal wealth of millions of individuals is voluntarily handed over to the managers to be taken care of. There exists a complex set of contracting relationships between managers and owners (individuals and others) which lead to the agency costs. The agency costs

depend upon company's ownership structure, governing laws and human artistry in devising contracts.

Furthermore, the results indicate that the more the market capitalization and the older the firm the better would be the governance. High market capitalization firms tend to be more sensitive to CG practices and would have positive spillover effects on foreign investment but that has to be within the legal restrictions and caps on foreign investment in the Indian companies (Varma, 1997).

Another concern that emerges is that foreign shareholders are expected to increase their holdings in more successful, bigger, older, and profitable companies. At the same time, a firm that attracts foreign shareholders being big in size and generates high profits would be better governed. If this is indeed the case, then the extent of ownership matters. The more the ownership stake, the more the ownership rights and the more is the incentive to monitor. It has been strongly argued that large shareholders monitoring and control activities limit agency problems though to their own gains and benefits (Shleifer & Vishny, 1986). At the same time, such monitoring may be too little and the free rider problem may still persist (Grossman & Hart, 1980).

The study finds evidence that the relation between governance score and FES is non-linear. Foreign shareholdings before 15% equity stake would improve governance of recipient firms but not beyond. After the threshold level of 15%, foreign investors enjoy the rights and benefits of concentrated ownership and thus the incentives of good governance are lost. The results conclude that Indian CG problem would then be the Type II agency problem. By focussing on the majority shareholder and minority shareholder relationship, CG can be improved in the Indian context. This result is

consistent with the convergence of interest hypothesis which works on the premise that the positive effects of monitoring by institutional investors would not last forever.

These results are also consistent with the previous studies wherein it is found that FES would decrease firm value once the ownership stakes reach a certain threshold level. Therefore, higher FES may encourage such decisions that would ruin firm value (Chen et al., 2008; Brickley et al., 1988). Likewise, Lin and Chang (2010) found a non-linear relation between institutional ownership and financial performance in case of family firms.

The study presents the case for foreign investors valuing good governed companies, bringing in good governance practices and improving governance practices within the companies they invest in. Good CG has been recently added to the list of positive effects of foreign investment in the emerging markets (Ananchotikul, 2006; Shleifer & Vishny, 1986). The study asserts the possible linkage from foreign shareholdings to good governance in the Indian context also (Balasubramanian et al., 2008; Chevalier et al., 2006; Durnev & Kim, 2005; Klapper & Love, 2004). This would lead to high firm valuation as a probable direction of causality.

Since economic reforms, post-1990, especially since November 2013, Indian economy witnessed a persistent increase in foreign investment inflows as against many other developing countries of Asia. This phenomenon is expected to continue in future due to relaxation of various restrictions on foreign investment inflows by the Indian government. These changes would improve the Indian investment regime and provide higher growth prospects to foreign investors for the times to come.

Heugens et al. (2009) pointed out the requirement of a minimum level of institutional development for effective CG structures and practices. This would include strong

governance environments and market infrastructure at the macro level (Reenu & Sharma, 2015) along with least political risk (Knill, 2013). The higher the political risks, the lesser would be the diversification internationally by foreign investors and vice versa. Ko et al. (2007) confirmed that increase in political risks leads to investment in liquid stocks by foreign investors. This would never bring with itself any monitoring benefits.

The level of legal protection is an additional CG facet. Resilient legal protection of shareholders marks ownership concentration as insignificant and consequently redundant. Lastly, in jurisdictions where owners can effortlessly take advantages from the corporations, they control despite their feeble legal protections. However, their pivotal relationships become weaker, presumably on account of minority shareholder expropriation. This is in line with conflict of interest hypothesis and strategic alignment hypothesis wherein positive effects of monitoring by institutional investors are lost.

8.2.4 Stakeholders' Perception of Current Corporate Governance Regime

The perception of various stakeholders' regarding the current CG regime is assessed and it is established that it is of utterly importance for all the stakeholders' to develop, ensure and provide a CG culture in business organizations. The research results that stakeholders' perceive Indian CG regime to be fair enough as compared to that of other developed nations. Further, the adaptation of good CG practices will have substantial effects on foreign investments in Indian companies. The conclusions are summarized as follows:

- Present regulations are suitable to ensure good CG climate and no more rigorous CG rules are required.

- Improved CG regime would improve corporate social responsibility.
- Stakeholders' acknowledge the importance of CG and fully understand the importance of adopting best practices similar to other developed countries. Nevertheless, they are less certain as to voluntary adoption of measures to strengthen CG.
- Stakeholders' agree that further measures should be taken for minority shareholder protection.
- Most of the time there exists disagreement on important issues among Indian board of directors. The controlling owners dominate the board. This is in line with conflict of interest (Pound, 1988) and strategic alignment hypothesis (Brickley et al, 1988; Chen et al., 2008) wherein the principle of mutual gains, cooperation and agreement operate between controllers and management. Both find it mutually advantageous to cooperate. They would promote areas of mutual benefits and avoid disagreements and conflicts. To avoid this, the dispersed owners must actively participate in company management and fix accountability and responsibility of the board of directors.
- Independence of directors is perceived as an arbitrary term. Practically, no board member is considered independent. Firms are alleged to be artificially controlling share prices by directors who are again puppets in the hands of owners/promoters.
- The fact that these results emerge indicate that the respondents are conscious of the present Indian corporate ownership structure wherein big family houses manage and control the firm through their own people on the board leading to exploiting the minority. This is justified by the fact that mandatory appointment of women directors

has led to daughters and daughter in laws and wives entering the boardrooms. Thus, the independence of the board is debatable. Perhaps, this demonstrates questionable efficiency of the capital markets and artificial price fluctuations.

- The most significant statement on management concern is about the improvement in CG practices leading to firm's ability to generate equity share capital. This reinstates the fact that stakeholders' feel that investors can be attracted by good governance practices.
- Further, stakeholders' recognition of the company's internal management, that is, its board of directors as an important mechanism of efficient and good CG is a positive step in right direction.
- The results exhibit a tendency of considering CG as a set of rules, procedures, and practices to be followed as a matter of mandatory compliance. This is an interesting finding that CG is actually followed in letter and not spirit.
- In line with the same, respondents strongly agree that the regulatory framework including monitoring institutions play an important role in CG regime. In sum, it is perceived that there is no compliance above the mandatory norms and regulations and only that is adopted which the regulator will monitor. This is probably due to compliance costs and practical constraints associated with it. Still, it is believed that despite various costs of improving CG at the firm level, many firms will still practice governance provisions beyond what is mandatory for the perceived value it creates for the businesses. This is evidenced by the finding that stakeholders' believe that improved CG would improve market capitalization and hence would create firm value.

- The study provides evidence of the fact that stakeholders' believe related party transactions that are, drain off funds amongst associates and subsidiaries as another major issue of CG.
- The respondents agreed on judiciary system of the country should be included in the CG system so that both regulators and judiciary can take punitive and remedial actions against wrongdoers.

In sum, the above results indicate that stakeholders' perceive that owners and managers should act as a corrective mechanism or monitors to practice and improve CG regime. The agency theory which is the starting point of the CG debate exerts that the interests of both owners and managers do not align. Managers who are the decision makers depart from shareholder wealth maximization actions and decisions (Mallin, 2004). They take such decisions which are not in the best interests of capital providers. In the present day scenario, managers need to optimize their decisions in the best interests of not only shareholders' but all the stakeholders'. The stakeholders' (other than shareholders) in turn expect enforcement by the owners and an ethical integrity based management of companies by its Board of Directors.

This exploratory study investigated the current CG regime in India and identified some issues, barriers, and challenges which are as follows:

- Owners concerns over management
- Board of Directors responsibilities
- Regulatory and enforcement issues

Thus, despite satisfactory present CG regime, there arises a need for owners to act as monitors of management and reduce agency costs. Ownership ends up as a CG

mechanism whereby owners will monitor management and management will work in best interests of all stakeholders'.

8.2.5 Insights provided during the Interviews

The results of primary and secondary data analysis are being supplemented by interviews of ten eminent fund managers and corporate top management personnel actively engaged in financial investment decisions. These eminent fund managers and corporate top managerial personnel reconfirmed the results of primary and secondary data analysis. The interviews have been conducted face to face or telephonic. The interviews lasted for an average of 30 minutes. The insights provided by them are as under:

- The interview data reveal that majority of the interviewees find Indian CG rules and norms largely in line with that of developed markets except that the ownership structure of Indian corporates is such that the firms' are promoter run enterprises that are generally not professionally run and managed.
- There occurs a wide-ranging gap among the desired and actual management quality. In most of the cases, firms are managed and run by non-professional managers who are the appointees of promoters and/or controllers. The professionalism on the boards is the need of the hour.
- The pyramiding and tunneling within these enterprises have led to more and more involvement of the promoters. Many times, it is found that C suite is not even a part of the decision making processes. Further, the interests of the board members are aligned only to the interests of the promoters belonging to the family-run dominated enterprises.

- Some of the interviewees questioned the credentials of board members. They feel that board members are just for namesake wherein firms are managed by promoters or family members. In this context, and at the end; action has to be taken by the company itself. The change would happen but gradually in this family-run promoter dominated enterprises.
- When asked about the minority shareholder rights and protection, the interviewees indicated that codes highlight the minority shareholder rights and protection but nothing happen practically. This is because of lack of interest and activism on the part of minority shareholders. The company law has incorporated the provision of class action suits yet the results are yet to emerge.
- In terms of the impact on firms improved ability to generate equity share capital, the majority of interviewees believe that the corporate image impacts the investment in equity share capital of these firms. Ratings play a little role in real investment decisions. Foreign investors consider firm characteristics as well as CG practices of firms while taking investment decisions. They take due diligence and care with the help of local experts and professionals who have knowledge of local economic conditions and/or their own team of professionals. Various other factors work on personal subjectivity. The image or branding of securities and/or perceived image as a big business house works. There exist certain families or big business houses who have built and enjoy reputations in the market which is considered by the investors. They actually act as pointers to good CG practices.
- With regard to the regulation, the interviewees indicate that if in case the market is not free than regulation works. The regulatory part of CG regime is fairly good

with Securities and Exchange Board of India (SEBI) working with stock exchanges to promote compliance and transparency. SEBI is a regulator with threefold power of legislature, execution, and judiciary. However, stock market laws and listing rules are often followed in letter and not in spirit. Furthermore, if law is in place, the judiciary can play an important role. It must exercise its powers diligently and quickly.

- The insider trading and related party transactions though not visible yet it happens. Share prices move both before and after declarations and /or announcements. Front-running is practiced through promoters or employees or both.
- With respect to the activism of investors, it is believed that there exists a conflict of interests with institutional investors. Investment returns matter the most. It is a grey area, activism is found in the developed world and not yet in developing economies.

These findings are in line with the previous outcomes of the study. It can be established that the power, ownership, and control must be brought in together with all stakeholders' participating or actively monitoring, which could be through a seat on the board and/or shareholder meetings. The real battles must occur there.

8.3 Recommendations of the Study

CG depends upon transparency, accountability, disclosure on the part of the management of the company and the participation and activism on the part of its shareholders. Good CG ensures the security of the interests of all stakeholders', that is, the wide range of constituents/communities within which the firm operates. Long-term interests of all the stakeholders' whereby businesses need to create a value which is not only profitable but

sustainable is to be met. Based on the evaluation of various aspects of the study and insights provided by respondents and interviewees, some recommendations are provided to practitioners, policymakers, think tanks, corporates, management, and investors, to enable them to create better CG regime wherein firms are run with a great amount of moral conduct and obedience of rules and laws in spirit. Ethical governance and management are needed which would look outside present systems and procedures. Mere obedience to the codes in form is not required but we need compliance in substance. This can be achieved by reinforcing the role and participation of all stakeholders'.

In sum, the laws and regulations come from the stakeholder's theory of CG. The stakeholder theory works on "the trust and commitment on the part of management". It widens managerial responsibility to all stakeholders', besides only shareholders. Based on these findings, an overhaul of both the enforcement mechanism by the owners and the behavior of board of directors is required.

The more specific recommendation is that there is a need for ethical, integrity based management of corporates' when it comes to thinking about CG regime. Corporate management is expected to be independent, accountable and responsible which must ensure an environment of trust and commitment, thereby minimizing the principal-agent problem.

The findings of the study recommend that better governance can be achieved when the ultimate owners, who are the insiders, play their most important role in firm's CG framework. The stakeholders' expectation from owners regarding the enforcement of best CG practices would allow the development of stakeholder friendly CG regime. It is believed that oversight, enforcement, disclosure standards and penalties for violations should be raised. The owners must:

- Ensure independence and commitment of board of directors
- Devise a mechanism to curb artificially controlling of share prices
- Strengthen minority shareholders protection mechanism
- Ensure dispute resolution amongst the board of directors

Shareholder activism in India is relatively muted. Greater scrutiny by shareholder could bring substantial improvement in CG. Shareholder activism leads to shareholders control via their involvement and engagement in company management which could be through the exercise of the vote, the power to file suit and/or sale of interests in the firm. This would bring into line the interests of managers and shareholders leading to corporate sustainability and long-term survival. SEBI has come up with e-voting to make voting easier and efficient. It has made mandatory for mutual fund asset management companies (AMC) to publish a summary of the votes cast across all its investee companies together with the breakup in terms of number of votes cast in favor, against or abstained from voting. It provides an opportunity for mutual funds to evaluate their activism and representations in the corporate affairs. It is likely to inculcate activist engagement style for the benefit of both investors and investees. The lawmakers may think of extension of voting regulations to both foreign and domestic institutional investors other than AMC, like wealth funds, banks, pension funds, insurance companies.

The listed firms are complying with the mandatory norms and regulations. The compliance above the mandatory norms and regulations is often a matter of subjective analysis which has compliance costs and practical constraints associated with it. Still, the firms might go beyond mandatory governance provisions for the perceived value it creates for the businesses.

The companies can educate the stakeholders' by various means such as investor meetings, emails, reference material, seminars etc. regarding the various facets of CG practices prevalent in their companies which would promote stakeholder involvement and activism.

The investments in large-cap companies are less volatile because of their size despite the disadvantage of lower growth potential than smaller companies. Smaller companies might offer dividends. The untapped growth potential of small companies prospects big gains in a relatively short period of time. The Indian small firms must encash this opportunity. The small firms in need of external capital due to diversification or growth prospects can attract foreign capital. This flow of funds would increase investments in fixed assets and result in enhanced profits in the long term (Knill, 2013).

The shareholdings of foreign investors are anonymous capital and are considered to be a two-edged sword. If the investment horizon is short and the objective of the investment is to encash capital gains then such investors would not be interested in CG practices of the firms they invest in and rather be passive investors. It actually limits the desire to be activists (Kim & Nofsinger, 2007; Martin & Nisar, 2007). On the other hand, if the investment horizon is long-term then they would be active and effective investors for improving CG in the investee firms. It is expected that the long-term investments, besides financial, will promote non-financial aspects like better governance, increase in value, increase in goodwill and promoting future sustainability of the firm. It is, therefore, contentious as to the extent foreign investors would act as objects and subjects of improving CG of the investee companies.

With the present ownership pattern, wherein family houses have large (concentrated) stakes or they are controlling shareholders, it is uncertain whether exertions of FES at cultivating good CG practices would succeed. The incumbent management of companies acting on behalf of big business family houses faces no threat. As a result, improvements in laws governing CG would not give desired results unless and until they are adopted in spirit rather than the letter.

More and more foreign investments would bring more and better governance practices of host countries, thus government, regulators, ministries, stock exchanges and others must make all possible reforms to increase foreign capital inflows in India. The firms should exploit the good governance practices followed in the home countries of their foreign investors and strengthen governance of their own companies.

When the foreign shareholders have a small stake, it seems that they have low expectations on CG practices of the firms they invest in. They may be of the view that CG framework of such firms can be improved and strengthened as an insider or an investor, after their investment. It is suggested that when foreign investors buy equity in a firm and become insiders then they can be an important CG mechanism. Such foreign investors must be motivated to actively participate in corporate affairs and strengthen the CG practices of these firms. This would help to mitigate the agency problem and resolve the free rider threats.

FES can be representative of the magnitude to which foreign investors are actively engaged in monitoring the firms (Huang & Shiu, 2009) and augmenting CG practices of the domestic firms by stimulating international practices of answerability and expertise which would decrease a firm's cost of capital and/or escalate its stock price.

Thus, the firm should exploit the good governance practices followed in the home countries of their foreign investors. Lastly, the efficient monitoring hypothesis would operate if there exists an incentive for improving governance by owning high market capitalization firms with substantial growth prospects.

Market capitalization is perceived as an indicator of company's net worth and a basis for ranking of the size of companies as well as stock exchanges. It is also a determinant of foreign capital inflows. At the firm level, it sets the expectations with respect to growth, risk, and dividends. The results support this view as the study found that foreign investment depends upon market capitalization, size of the firm and its age. In light of the above, it is recommended that the stock exchanges must ensure that end investors benefit from safe and transparent dealings. The development and regulation of stock markets is a must. At the same time, the foreign investments are dependent on many macro-level factors namely, economic growth rate, inflation, interest rates, customer relations, supply chain, growth potential. Thus, vibrant, transparent and regulated stock exchanges may not suffice.

The study expresses out that firm characteristics are the determinants of FES and thus, improving firm characteristics together with market infrastructure and CG regime would bring in more and more of FES.

8.4 Implications of the Study

In transition economies, firm's CG regime is important to conceptualize how the economy will overcome the shortage of capital for its economic growth. The empirical findings presented by the study highlights the role foreign owners could play in CG in an emerging market, India. The current CG regime, viz a viz its substance, inclusiveness,

credibility, accountability, and integration has also been examined. The study suggests governance practitioners, policymakers, regulators, investors, corporates as well as researchers an opportunity to evaluate, appreciate, practice and/or improve the existing regime. The points of interest are mentioned one by one below:

8.4.1 Implications of the Research to Practitioners, Policymakers, and Regulators

The stock market development within itself encompasses the CG regime. It is believed that the CG regime in India is relatively good due to objectively framed laws and regulations. Yet, the present CG regime has its own gaps and lapses mainly in the application of governance rules. There is considerable room for improvement especially in the application of the existing laws and regulations at the firm level.

The results of the study would push governance practitioners, policymakers, regulators, stock exchanges, and think tanks to rethink and prioritize as to which areas are to be addressed first. They should develop such norms or codes for best CG practices that would respond to the expanding need for good CG structures.

Upon careful examination of the CG reforms and initiatives, it can be said that till now, the focus has been on the independence of boards, audit committees, whistleblower policy, related party transactions, disclosures, protection of the minority, proxy voting etc. to name a few. The legislative intent has been to protect the interests of minority investors in a more comprehensive manner.

The latest provisions of Companies Act, 2013 followed a dual approach towards enforcement of minority and small shareholder rights. It is seen that the rights granted may not always lead to their execution. If incase, shareholders especially institutional

investors do not wish to use their powers and influence CG structures, the question of effectiveness of regulation does not arise.

Regulation is an external CG mechanism. Despite numerous regulations, their enforcement is quite weak. The Indian regulators have turned out to be ineffective due to the unreasonable lengthy process of inquiry, trial, and decision. Further, numerous government departments, multiple layers of bureaucracy and complex power-sharing equation suppress the enforcement of regulations. The regulators should take measures to strengthen all these issues in order to strengthen CG framework. They should rethink on the penalties and prosecutions of non-compliance. Presently, the cost of non-compliance or late compliance is seems quite low as against the costs of compliance.

Lastly, the policymakers must permit more and more foreign investment and let India procure the entire performance benefits of ownership of foreign investors. Also at the economy level, the think tanks and policymakers of other emerging economies can formulate strategies for foreign capital inflows.

8.4.2 Implications of the Research to Investors, Corporates, and Researchers

The present study has evolved a vision for foreign investor activism on good governance. It has tried to reinstate the importance of activism of foreign shareholders as in other developed nations that will lead to the emergence of a more activist engagement for the benefit of both investors and investees. Looking at the present participation rate of AMC's as shareholders which is quite low, it's difficult to rely on them as an important factor in promoting CG and protecting shareholders rights. This could be probably due to the weaknesses in the legal systems. However, it is expected that voting levels would increase in future because of pressure on AMC from regulators.

Furthermore, the results also offer several implications for corporate policies. Firstly, global risk-sharing phenomenon suggested for foreign and domestic investors can be exploited and thus Indian listed firms may encash the valuation benefits associated with it (Chan et al., 2009). Secondly, FES from economies with strong shareholder protection as well as CG regimes may bring in their better CG mechanisms in domestic firms which would lead to higher firm valuation and at times, even termination of poorly performing management (Aggarwal et al., 2011).

The study enhances knowledge of the firm's financial characteristics that influence foreign capital inflows which in turn would help Indian firms to act accordingly and tap more and more foreign capital. The study would help firms of other emerging economies like Indonesia, Thailand, Pakistan to broaden their understanding and formulate policies to attract foreign capital.

8.5 Scope for Future Research

The study found the relation between FES, governance and firm characteristics in select listed Indian companies and analyzed the stakeholders' perception of current CG regime. It is pertinent that the companies need to evaluate their CG practices to invite more and more capital to India. Some of the possible future research areas in this field are:

- The framework of CG is moulded to be only the compliance of mandatory norms and laws. An analysis might be taken up to find out real compliance with these mandatory norms and laws in letter or in spirit.
- The regulatory bodies, stock exchanges, and other related organizations can conduct intervallic research on CG practices relating to stakeholders' perception so as to make amendments in the laws and regulations that best harmonizes with

the present day requirements. It would further facilitate alignment with the codes of different economies as well as international bodies/organizations.

- Future researchers can also determine macro-level economic variables of FES in Indian listed firms during the period of increasing foreign inflows.
- Future research can relate to sector-specific study for instance manufacturing, pharma, oil as the stakeholder's perceptions may vary from industry to industry basis. A comparative study on the basis of sectors can also be done.
- A comparative study can be taken up to analyze the relation between FES and governance in various emerging markets of Asia.
- Moreover, different foreign investors may act differently and their impact on CG score can be studied separately and comparatively.
- A comparative study on CG adoption for various developing economies could be done, but that again would have the limitation of divergent rules and regulations within countries and difference in levels of enforcement of those rules and regulations.

8.6 Limitations of the Study

The study is based on a sample. The results drawn from the analysis and interpretations are likely to be representative of the total population. The results are suggestive rather than decisive. However, the study is subject to some limitations which are as follows:

1. There may be an aggregation bias in the results projected by the study as companies within a particular type of classification such as sector/industry may be influenced by a different set of variables.

2. Non-economic control variables impacting FES are not included in the multiple regression analysis. These considerations could be related to home country of the foreign investor or the country where investments are to be made.

3. The investment in shares of companies is dependent upon many interrelated considerations vis a vis national and international developments, the market sentiments and the perception of the people regarding the stock market movements.

4. Again, some of the known sources of variation cannot be incorporated into the specification either due to non-availability of data or due to the nonquantifiability of variables. Another factor, which cannot be easily isolated, is the influence of government intervention and policies on the inflows and outflows of funds in our country.

5. The study assesses stakeholder's perception of CG regime in India, so the findings do not apply to other countries. In addition, future research may be done with a more diverse sample of stakeholders'.

6. The aspects which directly relate to the CG regime are incorporated in the study. The other aspects which may also require the attention for the study of CG may not be included for their nature, want of time, awareness of the respondents, and other considerations. Hence, to that extent, the study will not reflect those variables/factors.

7. The validity of results depends on the nature of the database. At times, a longer time horizon may be preferable.

8. The credibility and reliability of governance score depend upon the disclosure in financial statements, annual reports and the CG reports of firms which are susceptible to fraud and errors. The window dressing of the financial statements is an unfortunate reality witnessed worldwide.

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Annexures

ANNEXURES

ANNEXURE 1: QUESTIONNAIRE FOR THE STUDY OF STAKEHOLDERS PERCEPTION OF CURRENT CORPORATE GOVERNANCE REGIME

Ruchi Kansil

Research Scholar, Delhi School of Management

Delhi Technological University

Title of the present study: Foreign Ownership and Corporate Governance Practices: A Study of select Indian Companies

Research Objectives

The specific objectives of the present study are:

1. *To analyze foreign equity shareholdings in sample Indian companies*
2. *To examine the relation between foreign equity shareholdings and firm characteristics*
3. *To examine the impact of foreign equity shareholdings on corporate governance*
4. *To assess the stakeholders' perception of the current corporate governance regime*

Personal Information

1. Gender

- Male
- Female

2. Age

- 20-29
- 30-39
- 40-49
- 50 and over

3. Qualifications

- Graduate
- Post Graduate
- Professional

4. Designation/Occupation

- Employees
  - Top level management
  - Middle level management
- Independent Analyst, Auditor, Accountant and Representative of Regulatory Authority/Capital Market
- Others

1. In your opinion, how important is the company's internal management that is its board of directors in corporate governance regime?				
1	2	3	4	5
Extremely Unimportant				Extremely Important

2. How will you rate the importance of legal framework of India with respect to corporate governance?				
1	2	3	4	5
Extremely Unimportant				Extremely Important

3. Do you feel that regulatory framework including monitoring institutions play an important role in corporate governance regime?				
1	2	3	4	5
Extremely Unimportant				Extremely Important

4. Do you feel that the owners, who are the holders of equity share capital, are major caretakers of corporate governance in a company?				
1	2	3	4	5
Strongly Disagree				Strongly Agree

5. Corporate governance is nothing but a set of rules, procedures and practices to be followed.				
1	2	3	4	5
Strongly Disagree				Strongly Agree

6. It is only the inhibit culture and value system of the society that will build the corporate governance regime?				
1	2	3	4	5
Strongly Disagree				Strongly Agree

7. Do you expect improvement in firm's ability to generate equity share capital because of improvement in corporate governance?				
1	2	3	4	5
Strongly Disagree				Strongly Agree

8. Do you agree that improved corporate governance regime would improve Corporate Social Responsibility?				
1	2	3	4	5
Strongly Disagree				Strongly Agree

9. Do you believe that improved corporate governance practices would attract more investors at a reduced cost of capital?				
1	2	3	4	5
Strongly Disagree				Strongly Agree

10. Do you think that the improved corporate governance practices improve the firm's market capitalization?				
1	2	3	4	5
Strongly Disagree				Strongly Agree

11. What do you think about Indian corporate governance regime as against the corporate governance regime of other developed countries?				
1	2	3	4	5
Extremely Bad				Extremely Good

12. Do you believe that the existing corporate governance regulations are fair enough to ensure good corporate governance climate?				
1	2	3	4	5
Strongly Disagree				Strongly Agree

13. Do you find that the existing corporate governance regulations are being implemented by most listed companies?				
1	2	3	4	5
Strongly Disagree				Strongly Agree

14. Do you find there is any need for more rigorous corporate governance rules to be framed by legal and regulatory authorities?				
1	2	3	4	5
Extremely Unlikely				Extremely Likely

15. Do you find companies voluntarily taking measures to strengthen corporate governance practices?				
1	2	3	4	5
Extremely Unlikely				Extremely Likely

16. How will you rate the presence of integrity and ethics amongst Indian Board of Directors?				
1	2	3	4	5
Extremely Low				Extremely High

17. Do you believe that further measures should be taken for minority shareholder protection?				
1	2	3	4	5
Strongly Disagree				Strongly Agree

18. Do you believe that most of the time, there exists disagreement on important issues among Indian Board of Directors?				
1	2	3	4	5
Strongly Disagree				Strongly Agree

19. Do you believe that independence is an arbitrary term? No board member can be independent in decision making.				
1	2	3	4	5
Very Infrequently				Very Frequently

20. Do you believe that artificially controlling share prices by directors is a common phenomenon?				
1	2	3	4	5
Strongly Disagree				Strongly Agree

21. Do you believe that the corporate governance regime is being hampered due to drain off of funds amongst associates and subsidiaries?				
1	2	3	4	5
Strongly Disagree				Strongly Agree

Disclaimer: *Thank you for sparing your valuable time. Your contribution to the present study is highly appreciable and will be used for academic purpose only. Being a stakeholder, your response is highly valuable for my study. I assure you that all the information provided by you will be kept confidential and used for fulfilling the requirements of the Ph.D. Degree from Delhi School of Management, Delhi Technological University.*

ANNEXURE 2: BIO DATA OF THE RESEARCH SCHOLAR

Name: Ruchi Kansil

Educational Qualifications: B Com (H), M Com, M Phil, C. A., NET (Commerce)

Paper Published in International Journals

1. Kansil, R. & Singh, A. (2018). Institutional Ownership and Firm Performance: Evidence from Indian Panel Data. *International Journal of Business and Emerging Markets, 10*(3), 250-269. ISSN: 1753 - 6227 (Print) ISSN: 1753- 6219 (Online)

2. Kansil, R. & Singh, A. (2018). Sustainability Enhancement of Corporate Governance Regime in India**.** *World Journal of Science, Technology and Sustainable Development***,** *15*(2), 1-14. ISSN: 2042-5945

3. Singh, A. & Kansil, R. (2017). Impact of Foreign Shareholdings on Corporate Governance Score: Evidence from Bombay Stock Exchange, India. *International Journal of Business and Globalisation*, *19*(1), 93-110. ISSN: 1753 -3635 (Print) ISSN: 1753-3627 (Online)

4. Kansil, R. & Singh, A. (2017). Firm Characteristics and Foreign Institutional Ownership: Evidence from India. *Institutions and Economies*, *9*(2), 35-53. ISSN: 2232-1640 (Print) ISSN: 2232-1349 (Online)

5. Kansil, R. & Singh, A. (2016). Shareholders activism as a Corrective Mechanism: A Case Study of Indian Mutual Funds AMC. *Journal of Global Economics, Management and Business Research*, *7*(4), 306-312. ISSN: 2454-2504

6. Singh, A. & Kansil, R. (2016). Institutional Ownership and Firm value: A Case Study of Listed Firms in Indian Stock Exchanges. *Journal of Research: THE BEDE ATHENAEUM*, *7*(1), 98-106. ISSN: 0976-0598 (Print) ISSN: 0976-1748 (Online)

Research Papers Published in National Journals

7. Kansil, R. & Singh, A. (2016). Internal Stakeholders' Perception of Current Corporate Governance Regime. *International Journal of Scientific Research*, *5*(11), 1-4. ISSN: 2277-8179

8. Kansil, R. & Singh, A. (2016). Foreign Shareholdings on Bombay Stock Exchange – An Empirical Assessment. *Global Journal for Research Analysis*, *5*(5), 32-33. ISSN: 2277-81600

Research Papers Published in Full Length Conference Proceedings

9. Singh, A. & Kansil, R. (2013). Corporate Governance in India – A review of structure and practices. Full length Conference Proceedings, 2 nd *Conference on Innovative Financial Practices and Developments- Emerging Financial Paradigms* at Apeejay School of Management on December 20, 2013 Pages 212-220 ISBN-978-81-906991-5-1

Research Papers Presented in International Conferences

10. Singh, A. & Kansil, R. (2013). Corporate Governance in India - A review of structure and practices presented at International *Conference on Innovative Financial Practices and Developments- Emerging Financial Paradigms* at Apeejay School of Management, New Delhi on December 2013.

11. Kansil, R. & Singh, A. (2016). The Effect of Firm Characteristics on Foreign Institutional Ownership: Evidence from Indian Panel Data presented at *International Conference - 2016 on Corporate Finance, Governance and Sustainability* at Delhi School of Business, New Delhi on 21-23 October.

Research Papers presented in National Conferences

12. Kansil, R. & Singh, A. (2017). Concentrated Foreign Shareholdings and Corporate Governance in the Indian context at *India Finance Conference 2017,* 20 - 22 December 2017 at IIM Bangalore, India.

13. Kansil, R. (2014). Role of Foreign Direct Investment in Corporate Governance presented at *National Conference on Challenges of Development: Revisit to Inclusiveness* at Zakir Husain Delhi College, New Delhi on January 17-18.