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Bala N. Balasubramanian
Samir K. Barua
D. Karthik

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INDIAN INSTITUTE OF MANAGEMENT
AHMEDABAD-380 015
INDIA

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Bala N. Balasubramanian¹
Samir K. Barua²
D. Karthik³

Abstract

The crisis in the financial and the banking sectors in 2008-2009 brought back into focus the issue of CEO and top management compensation. The unconscionably high compensations, unjustified even remotely by performance, raised concerns about governance of companies. The study, the first of its kind, investigates the efficacy of board diversity and various measures of board independence for different ownership structures and different types of concentrated owners – private domestic, private foreign and government, in controlling CEO compensation in the same economic setting. The sample for the study consists of companies that were a part of the diversified 100 stock index of the National Stock Exchange in India for the period 2007-2012. The main theoretical contribution is that the impact of board diversity and board mechanisms is moderated by the type of concentrated ownership. Separation of board chair and CEO positions is the single most important governance measure for controlling excessive compensation to CEOs. Other board mechanisms to check executive compensation work along predicted lines for firms with dominant foreign owners but do not work for other types of concentrated ownership. Gender diversity and large number of non-executive independent directors deflate CEO compensation only in case of companies with foreign dominant owners. Besides theoretical contribution on moderating influence of type of concentrated ownership, the results provide actionable inputs for changes in legislation and practice of corporate governance.

¹ IIMB-Centre for Corporate Governance and Citizenship and IIM Ahmedabad, email: bala4391@gmail.com

² Professor, Indian Institute of Management, Ahmedabad, email: skbarua@iimahd.ernet.in

³ Assistant Professor, Indian Institute of Management, email: dkarthik@iimahd.ernet.in

Introduction

As fiduciaries, one of the important responsibilities of the board of a company is to decide the compensation of the CEO and the top management of the company. As studies by Hoskisson et al. (2009) and Bebchuck et al. (2010) show, in the years leading up to the crisis in the financial and the banking sectors in 2008-2009, there was large scale failure on the part of boards to fulfil this fiduciary responsibility. Though short lived, the overwhelmingly high levels of executive compensation, unjustified, even remotely, by financial performance of companies, highlighted by the ‘occupy wall street’ movement, left a mark on the consciousness of management thought process. The boards of companies across countries are under increasing pressure to ensure that executive compensations are within the bounds of reason. Extant theories assume that the board mechanisms influence CEO compensation in the same way irrespective of the ownership structure. However, as noted by La Porta et al. (1999), separation of ownership from control is essentially limited to the corporate sector in the US and the UK. Concentrated ownership of varying but significant degree prevails in the rest of the world. The management of such companies is controlled by the dominant owner/s. The largest listed companies in China for example are Public Sector Enterprises (PSEs) with government as the dominant owner. Large family owned conglomerates dominate the corporate landscape in South Korea and Japan. Concentrated ownership prevails in Western countries too: Canada, France, Germany, Italy and Sweden. Listed companies in India have concentrated ownership with the dominant owner being a family, a foreign multinational company or the government.

Institutional ownership too in the US and the UK companies tends to be widely dispersed with no single institution owning a significant proportion of the outstanding equity. In several other countries, including India, however a few large institutions hold significant proportion of equity. Hence investigations are needed to assess the efficacy of various governance variables to rein in excessive compensation to CEOs of firms for differing ownership structures.

The bulk of empirical research published in the mainstream journals on executive compensation pertains to the listed companies in the US and the UK (Leung, 2007). As a result, empirical studies on CEO compensation have not adequately explored the influence of the type of concentrated ownership with significant controlling and block shareholding. The influence of board diversity and independence too in the context of concentrated ownership with different owners has not been adequately explored by empirical studies. In this paper we attempt to fill this gap by investigating the moderating effect of the type of dominant owner on the relationship between executive compensation and board characteristics including independence, diversity and duality.

We use panel data methods to test moderation. The period 2008-2012 of severe global economic downturn presents an ideal opportunity to investigate whether the reforms in corporate governance across countries in the preceding years were effective in containing excessive CEO compensation. We chose the context of India as it has a rich diversity of ownership structure: private domestic companies, with concentrated ownership and identified promoters who are board members as well as in charge of executive management; foreign domestic companies that are subsidiaries of multinational corporations, with professional boards and executive management; public sector enterprises that are government owned, with government nominees on the board and executive management being entrusted to government appointees. With corporate governance requirements that are comparable to the best in the world, India provides an opportunity for a natural experiment to investigate how ownership structure interacts with board structure and processes to influence CEO compensation across different types of owners. Our study exploits this interesting setting to contrast the effect of different dominant owners on board mechanisms to contain CEO compensation while controlling for other aspects such as institutional context etc. and attempts to fill the gap in our understanding about the issues involved.

We find that the impact of board mechanisms and diversity are contingent on the type of dominant owner. Mechanisms to mitigate CEO's say on compensation such as separation of board chair and CEO positions and compensation committee to adjudge pay work well in firms with domestic owners

as concentrated owners. These mechanisms do not work well in firms dominated by government and foreign owners. On the other hand, measures to encourage multiple perspectives such as number of non-executive independent directors (NIDs), gender diversity have no effect on firms with domestic owners as concentrated owners but contain CEO compensation in case of foreign concentrated owners. We further find that non-executive independent directors are able to control CEO compensation for firms with dominant foreign owners when their numbers are large.

The rest of the paper is organized as follows. The next section reviews the literature on CEO compensation, concentrated ownership and board characteristics including diversity. The sample, variables and estimation methodology are described next. The results and analysis section outlines our main results and finally discussion and recommendations highlight the main insights and conclusions of the paper.

Literature Review

The agency theory proposed by Jensen and Meckling (1976) in their seminal paper was perhaps the earliest attempt to provide a theoretical framework for CEO compensation. They reasoned that since professional managers are agents of owners (the shareholders), compensation to top management should be aligned with the performance of the company so as to protect the interests of the owners. Such alignment between compensation and performance could be achieved by the board of directors of the company. While early research did appear to support agency theory, over the years empirical studies (Bebchuk and Fried, 2003; Brick et al., 2006; Core et al., 1999; Cosh and Huges, 1997; Frydman and Jenter, 2010; Taylor, 2013) have concluded that CEOs and top management of firms are often able to extract compensation that cannot be justified by performance.

In view of such findings, alignment was sought to be achieved between interests of the executives and the owners by converting executives into part owners through stock options. This approach was used extensively by industries based essentially on intellectual capital to minimize agency costs. The

efficacy of this sweat equity based approach too reached its limits due to a downturn in the stock markets as well as regulatory changes regarding taxation of such compensations. The observed divergence between performance of companies and the compensation to their top management arises because of board ‘capture’ by CEOs of the companies (Bebchuk and Fried, 2006; Hermalin and Weisbach, 1998). Research has recognized the immense power CEOs of companies are able to exercise on the choice and continuance of individuals on the boards of companies (Adams, et al., 2005; Baldenius, et al., 2014; Combs, et al., 2007). Citing the Enron affair, Perel (2003) has argued that focus essentially on stock market based performance measures coupled with poor oversight by the boards (due to capture by CEOs) have resulted in proliferation of unethical practices to enhance performance to justify excessive compensations to CEOs. Based on a study of the pay setting process of well governed companies in the UK, Bender and Moir (2006) concluded that regulatory compliance does not necessarily ensure an ethical approach, and “even a well-intentioned scheme can result in dysfunctional behaviour by executive.” The quality and the efficacy of corporate governance therefore has a significant influence not only on controlling excessive CEO compensation but also in ensuring ethical functioning of companies.

The focus on corporate governance in the last two decades began with the ‘Cadbury Code’ (enunciated in the report by Committee on the Financial Aspects of Corporate Governance, 1992) on corporate governance for companies in the UK. The next decade witnessed several countries produce their own versions of corporate governance requirements, based largely on the principles for good governance enunciated by the Cadbury Committee. The spectacular failure of giant corporations in the US in 2001 changed the landscape of corporate governance. Lawmakers in the US responded by framing of the Sarbanes Oxley Act (SOX) in 2002 for US companies to significantly improve their governance through a variety of measures pertaining to board structure and processes as well as through enhancing the liability of the board members with imposition of hefty fines and even imprisonment for inadequate monitoring of delinquent management. Following SOX, the corporate governance norms in countries across the world have been made more stringent.

The governance variables that directly influence CEO and top executive compensation pertain to enhanced role for non-executive independent directors (NIDs), removing board duality (i.e. the position of the board chair and the CEO being occupied by the same individual) and making the nominations and remuneration committee of the board a statutory committee to be chaired by an NID. More recently, board diversity and in particular gender diversity, has been recognized as an important determinant of board independence. Therefore, board diversity too would be an important influencer of CEO and executive compensation. Empirical studies have contributed interesting and varying perspective on the influence of board structure and processes on CEO and executive compensation (Chhaochharia, et al., 2009; Balasubramanian, 2013).

A comprehensive meta-analysis on executive compensation was carried out by Essen et al. (2012). They synthesized the understanding from 332 empirical studies on executive compensation across 29 countries. Their study begins with confirming that by and large firm performance does influence executive compensation. However, since 57% of the sample consisted of US companies with strong relationship between firm performance and executive compensation, the authors carried out a disaggregated analysis. Such analysis revealed that the strength of association between executive compensation and firm performance varied considerably across countries, with several countries showing poor association between the two. The authors then investigated whether standard corporate governance variables could explain the variation in the executive compensation unexplained by performance variables. While the governance variables added to the explanation provided by the performance variables, a significant part of the variation in executive compensation still remained unexplained. The authors discovered that country specific factors measured by the level of development of formal and informal institutions and the interaction between them significantly influenced the strength of association between executive compensation and firm performance. Researchers have noted the relationship between the structure of ownership and the level of institutional development. Khanna and Palepu (1997, 2000) have argued that concentrated ownership is the result of institutional voids including absence of intermediaries in the capital markets. In the context of agency theory, Gillan (2006) and Heugens et al. (2009) have argued that there is lower

incentive for concentrated ownership in countries with well-developed institutional framework for monitoring and containing managerial opportunism. Therefore we argue that concentrated ownership may prove an important factor in moderating the relationship between governance variables and CEO compensation.

Researchers have also investigated the influence of ownership structure on executive compensation (Barontini and Bozzi, 2011). One of the earliest studies on the influence ownership structure on CEO compensation was carried out by Hambrick and Finkelstein (1995). Defining concentrated ownership as one with at least one major shareholder who was not a manager of the firm, the study conducted on US firms concludes that the pay of CEOs of firms with concentrated ownership is more strongly influenced by performance of the firms as compared to the pay of CEOs of firms with dispersed ownership. The result supports the view that the possibility of capture of the board of a company by the CEO is lesser if ownership is concentrated rather than dispersed. The major shareholder/s can counter the power of the CEO over the board. The inferences from the study however are unlikely to be applicable to situations where concentrated ownership is accompanied with the dominant shareholder also being in charge of executive management. Such situation prevails in many countries with concentrated ownership.

What is also missing from empirical research is investigation of the direct influence of the type of the dominant owner and its indirect influence through governance variables on executive compensation. In this study we posit that the influence of governance variables such as proportion of NIDs and the number of NIDs in the board, board duality, board compensation committee, and board gender diversity is contingent of this key institutional factor – the type of owner – in case of concentrated ownership.

Influencers of Executive Compensation

While considerable empirical research has been done on the influence of performance and governance variables, there is paucity of empirical work focused on the influence of ownership structure on

executive compensation. The effect of governance variables on CEO compensation for different types of owners within the same institutional set up has also not been studied. Empirical investigation of these two issues is important since it would reveal the efficacy of various governance variables for varying owner and ownership structure combinations. The Indian corporate landscape with three distinct types of dominant owners - private domestic, private foreign and government provides perhaps one of the most diversified tapestry of owners. Since the proportion of companies with dispersed ownership in India is limited, focusing on firms with concentrated ownership, the study investigates how ownership structure and governance variables influence CEO compensation across different types of owners. The hypotheses tested are based on the prevailing understanding of the influence of specific dimensions of governance and ownership structure.

Influence of Non-executive Independent Directors (NIDs)

Company boards have to make difficult choices. Though they are required to act essentially in the interests of the shareholders, the NIDs may feel obliged to the CEO who may have been instrumental in getting them on the board. The CEO is also likely to be instrumental in bestowing some of the perks enjoyed by members of the board. In such situations, board member become[s] ‘captured’ by the CEO” (Weisbach, 2006). Larger proportion of NIDs on the board would imply greater board independence and better monitoring and control of executive management. Theoretically therefore, the proportion and the number of NIDs on the board should have a negative influence on CEO compensation.

Influence of Board Chair – CEO Duality

There is considerable divergence of views on letting a CEO also serve as the board chair. One view is that such duality (both position being held by same individual) is good for an organization as it ensures unified command at the top, with attendant benefits to the organization. Another view is that duality erodes the much needed checks and balances for good governance. The conflict of interest inherent in duality would compromise the independence the board must have vis-à-vis the executive management. Large influential institutional investors such as California Public Employees Retirement System (CalPERS) have pushed for separation between the CEO and the chair. As a result, companies

in the US are slowly giving up duality which till the turn of the new millennium dominated the corporate landscape in the US. Combining the two positions in the same person is clearly dysfunctional from the point of view of governance. The situation creates very evident conflict of interest when the CEO's compensation has to be approved by the CEO himself wearing the board chair hat. Separation of the two positions clearly therefore has several advantages including pre-empting "considerable concentration of power" in one person and ensuring "a balance of power and authority, such that no one individual has unfettered powers of decision," thus justifying the theoretical position that the two positions are best separated. Theoretically, duality would have a positive influence on CEO compensation, thereby implying ineffective monitoring and control of executive management.

Influence of Compensation Committee

Best practice requires that a sub-set of the board consisting exclusively of NIDs be constituted as a board Compensation Committee to determine the remuneration of the CEO for subsequent board endorsement and shareholder approval. This requirement is designed to ensure utmost objectivity in settling CEO compensation and (virtually) removing any possible bias in the decision making process. The performance of Compensation Committees around the world however has always been looked upon with mistrust and cynicism. One of the reasons for such mistrust is that Compensation Committees do not always consist exclusively of NIDs, but include whole time directors. The constant dilemma before the directors is how to walk the tight rope of being "nice" to the CEO and at the same time to protect the interests of the shareholders at large. Theoretically, existence of Compensation Committee that implies formal objective evaluation of the performance of the CEO, would negatively influence CEO compensation.

Influence of Gender Diversity

Gender equality of opportunities on sociological and human rights grounds have been debated for centuries (Mill, 1869; Wollstonecraft, 1796). Women's beneficial contribution to group diversity and specifically to corporate boards as a measure of diversity with its accompanying benefits has been

quite extensively discussed in literature (Digman, 1990; Forbes and Milliken, 1999; McDougall, 1932). Researchers have argued that women directors take their roles more seriously and prepare better for meetings (Izraeli, 2000), prevent groupthink (Huse and Solberg, 2006) by adding different perspectives to the board deliberations (Zelechowski and Bilimoria, 2004). Women bring different perspectives and voices to the table, to the debate and to the decisions (Zelechowski and Bilimoria, 2004). Women improve the monitoring role of the board (Campbell and Mínguez-Vera, 2008) and women improve financial performance of firms operating in complex environment (Francoeur et al., 2008). The number of women on the board improves a firm's CSR rating and through that the reputation of the firm (Bear et al., 2010). In sum, presence of women on the board of companies results in greater board independence (Lucas-Perez et al., 2014) and greater effectiveness. Theoretically therefore, since gender diversity enhances board independence and effectiveness, it should negatively influence CEO compensation.

Influence of Institutional Block Holders

In concentrated ownership, the non-promoter institutional block holders are expected to counter the power of the promoters. As well-informed and well-equipped investors (unlike most retail investors), institutions have both the wherewithal and economic motivation to monitor performance of their investee companies. Large institutional investors in the US, like pension funds and others with at least 5% of equity in their investee companies, react strongly and flee from investing in companies that are deficient in governance (Dobbin and Jung, 2011). Top domestic financial institutions in India (other than mutual funds) usually have substantial equity holdings in their investee companies. Often, they also have their nominee directors on the board of investee companies by the virtue of their substantial share-holding. In general non-promoter institutional block-shareholding would negatively influence CEO compensation. However, the possible variation in the influence of institutional block shareholding on CEO compensation for different types of owners within the same economy has not been researched.

Influence of Ownership Structure

As already stated, much of the empirical research on executive compensation has been in the context of companies in the US and the UK where the ownership is dispersed. There are relatively fewer studies on the situation that prevails in countries like India where ownership is predominantly concentrated in the hands of different types of promoters and other block holders like domestic financial institutions. The general presumption is that greater the dominance of promoters (as measured by their percentage holding), higher will be the CEO compensation. The other view that has been advocated, especially for family controlled companies, is that the compensation to the CEO may be deliberately kept at relatively modest levels to contain pay expectations in the top management or as a way of image building to reflect responsible corporate behaviour. The second view is contingent on the belief that the promoters find other ways of tunnelling to expropriate benefits for themselves from the company. The influence of ownership structure on CEO compensation and how it interacts with board structure and governance process for different types of owners within the same economic set up have not been extensively researched.

Hypotheses

After considerable discussions, the corporate governance requirements for listed companies in India were finally frozen and made mandatory from April, 2006. Uniform requirements were therefore applicable during the period of the study across all types of ownership. The influence of the governance variables on CEO compensation after controlling for the influence of firm performance however is likely to vary across types of owners due to differing considerations of owners. The resulting hypothesis may be stated as follows:

Hypothesis 1: The influence of the three standard governance variables, namely, duality, proportion of NIDs and existence of compensation committee, on CEO compensation will be moderated by the type of concentrated owner as well as the proportion of ownership. While duality will inflate, the proportion of NIDs and existence of compensation committee would deflate CEO compensation. The influence of these variables on CEO compensation is likely to be most

significant for foreign owned companies that typically have professional executive management and boards and is likely to be the least significant for government companies since CEO compensation for government companies is also materially influenced by external considerations and parameters.

The institutional ownership in India tends to be concentrated with a few government owned institutions accounting for significant block-shareholding. The proportion of institutional ownership would be expected to negatively influence CEO compensation as institutions would be expected to protect their (as well as that of the absentee shareholders) interests by controlling excessive executive compensation. This effect would essentially be visible in the case of private companies. The hypothesis therefore may be stated as follows:

Hypothesis 2: The influence of institutional block-shareholders on CEO compensation will be moderated by the type of ownership as well as the extent of institutional ownership. Higher institutional ownership would tend to deflate CEO compensation. The influence of institutional ownership on CEO compensation is likely to be insignificant for government owned companies since institutions with large block-shareholding in India are typically government owned institutions. Their influence on CEO compensation for both the types of privately owned companies is likely to be significantly negative.

As with many countries, there was no regulatory requirement on either the number or proportion of women on company boards in India during the study period. As a result, the number of women on boards of Indian companies was low. The gender diversity was therefore measured simply as the number of women in the board. While there are studies on influence of gender diversity on executive compensation, there has been no investigation of the influence of gender diversity for different types of owners of companies within the same economic setting. The hypothesis on the influence of gender diversity may be stated as follows:

Hypothesis 3: The influence of gender diversity on CEO compensation will be moderated by the type of ownership. In general, existence of gender diversity would tend to deflate CEO compensation. The influence of gender diversity on CEO compensation however is likely to be the most significant for foreign owned companies since women board members in these companies are likely to be professionals. The impact of gender diversity in case of private domestic companies is likely to be the lowest since women board members in these companies are likely to be influenced by the promoters.

The extent of independence of a board has typically been measured by the proportion of NIDs on the board. It is however debatable whether the ability of NIDs to escape ‘capture’ by the CEO (and therefore, to be truly independent) is adequately measured merely by the proportion. For examples, two boards with 40% NIDs, one of size 5 and another of size 10, would imply presence of 2 and 4 NIDs on the board respectively. Critical mass theory postulates that a subgroup’s influence is amplified when the size of the subgroup crosses a threshold (Asch 1951; Konrad et al., 2008; Torchia et al., 2011). In view of this, we used both the proportion of NIDs as well as the number of NIDs in the set of explanatory variables. The resulting hypothesis may be stated as follows:

Hypothesis 4: The influence of the number of NIDs (on the board) will be moderated by the type of ownership. In general, larger number of NIDs will tend to deflate CEO compensation. The influence of this variable on CEO compensation is likely to be the most significant in case of foreign owned companies, since the NIDs in these companies are likely to be professionals. The influence of the variable in case of private domestic companies is likely to be lowest since NIDs in these companies are likely to be chosen by the promoters.

Sample and Methodology

Sample

The sample for this study was drawn from National Stock Exchange listed companies in India and were part of the NSE CNX 100 Index set during 2007–2012. As the name of the Index indicates, at any point in time the index set consists of 100 stocks. The sample comprised 113 companies. The choice of the companies from the NSE CNX 100 Index set ensured that the sample represented a large proportion of both the total as well as the free-float market capitalization, a very high proportion of trading volume and investor interest in the Indian market. This ensured that the sample is representative of companies in India.

The data was accessed from a variety of sources: the Stock Exchange (NSE), the CMIE (Prowess database), CapitalLine database, and company annual reports. The clean up and validation of data from multiple sources was done manually. The information on board of directors, women directors and CEO compensation was hand collected from the Annual reports of companies.

Methodology

The level of CEO compensation as the dependent variable is regressed against three sets of independent variables: a) the governance variables that capture the board structure and processes, b) the ownership structure variables, including the type of dominant owner, and c) the control variables that measure the performance of the company. In addition, interaction variables are included in the set of explanatory variables to investigate for joint influence of variables.

Dependent variable

Information on the dependent variable, the total CEO compensation is computed from companies' filings and annual reports. The values were Winsorized at 5% to take care of outliers.

Independent variables

Governance Variables: The governance variables were the number of independent directors, the proportion of independent directors, duality, existence of nomination committee and gender diversity. The number of NIDs is the number of NIDs at the end of the financial year, as reported in the annual reports of companies. The proportion of NIDs is measured by the ratio of the number of NIDs and the total number of directors at the end of the financial year, as reported in the annual reports of companies. Binary variables are used to represent board duality (the variable is assigned a value of 1 when the positions of CEO and Chairman are held by the same individual); existence of compensation committee (the variable is assigned a value of 1 if the board has a compensation committee). Gender diversity is measured by the number of female directors in the board. The influence of these variables is as hypothesized in the hypotheses stated in the preceding section.

Ownership Variables: The type of ownership, that is, private domestic, private foreign, government and dispersed is based NSE (National Stock Exchange) definition. As there are four categories of promoters, three binary variables are used to represent the category of ownership. Government ownership is represented by the three binary variables assuming zero values. In addition to the type of owner, the percentage of ownership is also used as a variable. The percentage of promoter ownership is measured by the end of the financial year ownership as stated in the annual reports of companies. Promoters include individuals, entities, or a group of individuals and/or entities acting in concert and being in control of the corporation, in line with the classification used by the NSE for the purposes of company filings relating to ownership. The percentage of institutional ownership is used to measure the influence of ownership of institutional block-shareholding. The percentage of institutional ownership is measured by the end of the financial year ownership as stated in the annual reports of companies. Institutional investors include pension funds, insurance companies, mutual funds, unit trusts, banks, or other such institutions, both domestic as well as foreign, engaged in investing beneficiary funds. This definition is in line with the classification used by the NSE for the purposes of company filings relating to ownership. The influence of these variables is as hypothesized in the hypotheses stated in the preceding section.

Joint Effect of Ownership and Governance Variables: The possibility of joint effect of variables from these two sets is assessed by including the product of percentage of promoter holding with duality and with percentage of NIDs in the set of explanatory variables. These variables help in assessing the possible joint influence of the two pairs of variables.

Control Variables: The standard economic determinants of CEO compensation have been used as control variables. Their inclusion achieves a complete specification of the model whereby the coefficients for the other variables can be interpreted statistically. The two internal (accounting based) control variables used are size of the firm measured by logarithm of income (the top line) and profit after tax (PAT), that is the bottom line in the profit and loss accounts of the company as published in the annual report. The external (market based) control variable used is lagged excess return. Lagged excess return is measured by the difference between the percentage change in market capitalization of the company and the percentage change in the market index (CNX NIFTY 100 index of NSE). The market capitalisation of the company at the end of each financial year was taken from annual reports. Lagged excess return for a year is the excess return for the preceding year. Since the focus of the study is not on these variables, no hypotheses are tested on these variables.

The Model

We test the hypotheses framed in the preceding section using the following regression model:

CEO Compensation

$$\begin{aligned}
 &= \beta_0 + \beta_1 (\% \text{ of NIDs}) + \beta_2 (\text{Number of NIDs}) \\
 &+ \beta_3 (\text{Existence of Compensation Committee}) + \beta_4 (\text{Duality}) \\
 &+ \beta_5 (\text{Gender Diversity}) \\
 &+ \beta_6 (\text{Institutional Percentage Holding}) \\
 &+ \beta_7 (\text{Promoter Percentage Holding}) \\
 &+ \beta_8 (\text{Promoter Percentage Holding} \times \% \text{ of NIDs}) \\
 &+ \beta_9 (\text{Promoter Percentage Holding} \times \text{Duality}) + \beta_{10} (\text{PAT}) + \beta_{11} \text{Ln}(\text{Income}) \\
 &+ \beta_{12} (\text{Lag Excess Return})
 \end{aligned}$$

Results and Analysis

The descriptive statistics and the correlation matrix for all the variables are presented in Table 1. The maximum CEO compensation in the sample is INR 152.8 million (\$2.46 million), average is INR 39.4 million (\$0.64 million). The average size of the firm is INR 62480 million (\$1 billion). The average number of women directors on board is about 0.19 with maximum being 2 women directors. The average proportion of independent directors is about half. The number of independent directors ranges from 2 to 12 with an average of about 6 person per board. About 81 per cent firms have compensation committees. In about 62 per cent cases the positions of CEO and chairperson of the board are occupied by same individual, implying board duality.

Table 1

Descriptive statistics and correlation

	variable	min	max	mean	Std dev	1	2	3	4	5	6	7	8	9	10	
1	Remuneration INR million	1.52	152.8	39.43	42.16											
2	% of Independent directors	0.14	0.88	0.5	0.13	0.15*										
3	Number of Independent directors	2	12	5.58	1.88	0.15*	0.60*									
4	Compensation Committee	0	1	0.81	0.39	-0.03	0.14*	0.09*								
5	Duality	0	1	0.38	0.49	0.06	-0.01	0.03	-0.01							
6	Gender diversity	0	2	0.19	0.41	-0.05	0.08	0.13*	0.03	-0.02						
7	Institutional % Shareholding	1.11	87.87	30.75	14.89	0.13*	0.21*	0.28*	0.20*	-	0.08					
8	Promoter % Shareholding	0	89.78	48.64	20.48	-	-	-	-	0.15*	-	-				
9	PAT INR million	-30520.5	251229.2	16456.27	30381.14	0.16*	0.25*	0.25*	0.23*	0.17*	0.09*	0.80*				
10	Log Total income INR million	6.9	15.06	11.04	1.34	0.11*	0.02	0.26*	0.06	0.13*	0.07	-0.02	0.08			
11	Lag Excess Return	-1.2	7.9	0.18	0.72	0.09*	-0.05	0.26*	0.05	0.14*	0.07	0.14*	0.05	0.63*		
11	Lag Excess Return	-1.2	7.9	0.18	0.72	0.07	0.04	0.01	0	-0.04	0.02	0.04	-0.01	0.01	0.04	

N=562 * $p < 0.05$

The compensation practices could vary across firms. Hence models were estimated using panel data methods to account for any unobserved firm specific practices related to executive compensation. We used random effects model because some of our main explanatory variables do not vary across time and hence fixed effects estimation cannot be used. Further, we used robust standard errors to account for any heteroscedasticity. The results of regression are presented in Table 2. As measured by the F-statistics, all the regressions results are statistically significant. Model 1 shows the results for all companies. These include the dummy variables identifying the type of dominant owner. Model 2 to 4 show the results for each type of dominant owner. Model 2 shows the results for firms where the ownership is concentrated in the hands of private domestic owners, model 3 for foreign owners and model 4 for government owners.

Table 2

Results of Random Effects on CEO compensation

Variables	Model 1 All Firms	Model 2 Domestic Private Firms	Model 3 Foreign Private Firms	Model 4 Government Firms
(Intercept)	-171.6835*** (32.4693)	-116.1263** (42.0696)	-83.0761* (34.448)	10.4502 (8.9208)
% of Independent directors	-9.6725 (16.5712)	-7.6306 (21.0905)	51.041*** (10.6241)	1.1848 (2.733)
Number of Independent directors	1.436 (1.4248)	1.9241 (1.6849)	-4.1623* (1.6103)	0.0116 (0.2013)
Compensation Committee	-7.5718* (3.2473)	-15.101* (7.5575)	0.3499 (8.8206)	0.1115 (0.5208)
Duality	15.6798** (4.8439)	18.5248*** (5.4917)	1.14 (7.216)	-0.6525 (1.1629)
Gender diversity	-1.8132 (2.0385)	-3.419 (2.9904)	-14.8532*** (3.9332)	0.1748 (0.3711)
Institutional % Shareholding	0.516* (0.2009)	0.6478* (0.2585)	-0.2385 (0.5361)	-0.0388 (0.0599)
Promoter % Shareholding	0.3377+ (0.2016)	0.1074 (0.2537)	0.0514 (0.4509)	-0.173+ (0.0882)
Promoter holding % X % of independent directors	0.4901 (0.3611)	0.6538 (0.894)	-1.3008* (0.5378)	-0.0244 (0.0974)
Promoter holding % X	-0.1701 (0.2515)	-0.3386 (0.3987)	10.7645*** (0.9473)	0.0821* (0.0331)
Duality	0.0001 (0.0001)	0.0001 (0.0001)	0.0005+ (0.0002)	0 (0)
PAT INR million	10.4222*** (2.3072)	13.0968*** (3.45)	10.8472** (3.7316)	0.4017 (0.2971)
Log Total income INR million	2.4562+ (1.3406)	2.5864 (1.6759)	-0.4617 (2.2894)	0.5078 (0.409)

Type Domestic Private dummy	75.2308*** (8.5455)			
Type Foreign Private dummy	56.4686*** (8.3164)			
Type Dispersed ownership dummy	76.8939*** (15.7803)			
No of firms	113	68	20	19
No of firms	562	330	99	95
T	4-5	1-5	4-5	5
Adjusted R Squared	0.1822	0.1852	0.4669	0.1965
F statistic	8.4008	6.2975	8.3299	2.0143

⁺ $p < 0.10$, ^{*} $p < 0.05$, ^{**} $p < 0.01$, ^{***} $p < 0.001$. Robust clustered standard errors in parenthesis

Results for All Companies

As expected, the CEO compensation for the government owned companies is significantly lower than the compensation to their counterparts in private domestic and private foreign companies as shown by the significance of the three dummy variables pertaining to type of ownership. The governance variables that significantly influence CEO compensation are duality and existence of compensation committee. Consistent with existing literature (Lucas-Perez et al., 2014), we find that when the same person occupies the position of the CEO and the Chairman of the board, it has a statistically significant (at 1%) positive influence of CEO compensation. Existence of compensation committee has a statistically significant (at 5%) negative influence on CEO compensation. Thus, of the four governance variables, two influence CEO compensation on expected lines.

As regards structure of ownership, the percentage of institutional ownership has a statistically significant (at 5%) influence on CEO compensation. The positive influence of this variable is however contrary to expectation. Higher institutional ownership is typically accompanied with diffused ownership by a larger number of institutions. The oversight of board functioning suffers as a result of this diffused ownership. The promoter CEOs in such situations get away with relatively higher compensation than their counterparts in companies with lower institutional ownership. As discussed later, Models 2 to 4 confirm that the efficacy of governance variables does vary by the type of dominant owner.

Results for Private Domestic Companies

The results for this group are similar to the results for all the companies. The governance variables that significantly influence CEO compensation are duality and existence of compensation committee. Duality has a statistically significant (at 1%) positive influence of CEO compensation. Existence of compensation committee has statistically significant (at 5%) negative influence on CEO compensation. Thus, of the four governance variables, two influence CEO compensation on expected lines.

As regards structure of ownership, the percentage of institutional ownership has a statistically significant (at 5%) influence on CEO compensation. The positive influence of this variable is however contrary to expectation.

The CEO compensation is not influenced either by the proportion of independent directors or the number of independent directors. Gender diversity too does not influence CEO compensation. The positive influence of duality on CEO compensation implies that when one individual holds the positions of chairman and CEO, then the payment to promoter CEO is statistically significantly higher. The negative influence of compensation committee implies that this governance measure is able to control excessive payment to promoter CEOs.

Results for Private Foreign Companies

Except for existence of compensation committee, all the other governance variables significantly influence CEO compensation. While proportion of independent directors, gender diversity and the number of independent director directly influence CEO compensation, duality influences CEO compensation through interaction with promoter holding.

The proportion of independent directors positively influences CEO compensation (significant at 0.1%); the same proportion however has a significant (at 5%) negative influence on CEO

compensation at higher levels of ownership. The number of independent directors on the board has a significant (at 5%) negative influence on CEO compensation. Gender diversity has a statistically significant (at 0.1%) negative influence on CEO compensation. Duality has significant (at 0.1%) positive influence on CEO compensation at higher levels of ownership. The results are intricate and require careful interpretation.

Higher level of foreign ownership would typically imply greater commitment and responsibility of the parent company. The positive influence of duality at higher levels of ownership implies that the oversight is weak as regards CEO compensation in the presence of duality. In such situations the parent would benefit from using the institution of non-executive chairman to oversee the functioning of the company. The nature of influence of independent directors is more subtle. Typically, large proportion of independent directors implies smaller boards and larger number of independent directors implies larger boards. The negative influence of the number of independent directors on CEO compensation implies that managerial power is neutralized when a larger group of NIDs is present in the board. Board capture by the CEO becomes more difficult, despite the board members being from the same fraternity, if a larger number of NIDs are in the board. The positive influence on CEO compensation of the proportion of NIDs is indicative of board capture by the CEO. Typically, women on boards of MNC subsidiaries (unlike for example domestic firms which might bring in women from controlling families) are well known professionally competent individuals. With such background, it is not surprising that they exert a negative influence on CEO compensation.

Results for Government Owned Companies

The only governance variable that has significant influence on CEO compensation is duality. Even this variable has a positive influence (at a significance level of 5%) only at higher levels of government ownership.

The absence of influence of governance variables for PSEs is to be expected. The CEO compensation is determined by the larger compensation structure that is followed by the government for all its employees. It is therefore not influenced either by governance variables or by performance variables.

The above results from the study ought to raise concerns about management of PSEs. Most emerging economies have a large number of government owned companies in key sectors of the economy. If the CEOs of these companies are not compensated based on performance, albeit through a governance process that does a fair evaluation of their performance, then the returns from a significant proportion of invested capital in these economies may be indifferent due to absence of motivation of the CEO. Such a situation is not good for any economy.

Discussion and Recommendations

Corporate governance standards and best practices in market-based economies have evolved over the years based essentially on the agency theory tenets that emphasised the inevitability of divergence between the interests of shareholders as principals and the executive as their agents in operationalizing a company's business objectives. This led to putting in place a number of measures for the board of directors as the principals' representatives to oversee executive behaviour and performance with the twin objectives of maximising wealth creation and mitigating potential executive expropriation of such created wealth and wealth-creating assets to the detriment of shareholders. Such measures included strengthening the board through induction of more independent directors on the board, distancing executive management from board supervision by separating the roles of the board chair and the chief executive, constituting board committees for more rigorous and specialised surveillance over management, and enhancing the quality of board discussions and decisions through diversity in its composition. CEO compensation being a key component of incentivizing management for both better corporate performance and lesser expropriation of profits, compensation committees comprising independent directors were introduced with the objective of

ensuring an appropriate balance between minimising costs to shareholders and attracting, retaining and motivating top quality talent to run the operations.

The last two decades have witnessed convergence of the above ideas on corporate governance across countries. The universalization of norms however has happened in the backdrop of very different ownership structures. While ownership of listed companies is typically highly dispersed in the US and the UK, in the rest of the world ownership is concentrated. The nature of dominant owner also varies considerably. An empirical question that has remained inadequately explored is the efficacy of governance structures and processes, patterned after those in the US and UK, in the context of concentrated ownership structures that prevail in other countries. The issue of efficacy of governance became a focal point of discussion in the context of apparent excessive executive compensation during the recent period of economic downturn across countries. This study investigated the moderating influence of concentrated ownership on the relationship between the governance structures and processes and CEO compensation in the context of listed companies in India. Given the different types of dominant owners and the extent of their ownerships that prevail in India, the inferences from the study provide insights that would be useful across different countries with concentrated ownerships.

The main theoretical contribution of the study is the recognition that the governance variables advocated by US and UK and accepted by the rest of the world may not be universally effective in the context of different types of corporate issues. In dealing with compensation to CEOs of companies with concentrated ownership, the efficacy of governance variables is moderated by the type of dominant owner. While the influence of governance variables on CEO compensation is most significant for foreign dominant owners, it is the least significant when government is the dominant owner. The degree of influence in case of private domestic owners falls in between the other two categories. The results in case of foreign dominant owners is similar to the results reported by Hambrick and Finkelstein (1995). The board capture by the CEO is made difficult by the dominant owner who is not a part of the executive management. As postulated by Essen et al. (2012) the

explanation for concentrated private domestic ownership is likely to be weak institutional mechanisms to provide owners with legal protection of their wealth. In such situations, while complying with the governance requirements as per regulations, the dominant owners do not allow governance variables to freely influence CEO compensation. The results establish the fallacy in believing that the governance measures enunciated in the context of US and UK, with predominantly dispersed ownership structure, would be equally effective in the context of different types of dominant owners. Empirical work on similar lines (as this study) would be needed in the context of other countries to reach conclusions that can be generalized.

In addition to board mechanisms, our study also contributes to the growing literature on unravelling the nature of contribution of gender diversity to board processes. The results indicate that women on boards, even in small numbers, help in enhancing corporate governance. Our findings show that presence of women directors on the boards helps in controlling excessive compensation to CEOs only in companies where the dominant owners are from foreign countries. Unlike private domestic companies with concentrated ownership, companies with concentrated foreign ownership tend to choose women of eminence to signal quality of their board composition. Hence, gender diversity deflates excessive CEO compensation in case of foreign dominant owners. This result on women directors qualifies the claim that gender diversity improves board effectiveness (Lucas-Perez et al., 2014).

Several policy recommendations emerge from the results of our study. The new governance structures and processes have practically no influence on CEO compensation in case of PSEs. The reason for this is likely to be rule based compensation structures that dictate CEO compensation in PSEs. This ought to be a major concern for many emerging economies where PSEs control a large part of productive investments. There is a need to free the antiquated executive compensation structures and to let the governance processes work to motivate executives to improve performance of PSEs.

Separation of the board chair from the CEO is the single most important governance measure that would be able to control excessive compensation to CEOs as far as private ownership is concerned. The separation has a direct as well as an indirect controlling influence on CEO compensation. It will be useful for countries to legally mandate such a separation. In contrast, the influence of the compensation committees in controlling excessive compensation to CEOs appears to be limited. Hence mandating compensation committees may not be as important as removing duality.

The proportion of NIDs shows a diabolical influence on CEO compensation. Managerial power or board capture by the CEO is evidenced by the absence or positive influence of the proportion of NIDs on CEO compensation for privately owned companies. Our results indicate that in addition to proportion of independent directors, it is important to also consider the strength of independent directors in terms of absolute count. This result is in conformity with the critical mass theory on influence of subgroups (Asch, 1951). The governance benefits from presence of NIDs are likely to be realized only if their numbers are large (and not just their proportion in the board) to neutralize the well-documented power CEOs have over board members. This dimension of a critical number of independent directors in addition to the proportion of independent directors was hitherto ignored in the literature.

Agenda for Future

The study reported in the paper shows that in cases of concentrated ownership, the practice of excessive compensation to CEOs, not justified by performance, cannot be fully countered by board structures and processes that promote good corporate governance. The observed wide-spread incidence of excessive CEO compensation across countries with concentrated ownership indicates that similar situation possibly prevails in other countries too. As suggested by several research studies, excessive CEO compensation may often be a symptom of unethical practices by companies and executives (Bender and Moir, 2006; Perel, 2003). Such dysfunctional behaviour cannot always be controlled by compliance oriented governance practices. It may be necessary to go beyond the

standard good governance precepts. That is what has been attempted in the Companies Act, 2013 that is now applicable to all listed companies and large unlisted public companies in India.

The new Companies Act mandates board structure and processes that promote good governance: separation of board chair and CEO positions, constitution of compensation committee, inclusion of at least one female board member and a minimum of one-third NIDs on boards. As the study shows these standard measures may not be adequate to control unconscionably high compensation in case of promoter managed companies. Perhaps recognizing this possibility, the new Companies Act in India stipulates that decisions that directly benefit the promoter shareholders in charge of management would require approval by more than 50% of the other non-related shareholders in a general meeting before they can be acted upon. Compensation to CEO beyond a specified limit (linked to income of the company) is one decision that requires such clearance. The first instance of this requirement's impact was evident when the compensation proposal for the CEO of a large listed company in India was disapproved by the non-promoter shareholders (Chilkoti, 2014). This may be an effective mechanism to contain the menace of excessive compensation to promoter CEOs that may be adopted by other countries too.

The Companies Act, 2013 also strengthens the institution of non-executive independent directors. It mandates presence of at least one NID in case of short-notice board meetings where certain key decisions are taken that have significant bearing on the future of the company. In addition, the Act holds NIDs accountable for negligence, connivance and collusion with the executive management or promoters in acts of delinquency and fraud. The penalties imposed have been significantly enhanced to ensure greater care and loyalty to all stakeholders' interests.

The last word on executive compensation has clearly not yet been said. Further research is needed to fully understand the nature and extent of moderating influence of the type of owner on executive compensation. The results from such research would help in evolving more effective norms and regulation to deal with serious mis-alignment between performance and compensation that still

prevail in the corporate world. It will remain an interesting area for empirical research in the foreseeable future as countries formulate their response to deal with the matter.

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