RESPONSE

CORPORATE GOVERNANCE RATINGS: ONE SCORE, TWO SCORES, OR MORE?

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In response to Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1263 (2009).

Over the last decade or so, a great deal of important scholarship has found positive associations between better corporate governance and firm market value, firm performance, stock market development, and economic growth.[1] In light of these findings, it is not surprising that scholars have focused considerable attention on trying to develop methods of assessing whether a firm has good governance.[2] However,

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[1] *See* Lucian Bebchuk, Alma Cohen & Allen Ferrell, *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783, 786 (2009) (finding that certain provisions entrenching managers appear to also negatively influence firm valuation and stockholder returns); Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Legal Determinants of External Finance*, 52 J. FIN. 1131, 1139 (1997) (finding that "the results on debt, like those on equity, suggest that legal rules influence external finance"); Ross Levine, *Law, Finance, and Economic Growth*, 8 J. FIN. INTERMEDIATION 8, 24 (1999) ("[T]he legal and regulatory environment materially affect financial intermediary development."); Dhammika Dharmapala & Vikramaditya Khanna, *Corporate Governance, Enforcement, and Firm Value: Evidence from India* 1 (Univ. of Mich. Law & Econ., Olin Working Paper No. 08-005, 2008), *available at* http://ssrn.com/abstract=1105732 (presenting a "strong case for a causal effect of [corporate governance] reforms on firm value").

[2] *See* Sanjai Bhagat, Brian Bolton & Roberto Romano, *The Promise and Peril of Corporate Governance Indices*, 108 COLUM. L. REV. 1803, 1807 (2008) ("Today, a market for corporate governance ratings exists . . . ."); Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Law and Economics of Self-Dealing*, 88 J. FIN. ECON. 430, 432-33 (2008) (discussing the Anti-Self-Dealing Index); Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Law and Finance*, 106

developing governance standards that apply to all firms has not been easy, as there are important differences among firms (and countries) that tend to undermine such efforts. In *The Elusive Quest for Global Governance Standards*, Professors Bebchuk and Hamdani address this issue and provide an analytical framework that leads to the development of two standards for assessing good corporate governance that have applicability across many firms and countries.

In this response, I examine Bebchuk and Hamdani's analysis and explore how one might implement parts of it. In the process, I rely on some of the experiences of other countries—especially emerging markets such as India, Korea, Russia and Brazil—to enrich the discussion and aid our understanding. Part I briefly summarizes Bebchuk and Hamdani's analysis. Part II discusses their analysis and examines potential critiques. It concludes that these critiques do not weaken Bebchuk and Hamdani's recommendations and discusses why their recommendations are both valuable and well-balanced. Finally, Part III concludes with some thoughts on how to begin to implement Bebchuk and Hamdani's recommendations.[3]

I. BEBCHUK AND HAMDANI—MORE THAN ONE STANDARD FOR GOOD GOVERNANCE

Most corporate governance rankings and indices provide a uniform scale for assessing a firm's governance. In other words, the indices use the same factors to compute the governance scores of firms regardless of differences in firm characteristics (e.g., ownership structure, size, or industry) or countries.[4] This has the advantage of producing a single number for each firm against which other firms can be compared in order to get a sense of relative governance quality. However, Bebchuk and Hamdani argue that such a single score may

J. POL. ECON. 1113, 1126-28 (1998) (discussing the Antidirector Rights Index); Robert Daines, Ian Gow & David Larcker, *Rating the Ratings: How Good Are Commercial Governance Ratings?* 8-14 (Stanford Univ. Law & Econ., Olin Working Paper No. 360, 2008), *available at* http://ssrn.com/abstract=1152093 (examining governance ratings from three rating firms).

[3] The analysis focuses only on the issue of developing governance ratings that capture which firms have "better" governance and does not discuss whether better governance *causes* changes in firm market value or whether common law jurisdictions have better governance rules than civil law jurisdictions.

[4] *See generally* Bernard S. Black, Hasung Jang & Woochan Kim, *Does Corporate Governance Predict Firms' Market Values? Evidence from Korea*, 22 J.L. ECON. & ORG. 366 (2006); Djankov, La Porta, Lopez-de-Silanes & Shleifer, *supra* note 2; La Porta, Lopez-de-Silanes, Shleifer & Vishny, *supra* note 2.

lead to mischaracterization and misranking of firms' governance practices.[5]

This is because what may be considered the best governance for a particular firm may not necessarily be the best for a differently situated firm.[6] Optimal governance is generally not one-size-fits-all and hence, a uniform scoring standard could lead to misranking.[7] Indeed, other studies have raised serious doubts about the value of uniform corporate governance rankings.[8]

However, if optimal governance is largely endogenous to other firm characteristics (and other governance practices), then one wonders whether there is much value in having governance rankings. After all, if the best governance for a firm "depends" on so many other things, then what is the point of having a ranking system that says that governance practice "X" is better than practice "Y" for all firms?

Bebchuk and Hamdani take these insights and develop a middle ground that recognizes that while optimal governance does vary, the

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[5] Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1263, 1281-1304 (2009).

[6] *See* N. Balasubramanian, Bernard S. Black & Vikramaditya Khanna, *Firm-Level Corporate Governance in Emerging Markets: A Case Study of India* 3 (European Corporate Governance Inst., Law Working Paper 119/2009, 2009), *available at* http://ssrn.com/abstract=992529 ("Our findings . . . suggest that the benefits of particular corporate governance practices vary depending on firm and country characteristics."); Sridhar R. Arcot & Valentina G. Bruno, One Size Does Not Fit All, After All: Evidence from Corporate Governance 2 (Jan. 15, 2007) (unpublished manuscript), *available at* http://ssrn.com/abstract=887947 ("[W]hen looking at various governance criteria, it may be realistic that in many cases deviating from a principle is optimal.").

[7] *See Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance: Hearing Before the Subcomm. on Securities, Insurance, and Investment of the S. Comm. on Banking, Housing, and Urban Affairs*, 111th Cong. (2009) (testimony of Professor John C. Coates IV, John F. Cogan, Jr. Professor of Law and Economics, Harvard Law School), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=c754606c-0b95-4139-a38a-63e63b4b3fa9&Witness_ID=49f23bdb-ae69-42a8-a6d5-82d7fb82502a (proposing solutions to solve collective-action problems among shareholders while avoiding "forcing a one-sized-fits-all solution on companies generally"); Balasubramanian, Black & Khanna, *supra* note 6, at 3 (arguing that governance is not one-size-fits-all); Arcot & Bruno, *supra* note 6, at 2 ("[I]n matters of corporate governance, *one-size-does-not-fit-all*."). Uniform scoring systems (such as the Body Mass Index (BMI)) can have unusual results. *See* Dan Mindus, *Tom Cruise: Hottie or Fatty?*, CENTER FOR CONSUMER FREEDOM, Dec. 25, 2003, http://www.consumerfreedom.com/oped_detail.cfm?oped=160 ("A BMI of 30 or more makes you obese, and at 5-7, 201 pounds, Tom Cruise has a BMI of 31. . . . Michael Jordan (6-6, 216 pounds, BMI of 25) . . . [was] also 'overweight' at the height of [his] athletic powers.").

[8] *See* Bhagat, Bolton & Romano, *supra* note 2, at 1808 (arguing that the "most effective governance institution depends on context and on firms' specific circumstances"); Daines, Gow & Larcker, *supra* note 2, at 4 (finding that even the best ratings systems have fairly unimpressive predictive validity).

primary areas of variation can be narrowed so that ranking systems retain some usefulness. The middle ground that they develop is not only theoretically justifiable but also one that can be implemented. Their approach divides firms into two categories—those that have a controlling shareholder (CS firms) and those that do not (NCS firms). Usually, scholars characterize the United States and the United Kingdom as having more NCS firms and most other countries as having primarily CS firms.[9] This division by ownership structure is theoretically important because the kinds of investor-protection (corporate governance) problems in these two types of firms are different.[10]

At NCS firms, there is no controlling shareholder, so de facto control tends to rest with management.[11] Thus, investors (shareholders) are most concerned with what management is doing, and hence the focus is on the manager-shareholder relationship.[12] In CS firms, there is a controlling shareholder and hence de facto control rests with the controller, not management. Thus, investors are most concerned with what the controlling shareholder does, and hence the focus is on the controlling (majority) shareholder–minority shareholder relationship.[13] While there is some overlap in these kinds of concerns, there are also important differences. For example, antitakeover defenses are important in NCS firms but of limited importance in CS firms because control is not contestable.[14] However, rules regulating freezeout transactions matter more in CS firms than NCS firms.[15] These differ-

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[9] Bebchuk & Hamdani, *supra* note 5, at 1267 & n.9, 1268.

[10] *See* John Armour, Henry Hansmann & Reinier Kraakman, *What Is Corporate Law?*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 31 (Reinier Kraakman et al. eds., 2d ed. 2009) ("[T]he structure of corporate law in any given country is in important part a consequence of that country's particular pattern of corporate ownership . . . ."); Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 785 (2003) ("The presence of a controlling shareholder reduces the managerial agency problem, but at the cost of the private benefits agency problem.").

[11] Bebchuk & Hamdani, *supra* note 5, at 1281-82.

[12] *See id.* at 1281 ("Because management's interests may diverge from those of shareholders, [the prime concern is addressing] management's potential to behave opportunistically at the expense of shareholders.").

[13] *See id.* at 1282 ("Controllers . . . may . . . have interests that do not overlap with those of outside investors . . . . In CS companies, therefore, the fundamental concern . . . is the controlling shareholder's opportunism.").

[14] *Id.* at 1285-89.

[15] *Id.* at 1304-06, 1310.

ences lead to different metrics for what is considered good governance in these firms.

Bebchuk and Hamdani then provide a list of which governance practices matter most in CS firms and, separately, in NCS firms.[16] They use this to develop two types of governance scores—one for CS firms and another for NCS firms. A summary is provided in Table 1.

Table 1: Summary of Bebchuk and Hamdani's Recommendations

Areas of Interest	**Factors Relevant in NCS Firms**	**Factors Relevant in CS Firms**
Control Contests	Rules on hostile takeovers and proxy fights.	Rules not critical in CS firms.
Shareholder Voting Procedures	Rules facilitating voting by majority shareholders: (i) vote by mail or proxy; (ii) vote without deposit shares; (iii) who can place proposals for vote; and (iv) confidential voting.	Rules not critical in CS firms.
Power Between Board and Shareholders	Rules on which governance changes shareholders may initiate.	Rules not as critical as in NCS firms.
Executive Compensation (NCS) and Self Dealing and Freezeouts (more CS firms)	Rules on substantive and procedural aspects of compensation and rules on shareholder ratification.	Rules on disclosure, voting requirements, and fiduciary duties governing self-dealing and freezeouts. These rules matter more in CS firms.
Power Between Majority and Minority	Rules not critical in NCS firms.	Rules on veto rights, related-party transactions (RPTs), and cumulative voting.
Director Independence	Rules examining ties between directors and management.	Rules examining ties between directors and controller. Rules on nomination and selection process and whether influenced by controllers.

[16] *Id.* at 1306-16.

Areas of Interest	Factors Relevant in NCS Firms	Factors Relevant in CS Firms
Controlling Minority Shareholders	Rules not critical in NCS firms.	Rules related to separating voting and cash-flow rights.
Evaluating Legal Systems	Country score for these types of firms.	Country score for these types of firms (different than for NCS firms).

II. DISCUSSION OF BEBCHUK AND HAMDANI'S FINDINGS

The Bebchuk and Hamdani approach has much to commend it—it provides a theoretically justifiable reason for having different governance scores for CS and NCS firms, thereby increasing the usefulness of the rankings. However, it still limits the number of governance scores to two kinds (CS and NCS) so that scholars and rating firms may construct governance rankings without great complication. This approach is desirable if the differences between CS and NCS firms are as Bebchuk and Hamdani describe *and* if the other factors that may influence good governance are not as important as the effect on governance of differences in ownership structures.

A. *Differences Between Controlling and Non-Controlling Shareholder Firms*

The differences between CS and NCS firms that Bebchuk and Hamdani identify find considerable support in the extant literature. At an anecdotal level, the types of fraud that typify CS firms and NCS firms tend to be somewhat different. For example, frauds like those that took place at Enron and Worldcom (United States) are more common in NCS firms, whereas the types of fraud seen at Parmalat (Italy) and Satyam (India) are more common in CS firms.[17] One of the key differences between the two categories of fraud is that the NCS fraud tends to involve management misrepresenting performance to cover up poor performance or to obtain benefits from ex-

[17] *See* Gilson & Gordon, *supra* note 10; Vikramaditya Khanna, *Corporate Governance in India: Past, Present & Future?*, 1 JINDAL GLOBAL L. REV. (forthcoming 2009) (manuscript at 17-22, on file with author) (contrasting the frauds in the United States (e.g., Enron) and India (e.g., Satyam)); John C. Coffee, Jr., *A Theory of Corporate Scandals: Why the U.S. and Europe Differ* 2 (Columbia Ctr. for Law & Econ. Studies, Working Paper No. 274, 2005), *available at* http://ssrn.com/abstract=694581 ("[D]ifferences in the structure of share ownership account for [important] differences in corporate scandals . . . .").

ecutive compensation, whereas CS fraud tends to involve controllers covering up expropriation of corporate funds or opportunities.[18] This suggests that the measures (and governance practices) that would be useful for deterring the two kinds of frauds are likely to be somewhat different.

Within the empirical literature, studies have found that the level of management entrenchment is important for assessing governance at NCS firms.[19] This would not be a significant issue in CS firms in most jurisdictions because the controller can easily replace managers.

However, some empirical studies in emerging markets provide intriguing results. Studies on the adoption of governance reforms in Russia, Korea, and India, among others, find that governance reforms are well received by the stock markets and, indeed, better governance is often associated with increases in firm market value.[20] The puzzle is that these reforms are almost uniformly the "better governance" prescriptions that would be relevant for NCS firms even though most firms in these countries are CS firms. This fact appears to suggest that the differences in CS and NCS firms do not translate into a need for different governance rules or ranking systems.

However, this interpretation may be hasty. First, many countries with predominantly CS firms may have had ineffective governance regimes initially. In such countries, any enhancement of governance (even if not perfectly tied to CS firms' concerns) would be an improvement over the status quo and would generate positive results.[21] Further, the signal sent by state-enacted governance reforms may be at

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[18] *See* Khanna, *supra* note 17; Coffee, *supra* note 17, at 15 ("The U.S./U.K. system of dispersed ownership is vulnerable to gatekeepers not detecting inflated earnings, and concentrated ownership systems fail to the extent that gatekeepers miss (or at least fail to report) the expropriation of private benefits.").

[19] *See* Lucian Ayre Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy*, 54 STAN. L. REV. 887, 939 (2002) (deeming staggered boards "by far the most important takeover defense mechanism in the market for corporate control"); Bebchuk, Cohen & Ferrell, *supra* note 1, at 823 (identifying a correlation between entrenching provisions and lower firm valuation).

[20] *See* Bernard S. Black, Inessa Love & Andrei Rachinsky, *Corporate Governance Indices and Firms' Market Values: Time Series Evidence from Russia*, 7 EMERGING MARKETS REV. 361, 378-79 (2006) (Russia); Black, Jang & Kim, *supra* note 4, at 410-11 (Korea); Balasubramanian, Black & Khanna, *supra* note 6, at 37 (India).

[21] Bernard S. Black and Vikramaditya Khanna have made a similar point. *See* Bernard S. Black & Vikramaditya Khanna, *Can Corporate Governance Reforms Increase Firm Market Values? Event Study Evidence from India*, 4 J. EMPIRICAL LEGAL STUD. 749, 788 (2007) ("[T]he same reforms could have net benefits in a poor governance country, such as India prior to [corporate governance reforms], yet net costs for companies that are already well governed, such as the United States.").

least as important as the reforms themselves.[22] The market would receive positively the signal that the government is friendlier to investor interests and that governance matters. Moreover, it may be that the response would have been even more positive had the reforms actually targeted the primary concerns of CS firms. Finally, all of these accounts seem to suggest that at least some of the NCS governance changes may help to alleviate some governance concerns at CS firms. This is both true and still consistent with the Bebchuk and Hamdani analysis. Their analysis does not suggest that there is no overlap in governance concerns but rather that there are specific governance concerns at CS (NCS) firms that should be addressed and assessed differently than at NCS (CS) firms.[23]

B. *Other Governance Factors Besides Ownership Structure*

The above analysis suggests that delineating governance practices between CS and NCS firms is an important step in making governance rankings more useful. However, for this approach to be most useful, other factors (e.g., firm characteristics) must have a lesser influence on optimal governance when compared to ownership structure. These other factors can be divided roughly into those related to the country where the firm is located (e.g., political stability, whether the state has a "grabbing hand,"[24] labor-friendly laws, tax laws, and law enforcement) and to firm characteristics (e.g., firm size and industry).

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[22] *See* Vikramaditya Khanna, *Law Enforcement and Stock Market Development: Evidence from India* 27-29 (Ctr. on Democracy, Dev. & Rule of Law, Working Paper No. 97, 2009), *available at* http://cddrl.stanford.edu/publications/law_enforcement_and_stock_market_development_evidence_from_india (discussing one way in which a state-enacted reform could send a signal); Robert N. Eberhart, Corporate Governance Systems and Firm Value: Empirical Evidence for the Value of Transparency 20 (May 2009) (unpublished manuscript), *available at* http://aparc.stanford.edu/publications/corporate_governance_systems_and_firm_value_empirical_evidence_for_the_value_of_transparency ("[T]he signaling provided by adoption of a system including outsiders promising a more transparent system does indeed operate to give Japanese firms a plausible and beneficial reason to adopt the *iinkai* system.").

[23] Bebchuk and Hamdani also suggest that, for countries with many CS firms, it may be easier politically to adopt reforms targeted at the concerns raised by NCS firms. Bebchuk & Hamdani, *supra* note 5, at 1316.

[24] *See* Naomi R. Lamoreaux, *Scylla or Charybdis? Historical Reflections on Two Basic Problems of Corporate Governance*, 83 BUS. HIST. REV. 9, 13-16 (2009) (discussing concerns with "grabbing hand" states and how certain institutional arrangements may have reduced this behavior); Mark J. Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539, 560 (2000) ("American corporate law is made in contexts (such as in Delaware's legislature and courts) where labor's influence is indirect and weak.").

First, consider the country factors. It would appear that whether a state has labor-friendly laws or is a "grabbing hand" (i.e., expropriates firm assets) will be factors that are relevant to governance.[25] Would these factors suggest different optimal governance for firms in states without these attributes as compared to firms in states with these attributes? One can imagine that less disclosure might be desirable for firms in "grabbing hand" states because enhanced disclosure might attract the state's attention and lead the state to expropriate firm assets. In such states, corporations might prefer alternate means of protecting shareholders from managers or controllers, rather than relying on enhanced disclosure. Similarly, in countries with weak enforcement, the validity of important corporate decisions might depend less on ex post judicial adjudication and more on "self-enforcing" measures, such as requirements for shareholder approval.[26]

Would these differences lead us to create different ranking systems for firms in "grabbing hand" states (or weak-enforcement states) and for firms that are not? Although such a result is certainly plausible, there are a few reasons that one might not create separate ranking systems. First, some of these factors are likely to be caught in Bebchuk and Hamdani's country-specific governance ratings. Second, CS structures often exist in countries that possess labor-friendly laws, use certain tax laws, or enforce their laws weakly.[27] Whether CS structures led to these laws or vice versa is not as important as the high degree of correlation between these factors. If so, then perhaps in calculating scores for CS firms we can include these factors as they are more likely to be present for such firms. Finally, the differences in governance that these factors trigger may relate to only one (or a few) governance practice(s) so that creating a separate ranking system may not be

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[25] *See* Lamoreaux, *supra* note 24, at 9 ("[T]he more successful investors are in protecting their capital from the grabbing hand of the state, the less they are able to call upon the state to protect it from the grabbing hand of corporate insiders.").

[26] *See* Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911, 1932 (1996) ("The self-enforcing model minimizes the need to rely on courts and administrative agencies for enforcement. Thus, it is robust even when these resources are weak.").

[27] *See* Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-Based Evidence*, 93 J. FIN. ECON. 207, 226-37 (2009) (examining the importance of enforcement to financial outcomes, ownership structure, and corporate governance); Roe, *supra* note 24, at 547-60 (discussing how political ideologies (e.g., social democracies and labor policies) influence corporate governance and ownership concentration); Mihir A. Desai & Dhammika Dharmapala, Taxation and Corporate Governance: An Economic Approach 11-13, 15-16 (Apr. 2007) (unpublished manuscript), *available at* http://ssrn.com/abstract=983563 (exploring connections between ownership structure and tax and corporate governance and tax).

worth the effort.[28] In comparison, the differences in optimal governance between CS firms and NCS firms are likely to be greater and to capture more of the likely differences in optimal governance. Thus, having different governance scores for CS firms and NCS firms may be desirable.

Other firm-specific factors may influence optimal governance practices. Studies have shown that both industry and firm size can influence optimal governance.[29] For example, it may be optimal for larger firms to have more detailed procedures and disclosures than smaller firms both because larger firms may have more agents to monitor and because they may be better able to bear the costs. Similarly, characteristics of an industry, such as the extent to which an industry depends on external capital, may alter optimal corporate governance.

Moreover, within CS firms, studies show that the same governance feature appears to have different effects in different contexts.[30] These studies provide mixed results on something as ubiquitous as board independence. Studies on Korea find that board independence is associated with higher firm market value, studies on India find that this relationship is either weaker or nonexistent, and studies on Brazil find no relationship or a negative relationship between board independence and market value (i.e., board independence is associated with lower firm market value).[31] All of these countries have CS firms pri-

[28] One could argue that these country-specific issues are not corporate laws and should not be part of corporate governance rankings. However, if firms adjust their governance to respond to the country-specific issues, then the issues may be significant enough for corporate governance rankings to account for them. Further, if these adjustments affect variables of interest (such as firm performance, firm market value, or stock market development), then the rankings should reflect the adjustments because the rankings are often used to assess whether governance practices correlate with the variables of interest, such as better firm performance.

[29] *See* Balasubramanian, Black & Khanna, *supra* note 6, at 29-30 (including firm size and industry as variables); Art Durnev & E. Han Kim, *To Steal or Not to Steal: Firm Attributes, Legal Environment, and Valuation*, 60 J. FIN. 1461, 1474 (2005) (using industry dummies and firm size in regressions to assess the impact of corporate governance on firm value); Raghuram G. Rajan & Luigi Zingales, *Financial Dependence and Growth*, 88 AM. ECON. REV. 559, 566-67 tbl.1 (1998) (analyzing data by industry).

[30] NCS firms in the United Kingdom show similar results. *See* Arcot & Bruno, *supra* note 6, at 26 ("[C]ompanies that depart from best practice because of genuine circumstances outperform all others.").

[31] *See* Black, Jang & Kim, *supra* note 4, at 411 (Korea); Balasubramanian, Black & Khanna, *supra* note 6, at 32-33 (India); Bernard S. Black, Antonio Gledson de Carvalho & Erica Gorga, *Does One Size Fit All in Corporate Governance? Evidence from Brazil* 24-25 (Northwestern Univ. Sch. of Law, Law & Economics Research Paper No. 09-20, 2009), *available at* http://ssrn.com/abstract=1434116 (Brazil).

marily.[32] The divergence in findings is difficult to reconcile unless we bring into the mix the notion that the same governance features may have different effects on firm market value depending on the surrounding context or institutional framework. This suggests that there are other firm- or country-specific factors besides ownership structure that influence optimal governance.[33]

If we were to account for all these differences by devising a multitude of ranking systems, then the overall process of performing corporate governance rankings would carry a heavy burden. However, there are reasons not to account for all of these differences but to have two ranking systems divided by ownership structure. First, the other firm characteristics may lead to only a few differences in optimal governance, whereas differences in ownership structure may lead to more differences between assessments of CS and NCS firms, thereby justifying two separate ranking systems. Second, these other characteristics are factors that can be used to create subsidiary rankings. It is fairly common in many ranking systems to have one or two features that create the main ranking systems while allowing for the development of subsidiary systems to account for more specialized interests. For example, Zagat's restaurant guide provides general rankings in certain cities and also more finely tuned rankings based on other factors (e.g., type of cuisine).[34]

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[32] *See* Tarun Khanna & Yishay Yafeh, *Business Groups in Emerging Markets: Paragons or Parasites?*, 45 J. ECON. LITERATURE 331 (2007) (detailing how ownership structures vary throughout emerging markets); Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471, 491-93 (1999) (noting that dispersed firms are seen primarily in the United States and the United Kingdom); Balasubramanian, Black & Khanna, *supra* note 6, at 18-19 (noting ownership structure in Indian firms); E. Han Kim & Woochan Kim, *Corporate Governance in Korea: A Decade After the Financial Crisis* (Univ. of Tex. Sch. of Law, Research Paper No. 123, 2007), *available at* http://ssrn.com/abstract=1084066 (discussing governance in Korea and ownership structure); Erica Gorga, Changing the Paradigm of Stock Ownership: From Concentrated Towards Dispersed Ownership? Evidence from Brazil and Consequences for Emerging Countries 18-21 (Sept. 2008) (unpublished manuscript), *available at* http://ssrn.com/abstract=1121037 (discussing ownership structure in Brazil).

[33] Balasubramanian, Black & Khanna, *supra* note 6, at 32-34.

[34] Zagat, http://www.zagat.com/ (last visited Oct. 1, 2009). Finally, there are firms between the NCS and CS extremes and different kinds of controllers (e.g., family, government, or groups of blockholders), and some CS firms may have professional managers. It is instructive to think of ownership structure as being more of a continuum rather than two extremes (CS and NCS). However, for purposes of a ranking system, the two extremes are a good place to begin, and if the intermediate points seem to carry great weight, the system can be adjusted to reflect that. Bebchuk & Hamdani, *supra* note 5, at 1271-72.

In the end, the overall decision about how many governance ranking systems to have is also a matter of judgment. Although one can make the case for using other governance metrics when creating governance ranking systems, the additional factors generally do not have as broad of an impact on optimal governance practices as ownership structure. In light of this, Bebchuk and Hamdani's recommendations to focus on ownership structure as the critical dividing line seems judicious and balanced.

III. CONCLUSION AND IMPLEMENTATION

Bebchuk and Hamdani have presented an insightful discussion of corporate governance ranking systems and developed a two-tier ranking system that is both theoretically justifiable and well-balanced. In this last Part, I briefly discuss some options one might consider when beginning to implement their recommendations.

Although one could explore many areas of governance, I limit my discussion to how one might operationalize the concept of independent directors in CS firms. As Bebchuk and Hamdani note, the key issue in NCS firms is whether the board is independent from management and, in CS firms, whether the board is independent from the controller. However, because boards are generally elected by majority vote, the controller selects the board members in CS firms. This fact raises questions about the independence of the board from the entity that voted it into office and underlines the importance of the nomination and selection processes. Indeed, Bebchuk and Hamdani identify these processes as being important to assessing a CS firm's governance rating. If so, then what sorts of factors should we look to in assessing these processes?

Emerging economies with many CS firms have tried different ways to enhance the chances that the selection of independent directors will ensure independence. For example, after the Satyam scandal in India, commentators suggested having an independent nominating committee for the board.[35] In Korea, a rule was utilized that reduces the controller's voting stake in voting for members of the audit committee (who are automatically board members in Korea). Thus, a controller's stake drops to carrying only three percent of the vote for selecting audit committee members.[36] Yet other countries maintain a

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[35] Khanna, *supra* note 17, 17-22.

[36] For reference, see § 409 and § 542-12 of the Korean Commercial Code.

dual-board structure that works to constrain the controller's influence in a different manner.[37] When examining the independence of the board in CS firms, one might need to look for these kinds of rules and provisions to obtain a better sense of whether the directors are truly independent from the controller. Thus, in order to implement the recommendations from Bebchuk and Hamdani, one must begin to explore in greater detail local laws and practices.

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[37] *See* Katharina Pistor, *Codetermination: A Sociopolitical Model with Governance Externalities*, *in* EMPLOYEES AND CORPORATE GOVERNANCE 163, 165-66 (Margaret M. Blair & Mark J. Roe eds., 1999) (describing the origins of labor representation on German supervisory boards); Mark J. Roe, *German Codetermination and German Securities Markets*, 5 COLUM. J. EUR. L. 199, 199 (1999) (describing the codetermination mechanism "by which employees control half of the seats on the German supervisory board"); *Is One Global Model of Corporate Governance Likely, or Even Desirable?*, KNOWLEDGE@WHARTON, Jan. 9, 2008, http://knowledge.wharton.upenn.edu/article.cfm?articleid=1877 ("At Japanese firms, dozens of loyal managers cap off careers with a stint in the boardroom. Founding families hold sway on Indian corporate boards. And in China, Communist Party officials are corporate board fixtures.").