

Chapter 3

Corporate Governance Structure in India

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Theory of governance and its apparatus keeps on changing with respect to changing needs of society over a period of time and thus the corporate governance structure will need to be examined in the context of both the changing contours of governance as well as the apparatus used to impart meaning to the objectives of the governance. This chapter seeks to examine the corporate governance structure that revolves around the apparatus of board of directors' composition, tenure, typology besides the process of selection and renewal of the board members. Specifically, this chapter examines the board structure and composition, the process of nomination and appointment of directors. Accordingly, the chapter has been divided into three parts. Section one highlights the evolution of governance system over a period of time and the changing role of board of directors. Section two delineates the concept and typology of directors. Section three analyses the board structure, demographics and cognitive aspects of directorships and relates the board structure with financial performance.

3.1 Evolution of Board Governance System

In India, the managing agency system¹ was in place to manage the companies, till it was abolished with effect from April 3, 1970, by the Companies (Amendment) Act, 1969. Family owned business houses in India, which owned managing agency firm, used to be in the control of the company amidst the concentration of ownership in the companies. The managing agents were doing the same task which the modern time managing director has to do and therefore, it can be seen in many cases that after abolition of managing agency system

¹ "The managing agency system may be defined as an institutional development of industrial organization where the promotion, finance and administration of a vast agglomeration of miscellaneous and unrelated enterprises, mines, plantations, mills, public utilities, shipping interests, sales agencies and investment trusts are controlled by a single firm. The managing agency firm may take the organizational form of a partnership, a private or public limited company, or an individual." – Basu, S.K. (1958), *The Managing Agency System – In Prospect and Retrospect*, The World Press Private Ltd., Calcutta, p.4-5.

some of the managing agents redesignated themselves as managing directors². The managing agency system was so much dominant that the boards of the companies were just ornamental boards, having most of its members hand-picked of the managing agents. The first mention of board of directors is found in the Indian Companies Act of 1866; however, its sovereign authority was established only in the year 1913³. It was the Companies (Amendment) Act, 1936, which has the roots of the present system of rotation of two-thirds of directors by rotation⁴.

The Companies Act, 1956, vide section 252 mandated appointment of the board of directors for public and private companies and restricted the directorship to individuals by excluding any body corporate, association or firm. However, managing agency system continued by the Act of 1956. The growing evils of managing agency system compelled the government to abolish it with effect from April 1970. Though the sovereign authority of board had long been enshrined in the Companies Act, but its absolute governing power came only after 1970. Section 2(6) of the Companies Act, 1956 defines 'the board' as the board of directors of the company and section 2(13) defines 'director' as any person occupying the position of director, by whatever name called.

The board of directors plays a pivotal role in corporate governance. Matters to be decided by the board of directors should be limited to matters related to oversight and supervision, i.e., approval of high level strategic decisions, nomination of candidates for director and executive positions, appointment and removal of the CEO, review and setting of management's salaries, general control of accounting and auditing, and other similar matters. In addition to the functions mandated by law the corporate governance framework should

² Mr. Rahul Bajaj who joined the Bajaj Auto Limited Company in 1965 as a managing agent is still working with the same company as a CMD. – 2000-2001 Annual Report of Bajaj Auto Ltd.

³ It also provided for removal of directors and vacation of office in certain cases vide section 86-1 (corresponding section 283 of the Companies Act, 1956).

⁴ Section 83 A (2), Indian Companies (Amendment) Act, 1936.

ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company shareholders. Board members should act on a fully informed basis, in good faith, with due diligence and care in the best interest of the company and the shareholders.

Against this background an effort was made to analyse the governance structure and composition that prevails in Indian companies.

3.2 Governance Structure and Board Composition

Differences in international patterns of corporate governance are embedded in law and social milieu. Despite the inbuilt differences in structure there are much similarities in the board practices. We observe two types of structures, i.e., unitary⁵ and two tier⁶. In case of two tier board, tier one is supervisory and tier two is executive, while unitary board is both supervisory and executive, but in reality more executive than supervisory. Board structures and rules alone cannot achieve standards of corporate governance, however, they provide a framework, which will encourage and support good corporate governance. Participation of people in the decision-making process is the root of the democratic system of governance. In democracy the governing body is elected from the people, by the people and for the people. In such a system of governance the right structure, size and composition of the governing body is vital for giving strategic direction and controlling the performance of the management to get the desired results. The board is regarded as the focal point of governance process and the fulcrum of accountability in the system since the institution of board is carrying with it the faith and fiduciary of the shareholder who appointed them *de jure*. The board functions on shared wisdom since the board members are taking decisions either unanimously or by majority. Even though organization of the board takes place from

⁵ As prevalent in the U.S., the U.K. and India

⁶ As prevalent in Germany and some companies in the France.

various strata representing various interests⁷, their decision must be in a unified manner fulfilling the other stakeholders' interests too. However, organization of the right type and size of board is a challenge. As and when the external or internal environment changes, one must change the board with person(s) having necessary knowledge to afford competitive edge and to neutralize the effects of such changes. Structure of board is critical because it provides the right kind of apparatus to the governance system therefore one needs to examine the structure of the board in terms of size, composition, demographics and the quality of board in terms of their capability to impart frank and candid professional opinion on the matters brought before the board.

3.2.1 Board Size

The right size of the board is vital for getting optimum results from the board. While too large board is unmanageable and difficult to co-ordinate, too small board finds it difficult to look after the company's functions properly. Large boards are less likely to be effective monitors of manager's activities and are more likely to be controlled by company CEOs (Jensen, 1993) and attract less institutional investments (Roth & Saporoschenko, 2001). Large board size is the uniqueness in Japan and small boards in the U.S. and the U.K. However, boards of various organizations suggest no particular/optimum structure and size of the board. Mertzanis Report (Greece) stated that "for reasons of flexibility in the decision-making process, it is recommended that the maximum number of board members be no higher than thirteen". However, changes in the mandatory requirements lead to restructuring of the board and restructuring process involves finding out the right composition, size and structure of the board (Kumar Mangalam Birla Committee Report, 2000). Hereunder, is the analysis of board size and change in board size in Indian companies.

⁷ Such as representation of small shareholders, institutional investors, government nominees, etc.

Variations in Board Size

Subject to the mandatory minimum requirement, the size of the board is left to the discretion of the company, which is fixed by the Articles of Association of the company. Neither Indian nor international codes attempted to determine the size of the board⁸. The minimum number of directors required for public company is three and that of any other company is two⁹. A recent amendment to the Companies Act¹⁰ has given an option to specific public companies¹¹ to have a director elected by small shareholders¹² in a manner as may be prescribed. This amendment is in conformity with the report of Kumar Mangalam Birla Committee (KBC, 2000).

Promoters must mention in the Articles of the Association, the minimum and maximum number of directors to be appointed on the board, which may be changed in the general body meeting by passing of special resolution to that effect¹³. However, permission of the Central Government is required to be sought if number of directors is increased beyond twelve¹⁴.

The data for all four years was available only for 101 companies for the analysis. For other 15 companies of the sample either the information for 4 years was not available or the companies were recently formed (i.e., no information was publicly available). Table 3.1 presents data with respect to changing board size over the period of study.

Table 3.1: Descriptive Analysis of the Board Size

Year	Minimum	Maximum	Average	Std.Dev	No. of Dirs
FY 97-98	5	19	10.1	3.37	1017
FY 98-99	5	21	10.3	3.49	1041
FY 99-00	5	18	10.3	3.18	1040
FY 00-01	5	20	10.4	3.13	1053

⁸ except in Martzanis Report, Greece.

⁹ Sec. 252 of the Companies Act, 1956.

¹⁰ Companies (Amendment) Act, 2000.

¹¹ Those, having a paid up capital of Rs. 5 Crores or more; and or one thousand or more small shareholders.

¹² "Small Shareholder" means a shareholder holding shares of nominal value of Rs. 20,000/- or less in a public company to which sec. 252 applies.

¹³ As per sec. 31 of the Act since it will amount to alternation of articles of association.

¹⁴ Under section 259 of the Companies Act, 1956.

Analysis of data shows that the minimum board size remained at 5 whereas maximum board size ranged from 18 to 21. It was also noted that the average board size remained same i.e., nearly 10 for all four years with varying standard deviation for all four years. For the null hypothesis that the average board size of companies did not change from year to year 2 tailed *t* tests were performed. Observed values of $t = 0.49$ for the FY 1997-98 and the FY 1998-99 (p -value = 0.62), $t = 0.02$ for the FY 1998-99 and FY 1999-00 (p -value = 0.98), $t = 0.29$ for the FY 1999-00 and FY 2000-01 (p -value = 0.77) were not found significant at 5% level of significance. Therefore, it can be inferred that the average board size of companies did not change from year to year.

Sectorwise analysis (table 3.2) shows that minimum board size in joint sector was higher than public and private sector whereas maximum board size in joint sector was less than private and public sector companies. Further, for the FY 2000-01 the minimum board size differed in all the three sectors, i.e., joint (7), private (6) and the public (5). Similarly, the maximum board size was highest in private sector (20) followed by public (17) and then the joint sector (10).

Table 3.2: Sectorwise Descriptive Analysis of the Board Size

Sector	Year	Minimum	Maximum	Average	Std Dev.
Joint (3 Cos.)	FY 97-98	9	11	9.7	1.15
	FY 98-99	9	11	9.7	1.15
	FY 99-00	9	11	9.7	1.15
	FY 00-01	7	10	9.0	1.73
Private (81 Cos)	FY 97-98	5	18	10.1	3.37
	FY 98-99	5	19	10.2	3.39
	FY 99-00	5	18	10.3	3.23
	FY 00-01	6	20	10.4	3.10
Public (17 Cos)	FY 97-98	5	19	10.2	3.72
	FY 98-99	5	21	10.9	4.23
	FY 99-00	5	16	10.5	3.26
	FY 00-01	5	17	10.6	3.51

The average board size in joint sector (9) was less than public (10.6) and private (10.4) sector companies for the FY 2000-01. The test for the significance of variability of board size from

year to year in each sector was carried out. For the null hypothesis that ‘there was no significant difference in the average board size of public and private sector companies from year to year’, 2-tailed *t*-test was performed. The observed value of ‘*t*’ for all four years, i.e., *t* = 0.13 for FY 1997-98 (*p*-value > .05), *t* = 0.79 for FY 1998-99 (*p*-value > .05), *t* = 0.22 for the FY 1999-2000 (*p*-value > .05), *t* = 0.25 for the FY 2000-01 (*p*-value > .05) was not found significant at 5% level of significance. Therefore, it was concluded that the average board size of public and private sector companies remained unchanged from year to year.

Change in Board Size

From the above table 3.1 it was noted that average board size remained nearly 10 for the four successive years and numbers of directors from year to year changed marginally and that in particular FY 1998-99 and FY 1999-00 number of directors remained unchanged. Therefore, it was further analysed that in how many companies board size changed and what was the range of increase or decrease in the board size from year to year? The analysis of same 101 companies (table 3.3) shows that the change in board size from year to year ranged from –6 (i.e., decrease in board size) to +7 (i.e., increase in board size).

Table 3.3: Frequency Distribution of Yearwise Change in Board Size

Change in board Size	FY (98-99)-(97-98)	FY (99-00)-(98-99)	FY (00-01)-(99-00)
-3 to -6	1	8	4
-2	5	6	5
-1	12	13	16
0	59	50	39
+1	14	14	22
+2	5	4	12
+3 to +7	5	6	3
Total Cos.	101	101	101

It was also noted that the percentage of companies that changed their board size changed it from year to year, i.e., 41.6% in the FY 1998-99 to 50.5% in the FY 1999-2000 to 61.4% in the FY 2000-01. On an average that one out of two companies changed its’ board size from year to year. It is evident from the data (table 3.3) that in majority of the companies the

change in board size took place in the range of up to ± 2 . Change in board size was attributed to: board member turnover, board restructuring pursuant to organizational restructuring, viz., disinvestments, mergers, acquisitions and takeover, bad performance of EDs, reaching the superannuation age by any member, on medical reasons, change in equity structure, bringing in experts for revival strategy, strategy to raise profile of the board, man with diversified knowledge being inducted, etc.

After analysis of board size it is quite obvious to explore the practices of board composition existing in India. Board composition deals with type of directors, director demographics and cognitive that collectively makes the whole board.

3.2.2 Types of Directorship

Two aspects have been taken into consideration for the explanation of type of directorship viz. insider vs. outsider and executive vs. non-executives.

Insider vs. Outsider

‘Insider’ directors are those who belong either to management of the company or the promoter himself or any family member of the promoter who is having stronghold on the business though he may be involved in the day to day management of the company. Outside directors are those who do not fall under any of the foregoing categories. The latter might be regarded as professional referee...” (Fama, 1980). Most outside directors are prominent persons, whose capability and integrity are well recognized by the public. Good reputation is of little use if the amount of time these directors can dedicate to the company is very limited. However, outside directors have incentives to develop reputation as experts in decision control (Fama, 1980; Fama & Jensen, 1983) and signal their competence to the market (Weisbach, 1988). Outside directors are often not familiar with the management of company and will have to rely on executive directors and management for information. Their

decisions, though impartial, well intentioned and independent, may not necessarily be optimal for the company. To have outside directors controlling the decisions of the board may therefore, not necessarily be preferable¹⁵.

‘Grey’ outsiders are those who are not insiders but at the same time they are related to the business of the company and include retired employees, relatives of CEO and/ or promoters, and persons with disclosed conflicts of interest such as outside business dealings with the company or interlocking directors relationships with the CEO (Shivdasani & Yermack, 1999). Apart from this we have also included in the definition any person who has any business relations or the employees of group companies. Grey directors, though are outsiders, are interested directors and cannot be regarded as independent director.

Executive vs. Non-Executive

The director can be categorized, on the basis of capacity in which he works, as executive director¹⁶, non-executive¹⁷, and independent director¹⁸. The one who is called as a ‘whole-time director’ in the law, is called as an ‘executive director’ in a common parlance. Committees on corporate governance worldwide recommended that the board should have balance of executive and non-executive directors, preferably comprising a majority of non-executive directors of whom sufficient should be independent of management for the protection of interests of dispersed minority shareowners.

¹⁵ (2001), Nikomborirak, Deunden, “An Assessment of the Role of board of Directors in Building Good Governance: The Case of Thailand” 4-5 April.

¹⁶ An individual who is involved in the day-to-day management and/or is in full time salaried employment of the company and/or any of its subsidiaries.

¹⁷ An individual who is not involved in the day-to-day management and/or is not a full time salaried employee of the company, or one of its subsidiaries, and is not a salaried employee of the holding company or its subsidiaries.

¹⁸ A non-executive director who is outsider with no material pecuniary relation with the company. There are many conditions for a person to be called as an independent director. The conditions are: If he/she (i) is not a representative of a major shareowner or nominated by such a shareowner; (ii) has not been employed by the company, or the group of which it currently forms part, in any executive capacity for the preceding three financial years; (iii) is not a professional advisor to the company or the group, other than in a director capacity; (iv) is not a significant supplier or customer to the company or group; (v) has no significant contractual relationship with the company or group; and (vi) is free from any business or other relationship which could be seen to materially interfere with the individual’s capacity to act in an independent manner.

Independent Directors

The listing agreement stresses upon the presence of majority of non-executive directors¹⁹ on the board. The presence of independent director gained the importance amidst the worldwide debate on “good corporate governance by the presence of independent directors on the board”. It is not simply the majority but a super-majority of independent directors on the board that is of a greater concern. Alongwith the board, the board committees also need the majority or 100% of members as independent members²⁰. The term ‘independent director’ has not been defined in company legislation, but the law has not been silent on the issue. Law required to disclose the interest of director under the Companies Act, 1956²¹ because where the director is an interested person he cannot take the decision independently. The mere fact that the director is an interested party in any manner or by any relation renders a director not to be an independent even though he is an outsider or a non-executive director, viz., the auditors sitting on the board of their clients, vendors, suppliers, consultants²², to the company, etc. Although, ‘independence’ of a director was not an important issue till recent past, the ‘interested’ director was always in the center of attraction of legislators and judiciary. In the case of *Cook vs. Deeks*²³ it was observed by their Lordships that “...Men who assume complete control of a company’s business must remember that they are not at liberty to sacrifice the interests; which they are bound to protect, and while ostensibly acting for the company, divert in their own favour business which should properly belong to the

¹⁹ 50% of the Non-executive directors if the Chairman is an executive Chairman and 1/3rd of total directors when the Chairman is a non-executive.

²⁰ As per listing agreement, the Audit Committee requires majority of members to be independent directors. Remuneration committee – No specific mandatory requirement however the non-mandatory requirement under Annexure-3 (b) prefers that the Remuneration Committee should comprise of at least three directors, all of whom should be non-executive directors, the Chairman of the committee being an independent director. Shareholders’ Grievance Committee requires only the Chairman of the Committee as Non-executive director.

²¹ Sections 297, 299, and 300.

²² Lawyers and CA of Trustee Bank or FI who provide consultancy services to them cannot sit as an IND on the board of Asset Management Companies (AMC) which are sponsored by the Bank or FIs as their loyalty will rest with the interest of the sponsor and fund promoted by him. – (2002), “Exempt Sponsors From New Director Definition: Amfi”, *The Economic Times*, Ahmedabad, October 9th.

²³ (1916) 1 AC 554: (1916-17) All ER Rep 285.

company they represent”. Independence thus calls for independence not only mentally and emotionally but also appearance-wise (Fern, 1985; McGrath *et al.*, 2001) where ‘mental and emotional independence’ is a condition precedent for objectivity and ‘appearance of independence’ is an organizational status²⁴.

The Kumar Mangalam Birla Committee report states that “the ‘independent director’, would mean a director who apart from receiving director’s remuneration does not have any other material pecuniary relationship or transaction with the company, its promoters, its management or its subsidiaries which in the judgment of the board may affect independence of judgment of directors”. The agreement has, however, restricted the definition of independent director only to the extent of any material pecuniary relationship or transaction of the director and it does not state anything about the familial relationship of the directors with any member of the board or management as a test of independence. However, SEBI ESOPS/ ESPE Guidelines, 1999 test a person on 2 criteria for the independence, i.e., he should not be a whole time director; and neither a promoter nor belongs to the promoter group. The TSE report used the word ‘unrelated’, the Cadbury committee report used the word ‘independent element with a recognized senior member’. The Cadbury Committee²⁵ was rather more comprehensive while explaining the term ‘independent’. It stated about independent of management and free from any business or other relationship that could materially, interfere with the exercise of their independent judgment, apart from their fees and shareholding.

According to Phillips (1978), complete independence is impossible and according to Lawrence B. Sawyer, “Total independence is as elusive as a perfect vacuum”. Despite the fact that independence is essential to the effectiveness, organizational status does not

²⁴ In assessing appearances the difficulties may be probable because of lack of consensus about the circumstances and relationships likely to affect the director’s independence and the resulting difficulty in determining whose views are “reasonable”.

²⁵ Vide paras 1.2, 1.5, 2.1 and 2.2 read together.

guarantee independence. The word 'unrelated' director used in 1994 Toronto Stock Exchange report refers to those directors who are free from any interest and any business or other relationships²⁶ which could, or could reasonably be perceived to, materially interfere with the directors' ability to act in the best interests of the corporation. A significant shareholding makes directors interested. Thus, the test of independence of a director is a material connection or relationship between the director and the corporation that impede upon the directors' ability to make objective judgments in the interest of the corporation and its stakeholders. Geoffrey Mills (1985) defines an 'independent' director as the one who 'is not bound by any firm allegiances' (p.9). Therefore, an individual is said to be independent if neither he nor his employer has received, or is expected to receive, substantial remuneration (in salary or dividends) from the company on whose board he sits. By this explanation, even the FI (which are shareholders) nominees cannot be regarded as independent director as declared by Indian companies in the Annual Report of FY 2000-01.

Independent directors are perceived to be in a better position than inside directors/non-executive directors to make objective decisions and to assess management recommendations²⁷ because they would have no personal interest in those decisions and recommendations. They can bring in forth righteousness in the discussion on business issues by evaluating the merit of the case instead of remaining passive or partisan²⁸. Independent director's presence make majority of investors feel more secure that their interests are being defended.

²⁶ Other than interests and relationships arising from shareholding.

²⁷ The Kumar Mangalam Birla Committee report expects non-executive directors (those who are independent) help bring in an independent judgment to bear on board's deliberations especially on issues of strategy, performance, management of conflicts and standards on conduct.

²⁸ SWC appointed independent directors to impart professional and cultural diversity – (2002), "SWC Appoints Three Independent Directors", *The Financial Express*, Mumbai, November 20th, p.4.

Who Can be an Independent Director?

Shareholders should possibly question the independence of NEDs who have served for longer than 10 years (Main, 1994). The Pensions Investment Research Consultant (PIRC) Shareholder Voting Guidelines (U.K.) provide perhaps the most stringent definition of director independence i.e., in order to be viewed as independent, directors should not: have held an executive position within the company group; have had an association with the company for more than nine years; be related to other directors or advisors to the company; have been appointed other than through an appropriately constituted nomination committee or equivalent; be employed with a professional adviser to the company; have a service contract, hold share options or other conditional share awards, receive remuneration other than [ordinary director's] fees, receive consultancy payments or be eligible for pensions benefits or participate in bonus schemes; receive fees indicative of significant involvement in the company's affairs; receive remuneration from a third party in relation to the directorship; benefit from related party transactions; have cross directorships; hold a senior position with a political or charitable body to which the company makes contributions; hold a notifiable holding or serve as a director or employee of another company which has a notifiable holding in the company [or] in which the company has a notifiable holding; be on the board of a significant customer or supplier to the company; act as the appointee or representative of a stakeholder group other than the shareholders as a whole; or serves as a director or employee of a significant competitor of the company.

From the foregoing disqualification if any one or more are present in a person he cannot remain independent director. Simha (1974)²⁹ stated about independent director as those having academic and professional background. After stating the characteristic required for an independent director, we now try to find out that who can become an independent

²⁹ While writing the forward to L.C. Gupta's book on *Corporate Management and Accountability -Towards a Joint Sector*.

director. The practical problem lies in discovering who is really disinterested, able, and committed. The word 'disinterested' immediately disqualifies vendors of professional services like lawyers, bankers, and consultants. Nevertheless, the TSE Committee opines that a variety of persons including retired employees of the corporation and representatives of a controlling shareholders, major creditors, customers or suppliers of the corporation, would qualify as independent directors, notwithstanding their potential conflicts of interest. As per NYSE recommendation, a director can't be considered independent if an immediate family member worked for the company in the previous five years³⁰.

Qualities of Independent Directors

Qualities of an independent / non-executive directors as per KBC report are- recognition of the importance of the board's task, integrity, a sense of accountability, track record of achievements, ability to ask tough questions, financial literacy, experience, leadership qualities, ability to think strategically, significant degree of commitment to the company, able to devote adequate time for meeting, preparation and attendance. Thus, a person who is committed and competent in participating in board meetings using his skills, experience and ability to raise questions on performance of the management and also able to assume certain roles and responsibilities is entitled to become an independent director whose main objective will be the optimization of the shareholder value of the corporation.

However, there are some limitations of having fully independent board. A study by the Australian consultancy company- Corporate Governance International and the University of Melbourne's Centre for Corporate Law and Securities Regulation indicated that companies with a majority of independent board members had underperformed in the stock market. It is

³⁰ Walt Disney Co.'s three directors who were designated as an independent director had children employed by the company in the previous year therefore even they were regarded as interested directors and not an independent director. – (2002), "Disney board Heading For Shake-Up", *The Financial Express*, Mumbai, August 13th, p.7.

argued that directors who are too far removed from the operation of the company can be misled or at least can be ill informed about its day-to-day affairs. Conversely, the study indicated a marked positive effect for shareholders when executives sit on the board. One of the main messages of the report is that independence in itself is not a substitute for quality on a board and there is a clear need for balance between independent and executive directors. Another lesson from the Australian experience is that independent directors should not be selected purely on the basis of their independence, but also with a close view to their background and the fact that they can contribute to the business.

In India, as per Cl. 49 of the listing agreement 141 publicly listed companies had to comply with the appointment of independent director by 31st March 2001. Annual reports of the company showed promoters, relatives of promoters and executive directors as independent directors. Some companies appointed independent directors on or just before 31st March 2001. Most of the NEDs are not independent and that they are either the family members of the promoter's, recently retired executives of the company, from the group company or from the firms that provide legal or audit or consultancy services to the organization. Nominees of FI were also declared as independent by some³¹, however, they can not be treated as independent because of their indirect interest and firm allegiances which they are representing.

As far as PSUs and PSBs are concerned, they too have not complied with the definition of independent director given under the listing agreement since directors nominated by the government and nominees of regulators, viz., RBI, on the boards of such organizations do not come under the purview of the definition. Therefore, IAS officials nominated as ex-officio or part-time non-official directors on boards of PSUs and PSBs are not independent for the

³¹ However, SEBI, vide its Circular Ref. No. SEBI/MRD/SE/31/2003/26-08 dated August 26, 2003, issued to all the stock exchanges, has revised Clause 49 of the listing agreement by which it has given an explanation under Cl. 49(I)(A) that 'institutional directors on the boards of companies shall be considered as independent directors whether the institution is an investing institution or a lending institution'.

increasing year to year. It was very important to note that the changes from FY 1999-00 to FY 2000-01 reveals that there was a sudden increase in the overall proportion of the IND directors from 18.6% to 36.4% (i.e., 95.7%) off-setting it by decrease in the proportion of NED since the overall proportion of ED remained nearly same. To check the significant differences between the proportions of three types of directorships a null hypothesis that 'there was no difference between the proportions of ED, NED and IND from year to year', z test for significant difference between proportions was performed.

Matrix of Results of z-test For Significant Difference Between Proportion of ED, NED and IND

Financial Year	Test for difference between proportion		
	ED	NED	IND
97-98 to 98-99	0.03	0.31	0.20
98-99 to 99-00	0.03	1.25	0.89
99-00 to 00-01	0.14	5.42	4.38

The observed values of z (as shown in the above matrix) were not found significant at 5% level of significance except for the FY 2000-01 wherein the overall proportion of NED and IND has changed significantly from the previous FY 1999-00 (p -value < 0.05). The said change was attributed to the introduction of Cl.49 of the listing agreement.

It was observed that in India, corporate boards had overall majority of non-executive directors (i.e., IND + NEDs) and the overall proportion of ED remained less than 1/3rd of the total board size. From the above tables (numbers 3.1 and 3.4) one can say that average board size in India, i.e., 10 was comprising of ED and NED (including IND) in the ratio of 3: 7 and that insider and outsider were in the ratio of 5: 5. Out of total NEDs the ratio of insider and outsider was 6:4 respectively. The foregoing discussions showed that the overall proportion of NED and IND changed significantly in the FY 2000-01.

Further analysis of sectorwise change in the overall proportion of ED, NED and IND for 4 years was carried out. Sectorwise analysis of four successive years (i.e., FY 1997-98 to FY 2000-01) at table 3.6 reveals that overall proportion of ED was highest in the public

sector companies and that overall proportion of NED was highest in the joint sector and that overall proportion of IND remained highest in the private sector companies for all 4 years.

Table 3.6: Sectorwise Frequency Distribution of Composition of Board of Directors - Yearwise

Sector	Year	ED	NED	IND	Total	%ED	%NED	%IND	%Total	Total Cos
Joint	FY 97-98	4	25	0	29	13.8	86.2	-	100	3
	FY 98-99	4	25	0	29	13.8	86.2	-	100	
	FY 99-00	4	25	0	29	13.8	86.2	-	100	
	FY 00-01	4	23	0	27	14.8	85.2	-	100	
Private	FY 97-98	226	455	134	815	27.7	55.8	16.4	100	81
	FY 98-99	231	445	150	826	28.0	53.9	18.2	100	
	FY 99-00	235	411	187	833	28.2	49.3	22.4	100	
	FY 00-01	237	261	347	845	28.0	30.9	41.1	100	
Public	FY 97-98	62	101	10	173	35.8	58.4	5.8	100	17
	FY 98-99	65	115	6	186	34.9	61.8	3.2	100	
	FY 99-00	62	110	6	178	34.8	61.8	3.4	100	
	FY 00-01	69	76	36	181	38.1	42.0	19.9	100	

In the joint sector companies, IND directors were not appointed until the end of the FY 2000-01. The possible reason could be that the surveyed joint sector companies were BSE 'B1' group companies and hence the Cl. 49 of the listing agreement was not applicable to them. This shows compliance behaviour of the corporates with respect to composition of board.

Mandating boards with majority of NEDs and INDs is not meaningful in India since most of the boards in India were already having NEDs in a significant majority and chairmen of companies were NED (promoters). After ascertaining the composition of board on the basis of types of directorship, a further exploration of the composition of board was carried out on the basis of the director typology.

3.2.3 Director Typology

Various director typologies are defined in the Companies Act, 1956 as under:

Director³²

The director's status is determined by his position and functions in the company and not by the designation. A director cannot be regarded as a manager or any other managerial personnel³³. He is neither an employee nor a servant of the company unless he has a separate agreement with the company to that effect³⁴. Further, where the director or board of directors is working under superintendence, control and direction of the government (central or state), they cannot be treated as directors under section 2(13)³⁵. A director can be classified as permanent directors³⁶, directors retire by rotation³⁷, and deemed to be director³⁸ (shadow director³⁹). Within the above three main categories the directors can be further classified on the basis of their designations as managing director⁴⁰, alternate director⁴¹, casual director⁴², additional director⁴³, nominee director⁴⁴ (such as Government nominees⁴⁵ and financial

³² Under sec. 2(13) of the Companies Act, 1956.

³³ Deen Dayalu, T. vs. Sri Bezwada Papi Reddy, (1984) 2 Comp. LJ 396 (AP) (DB).

³⁴ Lee v. Lee's Air Farming Ltd., (1960) 3 All ER 420 (PC).

³⁵ Department's F. No. 40/9/75-CL-II, dated 25-11-1975.

³⁶ Permanent directors are the whole time employees of the company and their appointment shall also be done in general meeting in absence of any regulations in the articles of the company

³⁷ Sec. 255, *Ibid.*

³⁸ Under sec. 307(10) of the Companies Act, 1956, any person in accordance with whose directions or instructions the board of directors of a company is accustomed to act, shall be deemed to be a director of the company. If a body corporate or an individual holds more than 50% voting powers or is in a position to control majority of the directors on the board, it will attract the provisions of this section.

³⁹ As stated in Ramaiya, A. (1999), *Guide to the Companies Act – Part I*, Wadhwa, Nagpur, p. 128. The person must have a total control of a company's affairs to be regarded as a shadow director. Eventhough the shadow director is neither a board member nor entitled to attend the board meetings. The directors on the board remain as 'dummy' or '*benamidar*' directors to carry on the instructions of a shadow director.

⁴⁰ Under sec. 2 (26) of the Companies Act, 1956.

⁴¹ Sec. 313 of the Companies Act, 1956 states about the appointment and term of office of alternate director. If the *original director* is absent, for a period of not less than three months, from the state in which meetings of the board are ordinarily held, then in his place an alternate director can be appointed by the board of directors (if authorized by the articles) to act for the said director in his absence. Such alternate director can hold the office for a term for which the original director was entitled to or till the period original director returns back to the state in which board meetings are ordinarily held, whichever is earlier. Alternate directors are mostly appointed in the place of foreign directors/institutions having either collaboration or majority stake in the concerned company.

⁴² Sec. 262 of the Companies Act, 1956. Any vacancy, which occur other than retirement of a director by rotation (under section 255 of the Companies Act) is casual in nature and can be filled in by the board of the directors in the board meeting.

⁴³ Sec. 260 read with Regulation 72 of Table A of Schedule I of the Companies Act, 1956 (substituted by Notification No. GSR 521, dated 23-4-1959. The power of appointment of additional director lies with the board and not the shareholders. Appointment of additional director/s is done by the board either by regular meeting of the board or by passing resolution by circulation⁴³, in case of emergency or for a short duration and/or alternatively till the next annual general meeting. However, in case of filling up of casual vacancies the appointment can be done only at the regular board meetings and not, by passing resolution by

institution/bank nominee)⁴⁶, debenture directors⁴⁷, directors appointed by BIFR⁴⁸ (called as special directors). As per Section 269(1) appointment of a manager or a managing director or a whole time director is mandatory for the public companies or a private company, which is subsidiary of a public company, having a prescribed⁴⁹ paid-up share capital. It is not only the designation or nomenclature, which matters but if a person is occupying the position of a managing director, by whatever name called, he is to be regarded as managing director.

Apart from the foregoing typologies of directors, following are three types of directors who are not directly defined but they are known for their position as they perform very important function in the governance process of the board.

Chairman⁵⁰

Even though, in legislation the functions of the Chairman are limited only to head the Chair of the meeting, in practice the position has a value attached to it and perceived as a

circulation. Appointment of an additional director can not be done by anybody else than the board of director or by general meeting (as provided by the articles) even if third party is engaged for the appointment of the directors on the board.

⁴⁴ Nominee directors are those who are nominated by other than shareholders under an agreement or an arrangement. Nomination to the board can be sought by a member holding a particular percentage of shares or equity capital. In case of Bombay Dyeing when Mahindra & Mahindra helped the company at the time of the hostile takeover bid by Mr. Bajoria was going on, M&M asked to put its nominees on the board of the Bombay dyeing.

⁴⁵ The Central Government may appoint such number of directors as it deems fit, on the board of the company as directed by the Company Law board (CLB) (under section 408 of the Companies Act, 1956) to safeguard the interest of the company or the shareholders or the public, to prevent the oppression or mismanagement of the company.

⁴⁶ The financial institutions while providing such can put a condition to nominate (Under section 25(2) of the Industrial Finance Corporation Act, 1948) one or more directors on the board of the company to protect their interest and to look after that the money provided to the company is put to the best use by the company.

⁴⁷ As per Section N subsection 2(a) of SEBI guidelines for the protection of the interest of Debenture-Holder.

⁴⁸ Under section 16(4) of Sick Industrial Companies (Special Provision) Act, 1985

⁴⁹ Rs. five crores as per Rule 10A of the Companies (Central Government's) General Rules & Forms, 1956.

⁵⁰ Eventhough a separate definition of the 'Chairman of the board' is not mentioned under the companies Act, 1956, Sec. 217 (4) clearly states that "The board's report and any addendum thereto shall be signed by its Chairman if he is authorised in that behalf by the board; and where he is not so authorised," And also sec. 175 of the Companies Act, 1956 states about the Chairman of the meeting. Chairman is to ensure that the board meetings are conducted in a manner which secures the effective participation of all directors, executive and non-executive alike, and encourages all to make an effective contribution, maintain a balance of power in the board, make certain that all directors receive adequate information, well in time and that the executive directors look beyond their executive duties and accept full share of the responsibilities of governance. In public sector companies, government being the promoter selects the Chairman of the board with dual role of Chairman and managing director. Therefore, the Chairman is executive always.

controlling power in a company. The Chairman can be elected for three reasons, namely for (i) general meeting⁵¹, (ii) for board meetings⁵², and (iii) for board committee meetings⁵³. A person can be a Chairman of the meeting as against the common usage by companies calling a person as “Chairman of the company”.

Whole-Time Director⁵⁴

The word ‘whole time director’ is not defined in the Act, however, this word appears in sec. 5(b), sec. 269, sec. 309(1).

Promoter Director⁵⁵

Section 62(6)(a) gives the meaning of a word ‘promoter’ only for the purpose of the section itself and it states that “the expression “promoter” means a promoter who was a party to the preparation of the prospectus or of the portion thereof containing the untrue statement,.....”. A clear definition is missing from the Act, which defines the term ‘promoter’. However, SEBI vide its circular dated 12-10-1995 defines ‘promoter’ and ‘promoter group’⁵⁶.

Director of the Holding or Subsidiary Company⁵⁷

The holding company may either nominate majority of directors or it may be provided in the memorandum or articles that the whole board may be constituted by nominee directors of the holding company.

⁵¹ Regulation 50 of Table-A of schedule I of the Companies Act, 1956.

⁵² Regulation 76 of Table-A of schedule I, *Ibid.*

⁵³ Regulation 78 of Table-A of schedule I, *Ibid.*

⁵⁴ The word ‘whole time director’ is not defined in the Act, however, the mention of the said word has occurred in sec. 5(b), sec. 269, sec. 309(1).

⁵⁵ The term ‘promoter’ is well-known in the business world and refers to a person who takes initiative to promote a company and is responsible to bring the company into existence.

⁵⁶ ‘Promoter’ includes (a) person or persons who are in overall control of the company (b) person or persons who are instrumental in formulation of plan or programme pursuant to which the securities are offered to public (c) person or persons named in the prospectus as promoters. However, if a director/ officer of issuing company is acting as such merely in his professional capacity, he shall not be treated as ‘promoter’.

⁵⁷ The relation of holding and subsidiary company can be found out if the holding company controls the composition of the board of directors or controls more than half of the total voting power or holds more than half in nominal value of equity share capital.

Directors at PSUs and PSBs

The boards of directors of public sector undertakings normally comprise of: Full time functional directors or executive directors, Nominees of the Administrative Ministry and other institutions, "Non official part time directors" (independent directors) and, at times special representatives (e.g. Worker representatives). Board composition of PSBs are regulated by SBI Act, Bank Nationalisation Act, IDBI Act, Banking Regulation Act, RBI Act, and the Companies Act. Major problem affecting banks has been the representation given to the various interest groups on the boards of the banks. The main objective behind these representations was to give voice to various sections of the society at the board level of the banks. These nominees are usually pursuing the class interests and hence may not be conducive to the overall health of the PSB.

Designation of Directors

To study the data of director on the basis of their designations, 10 broad categories of designations were derived (refer annexure-III), based on the designations as provided in the Companies Act, 1956. Frequency distribution of available data on category of designations of 1229 directors of 116 companies present in Indian companies is given at table 3.7. It can be inferred from the table that 74% companies (i.e., 86 out of 116 companies) had chairman that make 8% of total directors (i.e., 97 out of 1229 directors). In 17 companies there were more than one chairmen, including their variants such as chairman emeritus and vice-chairman. One person holding both the positions, i.e., Chairman and M.D., gives rise to the situation CEO duality whereby he/she has to be both supervisory as well as executive. In 39% companies (i.e., 45 out of 116 Cos.) CEO duality was present. In 58% of sample companies, the position of MD/CEO was occupied by 7% of total directors (i.e., 90 directors out of 1229 were MD/CEO in total 67 companies) in the range of 1–3.

Table 3.7: Frequency Distribution on the Basis of Category of Designation

Category of Designation	Frequency												No of Cos.	%of total Cos.	No of Dirs	% of total dirs.
	1	2	3	4	5	6	7	8	9	10	11	12				
Chairman	69	14	3 ⁵⁸	-	-	-	-	-	-	-	-	-	86	74	97	8
CMD	44	1 ⁵⁹	-	-	-	-	-	-	-	-	-	-	45	39	46	4
MD/CEO	50	12	4	-	-	-	-	-	-	-	-	-	66	57	86	7
MD(Functional)	2	3	2	-	-	-	-	-	-	-	-	-	7	6	14	1
WTD	25	28	9	7	6	1	4	-	-	-	-	-	80	69	185	16
Ordinary Directors	1	3	8	21	22	25	12	5	6	6	3	2 ⁶⁰	114	98	670	53
Additional Director	5	6	-	-	-	-	1	-	-	-	-	-	12	10	24	2
Alternate Director	11	3	2	-	-	-	-	-	-	-	-	-	16	14	23	2
Casual Director	4	2	-	-	-	-	-	-	-	-	-	-	6	5	8	1
Nominee	17	18	4	2	2 ⁶¹	1 ⁶²	-	-	-	-	-	-	39	34	76	6

Note: For the expression of designation and its variants refer the Annexure –III.

Apart from the CEO/ MD some companies (7 out of 113 companies) had MDs –Functional for specific functions and not as CEO of the company. Majority of directors, i.e., 53% (655 out of 1229) had a designation as director and such designation was present in almost all companies (i.e., 98%) with frequency ranging from 1 to as many as 12. Only 1/3rd companies (i.e., 34% companies) had nominee directors on their boards, which represented only 6% of the total directors.

After noting down the frequency of each designation and their proportion in the total number of directors, it will be interesting to note the type of directorship attached to director's designation for it will show the factual position of companies that declared various designations under the type of 'independent' director. The necessary data was available for 116 companies.

The data contained in the table 3.8 reveals that majority of chairmen were NED (64.6%) followed by ED (20.6%), and IND (13.4%).

⁵⁸ The Associated Cement Companies Limited, Tata Chemicals Ltd. and Raymond Ltd. (Chairman Emeritus, Chairman, and Vice-Chairman). In Raymond apart from three chairmen there also exists a position of CMD.

⁵⁹ Escorts Limited where there is one CMD and another person is Vice-Chairman cum MD

⁶⁰ Escorts Limited and UTI Bank Ltd.

⁶¹ The Ahmedabad Electricity Company Ltd. (5) and The Associated Cement Companies Ltd (5).

⁶² State Bank of India (6).

Table 3.8: Frequency Distribution of Type of Directorship on the Basis of Category of Designation

Category of Designation	Type of Directorship			Total Directors (%)	Total No. of Directors
	ED (%)	IND (%)	NED (%)		
Chairman	22.2	13.2	64.6	100	99
CMD	100.0			100	45
MD/CEO	95.4	4.6		100	87
MD (Functional)	100.0			100	14
WTD	95.0	3.0	2.0	100	198
Ordinary Directors		56.5	43.5	100	642
Additional Director	20.8	45.8	33.3	100	24
Alternate Director	26.1	39.1	34.8	100	23
Casual Director		75.0	25.0	100	8
Nominee Director		32.6	67.4	100	89
Total directors (%)	29.5	35.9	34.6	100	1229

The data contained in the table 3.8 reveals that majority of chairmen were NED (64.6%) followed by ED (20.6%), and IND (13.4%). It is interesting to note that 4 companies reported in their annual reports that their MD/CEO are IND, 3 % WTDs were reported as IND, and 2% WTDs were reported as NEDs. Majority of nominee directors (i.e., 67.4%) were reported as NED i.e., two-thirds of total nominee directors. 34.8% alternate directors were reported as NED and 39.1% as IND.

3.2.4 Director Demographics and Cognitive

The legal entity of corporation comes into real life play through the directors who are collectively known as “board of the directors” or “the board”⁶³. Thus, the collective ability in terms of knowledge and skills of board of directors determine the effectiveness of the board in supervising and controlling the executive management. A board that does not have members with desired levels of expertise may lack this ability. Director demographics and cognitive are explained with respect to age profile, gender, qualification and area of expertise, familial and business relationships, and length of service on the same board with respect to sector, type of directorship and category of designation.

⁶³ Sec. 2(6) of the Companies Act, 1956.

Age Profile of Directors

Despite the fact that schedule XIII of the Companies Act, 1956 provides for minimum and maximum age of a director, companies can fix up the minimum age for a director and an age of superannuation⁶⁴. Therefore, the age profile of directors was studied to find out the age differences with respect to type of sector, type of directorships and type of designation of directors. For this, the data of 1014 out of 1229 directors of surveyed 116 companies was found valid to ascertain the descriptive statistics relating to age.

Overall analysis (at table 3.9 A) shows that the age of directors ranged from 23 years to 93 years with an average age of 57 years. The most preferred age group was 55-65 years. However, sectorwise analysis showed that the minimum age of director in private sector was 23 years whereas in public sector companies it was 38 years. Average age of directors in public and private sector was found to be similar, i.e., 57 years with most preferred age group being 55-65 years across all sectors.

Table 3.9: Descriptive Analysis of Age of Directors

A. On the Basis of Sector

Sector	(Age in Years)					
	Minimum	Maximum	Average	Std. Dev.	No. of Dir	No of Cos.
Joint	25	71	51	12.42	27	3
Private	23	93	57	11.90	812	93
Public	38	83 ⁶⁵	57	6.79	175	20
Total	23	93	57	11.23	1014	106

B. On the Basis of Type of Directorship

Type of Directors	(Age in Years)					
	Minimum	Maximum	Average	Std. Dev.	No. of Directors	
ED	23	83	52	8.80	333	
NED	23	93	57	12.02	322	
IND	32	88	61	10.74	359	
Total	23	93	57	11.23	1014	

⁶⁴ Minimum age 25 years and maximum 70 years or the age of retirement, if any, specified by the company, whichever is earlier – Cl. (C) of Part I of Schedule XIII. As per notification GSR 418(E) dated 12-9-1996 schedule XIII was amended as – where the person has not completed 25 years, but has attained the age of majority or has attained the age of 70 years and where his appointment is approved by a special resolution passed by the company and without the approval of the central govt., giving thereby greater freedom to the company.

⁶⁵ Mr. Raja G. Kulkarni – aged 83 years was an independent director (IND) on the board of Hindustan Petroleum Corporation Ltd..

C. On the Basis of Designation

(Age in Years)

Category of Designation	Minimum	Maximum	Average	Std. Dev.	No of Directors
Chairman	33	93 ⁶⁶	59	12.50	78
CMD	31	83	54	9.53	39
MD/CEO	29	75	50	9.33	82
MD (Functional)	43	65	53	7.10	14
WTD	23 ⁶⁷	69	52	8.87	181
Ordinary Directors	23 ⁶⁸	88	60	11.57	523
Additional Director	34	67	49	8.93	17
Alternate Director	35	70	54	9.27	17
Casual Director	40	67	58	8.71	7
Nominee	35	72	55	7.89	56
Total	23	93	57	11.23	1014

Type of directorshipwise analysis (table 3.9B) shows that an average age (i.e., 52 years) of an ED was lowest and that of an IND was highest (average age was 61 years). This finding is consistent with that of Shivdasani & Yermack (1999) who also found inside directors are slightly younger than grey directors and IND directors.

Designationwise analysis (table 3.9C) shows that the minimum age was that of ordinary and whole time director (WTD) (i.e., 23 years) and that the maximum age was that of a Chairman (i.e., 93 years). Average age of MD/CEO was 50 years whereas CMD's was 54 years. The preferred age of MD/CEO and additional directors was lowest in all categories i.e., 45-55 years and all other directors' most preferred age was between 55-65 years. MD/CEOs are younger than the CMDs that shows that experiencewise when a person wears two hats he is bit more experience than having a single responsibility. On an average when a person reaches the age of 55-65 it was deemed fit to acquire a boardroom position in India.

Female Directors on Board

Women are a significant and growing percentage of entry and mid-level professional managers, yet it is imperceptible that corporates do not find 'women of prominence' for the board level jobs and only few companies have eliminated structural and attitudinal

⁶⁶ Mr. Holck Larsen, Chairman Emeritus was a non executive director in Larsen & Toubro Ltd.

⁶⁷ Amit Rai, aged 23 years was a whole time director in Information Technologies (India) Ltd.

⁶⁸ Sharvil Patel, aged 23 years was a non-executive director (NED) in Cadila Healthcare Ltd.

impediments to women's advancement at top. The reason for expected differences has more to do with women's progress up the corporate pyramid than with their potential contribution (Kesner, 1988). However, Kesner's (1988) finding suggests that women were not window dressing but do hold important positions on the boards of large corporations. Ten of the largest companies of fortune 500, ranked by revenues, had at least one woman on their board in 1999. Percentage of board seats held by women at all Fortune 500 companies showed a consistently increasing trend in appointment of female directors from 8.3% in 1993, to 8.7% in 1994, 9.5% in 1995, 10.2% in 1996, 10.6% in 1997, 11.1% in 1998, 11.2% in 1999, 11.7% in 2000 and 12.4% in 2001 (source: 2001 Catalyst Census of women board directors of the Fortune 500). As far as India is concerned, in 116 surveyed companies 26 companies have total 29 female directors on their board (i.e., 22.4% companies)(see table 3.10). However, the total percentage of female board members vis-à-vis their male counterparts was negligibly less i.e., 2.3% (i.e., out of 1229 directors only 29 are female directors).

Table 3.10 : Frequency Distribution of Directors on the Basis of Gender

A. On the Basis of Sector and Type of Directorship

Gender	Sector			Type of Directorship			Total Dirs.
	Joint	Private	Public	ED	IND	NED	
Female		27	2	5	10	14	29
Male	27	961	212	358	431	411	1200
Total Dirs.	27	988	214	363	441	425	1229

B. On the Basis of Category of Designation

Gender	Category of Designation										Total Dirs
	Chairman	CMD	MD/CEO	MD (Functional)	WTD	Ordinary Directors	Additional Director	Alternate Director	Casual Director	Nominee	
Female	2 ⁶⁹		2 ⁷⁰	1 ⁷¹	2 ⁷²	14	2	1		5 ⁷³	29
Male	97	45	85	13	196	628	22	22	8	84	1200
Total Dirs	99	45	87	14	198	642	24	23	8	89	1229

⁶⁹ In Trent Ltd. Chairperson was S.N. Tata and in Thermax Ltd. chairperson was Ms. Arnavaz Aga.

⁷⁰ In ICICI Ltd. Ms. Lalita D Gupte is Joint MD and CEO and in Saw Pipes Ltd. S. Jindal was MD.

⁷¹ In Nicholas Piramal India Ltd. Dr. Swati Piramal was Chief Scientific Officer

⁷² In HDFC Ltd. Ms. Renu Karnad was Executive Director and in The Indian Hotels Co. Ltd. Ms. C Panjabi was a whole time director.

⁷³ They all were FI – Nominees.

In joint sector companies of the sample, there were no female directors while in public sector the female directors were negligible i.e., 0.9% (i.e., 2 out of 214). In private sector female directors were 2.7% (i.e., 27 out of 988 private sector directors). 13 female directors out of 29 (i.e., 44.8%) had familial relations with one or the other board member and majority of female directors i.e., 55.2% were sitting on the board on the basis of their professional qualifications. In private sector companies the female directors were holding positions of chairperson, MD/CEO, and WTD in 2 – 2 companies each. There were 5 female directors who were nominated by the financial institutions on the board of other companies.

Qualifications and Area of Expertise of Directors

There are no set rules for the ability of decision making but a formal education and training in a given field increase the chances of better outcome of a decision. Though, the Sachar Committee report and a wide gamut of committee reports on corporate governance decry for professional directors for the objective independent decision making at the board, law has been silent on the issue. However, the law sketches only the disqualifications of a person who cannot become director by virtue of his disqualifications other than educational qualifications and area of expertise. Hence, in India board members were/ are invited many times on the basis of their business acumen only. Hereunder an enquiry has been made on directors' education qualifications and their area of expertise. Valid data of 902 directors spread over 116 companies has been tabulated at table 3.11. For remaining 327 directors the specific qualifications were not available. However, these were described as “man of business experience”.

Table 3.11A shows that most of the directors are highly qualified and that only 2.9% directors were undergraduates (i.e., 26 directors out of 902) on the board of 21 companies (i.e., 18.1% companies). Majority of board members (i.e., 53.9%) were holding professional qualifications.

Table 3.11 : Frequency Distribution of Qualification of Directors

A. On the Basis of Sector and Type of Directorship

Category of Qualification	Sector			Type of directorship			Total Directors
	Joint	Private	Public	ED	IND	NED	
Undergraduate		25	1	7	9	10	26
Graduate		101	7	37	27	44	108
Post Graduate		26	7	7	11	15	33
Professional	17	532	114	259	233	171	663
Bureaucrats	7	35	30	3	41	28	72
Total Directors	24	719	159	313	321	268	902

B. On the Basis of Category of Designation

Category of Qualification	Chair man	CMD	MD/C EO	MD (Functional)	WTD	Ordinary Directors	Additional Director	Alternate Director	Casual Director	Nominee	Total Dirs
Undergraduate	8	1	2	-	1	12	-	1	-	1	26
Graduate	17	7	10	1	16	55	-	-	-	2	108
Post Graduate	1	-	-	-	7	20	-	-	-	5	33
Professional	43	31	61	12	144	309	15	12	6	30	663
Bureaucrats	3	-	3	-	-	51	2	-	1	12	72
Total Dirs	72	39	76	13	168	447	17	13	7	50	902

The data also reveals that there were 72 bureaucrats on the board of 41 companies (i.e., 35.3%, almost 1/3rd of total companies) with frequency of 1 to 5⁷⁴.

Designationwise analysis (table 3.11B) shows that majority of position from chairman to nominee directors were held by highly qualified professional. Undergraduate directors were mostly private sector industrialist and that is why they were holding position like chairman, CMD and CEO etc. Bureaucrats were holding position of chairman in joint sector (1) and private sector (2) companies and also position of MD/CEO in the joint (1) and public sector (2) companies.

Area of Expertise

A well-balanced and effective board should, as noted above, should have directors with an array of multifaceted talent, experience, and expertise that bear on different aspects of the company's activities. To find out the area of expertise available on the board we considered available valid data of 842 directors spread across 116 companies. Available data is

⁷⁴ GNFC Ltd.

presented at table 3.12 which reveals that corporate boards were dominated by directors with experts from Engineering stream (175) and accountants (155) followed by management (96) and IAS officers (72) contributing 59.1% (i.e., 498 out of 842 directors) of total directors' expertise.

Table 3.12 : Frequency Distribution of Area of Expertise of Directors on the Basis of Sector and Type of Directorship

Area of Expertise	Sector			Type of Directorship			Total Directors
	Joint	Private	Public	ED	IND	NED	
Engineering	6	129	40	96	43	36	175
Accountant	7	124	24	54	61	40	155
Management	1	84	11	48	24	24	96
IAS	7	35	30	3	41	28	72
Commerce	-	56	5	19	22	20	61
Technocrat	1	45	6	31	8	13	52
Economics	1	42	8	7	31	13	51
Law	1	43	3	5	23	19	47
Science	-	32	10	14	10	18	42
PhD	-	26	12	8	20	10	38
Arts	-	21	2	6	4	13	23
Industrialist	-	21	1	7	7	8	22
Medicine	-	8	-	1	4	3	8
Total Directors	24	666	152	299	298	245	842

The other expertise of directors varies from Arts, Commerce, Economics, Industrialist, Law, Medicine, Ph.D., Science, and Technology, which make other 40.9% of board members' expertise.

Length of Service on the Same Board

Board members' tenure and its extension are sensitive to the perceived independence of the board. Thus, increase in CEO tenure leads to decline of the board independence (Hermalin & Weisbach, 1988) that, in turn, leads to laxity in the effective monitoring. Proponents of independence of board are of view that an independent director when serves for more than 9 - 10 years on the same board, he/she remains no more independent thereafter because of his affiliation with the management due to long tenure on the same board. Change in board takes place pursuant to section 255 of the Companies Act, 1956 that mandates retirement of two-thirds of board members by rotation and out of them one-third directors to retire every

year. However, there are many non-executive rotational directors who keep on re-elected term after the term and therefore they remain on the board for long period. An analysis of data on the basis of length of service on the same board shows following outcome:

Available data of 901 directors out of 1229 directors of surveyed 116 companies for the length of service on the same board ascertained from the first date of joining the board shows (table 3.13) that approximately 1/3rd of total board members (i.e., 35.7%) joined the board in less than 3 years time.

Table 3.13: Frequency Distribution of Length of Service on the Same Board

A. On the Basis of Sector and Type of Directorship

Length of Service on the same board (Yrs.)	Sector			Type of Directorship			Total Directors	% of Total Directors
	Joint	Private	Public	ED	IND	NED		
Upto 3	13	223	86	88	126	108	322	35.7
3-5	3	116	41	52	47	61	160	17.7
5-10	5	160	33	89	54	55	198	22.0
Above 10	3	214	4	56	91	74	221	24.6
Total	24	713	164	285	318	298	901	100

B. On the Basis of Designation

Length of service on same board (Yrs)	Category of Designation										Total Dirs
	Chairman	CMD	MD/ CEO	MD (Functional)	WTD	Ordinary Directors	Additional Director	Alternate Director	Casual Director	Nominee	
Upto 3	15	4	19	5	58	162	17	9	6	27	322
3-5	5	5	11	4	31	79	0	3	0	22	160
5-10	11	9	23	4	52	87	2	-	-	10	198
Above 10	39	15	18	0	15	128	1	2	0	3	221
Total	70	33	71	13	156	456	20	14	6	62	901

That the majority of board members, i.e., 53.4% joined the board in less than 5 years and 3/4th of total board members (i.e., 75.4%) joined the board in less than 10 years. That the 1/4th board members had been serving the boards for longer period than 10 years.

The sectorwise analysis shows that the turnover of directors joining the board was highest in public sector (i.e., 77.4%) followed by joint sector (i.e., 66.67%) and comparatively less in private sector (i.e., 47.5%) in a given time frame of 5 years. Whereas the directorshipwise analysis shows that turnover of NED is 56.7%, IND-54.4% and ED-49.1%, in a given time

frame of 5 years. It is interesting to note that the 28.6% INDs were serving on the same boards for more than 10 years. As per Naresh Chandra Committee Report (2002) those directors who are serving the board for more than 10 years cannot be regarded as INDs. So also the non-executive directors who have to retire by rotation and are outsiders, if get re-elected term after term will lead to the compromising behaviour to remain on the board. Re-election for at the most one more term will help companies to secure the independence of the director. The public sector leads in replacing the board members quicker than the private sector companies.

The above table (3.13B) shows that 28.6% chairmen, 27.3% CMD, 42.3% MD/ CEO joined the board in less than 5 years. The maximum length of service of MD (Functional) was noted for less than 10 years and that for nominee directors it was up to 15 years. 50% of WTD joined the board in less than 5 years. It is interesting to note that 15% of directors were serving the board in a capacity of additional director for more than 5 years and that 14.3% directors were serving the board in a capacity of alternate director for more than 10 years. It was also observed that 3 nominee directors had been working on the same board for more than 10 years.

Directors' Familial Relationship

Yet another measure to gauge interest of the director is to see his/ her 'familial relationship' with other board members. The term 'relative' has been defined in the Companies Act, 1956 under section 6 and schedule 1A which list-out 24 types of close relations (including filial and extended family relationships). Following this classification, data of 1229 directors of surveyed sample of 116 companies is analysed to ascertain the existence of familial relationships at table3.14. Familial relationships were found to be in with frequencies ranging from 2-6. Maximum familial relationship was found between two directors in 19

companies followed by familial relationship between 3 and 4 directors that exist in 13 companies in each case.

Table 3.14: Frequency Distribution on the Basis of Familial Relationship

Relationships between number of directors	Total Cos with familial relationships	% of Total Cos.
2	19	38.8
3	13	26.5
4	13	26.5
5	2	4.1
6	2	4.1
Total Cos.	49	100

Frequency distribution of directors with familial relationships was also analysed on the basis of type of directorship and also on the basis of sector. Table 3.15 reveals that familial relationships existed amongst 151 directors of 49 companies, i.e., 42.2% companies (48 private and 1 joint sector companies). Analysis of table 3.15A shows that familial relationship existed in case of 74 ED and 75 NEDs.

Table 3.15: Number Directors with Familial Relationships

A. On the Basis of Sector and Type of Directorship:

Familial relationship	Number of directors in each sector			Number of directors with type of directorship			Total number of directors
	Joint	Private	Public	ED	IND	NED	
Yes	2	149	-	74	2	75	151
No	25	839	214	289	439	350	1078
Grand Total	27	988	214	363	441	425	1229

B. On the Basis of Designation:

Category of Designation	Dirs. With Familial Relationship	Total Dirs.	% of Total Dirs.	Cos. having Dirs. With Familial Relationship
Chairman	37	99	37.4	31
CMD	19	46	41.3	18
MD/CEO	21	86	24.4	18
MD(Functional)	1	14	7.1	1
WTD	28	198	14.1	19
Ordinary Directors	40	642	6.2	27
Additional Director	3	24	12.5	2
Alternate Director	2	23	8.7	2
Casual Director	-	8	-	-
Nominee	-	89	-	-
Total	151	1229	12.3	49

It is interesting to note that 2 directors having familial relationship with other directors were reported as INDs by the respondents. Sectorwise analysis shows that the director with familial relationship was a phenomenon that existed in private sector companies only. However, 2 directors of joint sector companies also had familial relationships with each other and those directors belong to the private partners of the joint sector and not the government partner. In public sector companies such familial relation does not exist at all between the directors.

Table 3.15B shows that 37 chairmen (including chairman emeritus and vice-chairman) of 31 companies, 19 CMD of 18 companies, 21 MD/CEO of 18 companies had familial relationship with other members of the board or within themselves. It also shows that the leaders of the companies like CMD (with 41.3% directors) had maximum familial relationship with other board members followed by chairman (with 37.4% directors) than the other categories of directors.

Business Relationship

Beyond familial relationship, there is yet another type of relationship in existence, i.e., business relationships of directors with the company. 'Business relationship' explains the existence of business related relationship than just being a director on the board. A business relationship arises either out of current or past business transactions between a director and the company or between two entities, or by having common director/s, viz., promoter, financial institution nominee, Government nominee, other nominees (nominated by group of investors, collaborators, etc.), advisor/ auditors/ consultants/ solicitors, employee of present/ group company, group of investor/s, or vendors/customers of the company. The business relationship hampers a director's ability to take an independent and objective judgement in

the interest of company by over-emphasizing his personal or his business interest⁷⁵. This point of view helps in knowing the functioning of board as a whole. For this, we tried to analyse the existence of business relationship on three parameters i.e., on the basis of sector and type of directorship, and on the basis of designation of directors. For studying the same data relating to 1229 directors of 116 companies were considered.

Table 3.16A shows that there existed business relationship of 381 directors (31% of total directors) with their respective companies. In public sector companies, no other business relationships were found amongst directors than the financial institution and government nominees. Private sector was dominated by promoters or their representatives (195 directors) followed by nominee directors of financial institutions, Government and other nominees (90 directors). A large number of directors (i.e., 31.7%) in private sector had business relationships as compared with public sector companies (i.e., 23.4% directors).

Table 3.16: Frequency Distribution of Category of Business Relationship With the Company
A. On the Basis of Sector and Type of Directorship

Category of business relationship with the Co.	Number of directors in each sector			Number of directors with type of directorship			Total directors
	Joint	Private	Public	ED	IND	NED	
Promoter	2	195	-	90	5	102	197
FI Nominee	1	54	4	-	25	34	59
Govt. Nominee	5	8	38	6	9	36	51
Other Nominee	9	28	9	5	11	30	46
Advisor/ Auditors/ Consultants/Solicitors of Co.	-	12	-	-	2	10	12
Employee of present/Group Co.	-	10	-	3	3	4	10
Investors	-	4	-	-	4	-	4
Vendor	-	2	-	-	1	1	2
Sub-Total	17	313	51	104	60	217	381
No Business Relation	10	675	163	259	381	208	848
Total Directors	27	988	214	363	441	425	1229

⁷⁵ If an auditor of a company is made a chairman of audit committee by virtue of his directorship on the board than neither he can pass an adverse remarks against himself or his auditing firm nor he will be able to decide his remuneration as an auditor objectively since his interest as an auditor will overshadow his position as a chairman of the audit committee.

B. On the Basis of Designation

Category of Business Relationship with the company	Category of Designation										Total Directors
	Chairman	CMD	MD/CEO	MD (Functional)	WTD	Ordinary Director	Additional Director	Alternate Director	Casual Director	Nominee	
Promoter	50	24	24	1	31	60	4	2	1	-	197
FI Nominee	-	-	-	-	-	-	-	-	-	59	59
Govt. Nominee	2	2	2	-	2	16	-	-	-	27	51
Other Nominee	3	1	2	-2	-	32	-	3	-	3	46
Advisor/ Auditors/ Consultants/ Solicitors	-	-	-	-	-	12	-	-	-	-	12
Employee of present/Group Co.	-	-	-	-	3	6	-	1	-	-	10
Investors	-	-	-	-	-	4	-	-	-	-	4
Vendor	-	-	-	-	-	2	-	-	-	-	2
Sub-Total	55	27	28	3	36	132	4	6	1	89	381
No Business Relations	44	19	58	11	162	510	20	17	7	-	848
Total Directors	99	46	86	14	198	642	24	23	8	89	1229

The data further reveals that majority of the NED directors, i.e., 50.8% (i.e., 216 out of 425 directors) had one or the other kind of business relationship with the respective companies. It was interesting to note that 25 out of 59 financial institution (FI) nominees were reported as IND and 34 out of 59 financial institution nominees were reported as NED by various companies.

Table 3.16B shows that majority of chairmen, i.e., 55.6% (54 out of 97), and majority of the CMD, i.e., 58.7% (27 out of 46) had their business relationships with the company. For ascertaining whether the person was an independent director or not, KBC recommended the test of substantial pecuniary relationship⁷⁶. However, it was observed in the annual reports that five companies classified their promoters as independent directors. Sectorwise frequency distribution of category of business relationship of directors reveals that there were 381 directors who were having some kind of business relation with the respondent companies. It was interesting to note that though there was some kind of business relationship with the company yet 60 directors were reported as independent by the

⁷⁶ Either with the company or any of its directors, etc..

respondents⁷⁷. Further, out of these 60 directors 5 were promoters, 11 were nominees of parent company/ promoters, etc., 3 were employees of present/ group companies, 2 were advisors/ auditors/ consultants/ solicitors, 1 was vendor to the company. One wonders that representation of interest group creates the group interest, therefore, such persons should reasonably not to be called as ‘independent’ in the true sense of the term.

3.2.5 Board Size, Composition and Performance

Board Size vs. Performance Index

Yet another question that has been raised in the literature relates to the size of the board and its impact on the performance. There has been a debate about the optimum size of the board and research evidence has been mixed, therefore, the hypothesis formulated was ‘performance of the company was not related to the board size of the company’.

Table 3.17: Descriptive Statistics of Board Size vs. Performance Index

	N	Minimu	Maximu	Mean	Std Dev
Board Size	106	5 00	20 00	10 8491	3 1647
Performance	106	2 00	11 00	8 5000	2 1876

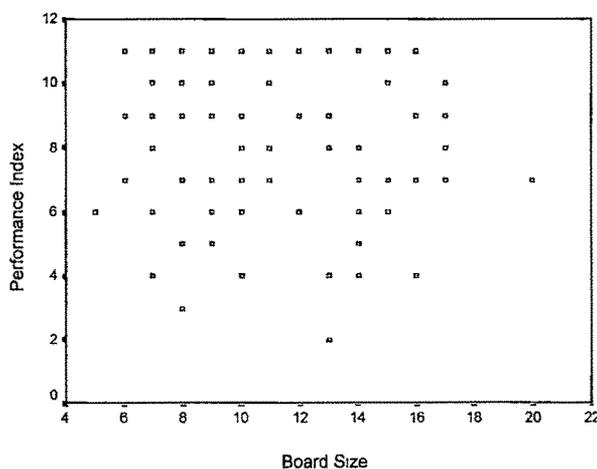


Fig. 3.1: Scatter Plot of Performance Index vs. Board Size

⁷⁷ As per listing agreement definition of independent director a person shall not have any pecuniary interest with the company however the table shows that right from the promoter, FI nominees, advisors/ auditors/ consultants/ solicitors of the company, employee of present/ group company, vendor have substantial pecuniary interest in the company.

To test the hypothesis, performance parameters (i.e., performance index) are same as explained previously in chapter 1. Scatter plot of performance index vs. board size was plotted in figure 3.1. The figure shows no particular pattern of relationship between the board size and performance index indicating absence of relationship between them.

Correlation Between the Board Size and the Financial Variables

It was also tried to find out the correlations between the board size and financial variable, viz., sales, profit after tax, non-business income, paid up share-capital and market capitalization on the basis of sector. Accordingly, the null hypothesis formulated was ‘there did not exist any correlation between the board size and financial variables’.

Table 3.18: Sectorwise Correlation Matrix of Board Size and Financial Variables (r-values)

Sector	Financial variables						No of Cos.
	Sales	Profit After Tax	Non-Busi. Income	Paid-up Share Cap	Reserves	Mkt. Cap. 31-03-2001	
Joint	0.56	-0.48	0.65	0.42	0.99*	0.54	3
Private	0.31*	0.23*	0.18*	0.16	0.33*	0.19*	94
Public	0.60*	0.46*	0.52*	0.50*	0.60*	0.65*	19
Total Companies							116

* significant at 5% level of significance (p-value < 0.05)

It can be inferred from the table 3.18 that correlation between board size and reserves in joint sector was significant (p-value < 0.05), however, this observation should be taken with a caveat that the sample had only 3 companies. In private sector, the correlation between board size and sales, profit after tax, non-business income, reserves and market capitalization was significant (p-value < 0.05) and the correlation between board size and paid up share capital was not found to be significant (p-value = 0.058), whereas in public sector correlation between the board size and all the financial variables were significant (p-value < 0.05). In private sector though the degree of correlation was positive but weak, however, it was significant. In public sector the degree of correlation was positive and moderate between the board size and all financial variables. But it was significant.

Relationship Between Board Composition and Performance of Company

After finding out the correlations between the board size and each performance variables, data was further analysed to determine whether the composition of board, i.e., proportion of ED, NED and IND has any impact on the performance of the company. Regression analysis of performance index vs. proportion of ED, NED and IND was carried out separately to test the null hypothesis that ‘board composition in terms of proportion of ED, NED and IND did not influence performance of the company’. By fitting different curves, model selection was performed in each case. Figure 3.2 shows fitting of different curves describing the relationship between proportion of ED and performance index. Quadratic model was found most significant (table 3.19) with p-value < 0.05 and $R^2 = 6.8\%$.

Therefore, using quadratic model, regression analysis was performed. The definition of the model is: $y = \beta_0 + \beta_1X + \beta_2X^2 + \varepsilon$.

Table 3.19: Model Selection For ED

Dependent : Performance Index
Independent: Proportion of ED

Model	R ²	d.f.	F ₀	p-value	b ₀	b ₁	b ₂	b ₃
Linear	.036	104	3.89	.051	7.6410	2.9166		
Quadratic	.068	103	3.78	.026	6.4998	11.8151	-13.850	
Cubic	.075	102	2.75	.047	7.1432	2.9875	16.2728	-28.432
Exponential	.034	104	3.66	.058	7.2081	.4138		

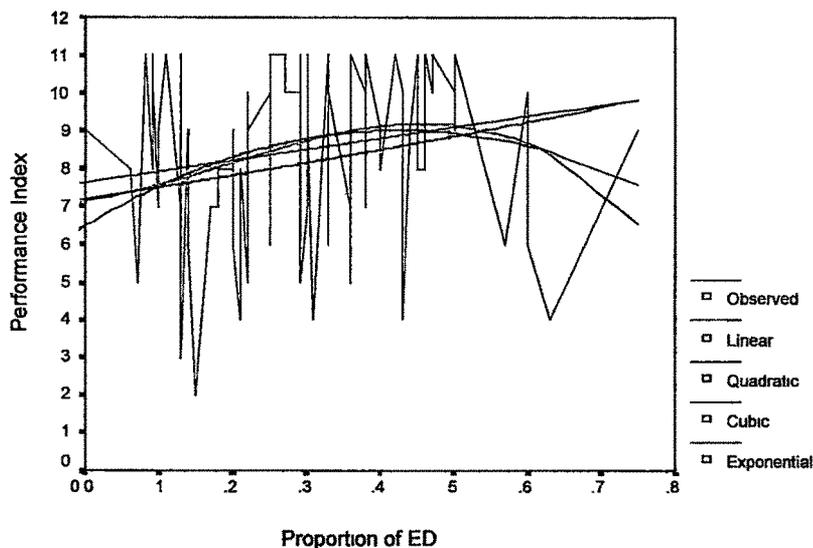


Figure 3.2: Scatter Plot & Fitted Curves For Performance Index vs. Proportion of ED

Table 3.20: Regression Analysis Using Quadratic Model

R Square .06841
 Adjusted R Square .05033
 Standard Error 2.13187

Analysis of Variance:

	DF	Sum of Squares	Mean Square
Regression	2	34.37836	17.189178
Residuals	103	468.12164	4.544870

F_o = 3.78211 p-value = 0.0260

----- Variables in the Equation -----					
Variable	b	SE b	Beta	t _o	p-value
ED	11.815131	4.925311	.769098	2.399	.0182
ED**2	-13.850113	7.320928	-.606546	-1.892	.0613
(Constant)	6.499772	.769366		8.448	.0000

Table 3.20 reveals that the quadratic regression model was found significant (p-value < 0.05) and is able to explain 5.033% of the variation in performance index. It was observed that the regression coefficients b₀ and b₁ were significant (p-value < 0.05). The optimal range of proportion of ED giving the best performance was observed as 0.43 ± 0.03. Therefore, the optimal range of proportion of NED+IND can be 0.57 ± 0.03 for the best performance of the company.

Further, it can be inferred from table 3.21 and 3.22 that in case of proportion of NED and IND respectively, none of the models were found significant in explaining their relationship with performance index.

Table 3.21: Model Selection For NED

Dependent: Performance Index
 Independent: Proportion of NED

Model	R2	d.f.	Fo	p-value	b0	b1	b2	b3
Linear	.010	104	1.09	.300	8.7916	-.8045		
Quadratic	.010	103	.54	.583	8.7638	-.5714	-.2739	
Cubic	.010	102	.36	.784	8.7677	-.6535	-.0110	-.2048
Exponential	.005	10	.53	.469	8.3885	-.0822		

Table 3.22: Model Selection For IND

Dependent: Performance Index
 Independent: Proportion of IND

Model	Rsq	d.f.	Fo	p-value	b0	b1	b2	b3
Linear	.000	104	1.1E-03	.973	8.4903	.0283		
Quadratic	.022	103	1.18	.313	8.2422	3.7440	-5.6159	
Cubic	.024	102	.82	.486	8.2722	1.3224	3.1964	-7.6596
Exponential	.001	104	.07	.787	8.2354	-.0331		

Therefore, it can be concluded that proportion of ED and NED+IND significantly influence the performance of the company whereas proportion of NED and IND individually do not influence the performance of the company.

Notwithstanding the foregoing discussion on board structure and composition in India, it is quite important to know the process of nomination and appointment of directors and to understand why the board composition is composed in a way it is composed.

3.3 Nomination and Appointment of Director

The existing beliefs regarding Indian companies are that: they are mostly closely held where the promoters who hold majority shares are in the total control of the organizational activities. The non-promoter members of the board often are hand picked by the promoters themselves either on account of their business dealings with them, or that they have invited them either for bestowing prestige value to their boards or on account of mutual understanding to be on each other's boards. Thus, the boards are occupied by family members, friends and celebrities and support one's decision silently.

The nomination process of directors is quite different, notwithstanding the legal stipulation that shareholders appoint directors in the general meeting. The board members re-nominate the retiring directors so as to in turn, assure their own re-nomination when they will retire by rotation. In practice nomination of any new person for the post of a director may come from any body, viz., shareholders may propose, a person may nominate himself, by Chairman of

the board, by CMD, and /or by the nomination committee of the board. The retiring director can also offer himself for the re-nomination. Members of the board would mostly be loyal to those who nominate them. Hence, when the company leadership invites a person as an independent director, the independence itself is in question⁷⁸. However, following is an attempt to find out the overall procedure of identification and invitation for new directors.

3.3.1 Identification and Invitation Procedure for New Directors

For this, analysis of 86 valid responses reveals criteria for identifying and inviting ED on the board at table 3.23. It reveals that normally in private sector the executives directors (ED) were identified from within the company, i.e., insiders and they were promoted on the basis of their performance and potential in 36 out of 67 companies.

Table 3.23: Sectorwise Frequency Distribution of Criteria For Identifying and Inviting ED on the Board

Identification of ED	Sector			No. of Cos	% of Total
	Joint	Private	Public		
Advertisement	1	4		5	5.8
Family members of promoters		11		11	12.8
Government through PESB			13	13	15.1
Insider executives promoted on the basis of performance and potential	1	36	3	40	46.5
Outsider having concerned business knowledge	1	7		8	9.3
Personal contact		1		1	1.2
Not Applicable		8		8	9.3
Total Cos.	3	67	16	86	100.0

And that in some companies (i.e., 7 out of 67 Cos.) persons from outside having concerned business knowledge were identified and invited for the position of ED. In some private sector companies (i.e., 11 out of 67) family members of promoters were considered for ED's positions. In joint sector there was no particular method for the identification of EDs.

However, in public sector the identification of ED is always through PESB (i.e., Govt.) and they are promoted on the basis of performance and potential. In PSUs, the chief executives and functional directors are recruited, selected/promoted by the Public Enterprises Selection

⁷⁸ In the U.S. in 89% companies surveyed by Korn/ Ferry, nomination of directors depends on the recommendations of the Chairman – in many cases the CEO – Salman, Walter J. (1993), "Crisis Prevention: How to Gear Up Your board", *Harvard Business Review*, January-February, pp. 68-75.

Board⁷⁹. The appointments of board members have to be cleared by the Appointments Committee of the Cabinet comprising of ministers. The recommendations of the Public Enterprises Selection Board for the appointments of Chairman, MD and other members of the board by examining the records of applicants followed by an interview.

Names are thereafter forwarded to the Administrative Ministry that appoints them after approval by the Appointment Committee of the Central Cabinet. The nominees of the Administrative Ministry are up to a maximum of two and they are usually the additional secretary and the joint secretary of the relevant departments. They are on a non-rotational basis but the individuals keep changing, as transfers are frequent in most ministries. All appointments are subject to due diligence and clearance by the Central Vigilance Commissioner. The responsibility for filling vacancies has been vested with the Administrative Ministries, the Department of Public Enterprises and the Public Enterprises Selection Board — the board itself has little power in board appointments, renewal or succession planning. Its' because of this well laid out procedure that all responses to the question regarding appointments of directors, their training, performance appraisal, etc. could not be received from the PSUs. The PESB also looks after the training, appraisal and other developmental programmes of the present or future board members.

Appointment of chairman and managing directors and executive directors of all PSBs is done by the RBI. The Narasimham Committee II had recommended that the appointment of chairman and managing director should be left to the boards of banks and the boards themselves should be elected by shareholders. However, Govt. has set up an appointment board chaired by Governor, Reserve Bank of India for these appointments. Only 5.8% companies identify EDs by advertisements.

⁷⁹ PESB was set up in the year 1974.

3.2.2 Procedure for Inviting NED/ IND

Analysis of the procedure of inviting NED and IND revealed that in case of public sector enterprises, Administrative Ministry identifies the persons who are experts in their respective fields. The chief executive of the company is also free to suggest the names. Then the names are sent to the search committee (in the Public Enterprise Selection Board) for making a panel of independent directors. They recommend the names of the required number of NED/IND to the administrative ministries of the concerned PSUs. The Administrative Ministry in consultation with CMD then nominate the directors. In PSBs 4 Shareholders' directors are elected through shareholders, one is nominated by the trade union, one is nominated by the non-workmen group of the bank

In 76% private and joint sector companies persons with excellence in their field normally were invited by the CMD/ Chairman/ Promoters/ MD by personal contacts, networking (also through various industry chambers and association meetings) or in consultation with the board members, formal process of selection, based on knowledge, expertise, and ability to contribute in the overall growth and image of the company by a person; by nomination committee or by the board, in subsidiary companies directors were appointed by parent company and they were the present or past employees of the parent company or on the personal contacts of the promoter of the parent company; and directors were nominated by FIs; in 4 companies the existed board members were there since long and no other person was appointed newly therefore the respondents did not know about the procedure.

The foregoing analysis shows that in PSUs and PSBs the Government decided the name of a director and in private sector and joint sector (for private partner) there was a clear majority of CMD/ Chairman/ Promoters/ MD inviting a director based on their personal contacts, networking (also through various industry chambers and association meetings) or in consultation with the board members.

3.2.3 Nomination and Selection of Directors

Procedure for appointments to the board should be formal and transparent. More “Grey” outsiders than the independent outsider directors are selected when the CEO is involved in the selection process (Shivdasani & Yermack, 1999). CEO is assumed to be involved in the selection process when the full board or a nomination committee (wherein CEO is a member) are selecting the directors. The INDs who are more likely to monitor the CEO, are appointed less frequently when the CEO is involved in director selection (Shivdasani & Yermack, 1999). The involvement of CEO in nominating new directors leads to managerial control. To curb down the managerial control with out increasing the number of large equity holders in firms, the involvement of the management in the selection of directors should be reduced (Tosi & Gomez – Mejia, 1989). Market reactions to IND appointments are negative when CEO is involved in director selection (Shivdasani & Yermack, 1999). Outside directors are invited by the CEO either directly (Mace, 1971) or indirectly by influencing Nomination Committee (Lorsch, 1989). Table 3.24 shows various agencies that nominate directors to the board.

Table 3.24: Frequency Distribution of Nomination of Directors by Various Agencies

Category of nominating agency	Sector			Total Cos.	% of Total
	Joint	Private	Public		
Chairman		24		24	25.8
MD/ CEO		10		10	10.8
CMD		4	1	5	5.4
Financial Institutions *	3	16	2	21	22.6
Full board		33	2	35	37.6
Nomination Committee		9		9	9.7
Govt	2	3	16	21	22.6
Shareholder of Specific Category	1	6	3	10	10.8
Any Other**		14	2	16	17.2
No. of Cos.	3	74	16	93	100

* Nomination by FI depends either on the agreement between the FI and the Company or its because of stock holding of the FI in the company.

** The other agencies were business collaborators, promoters/ promoter group, debenture trustees, Remuneration Committee, parent company, Senior executive directors, Vice-Chairman of the board, Reserve Bank of India, Whole time directors and other investors.

The table reveals that in India the nomination process was not dominated by any single agency and that multiple agencies were involved in nomination of directors on the board of the company. Sectorwise analysis shows that in public sector the concerned ministries and PESB nominated directors in consultation with other agencies, may it be WTD, or the NED or the IND. In private sector companies, the chairman as an individual and/or as a member of full board, i.e., total 57 out of 74 companies (77%) was involved in the process of nomination of directors on the board. And that full board nominated the directors in 44.6% private sector companies. The nomination committee was not found to be very important agency to nominate the directors as only in 12.1% private sector companies they nominated directors to the board.

In private sector, majority companies' nomination process was dominated by chairman, promoters, CMD and MD. These were the people whose performance had to be evaluated by the outsiders. For more transparency, the board should have majority of non-executive board members. But, if NEDs were nominated by those insiders who have the control over the processes and information, one cannot expect the NEDs to ask embarrassing questions to the one who have obliged them by nominating them to the board.

3.2.4 Factors Considered for Appointments of New Directors

Notwithstanding that in majority of companies the identification and nomination of directors was done by the CEO/ CMD/ MD/ promoter chairman on the basis of personal contacts and friendship or through networking, an attempt was made to find out whether any other factor was considered while appointing a director. For this ranking method on ordinal scale was used and respondents were asked to rank their preferences for the factors considered while appointing a director.

Analysis of 81 responses shows (see table 3.25) that ‘professional expertise’ and ‘business experience’ were the most preferred factors considered followed by ‘reputation’ and ‘professionalism’ consecutively while appointing directors on the board. Business relationship, location, clientele and the gender were given the least consideration. Contrary to this ranking, the foregoing analysis revealed that female directors were negligible in compare to their male counterparts which reflected the gender bias.

Table 3.25: Overall Ranking of Factors Considered While Appointing a Director

Factors considered	Overall Rank	Weighted Scores
Professional Expertise	1	805
Business Experience	2	781
Reputation	3	708
Professionalism	4	657
Integrity	5	584
Honesty	6	386
Visionary	7	368
Age/Seniority	8	321
Business Relationship	9	259
Location	10	132
Clientele	11	77
Gender	12	62
Any other	13	42

As far as business relationship is concerned it was found that 31% directors were on the board because of their business relationship with the company which shows that business relationship was given much importance than claimed by the respondents. Twelve respondents did not respond to the ranking either because the government appointed the NEDs or they said that people appointed for the post were so expert in their own field that it is difficult to rank the factors. Other factors that were also considered by a few respondents were – overall leadership quality, commercial considerations, proven track records, and the one who could add value.

3.2.5 Reasons for Joining the Board

While the foregoing discussion portrays the prevailing practices in identification, nomination and appointment of a new director from the point of view of the company, the following is an

attempt to find out what are the reasons for a person to join any board. Lorsch (1989) and Bhalla (1997) stated two most common reasons for a director joining the board and those are the ‘opportunity to learn about a new business and industry’, and ‘the prestige associated with the position’. Analysis of 84 responses on the basis of weighted score reveals that directors join the board for various reasons as shown at table 3.26.

Table 3.26: Reasons for Joining the Board

Reasons for joining the board	Weighted scores	Rank
Prestige/ Honour	465	1
To Contribute their knowledge, Experience and expertise to the business	358	2
Social Esteem	304	3
Desire for business and professional contacts	296	4
Visibility	285	5
For getting opportunities for business	209	6
Friendship & Personal Nostalgia	201	7
Personal Privilegdes	111	8
Any Other	94	9

Topmost reason for joining the board expressed by the respondents was ‘prestige and honour’ followed by ‘to contribute their knowledge, experience and expertise to the business’. Directors join the boards also for ‘getting opportunities for business’, ‘friendship and personal nostalgia’, and ‘personal privilegdes’ but the weightage was quite less compared to the foregoing factors.

3.2.6 Category of Shareholder Representation on the Board

Concentration of economic power and the nature of corporate control in a company affect the performance of an organization and ultimately decide the corporate governance system. For better corporate governance the Companies (Amendment) Act, 2000 introduced the concept of representation of “small shareholders” on the board of the public limited company. However, that remained only as rhetoric since there being only 2 companies who have small shareholders’ representatives on their board. For the overall shareholder representations 102 valid responses were analysed. Table 3.27 reveals the analysis of the valid responses.

Table 3.27: Sectorwise Frequency Distribution on the Basis of Specific Category of Shareholders Representation on the Board

Representation according to holding of shares	Joint	Private	Public	Total	% of Cos.
Up to Rs. 20000		2		2	1.96
20000 -5%		18	2	20	19.60
5%-20%	1	20	2	23	22.55
20%-51%	2	26	4	32	31.37
>51%	1	22	10	33	32.35
Any Other		10	2	12	11.76
Total Cos	3	81	18	102	

It can be inferred from the table that there were 19.6% companies (i.e., 20 out of 102 companies) with representation of the category of shareholders having shares above the nominal value of Rs.20000/- up to 5% of shareholding. 22.55% companies (i.e., 23 companies) had representation of 5-20% of shareholding category, 31.37% companies (i.e.,32) and 32.35% companies (i.e., 33) had representation of shareholding category of 20 to 51% and more than 51% respectively. In public sector various category of shareholders were the State Governments, Central Government with varying shareholdings. In private and public sector there were mostly promoters/ parent companies that had representation on board with varying shareholdings.

3.2.7 Qualification Shares

It is often argued that if directors do not hold shares, they may not be very much serious in the decision making process. However, qualification shares to be held by directors are not mandatory under the Companies Act, 1956 and it is left to the concerned companies to call upon directors to take qualification shares if so provided by the Articles. Holding qualification share being optional, it was inquired that how many companies required their directors to hold qualification shares. Table 3.28 presents the data for the same. Out of 91 responded companies, 91.2% companies (i.e., 83) did not require directors to hold qualification shares. In these companies there were all 100% (i.e., 3) joint sector companies, 91.9% private sector companies (i.e., 68 out of 72) and 75% PSUs (i.e., 12 out of 16).

Table 3.28: Sectorwise Frequency Distribution of Directors Required to Hold Qualification Shares

Directors to hold qualification shares	Sector			Total Cos
	Joint	Private	Public	
All except govt. nominee		1		1
All to have 500 shares (except institutional nominees)			1	1
ED		1		1
ED, NED, IND		1		1
ED, NED, IND, Additional		1		1
NED in joint name with state Govt			1	1
Shareholders Directors			2	2
Sub-total	0	4	4	8
None	3	68	12	83
Total Cos.	3	72	16	91

However, remaining 8 companies (i.e., 5.4% private sector and 25% public sector) required directors to hold qualification shares. In PSBs the shareholder directors were required to hold shares. In 6.25% PSUs (i.e., 1 out of 16) all directors were required to hold 500 shares except institutional nominee and in one state government organization the NEDs were required to hold qualification shares in the joint name of the state government. In 1.35% private sector companies (i.e., 1 out of 74) all except the government nominee directors were required to hold qualification shares. In 1.35% private sector companies (i.e., 1 out of 74) only EDs were supposed to hold qualification shares. 2.70% private sector companies (i.e., 2 out of 74) all ED, NED, and IND directors (also additional directors) were required to hold qualification shares.

3.2.9 Age of Superannuation and Renomination of Director

The Business Roundtable (BRT- US) was not in favour of the establishment of term limits for directors. Such limits often cause the loss of directors who have gained valuable knowledge concerning the company and its operations and whose tenure over time has given them an important perspective on long-term strategies and initiatives of the corporation. There are many young directors appointed on the board, however, it was found that the

directors with more age⁸⁰ were appointed and reappointed time and again. Even though, schedule XIII of the Companies Act, 1956 guides to fix up the age of a director, but the same is just a prescription and the individual company decides on the age limits of its directors. Taking the two various analyses into consideration for EDs and NEDs table 3.29 and 3.30 present the analysis of the age of superannuation of EDs and NEDs respectively.

Table 3.29 : Sectorwise Frequency Distribution of Age of Superannuation of EDs

Age of superannuation (yrs) of executive directors	Sector			Total Cos.	% of Total
	Joint	Private	Public		
58	1	12		13	14.4
60	2	16	16	34	37.7
65		15		15	16.6
70		5		5	5.5
75		2		2	2.2
Age limit does not exist		21		21	23.3
Total No. of Cos	3	71	16	90	100

Analysis of table 3.29 reveals that in private sector companies superannuation age of ED ranged from 58 to 75 years and that in 29.5% companies (i.e., 21 out of 71) the age limit did not exist for the retirement of a director. It was observed that some directors being promoters could sit on the board as long as they wish. In public sector companies the age of superannuation was 60 years whereas in joint sector it was either 58 years or 60 years. Analysis of data on age of superannuation of NED is given in table 3.30.

Table 3.30 : Sectorwise Frequency Distribution of Age of Superannuation of NEDs

Age of superannuation (yrs.)	Sector			Total Cos.	% of Total
	Joint	Private	Public		
60	1		2	3	3.33
65		5	1	6	6.66
70		3		3	3.33
75		7		7	7.77
Age limit does not exist	2	56	13	71	78.88
Total No. of Cos.	3	71	16	90	100

Analysis of table 3.30 indicates that the age of superannuation for NED did not exist in majority of companies i.e., 71 out of 90 companies (i.e., 78.88%) of all sectors and that it

⁸⁰ More age means an age more than 70 years for NED and 65 in case of EDs. This is fixed because of Schedule XIII of the Companies Act, 1956.

existed only in 21.12% companies where the range of age of superannuation of NED was between 60 to 75 years.

Reappointment of Directors

‘Continuity in the board should be subject to performance and eligibility for re-election should be based on the past performance of the director’ is on the agenda of several seminars and conferences these days. There was no question of re-appointment in majority of companies since the NED promoters were unquestionable exceptions to the ‘directors to be retired by rotation’. For finding out the reappointment process of directors the answer was sought to a question “Are superannuated directors eligible for reappointment?” The reappointment of superannuated directors was applicable to those 69 companies (see above table 3.29) who had responded that age of superannuation for ED existed and 19 those companies (see above table 3.30) that had responded that there existed an age limit for the retirement of NEDs.

Table 3.31: Sectorwise Frequency Distribution of Directors Eligible for Reappointment

Eligible for reappointment		Sector			Total Cos
		Joint	Private	Public	
ED	Yes		28	3	31
	No	3	22	13	38
	Not applicable		21		21
	Total	3	71	16	90
NED	Yes		5		5
	No	1	10	3	14
	Not applicable	2	56	13	71
	Total	3	71	16	90

It can be inferred from the table 3.31 that the reappointment of the EDs after retirement was possible in 34.44% (i.e., 31 out of 90) companies and that majority of companies, i.e., 42.22% (i.e., 38 out of 90) companies did not reappoint their EDs after attainment of the superannuation age. The above table also shows that in the majority of company 73.7% (i.e., 14 out of 19) companies reappointment of the NED did not take place and that only in 5 out of 19 companies (i.e., 26.3%) renomination of NED took place. It was evident from the table

that re-nomination of the NED existed only in private sector and did not exist in public or joint sector. That means in 61 out of 71 private sector companies (i.e.85.9%) there was no retirement of directors took place since in 56 companies there was no superannuation age for NEDs and in 5 companies reappointment took place.

Duration of Re-appointment

In case the reappointment of a director for the next term takes place, it was necessary to explore the duration of a single term that was fixed for such reappointment. There were various durations reported by the respondents for such re-appointments. That duration of reappointment was applicable to those 31 companies who responded that the re-appointment of ED took place and the frequency distribution of 31 companies on the basis of duration of reappointment is given in table 3.32. The table reveals that in 17.77% companies (i.e., 16 out of 90) duration of reappointment of ED was 3 years followed by 5 years (in 13.33% companies).

Table 3.32: Sectorwise Frequency Distribution of the Duration of Reappointment of Directors

Duration of reappointment	Sector			Total Cos
	Joint	Private	Public	
2 years		2	1	3
3 years		14	2	16
5 years		12		12
Sub-Total		28	3	31
Not Applicable	3	43	13	59
Total	3	71	16	90

In public sector companies the duration of reappointment was reported as either 2 years or 3 years whereas in private sector it varied from 2, 3 or 5 years. In case of 5 companies who responded that re-appointment of NED took place, there the duration of reappointment was 3 years only. Whereas in case of ED duration of reappointment varied from 2-5 years.

3.2.10 Nomination and Re-nomination of Chairman

Chairman of the board either can be selected in each board meeting or he can be a figurehead of the company on long term or permanent basis. *De jure*, the chairman should be selected by board of directors from amongst themselves⁸¹. Data pertaining to selection of chairman of the board is shown at table 3.33.

Table 3.33: Frequency Distribution of Selection of Chairman of the Board

Chairman selected by	Sector			Total Cos.	% of Total
	Joint	Private	Public		
Board of Directors	1	60		61	65.6
Nomination by Govt	1		15	16	17.2
Promoter	1	14	1	16	17.2
Total Cos.	3	74	16	93	100

The table reveals that in vast majority (i.e., 81%) of private sector companies the chairman was selected by the board of directors whereas in the public sector it was the government who nominated the chairman of the company. In joint sector, it was board of directors, government, and in one joint sector company the chairman was selected by rotation by both the promoters. In one public sector company which was a subsidiary of another public sector company the chairman of the holding company was usually the chairman of the subsidiary company. In 18.9% private sector companies (i.e., 14 out of 74) the promoter influenced the selection of the chairman either by projecting himself or his representative for the position of the chairman.

Term of the Chairman

The term of office of the chairman reveals that how long the chairman will serve the board as a 'Chairman'. Law prescribes for temporary position of a chairman stating that the chairman of the board be elected in each board meeting and also that in AGM one of the member can

⁸¹ The right to choose the Chairman cannot be exercised by the shareholders and it's the right of the board members to elect the Chairman of their meetings. The board may determine the term of a Chairman for a fixed period or it can be fixed through the articles of association. In public sector government owned companies, government mostly appoint Chairman⁸¹ who are charged with double responsibilities.

be elected as a chairman from amongst the members⁸². However, there is no doubt in our mind that in India the non-executive promoter chairman majority of time is a figurehead of the company and the company is known by the name of Chairman.

Table 3.34: Sectorwise Frequency Distribution of 'Term of Office of Chairman'

Term of the office of the Chairman	Sector			Total Cos	% of Total
	Joint	Private	Public		
1 year		1		1	1.07
2 year	1	1		2	2.15
3 year	1	25	3	29	31.18
5 year		18	9	27	29.03
As desired by the Government	1		4	5	5.37
Permanent		28		28	30.10
Not Applicable (where there is no chairman)		1		1	1.07
Total Cos.	3	74	16	93	100

Table 3.34 shows that there existed fixed term of the office of the chairman in majority of companies, i.e., 68.8% (64 out of 93) companies which varied from one year to five year term as well as 'on desire of government' in public and joint sector companies. Further, it reveals that in 28 out of 93 (i.e., 30.10%) companies the term of office of chairman did not exist, i.e., the position of the chairman was 'permanent' or 'not specified', as the position is non-rotational. In public sector companies the term depended on any of the three factors, i.e., 3 or 5 years at a time, desire of the government and the age of superannuation. Though the term was either 3 or 5 years, it depended on the government's (ministries) desire that how long a director will continue as a chairman. And if, he reaches the age of superannuation before a fixed term is over his term gets over on reaching the age of superannuation. In 33.78% private sector companies (i.e., 25 out of 74) the chairman's position was for a period of 3 year as they were the rotational directors being non-executive. However, 24.32% (i.e., 18 out of 74) private sector companies chairman's term was for 5 years. In majority of companies' boards' chairman being promoter could get re-elected to the board in continuation and their elections were just the rituals for the purpose of the law and so also

⁸² Sec. 175(1) of the Companies Act, 1956.

their chairmanship. In one case there was no position for board's chairman and the chairman was elected at each board meeting.

We further analysed that in those 64 companies where the term of office of Chairmen exist therein "Whether the chairman is eligible for the renomination for the next term?"

Table 3.35: Sectorwise Frequency Distribution of Responses "Whether the Chairman is Eligible for the Renomination for the Next Term"

Chairman eligible for renomination for the next term	Sector			Total Cos	% of Total
	Joint	Private	Public		
Yes	3	43	13	59	63.44
No		2	3	5	5.37
Sub-total	3	45	16	64	68.81
Not Applicable (Permanent Chairman)		29		29	31.18
Total Cos.	3	74	16	93	100

Analysis of table 3.35 indicates that chairman's renomination took place in all companies of all sectors, i.e., 59 out of 64 companies where the renomination of chairman for the next term took place. In 2 private sector companies and 3 public sector companies the chairman was not eligible for re-nomination for the next term after he completed the first term.

Conclusion

Legal requirements accelerated the changes in composition of boards of companies and not the average board size. Though companies changed their board size from year to year the average board size did not change irrespective of the sector. Moreover, there existed no causal relationship between the board size and the performance of the company, however, in private and public sector companies there existed somewhat weak positive relation with the turnover of individual financial parameters, i.e., sales, non-business income, reserves and market capitalization of the company. Private sector companies' boards were found to be composed of majority of insiders, viz., executive directors, familial relatives, people related through business contracts, etc.

It was found that the proportion of ED, and not the IND or NED, on the board influenced the overall performance of the company. Executive directors were younger than the non-executive and independent directors. A major shift in appointment of female directors has been observed with the fact that female directors were appointed on the basis of their professional qualifications also and not just on the basis of their familial relationship with the promoter directors. Though, majority of board members were professionally qualified yet there were few with 'business experience' only.

One-third of board members changed every three years and one out of four directors served boards for longer than 10 years. The private sector companies retained their directors more than the public sector. In public sector there was a fixed superannuation age, however, in private sector companies either there did not exist superannuation age for the non-executive directors or even if it exists there were all chances that their term got extended. Majority of promoters kept key positions with themselves such as Chairman, CMD and or MD/ CEO.

Executives were normally promoted on the basis of their performance and potential appraisals to take the position of executive directors on the board. Besides family members of promoters, outsiders were identified through advertisements for the positions of executive directors. In public sector the procedure of identification of ED and NED found well laid down through PESB and Administrative ministry alongwith CMD. Election of NED by shareholders and workers representation on the board was the uniqueness of PSBs. Personal contacts and networking by board members were used for identification of NEDs in private sectors.

Formal nomination by nomination committee was found rarely. In public sector the nomination was from outside the company, i.e., by the government and in private sector the nomination was influenced by the Chairman, CMD, MD as an individual or as a member of the full board. Representation of small shareholders was a very rare phenomenon, but,

blockholders and promoters did appoint their representatives on the board that included even financial institution and Government. Factors considered for the appointment of directors were professional expertise, business experience and reputation of a person. Similarly, a person joined the board of a company for a prestige/ honour and social esteem apart from his desire to contribute their knowledge, experience and expertise to the business. Moreover, directors were not required to hold qualification shares in majority of companies.

In private sector companies chairmen were selected either by the board of directors or the promoters while in the public sector, chairmen were selected by the Government. In private sector companies the term of chairman was either permanent or was for 3-5 years, however, in public sector the chairman's term was based on three factors, viz., his term, his superannuation age and the wish of the government. In public and private sectors the renomination of chairman took place for the next term in majority of companies.