Assessment of the role of Independent Director and its effectiveness for the growth and development of shareholders' value of the firm

A study by

S.P. Jain Institute of Management and Research, India

Supported by

National Foundation for Corporate Governance

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September 2017

ACKNOWLEDGEMENT

The SPJIMR Centre for Corporate Governance gratefully acknowledges the support received from the National Foundation for Corporate Governance (NFCG) for conducting the study. We are extremely grateful to NFCG for giving us an opportunity to carry out this pioneering study. We would also like to express our heartfelt thanks to NFCG for their support at all times. Dr. Arunima Haldar, Dr. R.K. Pattnaik, and Professor Jiban K. Mukhopadhyay along with the research associates – Dr. Deepti Chaturvedi and Ms. Pallavi Das carried out the research at S.P. Jain Institute of Management and Research (SPJIMR). This report is the joint intellectual property of the National Foundation for Corporate Governance and the SPJIMR Centre for Corporate Governance.

We would like to express our gratitude to Dr. Ranjan Banerjee, Dean, SPJIMR for providing the opportunity to pursue this research work at the Centre for Corporate Governance, SPJIMR. His constant encouragement and support is notable. The facilities, research group, and the general ambience of research at SPJIMR inspired the team to embark on a focused research journey. We are immensely grateful to our Dr. Sesha Iyer, Advisor to the dean, for his encouragement and support. Our sincere thanks to Dr. Snehal Shah, Head Research Initiatives, and Chairperson – Fellow Programme in Management, SPJIMR for the insightful suggestions. Her useful comments, suggestions, and continuous support are noteworthy.

During the interviews, we held discussions with a large number of senior management personnel in the selected firms and obtained valuable insights about their working in the organisation. We are extremely thankful to all of them for their cooperation and support in the study.

We are thankful to all the faculty members of SPJIMR who always whole-heartedly helped for the study. Special mention to Professor Krishnan for introducing the team to the board members, Professor Mohan for his insights on board room practices, Dr. Jha for technical insights, Professor Divatia for introducing the alumini participants, Professor Palekar and Dr. Dixit for their insights about Indian business houses, Dr. Sarabjeet for insights in designing survey, Dr. Vaidya for insights about qualitative research, Dr. Thakur for her guidance in research queries, Professor Ganguly for his guidance and support, Dr. Srivastava in his suggestion in preparing questionnaire. Special thanks to our executive in residence Mr. Gopalakrishnan for his invaluable advice at all times. Insights from our adjunct faculty and industry veteran Professor Parmeswaran and Professor Puliyel are highly appreciated. The team is thankful to Mr. Manna and Mr. Varghese for their contribution in improving the presentation of the report. Words fall short to express our gratitude towards Ms. Kapoor and Ms. Miranda who tirelessly supported the research work. Ms. Jayshree and her team were always helpful in arranging the webex calls with directors. The unconditional support of Mr. Vincent in providing financial support is notable. The team appreciates the tireless support of the library team (Mr. Narvekar, Ms. Noronha, Ms. Wadkar) headed by Mr. Kumbar who provided the research papers used for the study. The team is extremely thankful to the staff for their cooperation and support in the study.

Finally, it would not have been possible to complete this study without the unconditional support of the SPJIMR family. We are grateful to them. The team is thankful to their family members who supported their endeavour.

Executive Summary

Background

"A king can reign only with the help of others; one wheel alone does not move (a chariot). Therefore, a king should appoint advisors (as councillors and minsters) and listen to their advice. The opinions of advisers shall be sought individually as well as together (as a group)"

Kautilya

Board of directors in the diffusely held firm reduces the agency cost associated with the separation of ownership and control. These directors are elected by shareholders and are supposed to "monitor" the managers in view of the shareholder's interest. Classically, board consisted of firm's senior officers, outsiders with deep connections with the firm and few directors who were nominally independent but handpicked by CEO in 1950's. However, recently, board comprises of "independent directors" whose independence is strengthened by plethora of rule based and structural mechanisms. Inside director's numbers are declining; the nominees on the board are virtually an extinct species. Thus, the move towards independent directors, which began as a "good governance" practice, has become an obligatory element of corporate legislations.

The institution of independent director was initiated in United States as a governance mechanism to mitigate the agency problem between shareholders and professional managers. Although, large institutional investors cumulatively hold sizeable holdings in public listed companies, these are not enough to control its day-to-day operations. These investors primarily invest as financial investors and have little interest and incentive to participate in the management of the firm. These companies are run at the level of board meetings and general meetings act as rubber stamps to ratify the key issues. In case management drives these board meetings, these managers would pursue their personal agenda at the expense of investors. Thus, this backdrop of agency problem necessitated the need of having non-management board of directors who would not be obliged to management. These directors were expected to check managerial excesses and protect the shareholders interest at large. Thus, the idea of having non-management director has evolved in a phased manner to protect the dispersed investors from the self-serving management. It is in this background; the study would discuss the role and challenges faced by this governance mechanism in an emerging economy context – India.

Indian scenario

Securities and Exchange Board of India (SEBI) was formed in 1992 to improve the corporate governance landscape of Indian firms. This was followed by the formation of four major committees (Bajaj Committee in 1996, Kumar Mangalam Birla Committee in 2000, Naresh Chandra Committee in 2002, and the Narayanan Murthy Committee in 2003) to review governance issues and propose governance laws and reforms. These laws and reforms were formally implemented by the SEBI through the enactment of Clause 49 of the Listing Agreement. These reforms include issues such as increasing the number of outside directors, dealing with the issue of duality, and the existence of financial experts on board rooms. There has also been change to

Clause 49 of the Listing Agreement in 2005 (effective from January 1, 2006) specifying a minimum number of outside directors on the board (SEBI, 2000, 2004).

The Companies Act 2013 was introduced and effected from 1 April 2014. This act made efforts to incorporate some of the salient requirements mandated by the SEBI in Clause 49 of the listing agreement. Requirement such as mandatory appointment of independent directors, minimum number of independent directors, database for appointment of independent directors, tenure, and cooling off period between re appointment, code for independent directors, and liability of independent directors were the key amendments.

The Securities and Exchange Board of India issued SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 on September 2, 2015. This was introduced to consolidate and streamline the provisions of the existing listing agreement for varied segments of capital markets; thus, enabling better enforceability. Thus, listed entities need to submit quarterly compliance report on corporate governance to the recognised stock exchanges as per regulation 27(2) SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015. Provisions under the Clause 49 of the erstwhile listing agreement have been brought under Regulations 17 to 27.

Presently Indian listed companies are required to comply with the Corporate Governance requirements as specified in the Companies Act, 2013 and SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015. It is anticipated that these changes to the composition and operation of boards of directors might strengthen the institution of independent directors. Recently, the Ministry of Corporate Affairs amended provisions related to independent directors about appointment and qualification of directors (Companies Amendment Rules, 2017) and code for independent directors (Amendment to Schedule IV, Companies Act 2013).Thus, there has been a continuous process to strengthen the institution of independent directors in Indian firms.

Introduction

There is a growing body of theoretical and empirical literature that have made leaps by utilizing board of directors as an input variable with an output variable such as performance (Baysinger and Butler, 1985; Bhagat and Black, 2002; Anderson and Reeb, 2003; Fields and Keys, 2003; Adams et al., 2010 Haldar and Raithatha, 2017). These inferential leaps are distinct, but fail to provide any evidence on the processes and mechanisms, which is likely to enhance the efficacy of the input variable (i.e. board of directors) (Pettigrew, 1992). Being an established internal governance mechanism (Fama and Jensen, 1983), there is an implicit emphasis to discount the challenges faced by board of directors in their day-to-day functioning. Moreover, this lacuna becomes pronounced in case of independent directors.

The present study endeavors to analyse the challenges independent director encounters in policing managerial conflicts of interest and in monitoring the maximization of shareholder wealth. These important elements of the functioning of independent directors remain obscure and unexamined. In addition, the study endeavored to understand “independence” which is a malleable concept with varied conceptions. This variation depends on facets considered important in influencing a director’s decision-making and their perceived role in a country’s corporate governance tapestry. Thus, being a critical centerpiece in the corporate governance discussion (Khanna and Varottil, 2016), it depends on the context.

India, with its unique institutional setting provides an ideal laboratory for examining this pertinent issue for a variety of reasons. The nature of governance problem is largely dependent on the ownership and control structure of the corporation (Sarkar, 2009). India's Bombay Stock Exchange is endowed with the largest number of listed companies in the world ("http://www.bseindia.com/static/about/introduction," 2017) The ownership in these listed companies remains concentrated in families, highlighting the prevalence of an insider dominated structure (Sarkar and Sarkar, 2000). As on March 31, 2016, 45% of the listed companies in India have promoter shareholding (henceforth PSH) above 50%. This concentration is deeply embedded to the core with 6 companies having 100% shareholding and 4% companies with supermajority promoter shareholding (PSH > =75%) (Prowess, 2017). Thus, understanding this concept with a lens devoid of its original setting (i.e. Anglo-American scholarship) might be a useful exercise for emerging market context.

There is a growing emphasis on increasing the number of independent directors on the corporate boards as a response to the regulations adopted at varied times. This excessive reliance brought about super majority boards where 90% in UK public companies (Heidrick and Struggles, 2009) and 85% in US public companies (Velikonja, 2013) comprised of independent directors. This short-term phenomenon brings governance benefit, but fails to address the challenges faced by them. Addressing these pertinent lacunae could enhance the efficacy of the mechanism without enhancing their numbers.

Contribution

Majority work on independent director has been concentrated in the western world (Nowak and Mc Cabe, 2003; Clarke, 2007; Luan and Tang, 2007). However, this study contributes to the literature in an emerging market context. Firstly, the findings from this study will extend the literature by identifying major challenges for effective implementation of independent directors' guideline through a qualitative lens. In addition, this lens helped us in having a first-hand experience of the respondents through semi-structured interviews. The semi structured interviews gave the respondents a scope to share their personal thoughts, feelings, and opinions without being interrupted or been influenced by factors like those of any findings of previous research or any legal obligation by the companies. Thus, our study is an attempt to respond to the call for papers for qualitative researchers on corporate governance by contributing to the little evidence (less than 1%) on the same (McNulty et al., 2013).

Secondly, our study responds to the seminal piece by Pettigrew (1992) and engages directly with the actors in their natural settings. Our enquiry helps to open up the black box of boardroom and sheds light on the challenges faced by independent directors at individual, board and firm level. The study also adds to the limited evidence on the challenges faced by independent directors and has policy implications for policy makers and managers.

Thirdly, our study provides a basis for rethinking and challenging some of the dominant assumptions and meanings associated with the role of independent directors. Research to date on corporate governance has mainly dealt with the efficacy of various mechanisms that can protect shareholders from self-interested executives, and the focus has generally been on developed economies (Daily et al., 2003). Our study provides evidence on the relationship between the role of independent directors and its effectiveness on shareholder's value (measured by financial performance) of the firm in the context of an emerging economy. Prior literature has extensively explored this relationship in developed and developing economies, but little is known about transition or emerging economies characterised by concentrated ownership, business group affiliation (Khanna and Rivkin (2001), pyramiding, and tunneling (Chittoor et.al., 2015). Emerging economies such as China and India, which covers majority of the world's population, however, provide unique opportunities and challenges for governance practices and research (Davis, 2005). Internal mechanism such as independent are critical to the improvement of corporate governance, yet only few studies have been undertaken in emerging economies (Cai et al., 2015 Kakabadse et al., 2010).

Research Objectives

- To study the size and composition of independent directors in both private and public sectors.
- To analyze the role of independent directors along with relationship with other functional directors in firm's policy decisions to ensure growth and shareholders' value for the firm.
- To identify major constraints for effective implementations of independent directors' guideline in the interest of each stakeholders of firm

Research Design

Research Design section starts with the discussion on research objectives 1 and 2. The research setting of the research objective 3 follows this.

Research Objective 1 and 2

Data

The data on financial performance measures and control variables (such as leverage, book- market ratio, firm size, age) are obtained from Prowess Database compiled by the Centre for Monitoring the Indian Economy. We hand collect the Corporate Governance information from the CG reports of the firm. Further, we verified our data by referring to annual reports of companies and visiting firm's website. The data includes 500 large listed Indian firms from the period 2004 to 2016 (Figure 1).

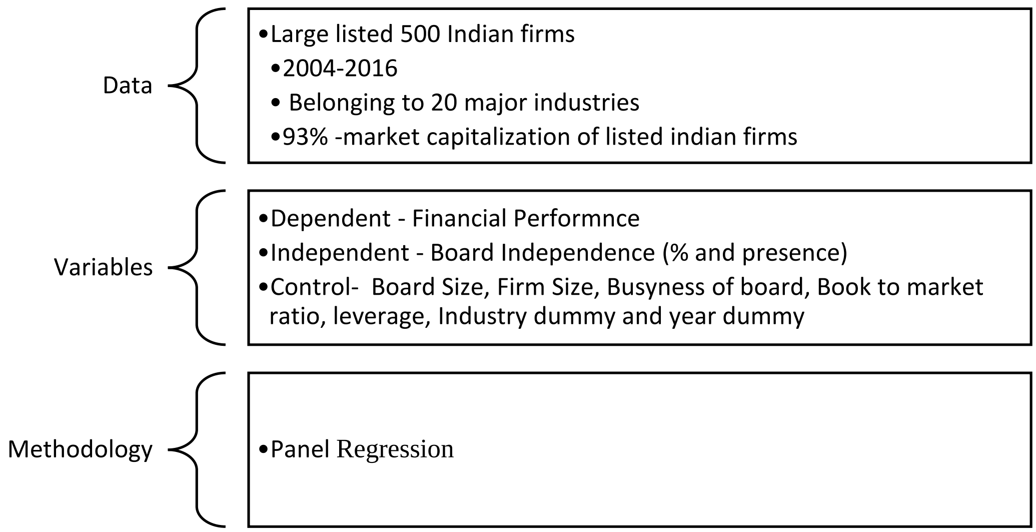

Figure 1 Research Design

The sample firms were predominantly private Indian firms (22%) followed by central government (10%) and private foreign firms (7%) (Table 1). Our sample represents nearly 93% of the total market capitalization of large listed companies in India and covers all 20 major industries of the economy (Table 2).

Table 1 Ownership classification by number and percentage of companies

Ownership Group	No. of Companies	Percentage of companies
Central Govt. - Commercial Enterprises	50	10
Joint Sector	1	0.2
NRI	1	0.2
Private (Foreign)	35	7
Private (Indian)	108	21.6
State and Private sector	1	0.2
Total	500	100

Source: Authors computation based on prowess classification

Table 2 Industry Classification of sample firms

NIC Range	Industry Classification	Number of Companies	Percentage of companies
0-3	Agriculture, Forestry, Fishing	7	1.40
3-9	Mining	6	1.20
9-33	Manufacturing	241	48.20
33-35	Electricity, gas, steam and air conditioning supply	14	2.80
35-39	Water supply; sewerage, waste management and remediation activities	0	0.00
39-43	Construction	25	5.00
43-47	Wholesale and retail trade; repair of motor vehicles and motorcycles	27	5.40
47-53	Transportation and storage	20	4.00
53-56	Accommodation and Food service activities	3	0.60
56-63	Information and communication	48	9.60
63-66	Financial and insurance activities	79	15.80
66-68	Real estate activities	3	0.60
68-75	Professional, scientific and technical activities	7	1.40
75-82	Administrative and support service activities	2	0.40
82-84	Public administration and defence; compulsory social security	0	0.00
84-85	Education	0	0.00
85-88	Human health and social work activities	5	1.00
88-93	Arts, entertainment and recreation	2	0.40
93-96	Other service activities	0	0.00
96-98	Activities of households as employers; undifferentiated goods- and services producing activities of households for own use	0	0.00
98-99	Activities of extraterritorial organizations and bodies	0	0.00
	Diversified	11	2.20
	Total Companies	500	100

Source: Authors computation based on National Industry Classification

Variables

Dependent Variables

Further, to verify the relationship of Financial Performance and Corporate Governance, financial performance is utilized as a dependent variable.

Financial Performance

Literature on financial performance

Profitability Indicators: ROA, ROE, Market- Book Ratio
Valuation Indicators: Price-Earnings Ratio, Tobin’s Q, Equity Returns
Most studies used: Tobin’s Q
Def: Tobin’s Q = [(BSE closing price) *(number of shares outstanding) + pref_capital + total borrowing] / Total assets
Authors - Jackling and Johl (2009); Sarkar and Sarkar, (2000); Khanna and Palepu (2000)

Source: Haldar (2014)

Accounting Returns are proxied by Return on Asset (ROA) and Return on Equity (ROE), whereas market-based returns are proxied by Tobin’s Q. Figure 2 depicts the performance data across ownership structure in Indian listed companies from 2003-13. Standalone firms have consistently performed (accounting returns measured by ROE, ROA, and EVA) over the years. However, market returns (measured by Tobin’s Q) is higher in foreign standalone firms.

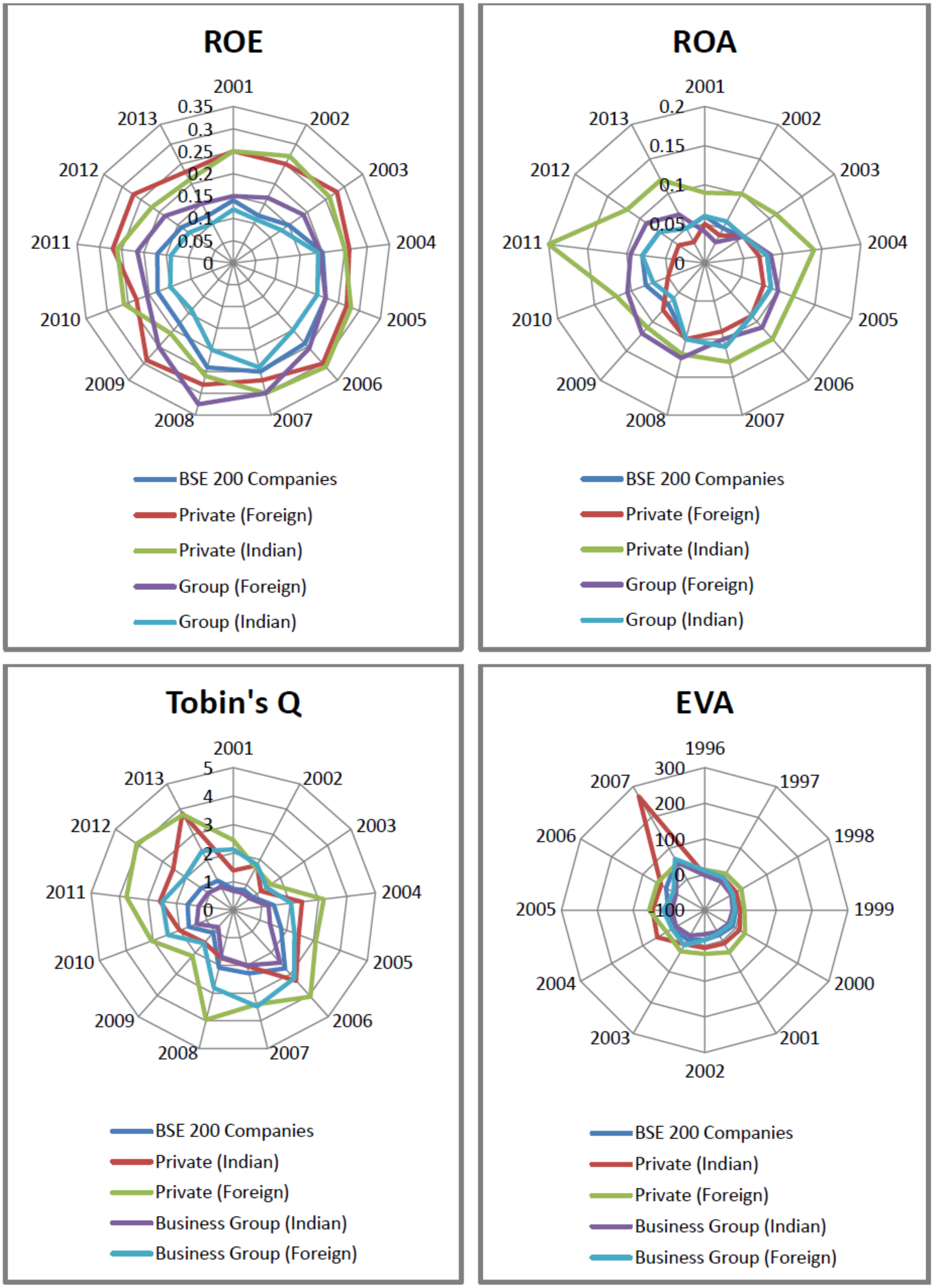

Figure 2 Financial Performance proxies (2001-13)

Independent Variables

Board Independence

We consider board independence (ID) as a proxy for corporate governance computed as proportion of number of independent directors to total number of directors. If the proportion is high, it means independent directors dominate the board and following resource dependency theory, such boards are expected to be more effective. We also consider dummy variable IDP for considering the presence/absence of independent directors.

Control Variables

To control for the effect of other factors that also may affect the variables of interest in our study, we include a comprehensive set of other variables in our analyses, which are in line with the previous studies exploring the relationship between corporate governance and firm performance. These control variables are BS (Board Size), Total Directors on Board; BUSY (Busyness of Directors); Number of Directors serving as director in more than 3 companies, LEV, the ratio of long-term debt to total assets; BMR, the book to market ratio; and FS (FIRMSIZE), the natural logarithm of total assets.

We describe the internal mechanisms of CG used for the study in Table 3 below.

Table 3 Corporate Governance Mechanism

CG Mechanism	Definition	
Board Independence (%)	Number of ID/ Total number of directors	ID
Board Independence(Presence/Absence)	Presence of Independent Directors 1 if present; else 0	IDP
Board Size	Total number of board of directors	BS
Firm Size	Log of total assets	FS
Busyness of Director	Number of Directors serving as director in more than 3 companies	BUSY
Book-Market Ratio	Book value of firm / Market value of firm	BMR
Leverage	Debt of firm/Total assets of firm	LEV

Dummy Variables

We also include year dummy variables and industry dummy variables. To ensure that we separate out all the unobserved year effects, including macroeconomic and environmental effects, we also use 11-year dummies to control for period effects pertaining to the study period. The industry dummy variable would provide us the industry level insight. We classified our data as per National Industry Classification and generated fifteen dummies.

Methodology

Panel models provide a number of improvements over the separate analysis of time series by cross-section. First, panel data allow for considerably more flexibility in the modeling of the behavior of cross-sectional units than conventional time series analysis (Greene, 2008). Second, the panel framework allows for the analytical incorporation of significantly more observations (and more degrees of freedom) than would a comparable analysis of individual time series. Panel data is commonly used method that control for spurious correlation. Panel Model facilitates capturing firm-specific variables and corrections for unobserved heterogeneity of the firms, as it includes time series data.

In panel data, the same cross-sectional unit (say a family or a firm or a state) is surveyed over time. In short, panel data have space as well as time dimensions (Gujrati, 2011).We estimated a balanced panel where we have the same number of each cross-section units so that the total number of observation is n.T. When n = 1 and T is large, we have the familiar time-series data case. Likewise, when T =1 and n is large we have the cross-section data. Panel data estimation methods refers to data where n >1 and T>1 (Johnston and Dinardo, 1996).

We estimate the equation by using panel data analysis. We conducted the test proposed by Hausman (1978) for determining whether to conduct fixed effects or random effects. We also verified by conducting Breusch and Pagan Lagrangian multiplier test for random effects. Further we computed the Breusch- Pagan (1979) statistic to check for heteroskedasticity and Wooldridge (2002) test for autocorrelation. We conducted estimation in Panel Data with White (1980) heteroskedasticity-consistent standard errors and covariance Test. We carried out the analysis using STATA Version 12.

Empirical Model

We examine the relationship between corporate governance variable- board independence and firm performance using nine econometric models.

Model 1 measures the impact of proportion of independent director on financial performance.

We replace the proportion of independent director with the independent director dummy variable in model 2. This enables us to measure the significant difference between companies having independent directors with those having none on financial performance.

The large proportion of family owned firms in India has meant that the role of outside directors might be minimized, as family firms tend to restrict executive management positions to family members. Thus, limiting the pool of potential qualified and talented labour resources. Model 3 measures the impact of proportion of independent director on financial performance in presence of board size.

Total Assets of the firm measure the size of the firm. Log transformation of the total assets has been used to correct skewness in firm size. Model 4 measures the impact of proportion of independent director on financial performance in presence of board size and firm size.

Directors serving on three or more companies are considered busy directors. Theoretically, busy directors devote fewer efforts to their duties whereas the argument against busyness of the directors is that they give quality time and are highly effective due to their abilities and expertise. The effectiveness of such busy directors on financial performance is interesting research area. Model 5 hence includes busyness of board and measures the impact of proportion of independent director on financial performance in presence of board size, busyness of board and firm size.

Model 6 measures the impact of proportion of independent director on financial performance in presence of other governance variables (such as board size, busyness of board), book to market ratio and firm size.

Model 7 measures the impact of proportion of independent director on financial performance in presence of other governance variables (such as board size, busyness of board), book to market ratio, leverage, and firm size.

Model 8 measures the impact of proportion of independent director on financial performance in presence of other governance variables (such as board size, busyness of board, book to market ratio, leverage, and firm size). Further, we introduce 11-year dummies to this model.

Model 9 measures the impact of proportion of independent director on financial performance in presence of other governance variables (such as board size, busyness of board, book to market ratio, leverage, and firm size). Further, we introduce 11-year dummies and 15 industry dummies to this model.

Research Setting for RO3

The third objective was to identify the challenges faced by independent directors. This research question could have been addressed best when there are no preconceived notions. The exploratory nature of the question necessitated primary study of the subject in question. It was decided that the best way to accurately and adequately collect information was to directly approach the experienced non-executive directors. The qualitative interviews gave the respondents a scope to share their personal thoughts, feelings, and opinions without being interrupted or being influenced by factors like those of any findings of previous research or any legal obligation by the companies concerning the appointment of the independent Director. Thus, during the interview process (where the questions were primarily semi structured) the participants could share their views willingly without being interrupted.

During our sampling stage, we started identifying the individuals who were presently serving on a board or have in the past served as the Independent Director of a board of a public or private organization. We compiled the director's names through annual reports, financial databases (namely Prowess, Capitaline, and Bloomberg) and references. However, we found that the directors identified through references were comfortable to share data and help us in understanding the boardroom practices. The dynamics of the boardrooms are extremely confidential and our intention was to understand the challenges of the ID in a board. Finally, we interviewed 20 independent directors across industries (demographics shared in Table 4).

We also interviewed academicians who had substantial theoretical understanding of the field and had contributed to the theoretical underpinnings in the area. There were two screening criteria for academicians. Firstly, their teaching/research area should be corporate governance. In addition, they must be engaged in a listed company as an independent director. This helped us in understanding their inherent beliefs of the challenges faced by ID in day-to-day working. Further, representatives of proxy advisory firms were interviewed to understand the holistic picture of the role and challenges of independent directors. Although it is a recent phenomenon in India, they guide institutional investors on the voting about corporate decisions. Unlike USA, the subscribers are not obliged to adhere to their advice. A proxy firm provides services to shareholders like those on voting, firm research, vote administration, vote execution. However according to the websites of these firms, not all provide vote execution.

We analysed the transcribed data using thematic analysis. During the thematic analysis, there were various significant statements, which emerged relating to various dimensions. When a comprehensive set of constructs was derived then it was realized that to segregate the complexities of the themes, place their association with the existing theories, and to enhance the relevance of the study we transcribed the interviews and adopted a Seven-Stage approach, suggested by Easterby-Smith et al., (1991) to sift through and process the interview data. This helped us to examine the salient challenges concerning the performance of the IDs (Clarke, 1998).

To get a good understanding of process we conducted a review of the relevant literature to get a good understanding of the subject in accordance with the guidelines provided by Corbin and Strauss (2014). We started contacting the Independent Directors through our possible sources. After ensuring them confidentiality, we started the exploratory study where we gave the scope to share their personal thoughts. Due to confidentiality, we decided to conceal the profiles of our respondents and have provided only certain demographic details. For avoiding the coding bias, three independent coders did the coding independently and then the fourth coder acted as a neutral coder. The coders were explained about the research objective and its importance. Inter rater reliability was compounded and the test met the standards as indicated by Lombard et al., (2002). Keeping in mind the guidelines of Corbin-Strauss (2014), the open codes were derived after the analysis of the responses. Each coder generated the themes that were hidden in the responses of the participants.

Table 4 Demographic of the sample respondents

Sl. No.	Gender	Experience (years)	Educational Qualification	Experience as an ID (years)	Directorships held in companies	International Experience
1	M	49	B. Tech	17	4	Yes
2	M	37	Ph.D.	10	5	Yes
3	F	35	Ph.D.	4	3	Yes
4	M	26	MBA	5	2	Yes
5	M	40	MBA	4	4	Yes
6	F	43	Ph.D.	7	4	No
7	F	16	CA	2	2	No
8	F	25	Ph.D.	2.5	1	No
9	M	35	MBA	6	3	Yes
10	F	26	MBA	4	1	Yes
11	F	25	CA	10	1	No
12	M	33	MBA	5	2	Yes
13	M	48	MBA	4	2	Yes
14	M	52	MS.C.	3	2	Yes
15	M	25	M.A.	5	2	Yes
16	F	15	MBA	2	2	Yes
17	F	23	Ph.D.	5	2	Yes
18	F	15	Ph.D.	3	3	Yes
19	M	38	MBA	6	2	Yes
20	M	41	MBA	2	2	Yes

Results and Discussion

Size of listed companies in India

Table 5 suggests the increase in percentage of average independent directors over the years from 43% in 2004 to 48% in 2016. Although, on an average, there were four busy directors on the boards; percentage of busy directors has reduced slightly from 40% to 37%. The companies having board size above eight has almost doubled from 192 in 2004 to 381 in 2016 indicating the preference for companies to have smaller board size. Large boards having board members above 12 have also increased from 76 to 129.

Table 5 Trends in Board Composition

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Average %ID	42.75	41.08	42.74	42.80	43.66	46.70	47.83	48.38	48.09	48.81	48.55	47.16	47.89
Average no. of busy directors							4						
Average % Busy directors	39.77	39.44	38.25	39.16	39.25	39.44	39.37	40.35	39.34	36.99	36.62	36.79	37.08
BS above 8	192	238	267	274	303	318	321	325	329	341	348	355	381
BS above 12	76	82	91	102	100	120	134	121	126	127	126	144	129

Source: Author Computation

Table 6 suggests that on an average number of independent director on the board has changed by hardly 20% from 2004 to 2016.No. of companies having ID has improved by 26% indicating that boards do believe that ID adds value to the board room dynamics. However, percentage of busy directors has reduced by 7%. Although busy director's demand has reduced, they are present in 98% of the boards in 2016.

Table 6 Trends in Independent and busy directors (2004-16)

	Average			
	No. of ID	Presence of ID	% of busy directors	Presence of busy directors
2004	4	78	0.40	0.78
2016	5	98	0.37	0.98
% Change (04-16)	25	26	-7	26

Source: Author Computation

Table 7 suggests that firm size in 500 large listed firm has substantially increased in comparison to all listed companies in India.

Table 7 Size of Indian listed companies

	All Listed companies			500 large listed companies		
			Average			
Year	Assets	Sales	Market Capitalization	Assets	Sales	Market Capitalisation
2016	126906	38405	23882	490795	131728	183181
2001	9659	3090	1568	22118	5937	16724
%change (2001-16)	13	40	97	2118	2118	995

No. of companies: 5460 (Figures in Rs. Million)

Figure 3 suggest average assets of Indian listed firms have substantially increased by 13%. There appears to be a 40% increase in average sales in Indian listed companies from the year 2001 to 2016.

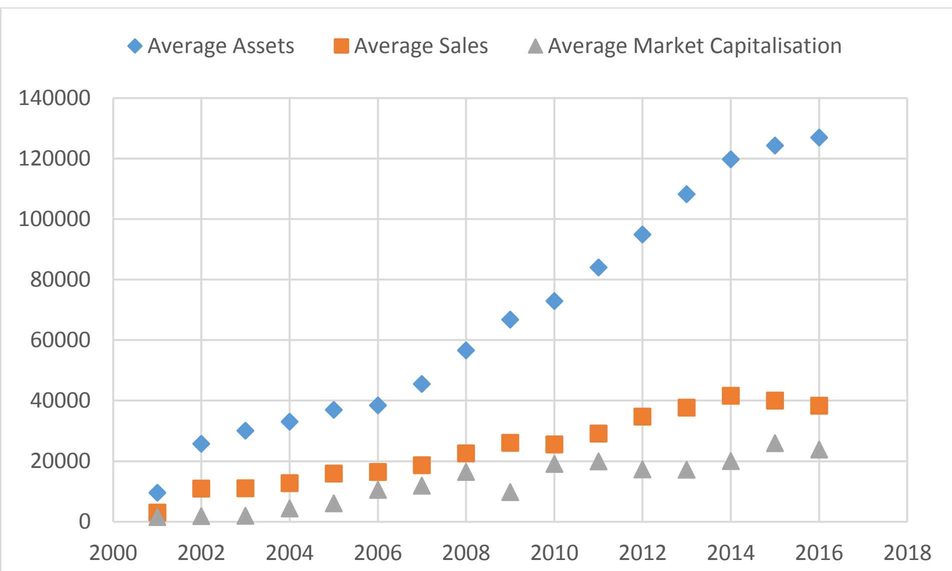

Figure 3 Size of Indian listed companies

In comparison to services industry, manufacturing companies have higher percentage of ID (figure 3). Figure 4 confirms our prior assumption that standalone firms, owing to their better corporate governance practices, have higher percentage of ID. Although percentage of independent directors remains relatively same across the years for both categories. The percent of Independent directors are consistently higher for standalone companies maybe as proportion of executive chairman in standalone companies are higher than business group affiliated companies leading to a higher proportion of Independent directors (Sarkar and Sarkar, 2012). Clause 49 introduced by SEBI in February 2000 required that in case of a non-executive chairman, one-third of the board must comprise of independent directors while for executive chairman it was mandated at 50% board members.

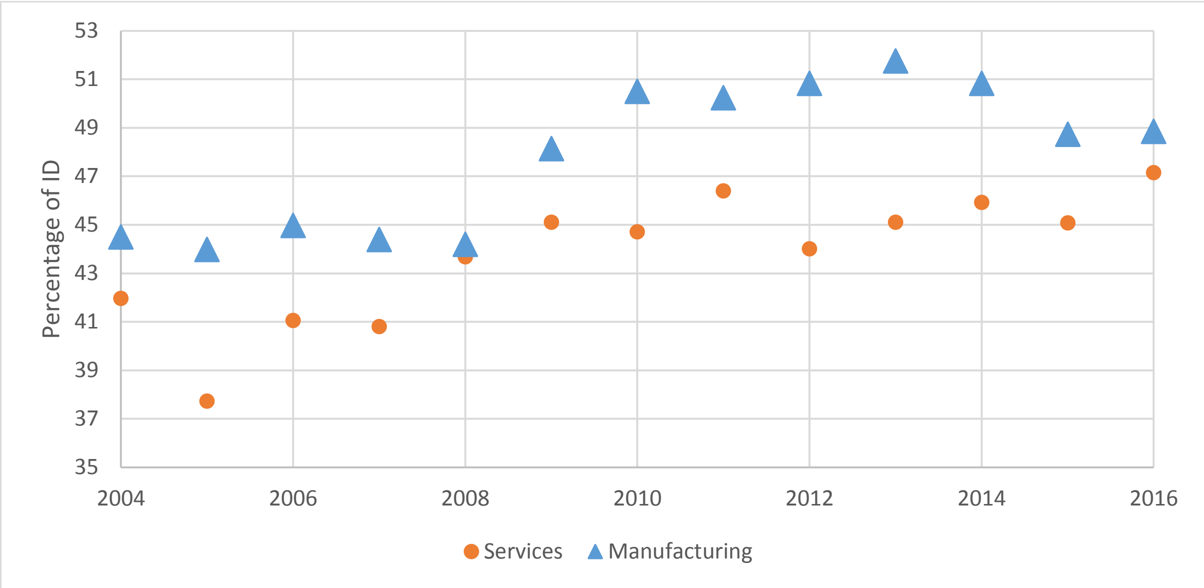

Figure 4 Average percentage of independent directors across industries

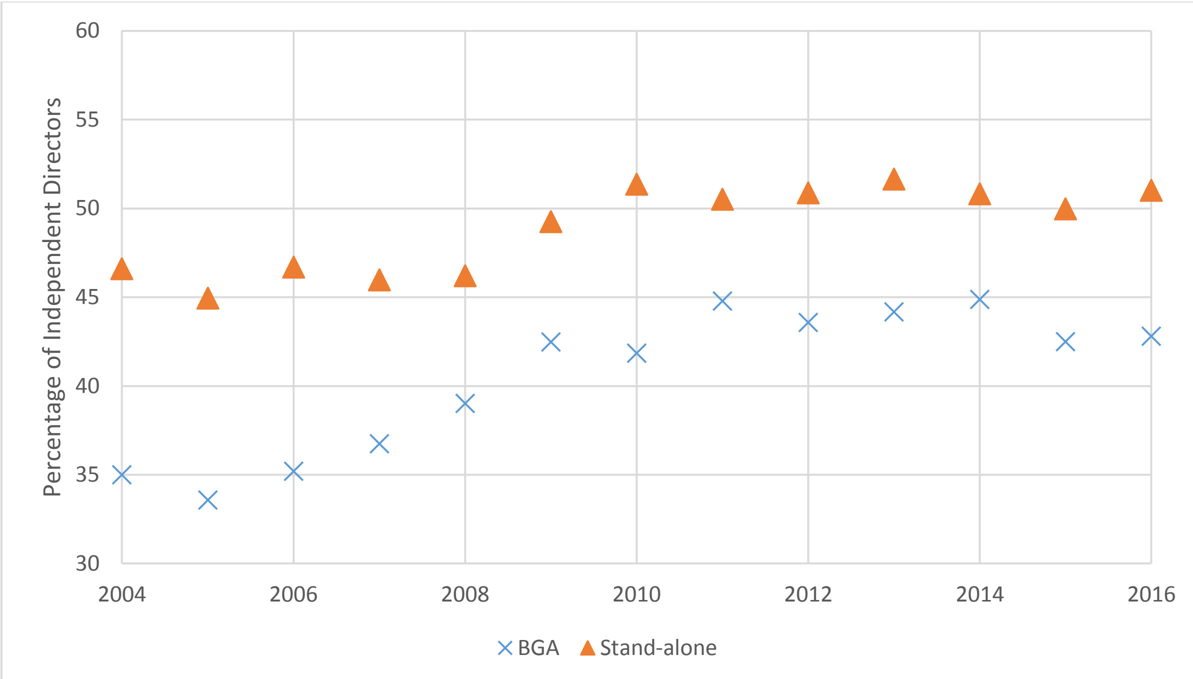

Figure 5 Percentage of independent directors in BGA and stand-alone firm.

A significant increase in presence and percentage can be seen in the 2008-2010 period, with the percentage approaching the 50% mark in the latter years, this may be attributed to the SEBI circular in April 2008 which specified that if the non-executive chairman is a promoter or related to any promoter or a person in managerial position then at-least half of the board shall consist of independent directors. A general increasing trend of presence of independent directors also suggests that companies perceive that having independent directors add value to the firm and leads favorable assessment by outside investors. (Sarkar and Sarkar, 2012). In addition, this period witnessed more than usual exits of ID post Satyam fiasco (January 2009) and hence busyness of existing directors increased (figure 6).

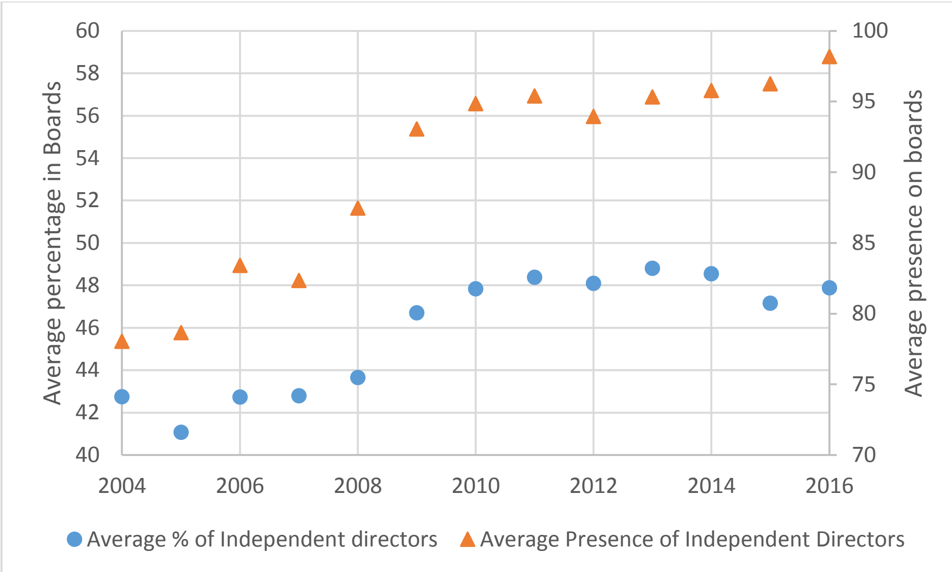

Figure 6 Average percentage and Presence of Independent Directors on boards.

Figure 7 suggest a positive relation between firm size and percentage of independent directors. One of the possible reasons could be, as firm size increases the possibilities of effective monitoring with independent directors. The increasing presence of ID as firm size increases show firm's commitment to better corporate governance practices by creating a perception of reduced expropriation of minority investors by controlling shareholders. Thus, independent directors are appointed to act as fiduciaries of the shareholders and overlook monitoring to be more attractive to outside investors.

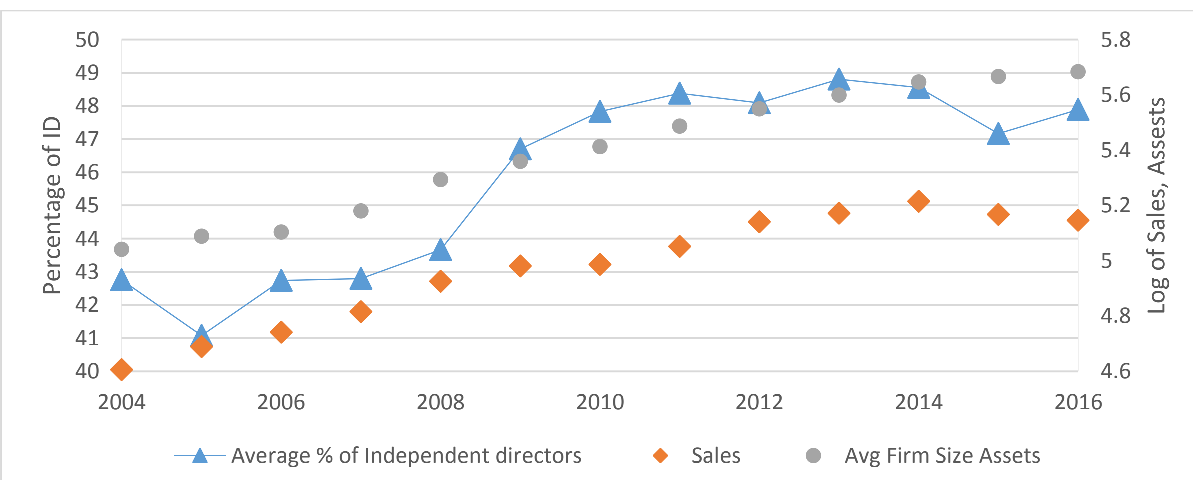

Figure 7 Average percentage of ID plotted alongside firm size

The Companies Act 2013 limited the number of directorship to not more than 15 public companies. The presence of busy directors has raised significantly during the 2008-2011 period, which could be because of the limited supply of independent directors to fulfil the required ratio after the Satyam Computer Services scandal in 2009 (Figure 8). A steady decline in percentage and presence can be observed in the years 2012-2015, which could be due to the Companies Act, 2013 that put stringent guidelines on responsibilities and accountability of Independent directors. This possibly caused independent directors to be more cautious while taking multiple directorship.

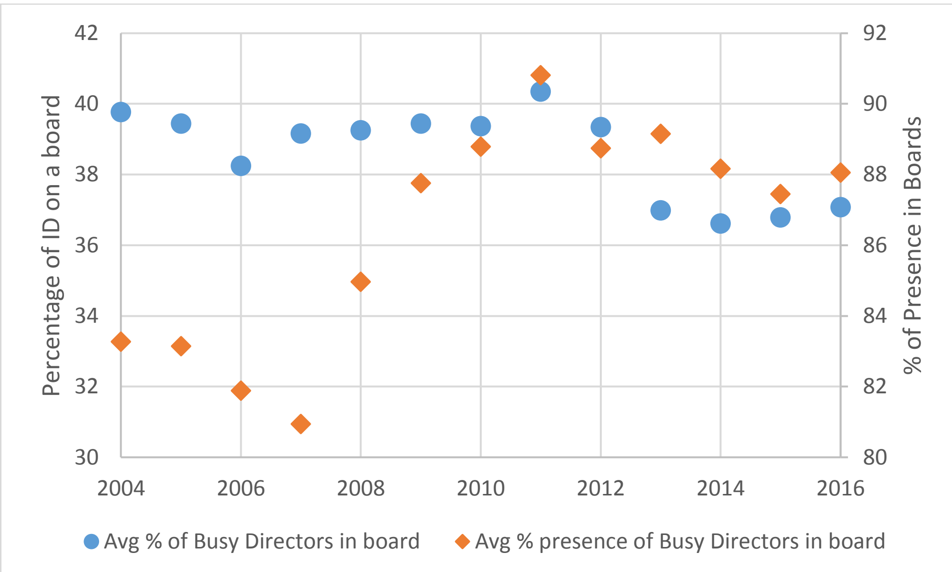

Figure 8 Average presence and percentage of busy board members

Independent director and Financial Performance

The proportion of independent directors on a board (ID) is positively associated with financial performance. In addition, the presence of independent director in is significantly affecting financial performance at 5% level. This significant effect propagates that independent director adds value and positively impacts firm performance (Rosenstein and Wyatt, 1990). This finding backs the agency theoretic claims that these independent directors more effectively monitor the insiders (management) whose interest might clash with outside shareholders (Weisbach, 1988). In addition, these independent directors effectively monitor to protect their reputational capital (Fama, 1980). Further, these independent directors, apart from providing their expertise, can open up their interlocks with other companies to exponentially enhance the needed resources, suppliers, and customers to a firm (Pfeffer, 1972).

Board Size is also negatively related to financial performance, which reiterates that larger board size reduces the monitoring function of directors leading to reduction of firm's value (Eisenberg et. al., 1998; Hossain et. al., 2001; Yermack, 1996). Larger boards impede communication and decision-making, thereby reducing the board's effectiveness of the monitoring function. CEOs’ control on these boards increases due to incremental cost (Yermack, 1996), coordination and process problems (Jensen, 1993). Inverse relationship has also been reported by Eisenberg et. al., 1998, Hermalin and Weisbach (1988), Mak and Kusnadi (2003), Alshimmiri (2004), Andres et. al.. (2005). Indian studies also found the board size to be significantly negative for all performance variables except market adjusted stock prices (Garg, 2007).

The insignificant relationship between the percentage of busy independent directors and financial performance might be explained by the poor average of percentage of busy directors. The size of the firm positively affects performance whereas leverage negatively affects performance. Book to Market Ratio also exhibits a negative significant relationship. Firm size is significantly affecting financial performance.

Challenges by independent directors

There are two broad themes, which emerged from the lived experiences of the interviewed participants. The research findings discussed here are inferred from the results of our study while attempting to understand the challenges of the Independent Directors in a board. Since the literature on the focal construct of the study is still in nascent stage, it was deemed necessary to conduct an exploratory primary study to generate such items that are believed to capture the constructs and develop the themes.

The demographic information (gender, qualification, and years of experience) was available to the researchers. The respondents were chosen from the group of the ID who are presently serving on the boards of a public or a private company. The research team gathered this data from secondary data sources (such as Prowess) and verified with the annual reports of the firm. Finally, a list of independent directors was formulated.

One of the main areas of focus of the research concerned the identification of factors, which hinders their day-to-day performance on the board. In-depth semi structured interviews were conducted by the researchers either in the office of the participants (who were located in Mumbai) or through webex (video calls, for the participants who were based out of Mumbai). It was divided broadly in two phases:

First was the "opening phase" where the participants were explained the purpose of the research. This was followed by "questioning phase.” Based on this analysis, the study aimed at identifying major constraints for effective implementation of independent directors’ guideline in the interest of each stakeholders of firm. The thematic analysis revealed the following themes (Figure 9).

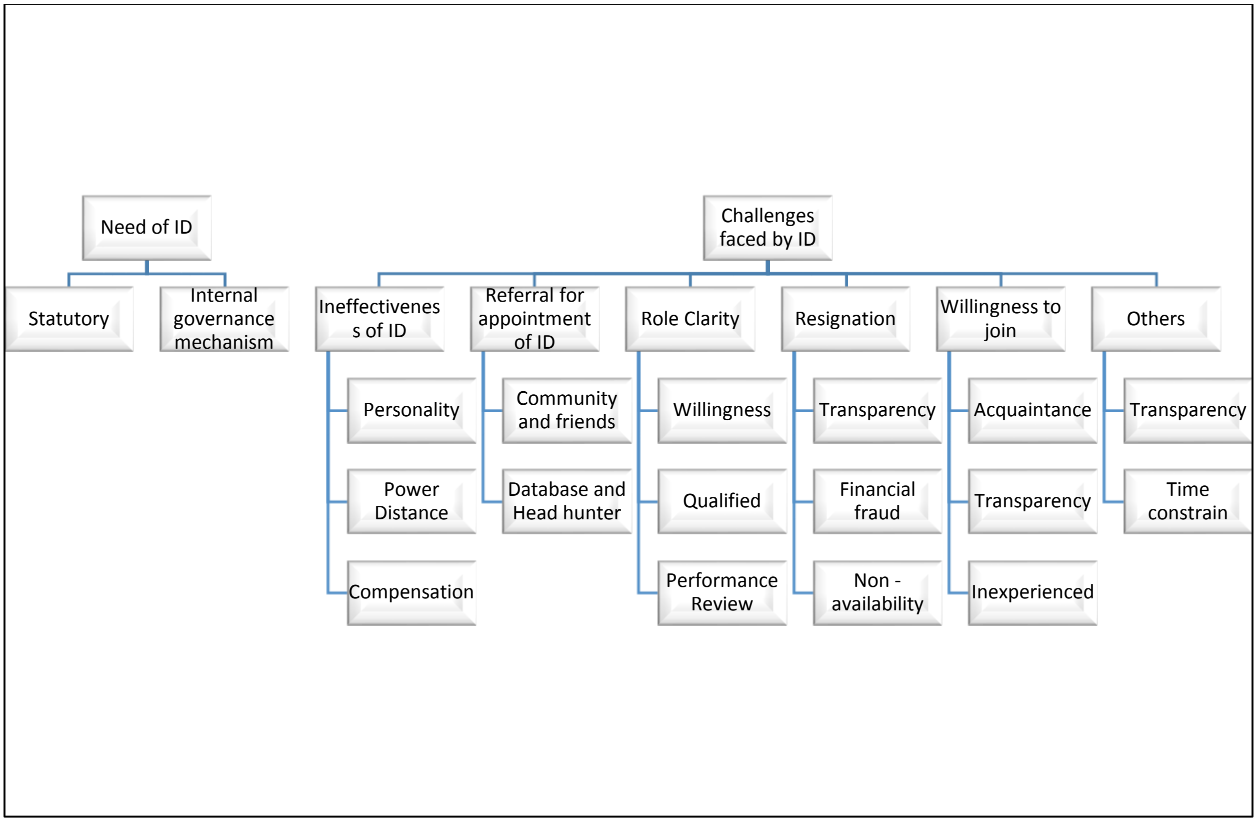

Figure 9 Themes from Interview

Conclusions

The study analysed the challenges faced by independent director and tried to validate the theoretical perspectives at individual and board level. At individual level, personality of an ID contributed towards the effectiveness of his role. The personality is shaped by director's education, experience, and skill (Becker, 1964). Our data revealed that on an average, ID's are seasoned professional with an average experience of 37 years. They held master's degree and were having expertise in either finance or law in addition to their domain industry specific expertise. Thus, human capital of ID is pertinent to their contribution at the boardrooms.

At Board level, our findings indicate that ID's presence in social gatherings within the community members gave them the opportunity to build networks. They were comfortable to join a board where they knew the promoter group. However, few ID has defied the appointment through friends or acquaintances. This suggests that an ID who is a friend of CEO could be independent in the eyes of the law, but would not be able to challenge a CEO. This is in line with the established research that in emerging economies like India, where the ownership is heavily concentrated - setting numerical targets for Independent Directors through regulations would not improve corporate governance.

In India, the controlling shareholders have a strong influence on the selection of an ID and to be an active board member and serve as an Independent Director they may have to work amicably with management Also, as suggested in Milligram's experiment the Directors enjoy a positive sense of well-being from their "reflexive obedience" to the CEO (Sarkar & Sarkar 2012). This situation might lead to having friends and acquaintances as ID who might succumb to emotional pressure at some point. Thus, our findings suggest that to be part of the elite board circle, an ID needs to have representative social networks. These social networks help them to be appointed at ID positions and later retaining that position was facilitated through ingratiating behavior.

Further, as ID's are appointed "at the pleasure of someone else" hence the sense of indebtedness and gratitude is in the minds of the ID's. Analysis of multiple directorship in Indian companies identified that there existed an inner circle with respect to Independent directors sitting on corporate boards of family owned group affiliates. About 67% of IDs in group affiliates were also located within other group affiliates (Sarkar & Sarkar 2009). IDs and CEOs are often friends and social acquaintances (Solomon 1978) and if the IDs are "invited" to join the firm by CEOs then loss of directorship in one board may result in uncertainty of continuation in other boards (Balasubramanium 2016).

Suggestions

Appointment of the Independent Director

Our study suggests that ID appointments should be strictly based on gap analysis (in terms of skills and experience) of existing board of directors of a firm. This should be followed by selecting ID through rigorous search using professional services for board level appointments. Nomination committee should discourage appointments, which might deter the rigor of this statute.

Role Clarity

The regulator should explicitly state the role, which an ID needs to bring in the boardroom. These roles should be clarified and communicated to the prospective candidate for ID positions to enhance the efficacy of this governance mechanism.

Resignations

Resignations of ID are a cause of concern and further investigation by regulatory bodies should be encouraged. This would enable regulators to take timely preventive actions for the benefit of minority shareholders.

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Abbreviations

ACRONYM	DESCRIPTION
BMR	Book-Market Ratio
BS	Board Size
BUSY	Busyness of Director
CEO	Chief Executive Officer
CG	Corporate Governance
CS	Company Secretary
FS	Firm Size
ID	Independent Director
IDP	Board Independence(Presence/Absence)
LEV	Leverage
OECD	Organization of Economic Co-operation and Development
SEBI	Securities and Exchange Board of India
UK	United Kingdom
US	United States

Abstract

Purpose: The present study endeavors to analyse the challenges independent director encounters in policing managerial conflicts of interest and in monitoring the maximization of shareholder wealth. In addition, the study ascertains the size and composition of boards and attempts to understand its relationship with financial performance.

Design/methodology/approach: The nature of the present research primarily lends itself to a qualitative research methodology including men and women directors on boards. The processes that we sought to study were unknown at the commencement of the research. Hence, important issues, themes, and variables were to be discovered through an emergent form of research. Further, we empirically examine the impact of independent director on financial performance using multivariate regression model for 500 large listed Indian firms.

Findings: The finding identifies the inherent challenges faced by independent directors and suggests the relationship between presence of independent director and financial performance in Indian firms.

Emerging policy lessons: Corporate governance reforms mandated in India like independent directors on board are considered a better monitoring function. However, this internal governance mechanism needs more focus on actual value contributing to the purpose. Busy independent directors are not fully committed to the companies where they serve. Independent directors add value whereas larger board size reduces the monitoring function of directors leading to reduction of firm's value.

Keywords: Board Independence, Corporate Governance, Independent director challenges, India

JEL Classification: G32, G34

1 Introduction

There is a growing body of theoretical and empirical literature that have made leaps by utilizing board of directors as an input variable with an output variable such as performance (Baysinger and Butler, 1985; Bhagat and Black, 2002; Anderson and Reeb, 2003; Hermalin and Weischbach, 1988; Fields and Keys, 2003; Haldar and Raithatha, 2017). These inferential leaps are distinct, but fail to provide any evidence on the processes and mechanisms, which is likely to enhance the efficacy of the input variable (i.e. board of directors) (Pettigrew, 1992). Being an established internal governance mechanism (Fama and Jensen, 1983), there is an implicit emphasis to discount the challenges faced by board of directors in their day-to-day functioning. Moreover, this lacuna becomes pronounced in case of independent directors.

The present study endeavors to analyse the challenges independent director encounters in policing managerial conflicts of interest and in monitoring the maximization of shareholder wealth. These important elements of the functioning of independent directors remain obscure and unexamined. In addition, the study endeavored to understand "independence" which is a malleable concept with varied conceptions. This variation depends on facets considered important in influencing a director's decision-making and their perceived role in a country's corporate governance tapestry. Thus, being a critical centerpiece in the corporate governance discussion (Khanna and Varottil, 2016), it depends on the context.

India, with its unique institutional setting provides an ideal laboratory for examining this pertinent issue for a variety of reasons. The nature of governance problem is largely dependent on the ownership and control structure of the corporation (Sarkar, 2009). India's Bombay Stock Exchange is endowed with the largest number of listed companies in the world ("http://www.bseindia.com/static/about/introduction," 2017) The ownership in these listed companies remains concentrated in families, highlighting the prevalence of an insider dominated structure (Sarkar and Sarkar, 2000). As on March 31, 2016, 45% of the listed companies in India have promoter shareholding (henceforth PSH) above 50%. This concentration is deeply embedded to the core with 6 companies having 100% shareholding and 4% companies with supermajority promoter shareholding (PSH > =75%) (Prowess, 2017). Thus, understanding this concept with a lens devoid of its original setting (i.e. Anglo-American scholarship) might be a useful exercise for emerging market context.

There is a growing emphasis on increasing the number of independent directors on the corporate boards as a response to the regulations adopted at varied times. This excessive reliance brought about super majority boards where 90% in UK public companies (Heidrick and Struggles, 2009) and 85% in US public companies (Velikonja, 2013) comprised of independent directors. This short-term phenomenon brings governance benefit, but fails to address the challenges faced by them. Addressing these pertinent lacunae could enhance the efficacy of the mechanism without enhancing their numbers.

1.1 Research Objectives

- To study the size and composition of independent directors in both private and public sectors.
- To analyze the role of independent directors along with relationship with other functional directors in firm's policy decisions to ensure growth and shareholders' value for the firm.
- To identify major constraints for effective implementations of independent directors' guideline in the interest of each stakeholders of firm

1.2 Contribution

Majority work on independent director has been concentrated in the western world (Nowak and Mc Cabe, 2003; Clarke, 2007; Luan and Tang, 2007). However, this study contributes to the literature in an emerging market context. Firstly, the findings from this study will extend the literature by identifying major challenges for effective implementation of independent directors' guideline through a qualitative lens. In addition, this lens helped us in having a first-hand experience of the respondents through semi-structured interviews. The semi structured interviews gave the respondents a scope to share their personal thoughts, feelings, and opinions without being interrupted or been influenced by factors like those of any findings of previous research or any legal obligation by the companies. Thus, our study is an attempt to respond to the call for papers for qualitative researchers on corporate governance by contributing to the little evidence (less than 1%) on the same (McNulty et al., 2013).

Secondly, our study responds to the seminal piece by Pettigrew (1992) and engages directly with the actors in their natural settings. Our enquiry helps to open up the black box of boardroom and sheds light on the challenges faced by independent directors at individual, board and firm level. The study also adds to the limited evidence on the challenges faced by independent directors and has policy implications for policy makers and managers.

Thirdly, our study provides a basis for rethinking and challenging some of the dominant assumptions and meanings associated with the role of independent directors. Research to date on corporate governance has mainly dealt with the efficacy of various mechanisms that can protect shareholders from self-interested executives, and the focus has generally been on developed economies (Daily et al., 2003). Our study provides evidence on the relationship between the role of independent directors and its effectiveness on shareholder's value (measured by financial performance) of the firm in the context of an emerging economy. Prior literature has extensively explored this relationship in developed and developing economies, but little is known about transition or emerging economies characterised by concentrated ownership, business group affiliation (Khanna and Rivkin (2001), pyramiding, and tunneling (Chittoor et.al., 2015). Emerging economies such as China and India, which covers majority of the world's population, however, provide unique opportunities and challenges for governance practices and research (Davis, 2005). Internal mechanism such as independent are critical to the improvement of corporate governance, yet only few studies have been undertaken in emerging economies (Cai et al., 2015 Kakabadse et al., 2010).

2 Literature Review

Governance can be defined as the determination of the broad uses to which resources in an firm can be deployed and the resolution of conflicts among the multitude of participants in the firms (Daily et al., 2003). Corporate governance mechanisms have been devised to facilitate the control of management and groups of power within corporations, thereby facilitating the achievement of firm value (Cuervo, 2002). Traditional literature has indicated that these mechanisms help resolve problems in corporate governance (Fama, 1980; Fama and Jensen, 1983; Turnbull, 1997).These mechanisms may be internal or external to the firm. The internal mechanisms are managerial compensation, the board of directors, control by large incumbent shareholders (Jensen, 1986), compensation contracts that encourage shareholder orientation, and concentrated ownership holdings that lead to active monitoring of executives (Dalton et al., 2003). External mechanisms include market for corporate control, the market for managers, and the market for products and services (Cuervo, 2002; Dalton et al., 2003).

However, the use of these mechanisms depends on the corporate governance system prevalent in the country, that is, whether the governance system is market-oriented or large-shareholder oriented (Franks and Mayer, 1997; Shleifer and Vishny, 1997). Amongst internal mechanism, board is recognized as important and helps in aligning the interests of managers and shareholders (Fama and Jensen, 1983). They are at the apex of the firm and have been the centre of corporate and political debate due to the continuing corporate debacles (Adams et al., 2010).

2.1 Independent director – origin

The Anglo-Saxon countries (namely United Kingdom and the United States) are credited with the creation of the concept of independent director and exporting it around the world (Baum, 2016). The managerialist model of corporate governance dominated the first half of the twentieth century in US (Mizruchi, 2004). Here, corporate boards were dominated by inside directors who were chosen and controlled by the CEO (Douglas, 1934). The concept of independent director originated in 1970 leading to the monitoring board model. This dramatic change was sparked by two defining moments. First, the collapse of the major railway company Penn Central in 1970; and second, M.A. Eisenberg's influential book 'The Structure of the Corporation', published in 1976.

This book defined the board's essential function as monitoring the senior management, which included selection, monitoring, and dismissing the members of the chief executive's office, by being independent from it (Eisenberg, 1976). This dependence on independent directors as a remedy for various corporate governance evils reached its peak in the US (Baum, 2016).

Similar to US, a typical board in UK was an advisory board predominantly held by insiders in 1950. The publication of the Cadbury report in 1990 paved the way for the British corporate governance movement. This report brought about the concept of independent directors for listed firms in UK (Aguilera et al., 2006). Independent directors have dominated on the boards of listed companies since early 2000. The concept of the independent director started permeating from UK towards the European Union as a vital corporate governance code. With the formulation of the European Model Company Act of 2015 and, the OECD Principles of Corporate Governance of

2015 on the supra-national level, independent board members started to be assigned important tasks (Baum, 2016). However, the empirical support for staffing boards with independent directors, remains surprisingly doubtful given the universal reliance on independent directors. The global financial crisis of 2008 made it even more uncertain (Baum, 2016). Appendices A3 to A6 highlights this journey.

2.2 Indian scenario

Securities and Exchange Board of India (SEBI) was formed in 1992 to improve the corporate governance in India. This was followed by the formation of four major committees (Bajaj Committee in 1996, Kumar Mangalam Birla Committee in 2000, Naresh Chandra Committee in 2002, and the Narayanan Murthy Committee in 2003) to review governance issues and propose governance laws and reforms. These laws and reforms were formally implemented by the SEBI through the enactment of Clause 49 of the Listing Agreement. These reforms include issues such as increasing the number of outside directors, dealing with the issue of duality, and the existence of financial experts on board rooms. There has also been change to Clause 49 of the Listing Agreement in 2005 (effective from January 1, 2006) specifying a minimum number of outside directors on the board (SEBI, 2000, 2004).

The Companies Act 2013 was introduced and effected from 1 April 2014. This act made efforts to incorporate some of the salient requirements mandated by the SEBI in Clause 49 of the listing agreement. Requirement such as mandatory appointment of independent directors, minimum number of independent directors, database for appointment of independent directors, tenure, and cooling off period between re appointment, code for independent directors, and liability of independent directors were the key amendments.

The Securities and Exchange Board of India issued SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 on September 2, 2015. This was introduced to consolidate and streamline the provisions of the existing listing agreement for varied segments of capital markets; thus, enabling better enforceability. Thus, listed entities need to submit quarterly compliance report on corporate governance to the recognised stock exchanges as per regulation 27(2) SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015. Provisions under the Clause 49 of the erstwhile listing agreement have been brought under Regulations 17 to 27.

Presently Indian listed companies are required to comply with the Corporate Governance requirements as specified in the Companies Act, 2013 and SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015. It is anticipated that these changes to the composition and operation of boards of directors might strengthen the institution of independent directors. Recently, the Ministry of Corporate Affairs amended provisions related to independent directors about appointment and qualification of directors (Companies Amendment Rules, 2017) and code for independent directors (Amendment to Schedule IV, Companies Act 2013).Thus, there has been a continuous process to strengthen the institution of independent directors in Indian firms.

2.3 Size and composition of board of directors

Board size and composition are not random or independent factors, but are, rather, rational organizational responses to the conditions of the external environment (Pfeffer, 1972).

2.3.1 Board size

Empirical research on the importance of board size is thin (Yermack, 1996) and is related to the size of an firm. Typically, large firms are more diversified and have greater impact on society and the economy owing to their size. This necessitates the need to have more members who can validate the firm with its external environment (Pfeffer, 1972). Van den Berghe and Levrau (2004) argues that by increasing the number of directors, the pool of expertise available to the firm increases. Boards need to be large enough to accommodate the necessary skill sets and competencies, but still be small enough to promote cohesion, flexibility, and effective participation (Raheja, 2005).

Further larger boards reduce the domination by the CEO (Goodstein et al., 1994; Forbes and Milliken, 1999). This finding was affirmed in emerging context too and large boards emerged as a deep reservoir of intellectual knowledge than smaller boards. This in turn improved decision-making and consequently firm performance, thereby supporting the resource dependency theory (see for example, Kathuria and Dash, 1999; Jackling and Johl, 2009). Larger board size provides, potentially, more monitoring resources, which may enhance firm performance (Alexander et al., 1993; Goodstein et al., 1994; Pfeffer, 1972, 1973; Pfeffer and Salancik, 1978; Mintzberg, 1983).

Alternatively, proponents of a smaller board, argue that larger boards reduce the effectiveness of monitoring as the size impedes communication, and decision-making. They emphasize size as a hindrance to effectiveness owing to coordination and process problems. In addition, they claim that drawbacks outweigh the advantages of large board on low effectiveness (Jensen, 1993). Further, Jensen argued that when boards grow beyond seven or eight members, they are less likely to function effectively and it becomes easier for the CEO to control. Researchers (such as Lipton and Lorsch, 1992; Cadbury, 1992) have also suggested to limit the number of directors to ten people, with an ideal size of eight or nine members - with an equal number of executive and non-executive directors.

Yermack (1996) points out that a clear problem in studying board size is that the number of directors might arise endogenously as a function of other variables, such as firm size, performance, or the CEO's preferences. On the similar note, Byrd and Hickman (1992) managerial quality hypothesis argues that high-calibre CEOs may 'dress up their firm's boards with independent directors' to please share-holders with an illusion of active monitoring; a similar argument could be made about the willingness of good CEOs to surround themselves with small boards. Because many intangible forces of this type might influence board size, we cannot accept at face value an association between board size and firm value without considering alternative explanation

In India, the large number of family-owned companies coupled with inadequacy of qualified directors, has meant that the role of outside directors is lessened (Balasubramanian, 2016). It is assumed that larger the number of members of the board of directors, greater is the potential resource capabilities available, given the unique characteristics of Indian companies (Balasubramanian, 2016). However, Jackling and Johl (2009) observes that the large proportion of family owned firms in India has meant that the role of outside directors may be minimized as family firms tend to restrict executive management positions to family members, thus limiting the pool of potential qualified and talented labour resources.

2.3.2 Board composition

Board composition has received subsidiary research attention. The composition of a firm's board is typically a proxy for the extent to which the board is independent of the firm's CEO (e.g. Seward and Walsh, 1996; Dalton et al., 1998; Dalton et al., 1999). Numerous measures of board composition can be found in relevant research (for example, the proportion of inside directors, outside directors, affiliated directors, or interdependent directors) (Dalton et al., 1999). These measures are all designed to capture some aspect of board independence.

An important aspect of board independence concerns set forth in agency theory is the composition of the board of directors (e.g., Eisenberg, 1976; Jensen and Meckling, 1976; Fama, 1980; Fama and Jensen, 1983; Dey, 2008). Economists give emphasis to the collective nature of the board and recognize that there should be an unspecified mix of insiders and outsiders in an optimally constituted board (Fama and Jensen, 1983). The presence of outsiders facilitates the board's validation of management's strategies. They monitor performance and progress towards implementing those strategies (Fama, 1980; Fama and Jensen, 1983; Williamson, 1984). They also aid in preventing collusion (among top managers on the board) and thereby increase the effectiveness of the internal managerial labor market (Fama 1980).

Therefore, both legal and economic perspectives lay the emphasis on corporate governance by a board. Board is viewed as a governing body where the identity of its constituent members and their relative proportions are potentially important. The board should have a mix of insiders and outsiders, as a component of the firm’s governance structure (Baysinger and Butler, 1985). There is near unanimity in the theoretical literature that effective boards will be comprised of greater proportions of outside directors (Mizruchi, 1983; Lorsch and MacIver, 1989; Zahra and Pearce, 1989). The corporate community also holds candid views on this issue. It is not unusual to find advocates for boards, which are comprised exclusively of outside directors among practitioners, especially institutional investors and shareholder activists (Dalton et. al., 1998). Most corporate governance codes, lays down boards of listed companies to have an optimum mix of inside and outside directors. Since the boards of directors are used to control managerial activities, they should be independent of the firm’s executive management. The number of outside directors should be large and CEO should not act as a chairperson of the board.

A preference for outsider-dominated boards is largely supported by the agency theory. Agency theorists perceive managers to be at an advantage over firm owners, who are largely removed from the operational aspects of the firm, by virtue of their firm-specific knowledge and managerial expertise (Dalton et. al, 1998). The prospective for this conflict of interest necessitate mechanisms for monitoring designed to protect shareholders as owners of the firm. In other words, have a board comprising of outside directors is ideal (e.g., Fama and Jensen, 1983; Jensen and Meckling, 1976).

When situation demands a shift in strategy, outside guidance is required. In other words, outsiders were more likely to be inducted after poor performance of the firm is recorded or the firm exits from an industry (Hermalin and Weisbach, 1988). Weisbach (1988) also observed that when the proportion of outside directors is high, the board is more likely to replace the firm's CEO after a period of poor firm performance.

Garg (2007) found that when the proportion of outside directors was between 50%-60%, there was a strong association between the impact of board independence on firm performance. Analysing this association, Jackling and Johl (2009) found that in the Indian market, the requirements of Clause 49 of the Listing Agreements for a specified representation of outside directors on boards might be an important aspect of corporate governance.

Larger boards have directors from diverse background possessing different skill sets thereby favouring the resource dependency theory (Jackling and Johl, 2009). The knowledge and intellect of these directors can be used for effective decision-making and strategic planning in the organisation. Coles et al., (2012) find that firms that require more advice derive greater value from the larger boards. Pearce and Zahra (1992) recommended that a larger board improves a firm's ability to comprehend and respond to varied stakeholders and are tougher to manipulate as compared to smaller boards.

In India, under Clause 49 of the Listing Agreements the board of directors of a firm is required to have an "optimum combination" of inside and outside directors with not less than 50 per cent of boards consisting of outside directors where the chairman is an insider. The requirement for outside directors on the board is reduced to 30 per cent where the chairperson is an outsider (Sarkar, 2009). It is important to strike an optimal balance between inside and outside directors, while having more independent directors on board that can be beneficial for shareholder interests. (Sarkar, 2009)

An alternative standpoint would suggest a dependence on a multitude of inside directors. That is the stewardship theory, which argues that managers are inherently trustworthy and not prone to misuse corporate resources (Donaldson and Davis, 1991, 1994). As suggested by Donaldson and Davis (1994) 'stewardship theory argues that managers are good overseers of the corporation and work efficiently to attain high levels of corporate profit and shareholder returns.'

2.4 Independent director and financial performance

There is an extensive body of multidisciplinary research and explanations addressing the issue of board composition and firm financial performance, thereby providing an astonishingly inclusive literature (e.g., Walsh and Seward, 1990; Dalton et al., 1998; Bhagat et al., 2008; Dalton et al., 2008; DeRue et al., 2009). Board composition is measured in numerous ways in the literature (Dalton et al., 1999). Similarly, there are multiple proxies of financial performance (such as return on assets, return on equity, return on investment, Tobin's Q, return on sales, shareholder returns, earnings per share, abnormal returns, Jensen's Alpha, market-to-book ratio, price-to-earnings ratio, and profit margin) (e.g. Dalton et al., 1998; DeRue, et al., 2009)

The financial performance of firms is pertinent to stakeholders in general and shareholders in particular for two reasons. Firstly, it serves as a basis for financing the current economic activities to increase the value of the business, and secondly it serves as the basis for distributing dividends, which in turn may attract investors (and their funds). Identifying and analyzing the factors that influence financial performance of entities is relevant to theory and practice (Müller, 2014).

In spite of the enormous work in the area, there is no evidence of systematic relationships between the two parameters based on these data (see Walsh and Seward, 1990, for an earlier assessment; Fogel and Grier, 2007; Bhagat et al., 2008; Dalton et al., 2008). In addition, there is an inconclusive and intangible evidence on the relationship between presence of independent director and financial performance. Even empirical evidence on the relation between the two is inconsistent and even controversial. There could be essentially three reasons for this. The first reason could be the absence of a statistical relationship between board independence and firm performance, which is purely an econometric reason. This could be because boards are endogenously selected to have an optimal mix of different types of directors (Dahya and McConnell, 2005). The second reason could be that director independence howsoever defined is a myth (Sarkar, 2009). Morck (2004) argues that in the absence of complementary institutional mechanisms, "genuine" independence of directors from management may prove to be elusive. A third reason according to MacAvoy and Millstein (1999) is that in studying the relationship between measures of board independence and firm performance researchers have used “old” data—that is, data that preceded boards taking an activist role.

An important issue to consider when evaluating these studies is the endogeneity of board composition. Hermalin and Weisbach (1998) suggest that poor performance leads to increase in board independence. In a cross-section, this effect is likely to make firms with independent directors look worse, because this effect leads to directors that are more independent on firms with historically poor performance. Both Hermalin and Weisbach (1991) and Bhagat and Black (2002) have attempted to resolve this effect by using simultaneous-equation methods. However, this is moderated by the finding that institutional investors are willing to pay a premium to own shares in a firm that demonstrates good corporate governance practices including having a majority of outside directors on its board who have no ties with management (Petra, 2005).

2.4.1 Positive relationship

In their empirical literature, Vance (1964) and Pfeffer (1972) examined the impact of the outsider orientation of corporate boards on firm value and found a positive association between outside board members and corporate performance. Following Vance and Pfeffer’s work, a stream of empirical research had confirmed this finding. In an examination of 266 U.S. corporations, Baysinger and Butler (1985) provide evidence that an increase in independent directors on firms’ boards improve corporate performance. Although the effect is mild and lagged, there is a higher relative financial performance. Rosenstein and Wyatt (1990) in a similar note indicated that the clearly identifiable announcements of appointing independent directors are associated with increase in shareholder wealth. This is by reporting significant positive excess returns accompanying the announcements of the appointment of additional independent directors on firms' boards, even if the numbers of independent directors were dominant before the announcements. In a related study, Hermalin and Weisbach (1988) find that poor performance leads to changes in board composition and a poorly performing firm is more likely to invite independent directors to join its board, although perhaps with a time lag.

Daily and Dalton (1992) are of the view that the board of directors specifically the outside directors provides a sensible tool in terms of expertise and resources when striving for the growth of the firm. Ezzamel and Watson (1993), in a study of UK companies, found a positive relationship between outsider, independent directors, and profit growth (after controlling for categorisation of the management firm). A number of other empirical studies have also reported a positive relationship between independent directors and firm performance (Schellenger et al., 1989; Rosenstein and Wyatt, 1997). Millstein and MacAvoy (1998) in their data analysis from 1991-1995 demonstrated that there have been significant increases in "economic profit" where a professional board was present. Although the results do not prove causation, corporations with active and independent boards appeared to have performed much better in the 1990s than those with passive non-independent boards.

Wagner et al., (1998) conduct a meta-analysis of 63 empirical studies on the correlation between board composition and firm performance. The result of their work indicates that the greater presence of independent directors is associated with higher firm performance. Subsequent research supports their result (Lee et al., 1999; Ferris et al., 2003; Hillman, 2005; Masulis et al., 2012).

2.4.2 Negative relationship

Contrary to the above empirical findings, another branch of empirical research has established that there is a negative relationship between independent directors and firm performance. Scholars have indicated that this negative relationship may be the result of a strong institutional environment (e.g., effective court system, active public and private enforcement, and large stock markets) where the value of board independence may be hard to separate from these other institutional elements or where the added value of board independence is difficult to ascertain (Bhagat and Black, 2002).

Zahra and Stanton (1988) conducted an examination on 100 randomly selected companies from the Fortune 500 list and observed that the ratio of independent directors has a significant negative effect on the firm's financial performance. In a test on the managerial monitoring hypothesis, Fosberg (1989) investigated the impact of various proportions of independent directors on the level of management performance. By using an extensive accounting means to measure firm performance, he provided the evidence that the relationship between the proportion of independent directors and firm performance is negative in general. Using panel data of 142 NYSE firms to control for the possible bias due to the joint endogeneity of variables, Hermalin and Weisbach (1991) found that the different proportions of independent directors on the board makes no noticeable difference. They have a negative effect on the firm's profitability measured by Tobin's Q. Consistent with this finding; Agrawal and Knoeber (1996) report a consistently negative and significant correlation between the proportion of independent directors and Tobin's Q, suggesting that firms having directors that are more independent rarely adds to firm value. The same is true of Yermack (1996), whose empirical work on the association between the fraction of independent directors and firm performance corresponds with the same finding. There is influential empirical research by Bhagat and Black (2002), who conducted the first large sample, long-horizon study of whether the proportion of independent directors affects firm performance. Using a wide variety of market and accounting measures, they find that there is a strikingly significant negative relation between the proportion of independent directors and firm performance measured by a large variety of accounting measures. In their follow-up studies, this finding has been confirmed again (Bhagat and Black 2002). The finding is also in alignment with a stream of other empirical works (Zahra and Stanton, 1988; Kaufman and Taylor, 1993; Daily and Dalton, 1993; Beatty and Zajac, 1994; Klein, 1998; Anderson et al., 2000; Beiner et al., 2004; Boone et al., 2007; Bhagat and Bolton, 2008).

2.4.3 No relationship

Numerous studies have reported insignificant relationships between accounting performance measures and the fraction of outside directors on the board examining contemporaneous correlations (MacAvoy et al., 1983; Hermalin and Weisbach, 1991; Mehran, 1995; Klein, 1998; Bhagat and Black, 2002). Notably, the empirical literature also includes the evidence that no association exists between independent directors and firm performance. Baysinger and Butler (1985), who find that there is no relationship between the proportion of independent directors on the board and the firm’s profitability in the same year in 1970, perhaps provide the earliest evidence. Although there is a slight, lag effect on the positive relationship between the proportion of independent directors on the board in 1970s and firm performance in 1980s. Rechner and Dalton (1986) document this no-relationship finding in their examination when board composition is measured by the percentage of independent directors on the board and its association with shareholder wealth. Chagati et al., (1985) and Dalton et al., (1998) provide support for the no-relationship proposition. Bhagat and Black (2002) found that firms suffering from low profitability respond by increasing the independence of their board of directors, but no evidence that this strategy works for firms with boards that are more independent. Their results do not support the conventional wisdom that greater board independence improves firm performance.

Some researchers also find similar controversial evidence. In a recent empirical work, Duchin et al., (2010) observe an interesting finding. In addressing the exogenous regulation changes in board composition that are presumably explainable for firm performance changes over the period 2000-2005 while controlling the endogeneity issue at the same time, they find that the relationship between independent directors and firm performance is conditional on information cost. Independent directors significantly improve firm performance, measured not only by accounting measures such as return on assets (ROA) and Tobin’s Q but also by market measure such as stock return, when information cost is low but hurt firm performance significantly when information cost is high, using the same performance measures. They provide an explanation for these dichotomy phenomena - “the positive and negative effects cancel out on average” and claim “the unconditional effect of outsiders, which in our sample is close to zero.” Fogel and Geier (2007) provide a direct and concise summary of this body of work, stating that there is no base, either in logic or in experience, to suggest that a majority of independent directors on a board will guarantee better financial returns for shareholders. Bhagat et al., (2008) thereby candidly concludes that there is no relation between director independence and performance, whether measured by accounting or stock return measures (see also Coles et al., 2012; Bebchuk et al., 2009). Some studies have found zero or near-zero effects (Schmidt, 1975; Kesner et al., 1986; Zahra and Stanton, 1988; Daily and Dalton, 1992, 1993; Buchholz and Ribbens, 1994). This overview demonstrates that there is little consistency in the research findings for board composition and financial performance.

2.4.4 Emerging markets

The effect of independent boards on firm value in developed and emerging economies offer contrasting results though they seem to do better with respect to discrete tasks and other performance measures like earnings management and earnings quality. According to Jensen and Meckling (1979), poor corporate governance and weak financial control leave managers and controlling owners with considerable discretion to manipulate reported benefits from outsiders. Board and audit committee activity and their members' financial sophistication may be important factors in constraining the propensity of managers to engage in earnings management (Xie et al., 2003). When a firm is not portraying its actual financial information by manipulating its earnings, to match a pre-determined target, its long-run performance is affected because the decision made is inaccurate and could harm the firm's performance in future (Busirin et al., 2015). The findings of Siagian and Tresnaningsih (2011), explains the importance of having independent directors and an independent audit committee in order to improve earnings quality.

Ramdani and Witteloostuijn, (2010) in their study on *the effect of board independence and CEO duality* on firm performance for a sample of stock-listed enterprises from Indonesia, Malaysia, South Korea and Thailand, found a positive relationship between CEO duality and firm performance. Whereas in India, Saibaba (2013) suggest that aspects like board independence and CEO duality do not have a significant impact on firm valuations. In addition, independent directors' tenure negatively moderates the relationship between related party transactions and firm value. However, controlling shareholders' ownership positively moderates this moderating effect in Malaysian firms (Liew et al., 2015).

We find that director independence is becoming more apparent internationally, in spite of the fact that the questions surrounding director independence and firm performance remain vague.

Studies conducted in corporate governance structures in organisations around the world in more recent years, shows increasing adoption of the practice of maintaining a minimum number of outside directors on firm boards. Compared with international studies, empirical research on the association between independent directors and firm performance in China seems to be abundant in scope but not plentiful in depth.

Peng (2004) did a study for a sample of listed Chinese firms that provides evidence of a positive effect of independent directors on firm performance when performance was measured in terms of sales growth, but found no effect if performance measured as return on equity. Lai and Tam (2007) conclude from their research that, in China, there is a negative relationship between the change in cash flows and accruals. This resulted in less-severe practice of income levelling when independent directors are included on the board. In the context of Ghana corporate governance structures, Abor and Adjasi (2007) conclude that the presence of external independent directors on boards enhances corporate competitiveness (Haldar et al., 2016) and provides new strategic outlooks. Choi et al. (2007) report that in Korea presence of independent directors has a positive effect on firm performance. This is in strong divergence to research in the US where the conclusions are inconclusive. Alternatively, Cho and Kim (2007) suggest that as independent directors were only introduced in Korea in 1999, their influence has been less than significant and it is too early to assess their impact on corporate management. Abdullah (2006) concludes from research into financially distressed and non-distressed companies, that in Malaysia, that board independence is not associated with a financially distressed position. These findings are conceivably determined within the context of differing jurisdictive and economic frameworks and rather than resolving the question of independent directorships have added to the dispute.

2.4.5 Indian scenario

With respect to the role of outside directors on firm performance, a study of 127 listed manufacturing companies in India for the year 2003 (Ghosh 2006) finds no statistically significant effect. In similar vein, Sarkar et al. (2008) do not find any effect of board independence on opportunistic earnings management for a sample of 500 large companies for the years 2003 and 2004. Instead, the relationship between board independence and firm performance is examined in empirical studies by impact of different approaches of independent directors, such as number, proportion, characteristic, and background. This is because there exist many issues such as lack of information of independent directors, weak independence, low enthusiasm, and shortage of talents in the exercise of the independent director system in India (Rajagopalan and Zhang, 2008). Subramanian and Chakrabarti (2012) suggest that the quantity and quality of independent directors on corporate boards is adversely affected by an increase in the perceived risk of personal liability faced by IDs, which in turn increases the cost of ID services on one hand and improves ID monitoring on the other hand. Studies showed that in India which has dominance of family controlled corporations where family members hold managerial positions for controlling the firm, having board independence did not guarantee improvement in firm performance due to poor monitoring function by independent directors (Garg, 2007). Greater number of independent directors on board will result in improved firm performance (Padmini and Vasanthi, 2011) while powerful executive directors with dual roles, promoter executive or executive being only the board manager would not have a unfavorable effect on performance (John and Jackling, 2009).

Sarkar and Sarkar (2009) established that independent directors engaging in multiple directorship or serving on multiple boards is positively related to the firm performance. While the costs associated with multiple directorships seem to be obvious, the existing theoretical literature also highlights potential benefits from such directorships. For one, given the presence of a well-functioning market for outside directors, the number of multiple directorships can signal a director’s reputational capital so that a director with multiple directorships may proxy for high director quality (Fama, 1980; Fama and Jensen, 1983). Thus, having directors on board with multiple directorships can lead to better monitoring and thereby positively impact firm performance. Second, from a resource dependency perspective it is argued that directors with multiple appointments, by virtue of being more networked, can generate benefits by helping to bring in the needed resources, suppliers, and customers to a firm (Pfeffer, 1972; Booth and Deli, 1996).

An alternate view provided by Jackling and Johl (2009) suggest that outside directors with multiple appointments appeared to have a negative effect on performance (Haldar et al., 2013). This is because large number of appointments can make directors over-committed and consequently compromise their ability to monitor firm management effectively on behalf of shareholders and adversely affect firm value (Fich and Shivdasani, 2004).

2.5 Challenges of independent directors

Examining the details, the structural constraints operate with reference to two specific instances. One relates to the process of appointment of independent directors. The other relates to the role, which the independent directors are expected to play and the constituency to whom they owe their allegiance.

Independent Directors are the trustees of good corporate governance as they bring accountability and credibility to the board process. However, mere presence of independent directors on a firm's board is not enough. We have significant evidence of worldwide corporate collapses and dismal board performance even with adequate number of experienced independent directors. It is therefore the value that IDs add to the board process and not their mere presence on the board, which will ensure effective corporate governance. The failures of corporate boards show that outside independent directors need to work in right direction to protect shareholders' interests.

Despite the presence of many independent directors in Enron, World Com, and Satyam’s boards, their presence could not avert the major corporate disasters. The challenges of independent directors are many folds and growing day by day. Independent directors are expected to bring an independent judgment to endure on the board’s discussions especially on the issue of strategy, performance, risk management; resources, key appointments, and standards of conduct and bring an unbiased view in the evaluation of the board performance. The public outrage in many corporate failures suggests that there is a huge expectation gap. This gap exists between what independent directors can do and what stakeholders expect them to do. (Bath et al., 2016)

2.5.1 Professionalism

An independent director without the right attitude to think and act independently will not be an effective independent director. Any director will need to have the ability and willingness to ask the hard questions, to be critical, and to be as objective as possible in order to contribute to an objective decision-making process and heedful monitoring (Berghe and Baelden, 2005). By offering a vigorous review of suspicious transactions, an independent board consisting of a majority of independent directors will be able to prevent self-interested activities that may harm the interests of shareholders. Independent directors who ask pointed questions can induce management to consider matters which their staff members. Hard issues are often filtered as they make their way up the line towards decision makers. During the information-filtering process, facts may be distorted, resulting in inaccurate information reaching the decision-makers. Therefore, an independent director must be willing to challenge managerial proposals and ask the critical questions that nobody else is asking (Chou, 2013).The independent board’s role of being a devil’s advocate can be challenging. In the words of Drucker “if everyone agrees with a decision without challenge, it probably is the wrong decision”.

2.5.2 Inclination in favor of management

There is an inherent prejudice that results from the composition and character of the board of directors, which may be defined as structural bias. Some directors who are categorized as independent are not truly independent of management, because they are obligated to the firm or its current CEO. This is contradictory to the traditional definitions of “independence.” For example, some nominee independent directors may serve as paid advisors or consultants to a firm, or maybe employed by a university or a foundation that receives financial support from the firm (Bhagat and Black, 2002). Additionally, independent directors and CEOs are often friends and social acquaintances (Solomon, 1978). It is generally seen that since CEO plays a critical role in the nomination process, therefore CEOs will rarely choose directors who will oppose them. Independent directors are still beholden to the firm’s CEO and directors seem paralyzed in the presence of powerful CEOs (Morck, 2004)

The challenge therefore is that since controlling shareholders in India have a strong influence on the selection of IDs, how can they monitor the controlling shareholders? If they do something, which is to the dislike of the controlling shareholders, how can they sustain themselves in the board?

Independent directors may be unbiased in some transactions where there is absence of direct personal conflicts of interest, but their decisions might help other interested directors. They may also do so in order to maintain their positions on the board (McDonnell and King, 2011). Literature also suggests that independent directors who can deliver nonconformist opinions regarding certain suspect transactions may be excessively influenced by the leader of the group. Therefore, removing the CEO as a member of the board means that an independent board is more likely to engage in candid discord and disagreement (Barclifft, 2011).

Independent directors have to face significant personal costs, both financial and psychological in order to serve an active, independent role in the boardroom. Therefore, independent directors may “have an incentive to work closely and amicably with management and little incentive to challenge it” (Chou, 2013). Thus, in the controlled companies, ownership and access to information remain in the hands of the controlling stockholders, which make it challenging for the IDs to exercise independent judgment.

2.5.3 Lack of adequate time

As the nature of engagement is part-time, many independent directors do not have enough time. They end up evaluating business decisions (Chou, 2013). This is because an independent director may work as a full-time employee for a firm, or may be simultaneously hired by several companies (Solomon, 1978). They cannot devote most of their time to one firm on whose board they serve. To work effectively, independent directors must be willing to devote a substantial amount of time in the firm. In the U.S., the lack of time has been an even more serious problem for the effectiveness of independent directors since the introduction of SOX in 2002. The time required for audit committee meetings has at least doubled so the independent director's committee work usually cannot be completed in the allotted time, and their discussions often end up being truncated or spilling over into hastily arranged teleconferences (Lorsch and Clark, 2008). Lack of time also limits their ability to delve deeper into financial, business and other matters involving the companies and lowers their effectiveness as corporate monitors (Core et al., 1999; Shivdasani and Yermack, 1999). Anecdotal evidence suggests that Indian directors spend less time than their foreign counterpart does in boardrooms.

Incentivity

Independent directors are usually outsiders who have no ownership interest in the firm (Elson, 2004). The performance of the firm normally does not have any financial impact on independent directors. Most independent directors own insignificant amounts of their firm's shares, and hence have limited incentives to monitor carefully (Bhagat and Black, 2002). Since the top executives influence the process for recruiting directors, independent directors have little incentives to perform their monitoring tasks conscientiously (Wade 2005).

Moreover, some scholars, for providing poor alignment with the shareholders' interest, criticize the mechanisms of independent director's remuneration. In addition, given the extensive protection granted to directors under the business judgment rule, the accountability system of independent directors would not sufficiently incentivize them to spend time and energy in monitoring (Marchesani, 2005; Fairfax 2010).

In most cases, while receiving a small amount of commission, independent directors are compensated primarily by cash payments (Cosenza, 2007; Clarke, 2007). Although independent directors may have enough incentives to provide active monitoring, these incentives will not always ensure optimal levels of monitoring, because boards must exercise power by collective actions that will likely raise the free-riding problem. Thus, faithful and active monitoring may be in line with individual director's interest, and he/she may assume that other colleagues will do the work for the whole group. Therefore, the free-riding problem will lower the board's capability to offer the optimal levels of monitoring (Chou, 2013). In addition, directors on small boards tend to have greater levels of stock ownership and are more likely to receive performance-based director fees in the form of stock options.

2.5.4 Information asymmetry

Jensen (1993) concludes that the lack of quality information on the firm on whose boards they serve limits the ability – even of the most talented directors – to make an effective contribution to control and review of the CEO, and to the firm's strategy.

IDs need to understand the business model of the firm and the business realities, to make effective intervention. As inside directors are well- informed or well aware of the internal conditions of the firm, therefore they are better positioned to help to make the right decisions on the appropriate business strategy (Baysinger and Hoskisson, 1990). Information deficits are especially serious in firms with high information costs and affect the independents' capability to effectively perform their tasks (Cosenza 2007; Tung 2011).

In addition to the lack of information, the amount and complexity of the data, independent directors receive may be another difficulty that most independent directors would encounter (Lipton and Lorsch, 1992). After the Satyam case, many independent directors are worried that their life's reputation can be ruined overnight and they in fact not only become persona non-grata, but also invite media ridicule and government prosecution. “Is the sitting fee they earn enough for them to expose themselves to such risks, is a question many are asking?” (Subramanian and Chakrabarti, 2012). An outsider who spends a small amount of time on any firm’s business is little different from a corporate manager who must evaluate the performance of a large number of divisions (Dundas and Richardson, 1982; Hoskisson and Hitt, 1988; Baysinger and Hoskisson, 1990).

Due to current strict standards of independence, many directors lack industry-specific experience and knowledge (Deakin, 2010). Even if independent directors are provided with comprehensive well-organized data, they will be unable to process such data (Lipton and Lorsch, 1992). Also because of their limited involvement with corporate activities, outside independent directors do not have exposure to the day-to-day activities of the firm. This could prove to be an impediment to management in their attempts to manage and monitor the operations of the firm (Petra, 2006)

2.5.5 Training and performance evaluation

As self-evaluation is not encouraged and the independent directors are not periodically evaluated, the effectiveness of the board reduces. There are several benefits, which can be realized with the board performance appraisal such as clarifying the roles and responsibilities of the directors and improving the relationship between directors and managers. Owing to the demand of the investors, this evaluation has become important.

Furthermore, independent directors can be effective only if they are provided adequate training and their performance is properly evaluated. As far as training is concerned, one survey suggests that 57% of the respondents are taking steps to provide training to their directors, although there is no mandatory training requirement in Clause 49.

Lack of periodical performance evaluation as a common practice of IDs in India hamper their incentive to carry out their roles diligently. This has been backed by a survey which shows that only a quarter of responding firms have an evaluation system for non-executive directors, while another survey indicates that about 39% companies surveyed had a formal board evaluation process (which perhaps covers the entire board rather than just the independent non-executive directors). This suggests that independent directors are often brought on boards merely to comply with the legal requirement rather than with a view of obtaining any significant contribution (either in terms of strategic value-add or monitoring).

2.5.6 Culture

Culture has a dominant influence on corporate governance. In Indian society, respect for elders is paramount; it is customary to demonstrate deference to their views. This cultural trait often influences the selection of independent directors and boardroom dynamics. Independent directors are often chosen based on whether the person would fit into the firm’s culture and be agreeable to the family (Kar, 2011). Deference to the firm patriarch often inhibits independent directors from voicing their concerns in board meetings. They may raise issues with the controlling shareholders or management outside board meetings, but are easily convinced to not press the issue further. These cultural barriers obstruct independent directors from performing their roles satisfactorily towards resolution of the agency problems between majority and minority shareholders. While independent directors are implicitly beholden to management and controlling shareholders due to cultural norms, they share no such relationship with minority shareholders (whose interests they are required to protect) (Varottil, 2011).

Outside directors are generally "invited" to join firm's boards by CEOs and CS. This practice renders a sense of indebtedness and gratitude in the minds of the IDs for the CEO and CS. While gratitude is one side of the coin, the other side is the threat of losing board directorship. Further, loss of directorship in one board may result in uncertainty of continuation in other boards (Balasubramanian, 2016)

2.5.7 Statutory Mandate

Regulators rely on independent directors as an institution to enhance corporate governance in an economy. They fail to recognise the fact that it is only one of several mechanisms that can perform the assigned duty. This includes strengthening several other corporate governance institutions (such as stringent financial and accounting regime, whistle blowing mechanisms, code of ethics) that may suitably support the independent director institution (Varottil, 2011). The problem is that an ID cannot play an effective role in isolation despite their commitment to ethical practices.

The firm and independent directors are required to “abide by the provisions specified in Schedule IV” of the Companies Act in 2013, which provides a detailed Code for independent directors. This incorporates fundamental legal, ethical, and procedural principles and best practices that will be of help to directors in their role as trustees and stewards for the firm and its shareholders. Some of the provisions of the Act tend to tilt the balance towards the firm’s structured format of do’s and don’ts which may hinder rather than help independent directors efficient functioning (Srinivasan and Srinivasan, 2011).Thus, all the directors including the Independent Directors owe liability equally for non-compliance of laws.

2.5.8 Conflict Management

According to Fama and Jensen (1983), independent directors act as a reliable mechanism to diffuse agency conflicts between managers and owners, which may occur in the decision to disclose information voluntarily. A scrutiny of the governance challenges in China and India suggests that the central problem in these contexts is unaddressed conflicts between the dominant shareholders and the minority shareholders (Varma, 1997). It is not practical to expect the board to discipline or punish the dominant shareholder because the board derives its power mostly from the dominant shareholder and this, in turn, contributes to the ineffectiveness of boards of directors in the Chinese and Indian contexts (Rajagopalan and Zhang, 2008).

2.5.9 Tenure of independent director

Long tenure of independent directors may provide opportunities for controlling shareholders to influence the independent directors in order to expropriate resources from the firm at the expense of minority shareholders. This expropriation could occur through related party transactions. (Liew et al., 2015).

The effectiveness of independent directors gets reduced due to long board tenures as long tenure independent directors are more likely to possess a friendly relationship gradually with the management (Vafeas, 2003). As controlling shareholders, possess the incentives to influence the independent directors, the independence of IDs is likely to be compromised as their tenure increase (Anderson et al., 2000). This particularly applies to firms in emerging markets, which possess high ownership concentration and are mostly family-controlled (Claessens et al., 2000; Morck et al., 2005). As Vafeas, 2003 puts it, if controlling shareholders are able to exercise their influence on the independent directors' tenure as the latter's tenure increases, this will enable the controlling shareholders to expropriate resources from the firm without significant checks and balances from the independent directors; hence, expropriating the minority shareholders.

2.5.10 Independence of Independent Directors

An independent director is expected to serve as a strategic advisor to management, and as a watchdog to protect the interest of the minority shareholders. Independent directors who fail as monitoring watchdogs will probably suffer soiled reputations and negative labor market consequences. Thus, they have incentives to carry out their tasks effectively and avoid colluding with managers to exploit shareholders (Davis, 2005; Fama and Jensen, 1983).

However, as the IDs are chosen by the promoters themselves so they prefer to be a friend of the promoters rather than be the watchdog of the board. This is more so the case in economies dominated by concentrated shareholding. Its promoters but all shareholders do not only own a firm so IDs are supposed to represent the interest of the minority shareholders. Independent directors are not independent when it comes to their age limit, qualification, interference in the day-to-day operations and time limit for replacement of an independent director

Not all nonexecutive directors are independent of executive management since some are tied to the executives through being retired executives of the firm or consultants or contractors to the firm or family connections (Kesner and Dalton, 1986; Kosnik, 1987).

Astute or opportunistic CEOs influence the inclinations of the board and, thus, set the premises for the board's deliberations and decisions (Baysinger and Hoskisson, 1990). Many believe for example, that managers dominate their boards by using their de facto power to select and compensate directors and by exploiting personal ties with them (Vance, 1964; Galbraith, 1967; Mace, 1971; Pfeffer, 1972; Allen, 1974; Herman, 1981; Jones and Goldberg, 1982).

2.5.11 Protecting shareholders

In the case of concentrated ownership structure, Independent Directors are not clear as to which shareholders' interests they must protect- the larger shareholder or the minority shareholder because the largest shareholder may extract resources from the firm on preferential terms (e.g., tunnelling) and thereby harm the minority shareholders (Cullinan et al., 2012). In corporations with concentrated ownership and control, the board's role is that of "horizontal governance", of mediating between the dominant stockholders who are also part of management, and the outside dispersed shareholders and preventing expropriation of the latter by the former (Roe 2004).

2.5.12 Risk management and review

Generally, this means identification, analysis, and economic control of all such risks that may threaten assets, resources, and earning capacity of the firm. Risks may be financial, strategic, or other. It is a challenge for independent director to ensure that all the investment, funds, and business transactions are directed in a right manner. The SOX does not set any particular requirements for the board as a whole entity, but does require that the audit committee should be entirely composed of independent directors and at least one should be financially knowledgeable (Dionne and Triki, 2005). More recently, Agrawal and Chadha (2005) have reported evidence supporting the benefit of having outside financial directors on the board. They find that the probability of earnings restatement is lower in firms whose boards have an independent director with a background in accounting or finance

3 RESEARCH DESIGN

Research Design section starts with the discussion on research objectives 1 and 2. The research setting of the research objective 3 follows this.

Research Objective 1 and 2

3.1 Data

The data on financial performance measures and control variables (such as leverage, book- market ratio, firm size, age) are obtained from Prowess Database compiled by the Centre for Monitoring the Indian Economy. We hand collect the Corporate Governance information from the CG reports of the firm. Further, we verified our data by referring to annual reports of companies and visiting firm's website. The data includes 500 large listed Indian firms. The data was available for the period 2004 to 2016 for most variables included in the study. Appendices A1 and A2 describe the sample characteristics of the firm level data.

3.2 Variables

3.2.1 Dependent Variables

Further, to verify the relationship of Financial Performance and Corporate Governance, financial performance is utilised as a dependent variable.

Financial Performance

Literature on financial performance

Profitability Indicators: ROA, ROE, Market- Book Ratio

Valuation Indicators: Price-Earnings Ratio, Tobin's Q, Equity Returns

Most studies used: Tobin's Q

Def: Tobin's Q = [(BSE closing price) *(number of shares outstanding) + pref_capital + total borrowing] / Total assets

Authors - Jackling and Johl (2009); Sarkar and Sarkar, (2000); Khanna and Palepu (2000)

Source: Haldar (2014)

Accounting Returns are proxied by Return on Asset (ROA) and Return on Equity (ROE), whereas market-based returns are proxied by Tobin's Q. Figure 1 depicts the performance data across ownership structure in Indian listed companies from 2003-13. Standalone firms have consistently performed (accounting returns measured by ROE, ROA and EVA) over the years. However, market returns (measured by Tobin's Q) is higher in foreign standalone firms.

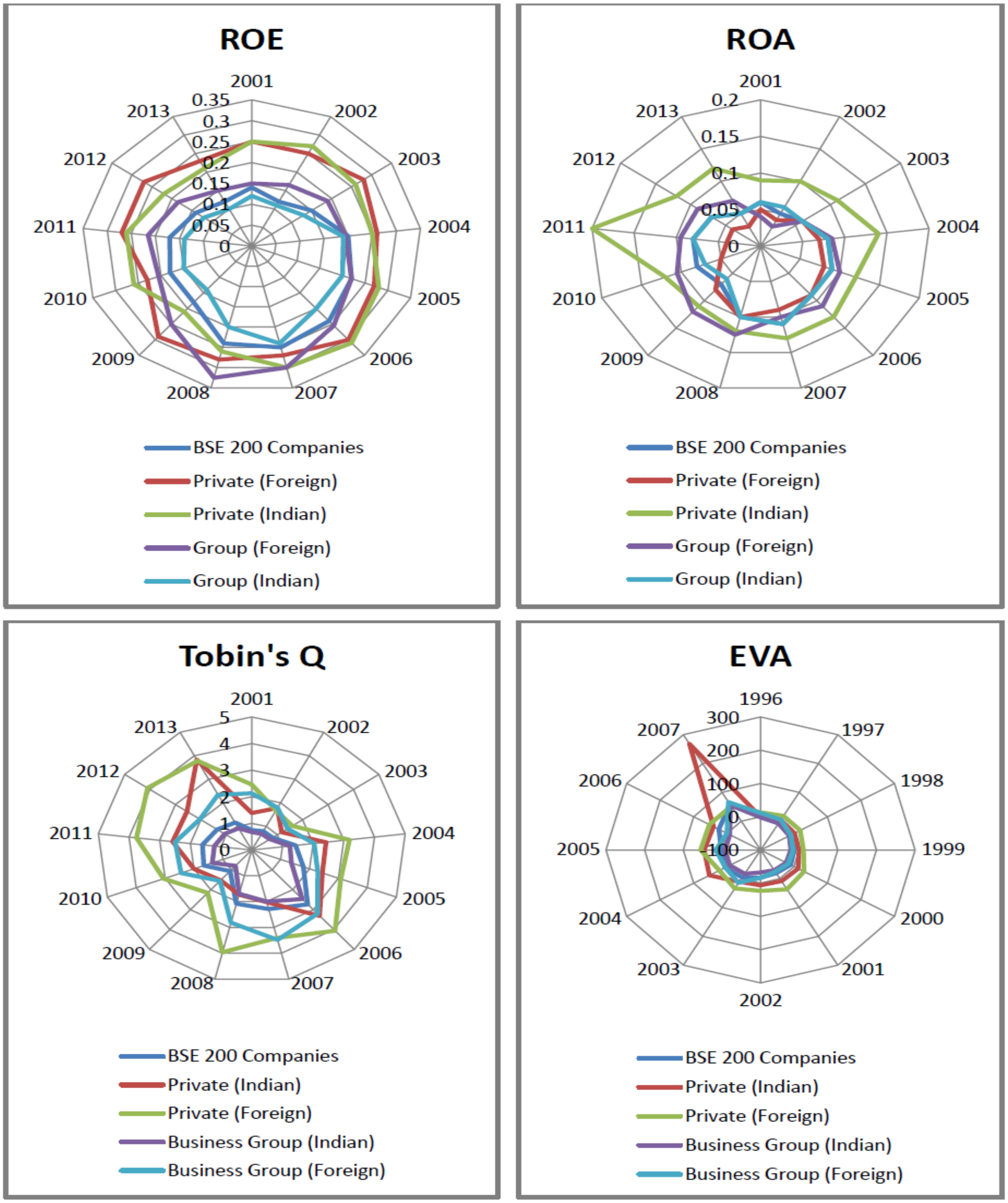

Figure 10 Financial Performance proxies (2001-13)

Source: Haldar and Rao (2014)

3.2.2 Independent Variables

Board Independence

We consider board independence (ID) as a proxy for corporate governance computed as proportion of number of independent directors to total number of directors. If the proportion is high, it means independent directors dominate the board and following resource dependency theory, such boards are expected to be more effective. We also consider dummy variable IDP for considering the presence/absence of independent directors.

3.2.3 Control Variables

To control for the effect of other factors that also may affect the variables of interest in our study, we include a comprehensive set of other variables in our analyses, which are in line with the previous studies exploring the relationship between corporate governance and firm performance. These control variables are BS (Board Size), Total Directors on Board; BUSY (Busyness of Directors); Number of Directors serving as director in more than 3 companies, LEV, the ratio of long-term debt to total assets; BMR, the book to market ratio; and FS (FIRMSIZE), the natural logarithm of total assets.

We describe the internal mechanisms of CG used for the study in Table 8 below.

Table 8 Corporate Governance Mechanism

CG Mechanism	Definition	
Board Independence (%)	Number of ID/ Total number of directors	ID
Board Independence(Presence/Absence)	Presence of Independent Directors 1 if present; else 0	IDP
Board Size	Total number of board of directors	BS
Firm Size	Log of total assets	FS
Busyness of Director	Number of Directors serving as director in more than 3 companies	BUSY
Book-Market Ratio	Book value of firm / Market value of firm	BMR
Leverage	Debt of firm/Total assets of firm	LEV

3.2.4 Dummy Variables

We also include year dummy variables and industry dummy variables, which are as follows:

Year Dummy Variable

To ensure that we separate out all the unobserved year effects, including macroeconomic and environmental effects, we also use 11-year dummies to control for period effects pertaining to the study period.

Industry Dummy Variables

This dummy variable would provide us the industry level insight. We classified our data as per National Industry Classification and generated fifteen dummies. Appendix A.1 and A.2 depicts ownership group and industry classification of the sample companies respectively.

3.3 Methodology

Panel models provide a number of improvements over the separate analysis of time series by cross-section. First, panel data allow for considerably more flexibility in the modeling of the behavior of cross-sectional units than conventional time series analysis (Greene, 2008). Second, the panel framework allows for the analytical incorporation of significantly more observations (and more degrees of freedom) than would a comparable analysis of individual time series. Panel data is commonly used method that control for spurious correlation. Panel Model facilitates capturing firm-specific variables and corrections for unobserved heterogeneity of the firms, as it includes time series data.

In panel data, the same cross-sectional unit (say a family or a firm or a state) is surveyed over time. In short, panel data have space as well as time dimensions (Gujrati, 2011).We estimated a balanced panel where we have the same number of each cross-section units so that the total number of observation is n.T. When n = 1 and T is large, we have the familiar time-series data case. Likewise, when T =1 and n is large we have the cross-section data. Panel data estimation methods refers to data where n >1 and T>1 (Johnston and Dinardo, 1996).

We estimate the equation by using panel data analysis. We conducted the test proposed by Hausman (1978) for determining whether to conduct fixed effects or random effects. We also verified by conducting Breusch and Pagan Lagrangian multiplier test for random effects. Further we computed the Breusch- Pagan (1979) statistic to check for heteroskedasticity and Wooldridge (2002) test for autocorrelation. We conducted estimation in Panel Data with White (1980) heteroskedasticity-consistent standard errors and covariance Test. We carried out the analysis using STATA Version 12.

3.4 Empirical Model

We examine the relationship between corporate governance variable- board independence and firm performance.

Model 1 measures the impact of proportion of independent director on financial performance.

Model 1: $Performance_{i,t} = b_0 + b_1 ID_{i,t} + e$…………Eq. 1

Where

$Performance_{i,t}$ = Financial Performance for firm i in period t

$ID_{i,t}$ = Board Independence (%) for firm i in period t

e = random disturbance term

b_0 = constant term

We replace the proportion of independent director with the independent director dummy variable in model 2. This enables us to measure the significant difference between companies having independent directors with those having none on financial performance.

Model 2: $Performance_{i,t} = b_0 + b_1 IDP_{i,t} + e$…………Eq. 2

Where

$Performance_{i,t}$ = Financial Performance for firm i in period t

$IDP_{i,t}$ = Board Independence (Presence/Absence) for firm i in period t

e = random disturbance term

b_0 = constant term

The large proportion of family owned firms in India has meant that the role of outside directors might be minimized, as family firms tend to restrict executive management positions to family members. Thus, limiting the pool of potential qualified and talented labour resources. Model 3 measures the impact of proportion of independent director on financial performance in presence of board size.

Model 3: $Performance_{i,t} = b_0 + b_1ID_{i,t} + b_2BS_{i,t} + e$…………Eq. 3

Where

$Performance_{i,t}$ = Financial Performance for firm i in period t

$ID_{i,t}$ = Board Independence (%) for firm i in period t

$BS_{i,t}$ = Board Size for firm i in period t

e = random disturbance term

b_0 = constant term

Total Assets of the firm measure the size of the firm. Log transformation of the total assets has been used to correct skewness in firm size. Model 4 measures the impact of proportion of independent director on financial performance in presence of board size and firm size.

Model 4: $Performance_{i,t} = b_0 + b_1ID_{i,t} + b_2BS_{i,t} + b_3FS_{it} + e$…………Eq. 4

Where

$Performance_{i,t}$ = Financial Performance for firm i in period t

$\%IND_{i,t}$ = Board Independence (%) for firm i in period t

$BS_{i,t}$ = Board Size for firm i in period t

$FS_{i,t}$ = Firm Size for firm i in period t

e = random disturbance term

b_0 = constant term

Directors serving on three or more companies are considered busy directors. Theoretically, busy directors devote fewer efforts to their duties whereas the argument against busyness of the directors is that they give quality time and are highly effective due to their abilities and expertise. The effectiveness of such busy directors on financial performance is interesting research area. Model 5 hence includes busyness of board and measures the impact of proportion of independent director on financial performance in presence of board size, busyness of board and firm size.

Model 5: $Performance_{i,t} = b_0 + b_1ID_{i,t} + b_2BS_{i,t} + b_3FS_{i,t} + b_4BUSY_{i,t} + e$…………Eq. 5

Where

$Performance_{i,t}$ = Financial Performance for firm i in period t

$ID_{i,t}$ = Board Independence (%) for firm i in period t

$BS_{i,t}$ = Board Size for firm i in period t

$FS_{i,t}$ = Firm Size for firm i in period t

$BUSY_{i,t}$ = Number of Busy Directors for firm i in period t

e = random disturbance term

b_0 = constant term

Model 6 measures the impact of proportion of independent director on financial performance in presence of other governance variables (such as board size, busyness of board), book to market ratio and firm size.

Model 6: $Performance_{i,t} = b_0 + b_1ID_{i,t} + b_2BS_{i,t} + b_3FS_{i,t} + b_4BUSY_{i,t} + b_5BMR_{i,t} + e$……Eq. 6

Where

$Performance_{i,t}$ = Financial Performance for firm i in period t

$ID_{i,t}$ = Board Independence (%) for firm i in period t

$BS_{i,t}$ = Board Size for firm i in period t

$FS_{i,t}$ = Firm Size for firm i in period t

$BUSY_{i,t}$ = Number of Busy Directors for firm i in period t

$BMR_{i,t}$ = Book to Market Ratio for firm i in period t

e = random disturbance term

b_0 = constant term

Model 7 measures the impact of proportion of independent director on financial performance in presence of other governance variables (such as board size, busyness of board), book to market ratio, leverage, and firm size.

Model 7: $\text{Performance}_{i,t} = b_0 + b_1 ID_{i,t} + b_2 BS_{i,t} + b_3 FS_{i,t} + b_4 BUSY_{i,t} + b_5 BMR_{i,t} + b_6 LEV_{i,t}$ $+e$……………..…Eq. 7

Where

$\text{Performance}_{i,t}$ = Financial Performance for firm i in period t

$ID_{i,t}$ = Board Independence (%) for firm i in period t

$BS_{i,t}$ = Board Size for firm i in period t

$FS_{i,t}$ = Firm Size for firm i in period t

$BUSY_{i,t}$ = Number of Busy Directors for firm i in period t

$BMR_{i,t}$ = Book to Market Ratio for firm i in period t

$LEV_{i,t}$ = Leverage for firm i in period t

e = random disturbance term

b_0 = constant term

Model 8 measures the impact of proportion of independent director on financial performance in presence of other governance variables (such as board size, busyness of board, book to market ratio, leverage, and firm size). Further, we introduce 11-year dummies to this model.

Model 8: $\text{Performance}_{i,t} = b_0 + b_1 ID_{i,t} + b_2 BS_{i,t} + b_3 FS_{i,t} + b_4 BUSY_{i,t} + b_5 BMR_{i,t} + b_6 LEV_{i,t} +$ b_7YEAR DUMMY +e…………Eq. 8

Where

$\text{Performance}_{i,t}$ = Financial Performance for firm i in period t

$ID_{i,t}$ = Board Independence (%) for firm i in period t

$BS_{i,t}$ = Board Size for firm i in period t

$FS_{i,t}$ = Firm Size for firm i in period t

$BUSY_{i,t}$ = Number of Busy Directors for firm i in period t

$BMR_{i,t}$ = Book to Market Ratio for firm i in period t

$LEV_{i,t}$ = Leverage for firm i in period t

YEAR DUMMY = 11 year Dummies (2003-13)

e = random disturbance term

b_0 = constant term

Model 9 measures the impact of proportion of independent director on financial performance in presence of other governance variables (such as board size, busyness of board, book to market ratio, leverage and firm size). Further, we introduce 11-year dummies and 15 industry dummies to this model.

Model 9: $Performance_{i,t} = b_0 + b_1 ID_{i,t} + b_2 BS_{i,t} + b_3 FS_{i,t} + b_4 BUSY_{i,t} + b_5 BMR_{i,t} + b_6 LEV_{i,t} + b_7 YEAR\ DUMMY + b_8 IND\ DUMMY + e$…………Eq. 9

Where

$Performance_{i,t}$	= Financial Performance for firm i in period t
$ID_{i,t}$	= Board Independence (%) for firm i in period t
$BS_{i,t}$	= Board Size for firm i in period t
$FS_{i,t}$	= Firm Size for firm i in period t
$BUSY_{i,t}$	= Number of Busy Directors for firm i in period t
$BMR_{i,t}$	= Book to Market Ratio for firm i in period t
$LEV_{i,t}$	= Leverage for firm i in period t
YEAR DUMMY	= 11 year Dummies (2003-13)
IND DUMMY	= 15 Industry Dummies
e	= random disturbance term
b_0	= constant term

3.5 Research Setting for RO3

The third objective was to identify the challenges faced by independent directors. This research question could have been addressed best when there are no preconceived notions. The exploratory nature of the question necessitated primary study of the subject in question. It was decided that the best way to accurately and adequately collect information was to directly approach the experienced non-executive directors. The qualitative interviews gave the respondents a scope to share their personal thoughts, feelings, and opinions without being interrupted or being influenced by factors like those of any findings of previous research or any legal obligation by the companies about the appointment of the independent Director. Thus, during the interview process (where the questions were primarily semi structured) the participants could share their views willingly without being interrupted.

During our sampling stage, we started identifying the individuals who were presently serving on a board or have in the past served as the Independent Director of a board of a public or private organisation. We compiled the director's names through annual reports, financial databases (such as Prowess, Capitaline, and Bloomberg) and references. However, we found that the directors identified through references were comfortable to share data and help us in understanding the boardroom practices. The dynamics of the boardrooms are extremely confidential and our intention was to understand the challenges of the ID in a board. Finally, we interviewed 20 independent directors across industries (demographics shared in Appendix A3).

We also interviewed academicians who had substantial theoretical understanding of the field and had contributed to the theoretical underpinnings in the area. There were two screening criteria for academicians. Firstly, their teaching/research area should be corporate governance. In addition, they must be engaged in a listed company as an independent director. This helped us in understanding their inherent beliefs of the challenges faced by ID in day-to-day working. Further, representatives of proxy advisory firms were interviewed to understand the holistic picture of the role and challenges of independent directors. Although it is a recent phenomenon in India, they guide institutional investors on the voting about corporate decisions. Unlike USA, the subscribers are not obliged to adhere to their advice. A proxy firm provides services to shareholders like those on voting, firm research, vote administration, vote execution. However according to the websites of these firms, not all provide vote execution.

We analysed the transcribed data using thematic analysis. During the thematic analysis, there were various significant statements, which emerged relating to various dimensions. When a comprehensive set of constructs was derived then it was realised that to segregate the complexities of the themes, place their association with the existing theories, and to enhance the relevance of the study we transcribed the interviews and adopted a Seven-Stage approach, suggested by Easterby-Smith et al., (1991) to sift through and process the interview data. This helped us to examine the salient challenges concerning the performance of the IDs (Clarke, 1998).

To get a good understanding of process we conducted a review of the relevant literature to get a good understanding of the subject in accordance with the guidelines provided by Corbin and

Strauss (2014). We started contacting the Independent Directors through our possible sources. After ensuring them confidentiality, we started the exploratory study where we gave the scope to share their personal thoughts. Due to confidentiality, we decided to conceal the profiles of our respondents and have provided only certain demographic details. For avoiding the coding bias, three independent coders did the coding independently and then the fourth coder acted as a neutral coder. The coders were explained about the research objective and its importance. Inter rater reliability was compounded and the test met the standards as indicated by Lombard et al., (2002). Keeping in mind the guidelines of Corbin-Strauss (2014), the open codes were derived after the analysis of the responses. Each coder generated the themes, which were hidden in the responses of the participants.

4 Results and Discussion

4.1 Size of listed companies in India

Table 9 suggests the increase in percentage of average independent directors over the years from 43% in 2004 to 48% in 2016. Although, on an average, there were four busy directors on the boards; percentage of busy directors has reduced slightly from 40% to 37%. The companies having board size above 8 has almost doubled from 192 in 2004 to 381 in 2016 indicating the preference for companies to have smaller board size. Large boards having board members above 12 have also increased from 76 to 129.

Table 9 Trends in Board Composition

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Average %ID	42.75	41.08	42.74	42.80	43.66	46.70	47.83	48.38	48.09	48.81	48.55	47.16	47.89
Average no. of busy directors							4						
Average % Busy directors	39.77	39.44	38.25	39.16	39.25	39.44	39.37	40.35	39.34	36.99	36.62	36.79	37.08
BS above 8	192	238	267	274	303	318	321	325	329	341	348	355	381
BS above 12	76	82	91	102	100	120	134	121	126	127	126	144	129

Source: Author Computation

Table 10 suggests that on an average number of independent director on the board has changed by hardly 20% from 2004 to 2016.No. of companies having ID has improved by 26% indicating that boards do believe that ID adds value to the board room dynamics. However, percentage of busy directors has reduced by 7%. Although busy director’s demand has reduced, they are present in 98% of the boards in 2016.

Table 10 Trends in Independent and busy directors (2004-16)

	Average			
	No. of ID	Presence of ID	% of busy directors	Presence of busy directors
2004	4	78	0.40	0.78
2016	5	98	0.37	0.98
% Change (04-16)	25	26	-7	26

Source: Author Computation

Table 11 suggests that firm size in 500 large listed firm has substantially increased in comparison to all listed companies in India.

Table 11 Size of Indian listed companies

	All Listed companies			500 large listed companies		
	Average					
Year	Assets	Sales	Market Capitalisation	Assets	Sales	Market Capitalisation
2016	126906	38405	23882	490795	131728	183181
2001	9659	3090	1568	22118	5937	16724
% change (2001-16)	13	40	97	2118	2118	995

No. of companies: 5460 (Figures in Rs. Million)

Authors Computation

Figure 11 suggest average assets of Indian listed firms have substantially increased by 13%. There appears to be a 40% increase in average sales in Indian listed companies from the year 2001 to 2016.

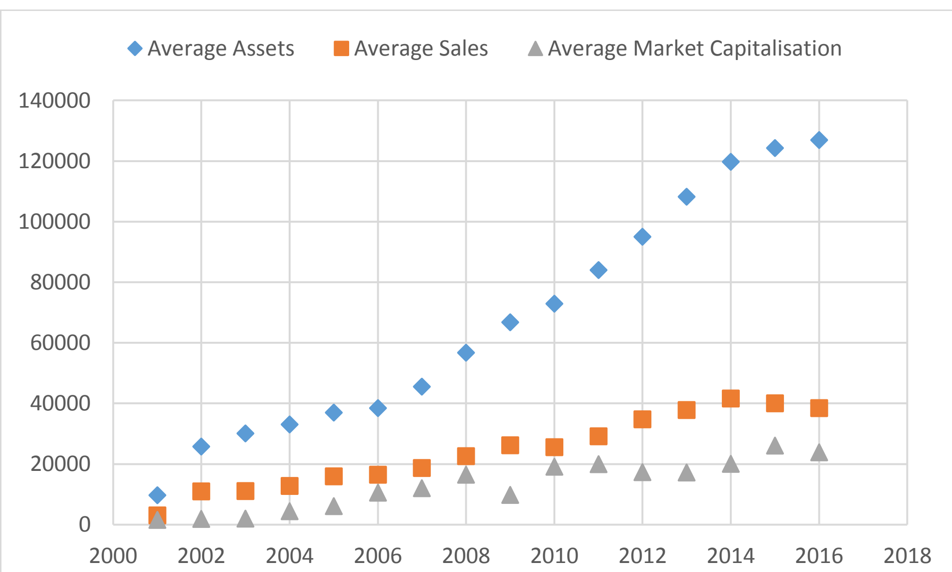

Figure 11 Size of Indian listed companies

In comparison to services industry, manufacturing companies have higher percentage of ID (figure 12). Figure 13 confirms our prior assumption that standalone firms, owing to their better corporate governance practices, have higher percentage of ID. Although percentage of independent directors remains relatively same across the years for both categories. The percent of Independent directors are consistently higher for standalone companies maybe as proportion of executive chairperson in standalone companies are higher than business group affiliated companies leading to a higher proportion of Independent directors (Sarkar and Sarkar, 2012). Clause 49 introduced by SEBI in February 2000 required that in case of a non-executive chairman, one-third of the board must comprise of independent directors while for executive chairman it was mandated at 50% board members.

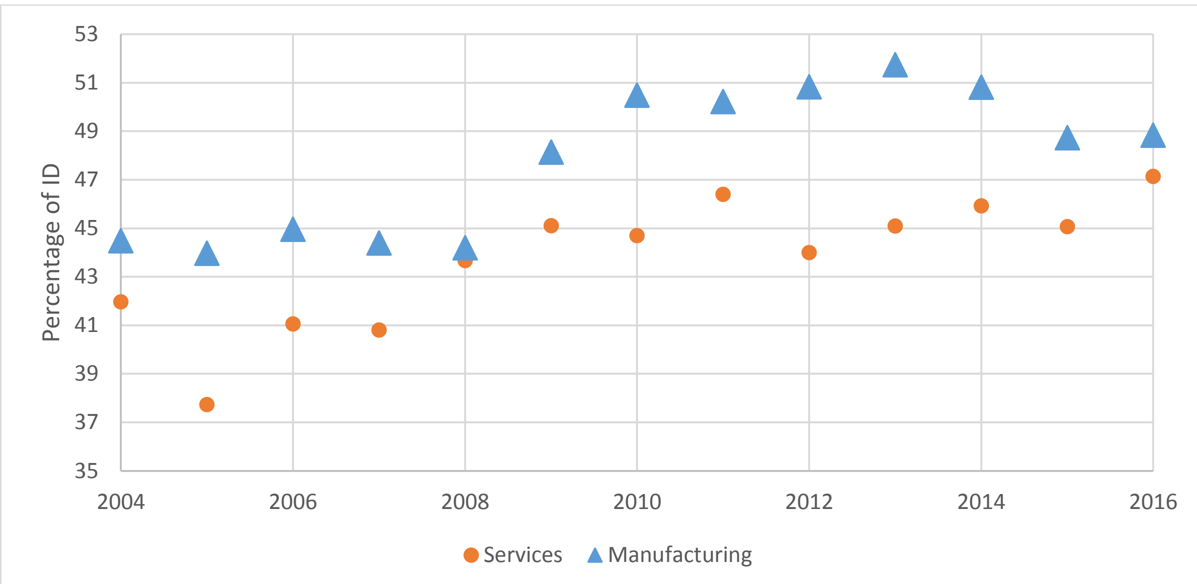

Figure 12 Average percentage of independent directors across industries

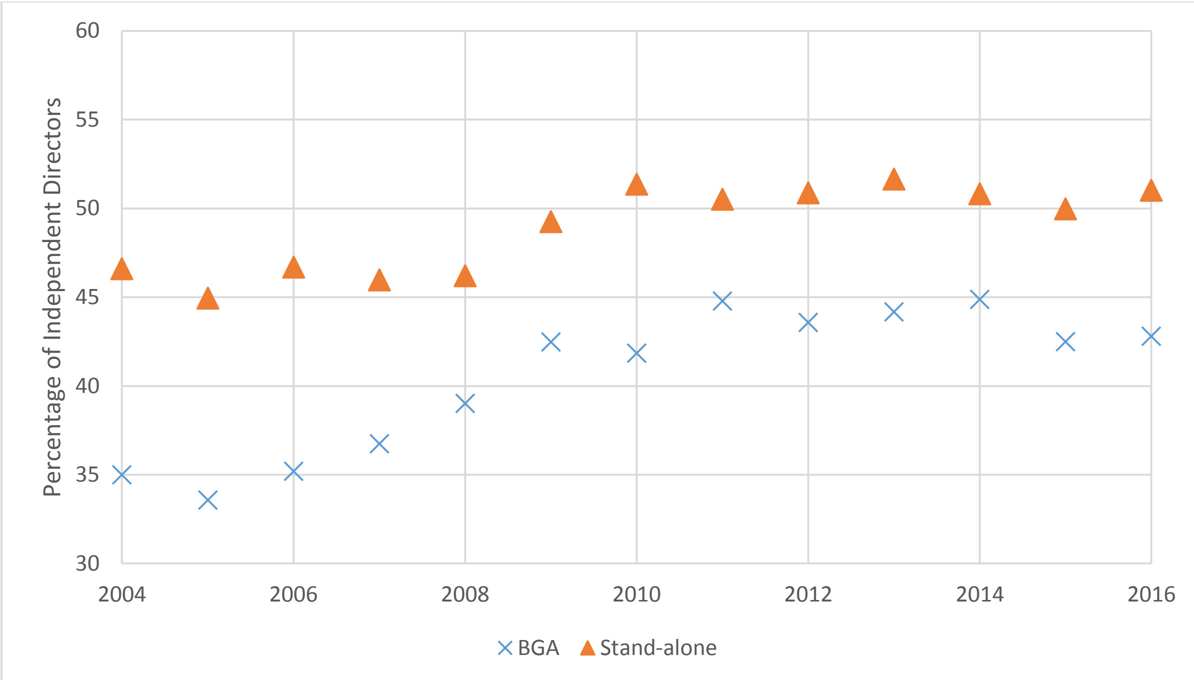

Figure 13 Percentage of independent directors in BGA and stand-alone firm.

A significant increase in presence and percentage can be seen in the 2008-2010 period, with the percentage approaching the 50% mark in the latter years, this may be attributed to the SEBI circular in April 2008 which specified that if the non-executive chairman is a promoter or related to any promoter or a person in managerial position then at-least half of the board shall consist of independent directors. A general increasing trend of presence of independent directors also suggests that companies perceive that having independent directors add value to the firm and leads favorable assessment by outside investors. (Sarkar and Sarkar, 2012). In addition, this period witnessed more than usual exits of ID post Satyam fiasco (January 2009) and hence busyness of existing directors increased (figure 14).

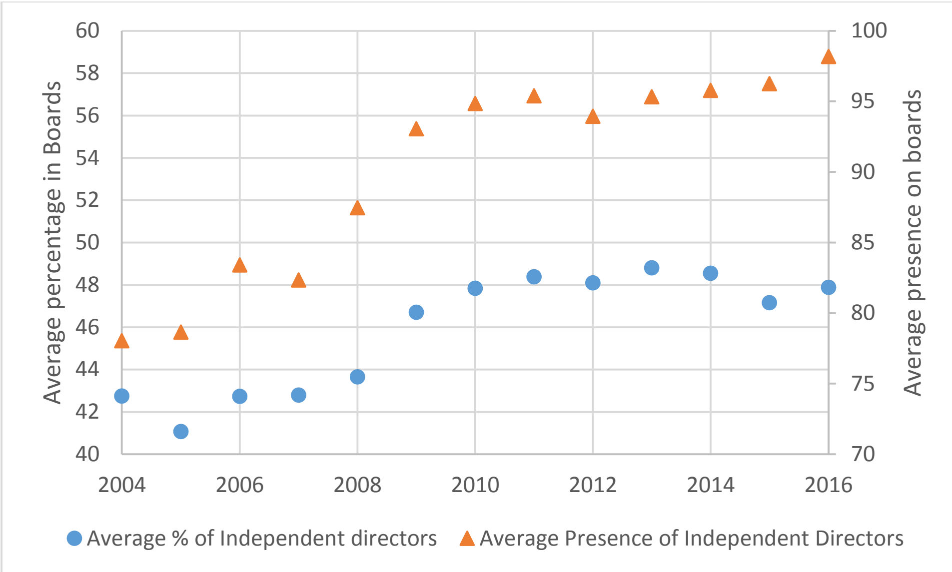

Figure 14 Average percentage and Presence of Independent Directors on boards.

Figure 15 suggest a positive relation between firm size and percentage of independent directors. One of the possible reasons could be, as firm size increases the possibilities of effective monitoring with independent directors. The increasing presence of ID as firm size increases show firm's commitment to better corporate governance practices by creating a perception of reduced expropriation of minority investors by controlling shareholders. Thus, independent directors are appointed to act as fiduciaries of the shareholders and overlook monitoring to be more attractive to outside investors.

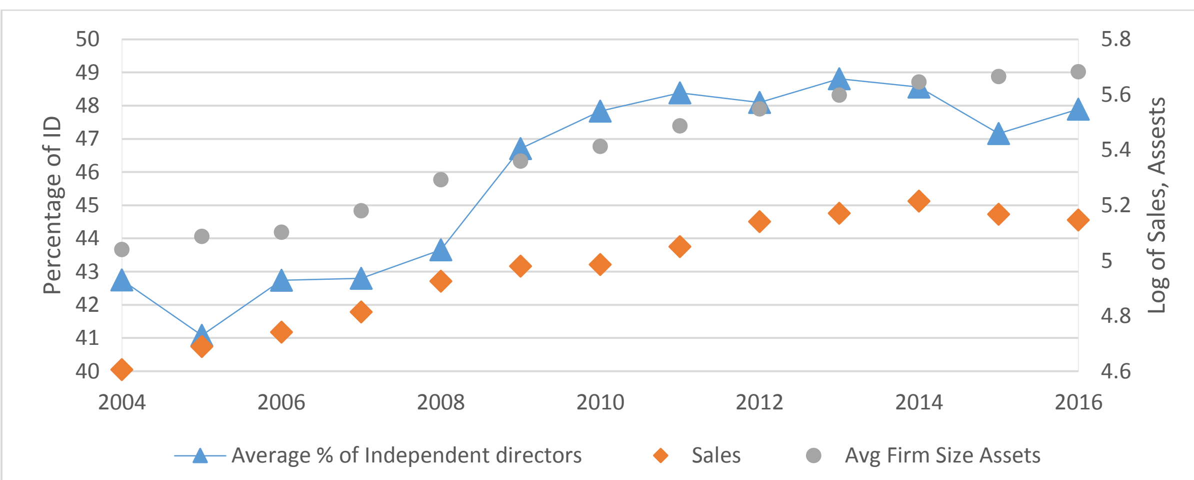

Figure 15 Average percentage of ID plotted alongside firm size

The Companies bill of 2009 proposed to limit the number of directorship to no more than 15 public companies. The presence of busy directors has raised significantly during the 2008-2011 period, which could be because of the limited supply of independent directors to fulfil the required ratio after the Satyam Computer Services scandal in 2009 (Figure 16). A steady decline in percentage and presence can be observed in the years 2012-2015, which could be due to the Companies Act, 2013 that placed stringent guidelines on responsibilities and accountability of Independent directors. This possibly caused independent directors to be more cautious while taking multiple directorship.

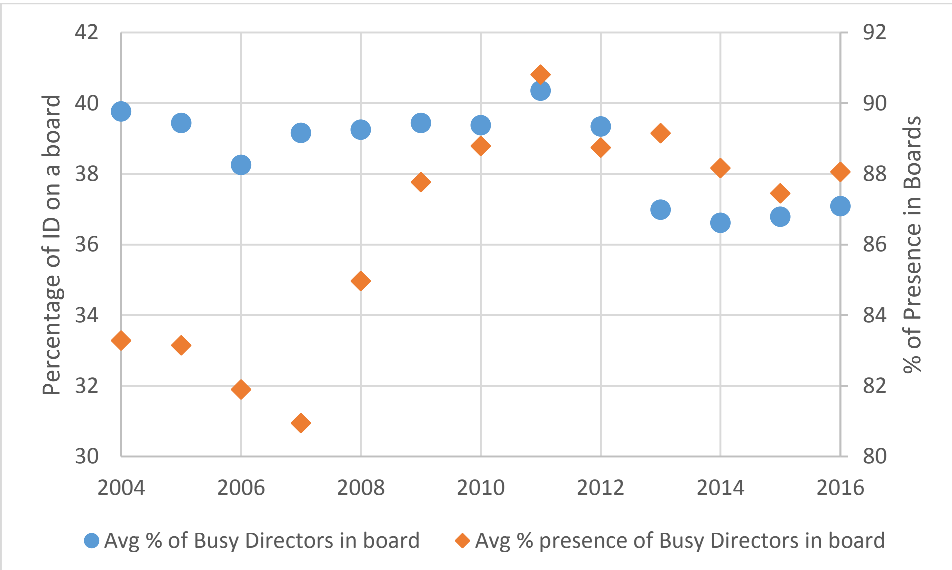

Figure 16 Average presence and percentage of busy board members

4.2 Independent director and Financial Performance

Table 12 presents the descriptive statistics of CG and FP for the sample firms. On average, as shown by positive financial performance, Indian firms are profitable. Our data also reveal that there are, on average, 9 directors on a board which is lower than US firms (average = 11 directors) (Yermack, 1996; Bhagat and Black, 2002). Board Independence ranges from no independent director to 18 independent directors with mean board independence at four directors.

Table 12 Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max
EVA	7.04	1.67791	-0.93	12.43
Q	2.48	1.694725	0.22	10.21
ROA	0.10	0.0741866	-0.06	0.51
ROE	0.24	0.14	-0.47	0.87
ID	3.78	3.00	0	18
BS	9.39	4.92	0	30
BUSY	3.41	3.08	0	16
BMR	0.74	1.16	0	18.24
FS	10.06	2.03	-2.30	16.56
LEV	0.24	.29	0	8.87

Table 13 presents the correlations among the variables. ID has a positive insignificant relation with FP. This contradicts the present Indian finding based on accounting measures that presence of Independent Director does not add value to the boards. This insight is important in the light of fact that financial performance measured by economic value-added removes accounting distortions and reflects true economic profits after deducting charge on equity capital as well.

Table 13 Correlation of CG and FP

	FP	ID	BS	BUSY	BMR	FS	LEV
FP	1.0000						
ID	0.0432	1.0000					
BS	0.0463	0.5458	1.0000				
BUSY	-0.0101	0.5643	0.4426	1.0000			
BMR	-0.0209	-0.0563	-0.0544	-0.1081	1.0000		
FS	0.2676	0.0673	0.1759	0.0235	0.1268	1.0000	
LEV	-0.0793	0.0049	-0.0749	0.0354	0.1710	0.0860	1.0000

Table 14 reports the results for the panel regression of financial performance on corporate governance and control variables with robust option (White, 1980). The proportion of independent directors on a board (ID) is positively associated with financial performance. In addition, the presence of independent director in is significantly affecting financial performance at 5% level (Column 2, Table 14). This significant effect propagates that independent director adds value and positively impacts firm performance (Rosenstein and Wyatt, 1990). This finding backs the agency theoretic claims that these independent directors more effectively monitor the insiders (management) whose interest might clash with outside shareholders (Weisbach, 1988). Also, these independent directors effectively monitor to protect their reputational capital (Bhagat et al., 1987; Fama, 1980). Further, these independent directors, apart from providing their expertise, can open up their interlocks with other companies to exponentially enhance the needed resources, suppliers, and customers to a firm. (Pfeffer, 1972). Our findings, contradicts the previous Indian studies which found no statistical significant results (Sarkar et. al, 2008; Ghosh, 2006).

Board Size is also negatively related to financial performance, which reiterates that larger board size reduces the monitoring function of directors leading to reduction of firm's value (Eisenberg et. al., 1998; Hossain et. al., 2001; Yermack, 1996). Larger boards impede communication and decision-making, thereby reducing the board's effectiveness of the monitoring function. CEOs' control on these boards increases due to incremental cost (Yermack, 1996), coordination and process problems (Jensen, 1993). Inverse relationship has also been reported by Eisenberg et. al., 1998, Hermalin and Weisbach (2003), Mak and Kusnadi (2003), Alshimmiri (2004), Andres et. al.. (2005). Indian studies also found the board size to be significantly negative for all performance variables except market adjusted stock prices (Garg, 2007).

The insignificant relationship between the percentage of busy independent directors and financial performance might be explained by the poor average of percentage of busy directors. The size of the firm positively affects performance whereas leverage negatively affects performance. Book to Market Ratio also exhibits a negative significant relationship. Firm size is significantly affecting financial performance.

Table 14 Panel Least Square results for financial performance on independent director

	Financial Performance								
Model	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**
Board Independence (%)	0.05* (4.59)		0.10* (5.6)	0.05* (3.35)	0.04* (2.75)	0.03** (1.91)	0.02 (1.77)	0.01** (0.63)	0.01** (0.63)
Board Independence (Presence/Absence) (1if present; 0)		0.35* (4.23)							
Board Size			-0.04 * (-3.79)	-0.04* (-4.14)	-0.04 * (-4.33)	-0.04 * (-4.29)	-0.04 * (-4.21)	-0.02 * (-2.63)	-0.02 * (-2.63)
Firm Size				0.47* (7.35)	0.46* (7.36)	0.73* (11.08)	0.74* (11.07)	0.23** (2.07)	0.23** (2.07)
Busyness of Director					0.02 (1.83)	0.02 (1.70)	0.02 (1.68)	0.02 (1.59)	0.02 (1.59)
Book-Market Ratio						-0.14* (-2.60)	-0.13 * (-2.43)	-0.11 ** (-2.0)	-0.11 ** (-2.0)
Leverage							-1.07 * (-3.26)	-0.52 (-1.55)	-0.52 (-1.55)
Year Dummy								Included	
Industry Dummy									Included
Cons	6.80* (125.32)	6.76* (101.5 1)	7.04* (91.10)	2.33* (3.50)	2.36* (3.58)	-0.33 (-0.48)	-0.23 (-0.33)	5.37* (4.25)	27440.8 2* (4.92)
R Square	0.00	0.00	0.00	0.06	0.06	0.07	0.08	0.11	0.11
F Statistic	21.03	17.92	15.97	28.13	22.36	32.58	28.62	21.90	21.90

*Significant at 1 % **Significant at 5%

4.3 Challenges by independent directors

There are two broad themes, which emerged from the lived experiences of the interviewed participants. The research findings discussed here are inferred from the results of our study while attempting to understand the challenges of the Independent Directors in a board. Since the literature on the focal construct of the study is still in nascent stage, it was deemed necessary to conduct an exploratory primary study to generate such items that are believed to capture the constructs and develop the themes.

The demographic information (gender, qualification, years of experience) was available to the researchers. The respondents were chosen from the group of the ID who are presently serving on the boards of a public or a private company. The research team gathered this data from secondary data sources (such as Prowess) and verified with the annual reports of the firm. Finally, a list of independent directors was formulated.

One of the main areas of focus of the research concerned the identification of factors, which hinders their day-to-day performance on the board. In-depth semi structured interviews were conducted by the researchers either in the office of the participants (who were located in Mumbai) or through webex (video calls, for the participants who were based out of Mumbai). It was divided broadly in two phases:

First was the "opening phase" where the participants were explained the purpose of the research. This was followed by "questioning phase.” Based on this analysis, the study aimed at identifying major constraints for effective implementation of independent directors’ guideline in the interest of each stakeholders of firm. The thematic analysis revealed the following themes (Figure 17).

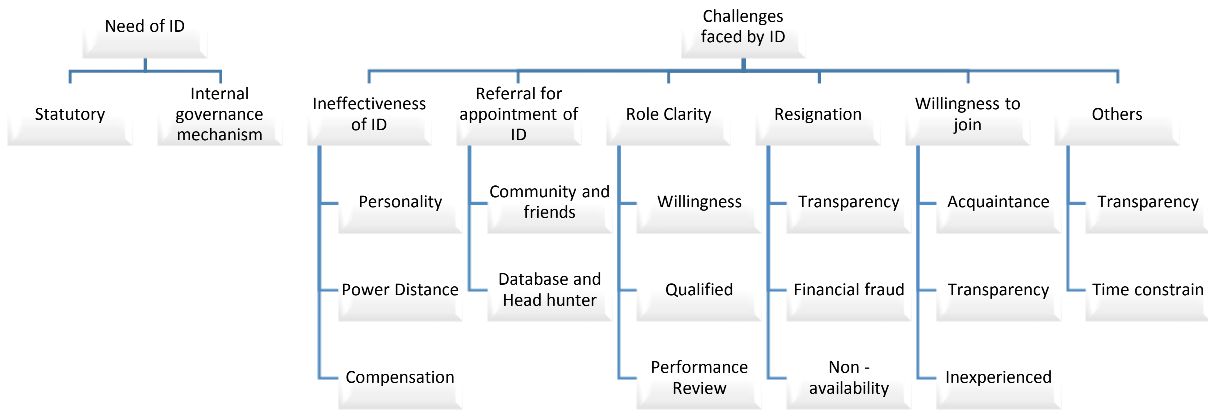

Figure 17 Themes from the interview

Themes

4.3.1 Need of independent directors

The research team tried to understand the participants' opinion on the rationale for the requirement of an Independent Director in the Board of Directors of a firm. The participants held two broad rationale for being an independent director on the board. Firstly, this was a statutory requirement by the regulatory authority to have a minimum number of independent directors in the board. In addition, they are there to protect the interest of the minority shareholders, and direct management towards shareholder's wealth maximization. Thus, they are vigilant monitors for minimizing managerial malfeasance. Independent directors remarked:

"The companies have the money from the public; hence there should be someone to take care of it"

"Role of the Independent Director is to provide an outside voice, caution the management for risky or unethical things, alert the company, the management about things that they might have missed by accident"

4.3.2 Challenges faced by the Independent director

The participants were asked to describe the challenges faced while performing their duties to the researcher during an in-depth semi-structured interview. Thus, the challenges that emerged from question probing phase generated a list of themes, which further helped us to evolve the next set of questions. Those statements were then categorized under the following themes:

4.3.2.1 Ineffectiveness of the Independent Directors

The independent directors are the trustees of good governance and they should have the willingness to ask the hard questions. Their answers revealed the challenges faced by the independent Director on the board and were classified in six major themes.

a) Personality

The director responses revealed that individual personality trait matters in their board engagements. The law gives them responsibility to monitor and if they are not performing their role to their utmost satisfaction –it is a personality issue. Independent directors remarked:

"Assuming that the concept of Independent Director is not working, it is because of the individual, who is on the position"

"you cannot get value of a person who keeps himself mum knowing the situation well"

b) Power Distance

The independent director may prove useful because they have sufficient distance from management. This enables them to exercise their Independent judgment and outsight (Khanna and Varottil, 2016). However, in countries where ownership is not divorced from management and power distance is high; their freedom to participate is curtailed. In these cases, ID are indebted to the firm's CEO and are seen to be paralyzed in the presence of powerful CEO (Morck, 2004). Independent directors remarked:

"The IDs are free to express their opinions where they have hired a CEO. If it is the other way around, generally the board members are nervous to express their opinion."

"The Independent Director can be independent only when the views expressed by him are free from any constrains (monetary, power etc.)

"I would not accept an offer from the board where friends were in the board or are the business owners, because due to emotional pressure (of friendship) it might be that someday I agree to something, which personally I don't believe in."

c) Compensation

Most of the Independent Directors own insignificant amount of their firm's shares, and have limited incentives to monitor carefully (Bhagat and Black, 2002). The respondents shared that in general, the role of the nonexecutive person in the board involves no ownership interest in the firm, and for many people the remuneration and incentives are minimum incentives to perform the monitoring task conscientiously.

"A lot of people do not want to take the responsibility for the kind of liabilities involved. Many big corporations pay little for the kind of liability involved."

4.3.2.2 Referral for appointment of an Independent Directors

The person seeking ID role might not have presence or networks to enable his/her appointment. The person appointing them has to find them through their social circle and acquaintances. Hence ID's are appointed within the close group as it is challenging to find people and their profile who are actively seeking ID role.

According to resource dependency role, board serves as a provider of resources. It is generally seen that the CEO plays a critical role in the nomination process of an ID. Therefore, CEO would choose directors who would not oppose them. They seem to feel paralysed in the presence of powerful CEO (Morck, 2004). They note that when an organisation appoints an individual on the board, it expects that the individual will come to support the organisation, will concern himself with its problems, will patchily present it to others, and will try to aid it (Pfeffer and Salanick, 1978) Thus, the organisations appoint an independent director through multiple channels.

a) Appointed through community, friends, and network

The directors indicated the sources of their own appointments in the boards, and mentioned that they had strong association with the board members of the firm through their community, or they were known to them in informal social circles. An ID is often chosen on the basis of whether the person would fit into the firm's culture and be agreeable to family (Kar,2011).This was reflected when the majority of the participants mentioned that they would not join a firm if they did not know the firm prior to being appointed as an ID. However, there were views by some of the participants that they did not know the owners or the management before joining the organisation. Thus, it emerged from the discussion with the participants that culture played a dominant factor and often influenced the selection of Independent Director.

"I am well known in my community and because of that reason; I was approached by the concerned business owners to join the company as an Independent Director"

"Till date the Independent directors have been friends with the promoters. Unless a person is not loyal, they don't become an Independent Director, nor do the companies appoint you"

"I would not join an organisation where I do not know the management personally"

"I am not related to and did not know any one before joining the organisation"

b) Appointed through Database and through Head Hunter

Corporate governance reformers suggest that the state should also take an effective role in assuring that the directors are chosen on the basis of their ability (Baysinger and Bulter, 1985) and impartially. One of our participant who was a retired public service officer had her details on the PSEB web portal. The firm got her reference from the portal and approached her for the ID position. Few appointments were through the regular recruiter route.

"I was recruited through a head hunter as that is the prevalent norm here"

"Because I was in the public sector, and my details were available on PSEB (Public Sector Enterprise Bureau) I was approached by the public sector organisation for the role of the Independent Director as my name was in the Public Sector Enterprise Bureau"

4.3.2.3 Role Clarity

a) Willingness

Though an Independent Director has limited information regarding the internal matters of the companies, yet they bring with them the wealth of knowledge from their work experience before they join a board. Hence, they have plethora of experience that they have witnessed elsewhere. As stated by the participants of the research study, it is the duty of an Independent Director to think and act independently. This would also include his willingness and ability to ask hard and pointed questions, which nobody in the board would ask. This would force the management to act on such subjects. Thus, it is expected from the ID to challenge the board proposal when required.

"A person contributes by giving his opinion when the person has a view, and when he/she is genuinely independent."

b) Qualified

The Independent directors should have sufficient professional qualification. As evident from our sample that majority held degrees across management, finance, law, sciences and arts. Their experience also varied across manufacturing and services sector.

c) Performance Review

Under Schedule IV of the Companies Act 2013, broad parameters for reviewing (including Peer Review method or external evaluation) the performance of ID including knowledge, commitment, integrity, maintaining of confidentiality, effective deployment of knowledge and expertise is specified. Entire board of directors does this evaluation. This also means that Independent Directors (other than the Independent Director being evaluated) also becomes a part to assess the Independent Director being evaluated. As we discussed with the participants, the concept of peer evaluation was brought out as one of the strong codes to make the role of an Independent Director more effective.

"In many companies, the independent director meets twice a year, and the minutes of that meeting are to be given to the chairman of the board."

"We have clearly specified performance metrics for evaluating the ID and this is published in our annual reports."

"The Independent Directors should be evaluated."

4.3.2.4 Resignation

a) Lack of Transparency

The Independent Directors are expected to be the trustees of good governance. However, they are usually outsiders who have no ownership interest in a firm (Elson, 2004). They need to understand the business model of the firm and the business realities so that they are in better position to make the right decisions. Jensen (1993) concludes that the lack of quality information limits the ability even of the most talented Directors to make an effective contribution. Our findings also contribute to the established fact that the IDs spend little time about the matters of each firm's board where they serve; hence, to uncover the frauds was difficult because they often received only filtered information.

"Independent Directors are supposed to be given real and honest picture, so that they can contribute with true and real opinion."

When I joined this firm as an ID, I was inducted in the company and was introduced to all senior management, policies and practices of the firm."

"When things are done in a way, with which one does not agree to then, one should agree to part ways."

b) Misappropriation of funds

The primary responsibility of the Independent Director is the protection of the interest of minority shareholders. "Corporate board needs directors who are not merely independent of management, but who are accountable to shareholder as well" (Gilson and Kraakman, 1991). Independent Directors are expected to work towards the maximization of shareholder's wealth. In countries like India where the ownership is heavily concentrated and the promoters often hold substantial equity, exercise operational control and enrich at the cost of other absentee shareholder, it is essential that the Independent Director act as watchdogs. One of the reasons for resigning from an organisation for many participants was lack of transparency in the use of funds.

"I resigned from one of the organisation because I didn't want to be a part of something which was strange in use of funds"

"When the organisation is not transparent regarding the use of funds"

c) Non-availability

Section 149 (6) of the Companies Act 2013 specifies the provisions regarding an Independent Director. As per the code an ID would strive to attend all the meetings, including the general meetings and of the board committees of which he is a member. Though there is an option to attend the meetings through video conferencing, yet there were participants who believed that they would prefer to resign from the organisation if they were physically away from that place for a longer duration. One participant mentioned that a board member from her organisation had moved to another Asian Country (Singapore), and though there was an option available to attend the meetings via electronic mode, he/she preferred to resign, because of his/her unavailability for a longer duration of time.

"When I am not in the country"

4.3.2.5 Unwilling to join an firm

a) Acquaintance

Role of an Independent Director includes his/her ability and willingness to ask the hard and pointed question, which nobody in the board would ask, and would eventually force the management to act on such subjects. In this way, an Independent Director is expected to challenge the board proposals. In emerging economies like India, where the ownership is heavily concentrated setting numerical targets for Independent Directors through regulations would not improve corporate governance, because a director who is a personal friend of CEO could be independent in the eyes of the law, but unwilling to challenge the CEO (Duchin et al; 2010).

"*I would not accept an offer from the board where friends were in the board or are the business owners, because due to emotional pressure (of friendship) it might be that someday I agree to something, which personally I don't believe in"*

b) Transparency

For the Independent Director to function as an effective shareholder protection mechanism and play an active role in formulation of the long-term strategic, financial, and firm goals of the corporation, it is important that the organisation ensure that it facilitates the Independent Director with the honest and true picture. However, if the organisation displays a picture, which is in contrast to the reality, it creates conflict of interests. There were examples of participants who did not accept the positions at such places.

"After looking at the annual reports before joining the organisation I asked the company that why for the past 5 years the top line and the bottom line of the company are not growing, the management responded that everything is perfectly fine and the organisation is doing good. After this response, I did not join the organisation. Independent Directors are supposed to be given honest picture, so that they can contribute with true and real opinion"

c) Inexperienced in the sector

Each Director brings with him unique resources to the firm in terms of expertise, skill, and information. However, it was brought to light that some directors preferred to join the organisation in terms of sector, with which they were familiar.

"I am not aware how the space industry or the software industry works. I would not join such organisations"

"Independent Director should know about as to how the sector works, else it is difficult to pick up"

4.3.2.6 Others

a) Transparency

The participants felt that transparency is a necessary condition for their effective functioning on the board. They emphasized that mere presence is not sufficient; transparency needs to be experienced by all the stakeholders of the firm. They further opined that transparency is required in the way agenda is shared and discussed in meetings. Independent directors remarked:

"Financial integrity of the company and transparency regarding the same is extremely important"

"When there are critical topics like removal of the CEO or the decisions regarding the mergers and acquisitions, in such cases when there is no transparency, then a person finds it a challenge to deal with such situations."

b) Time constrain and limited number of meetings in a year

It emerged from the conversation with the participants that the Independent Directors are not involved in day to day management of the firm and attend only a limited number of board meetings in a year (between 4-5), hence knowledge regarding the internal matters is extremely limited. The number of meetings needs to increase to enhance engagement with the firm. Independent directors remarked:

"time duration between the two meetings is long enough, and with long intervals, that during that time period if there were things which needed attention were missed"

" for a continuous attention, and full contribution, the minimum required meetings should be increased in a year. The time is less, to contribute 100%"

"In reality, the Independent directors do not know enough as to what is going on in the company "

"*in a meeting of 2 to 3 hours, nothing much can be discussed or contributed"*

"the challenge faced is that I am not in constant touch with the concerned business"

5 Conclusions

The study analysed the challenges faced by independent director and tried to validate the theoretical perspectives at individual and board level. At individual level, personality of an ID contributed towards the effectiveness of his role. The personality is shaped by director's education, experience, and skill (Becker, 1964). Our data revealed that on an average, ID's are seasoned professional with an average experience of 37 years. They held master's degree and were having expertise in either finance or law in addition to their domain industry specific expertise. Thus, human capital of ID is pertinent to their contribution at the boardrooms.

At Board level, our findings indicate that ID's presence in social gatherings within the community members gave them the opportunity to build networks. They were comfortable to join a board where they knew the promoter group. However, few ID has defied the appointment through friends or acquaintances. These suggest that an ID who is a friend of CEO could be independent in the eyes of the law, but would not be able to challenge a CEO. This is in line with the established research that in emerging economies like India, where the ownership is heavily concentrated - setting numerical targets for Independent Directors through regulations would not improve corporate governance.

In India, the controlling shareholders have a strong influence on the selection of an ID and to be an active board member and serve as an Independent Director they may have to work amicably with management Also, as suggested in Milligram's experiment the Directors enjoy a positive sense of well-being from their "reflexive obedience" to the CEO (Sarkar & Sarkar 2012). This situation might lead to having friends and acquaintances as ID who might succumb to emotional pressure at some point. Thus, our findings suggest that to be part of the elite board circle, an ID needs to have representative social networks. These social networks help them to be appointed at ID positions and later retaining that position was facilitated through ingratiating behavior.

Further, as ID's are appointed "at the pleasure of someone else" hence the sense of indebtedness and gratitude is in the minds of the ID's. Analysis of multiple directorship in Indian companies identified that there existed an inner circle with respect to Independent directors sitting on corporate boards of family owned group affiliates. About 67% of IDs in group affiliates were also located within other group affiliates (Sarkar & Sarkar 2009). IDs and CEOs are often friends and social acquaintances (Solomon 1978) and if the IDs are "invited" to join the firm by CEOs then loss of directorship in one board may result in uncertainty of continuation in other boards (Balasubramanium 2016).

6 Policy Implications

Appointment of the Independent Director

Our study suggests that ID appointments should be strictly based on gap analysis (in terms of skills and experience) of existing board of directors of a firm. This should be followed by selecting ID through rigorous search using professional services for board level appointments. Nomination committee should discourage appointments, which might deter the rigor of this statute.

Role Clarity

The study suggests that regulators should explicitly state the role, which an ID needs to bring in the boardroom. These roles should be clarified and communicated to the prospective candidate for ID positions to enhance the efficacy of this governance mechanism.

Resignations

Resignations of ID are a cause of concern and further investigation by regulatory bodies should be encouraged. This would enable regulators to take timely preventive actions for the benefit of minority shareholders.

7 Suggestions

7.1 Ineffectiveness of independent directors

7.1.1 Personality

- The independent director needs to be sensitized about the responsibilities of the position and their duty towards the non-controlling shareholders.
- They should understand the business and should be made accountable for their actions/ silence.
- They should be encouraged to take advice from professional agencies to base their decisions for making well-informed interventions.
- The independent director should be able to identify the most critical issues for the board to deal with and assist the board in achieving consensus on important issues.
- The independent director should play the role of a facilitator outside the boardroom especially on contentious issues and work with the CEO to prioritise issues, set the agenda, and enable it to focus on substantive issues.
- The independent director must ensure that board conversations do not veer in the direction of certain unwanted topics / individual preferences. They should be encouraged to provide candid feedback to CEO, CFO post an executive session.

7.1.2 Power Distance

- Appointment of independent director can be mandated through nomination committees after doing proper gap analysis of the existing board members. The documentation of the same should be provided to the regulators.
- Promoters need to be sensitized about the importance of diverse viewpoints and should be encouraged to promote such culture in board meetings.
- Board should develop and follow a code of conduct and adopt a consultative approach in setting meeting agendas and record and share minutes of the meeting.
- The independent director needs to be empowered to challenge the promoters. One of the plausible way is by segregating the CEO and chairperson role. In this case, an independent director can be appointed as a chairperson. However, this could also lead to tensions between executive directors and independent directors. Alternatively, the

idea of the lead independent director can be explored who might act as a lynch pin between independent directors and executive directors.

7.1.3 Compensation

- Given the more onerous duties and responsibilities of independent directors, it might be left to shareholders to decide as to what is the best way to remunerate independent directors and, in that context, make appropriate disclosures.

- Although firms are regulated by statute on the quantum of sitting fees, excess intervention might lead to micro-management and is likely to be counterproductive in the longer term. Therefore:

  - A major proportion of director's compensation might be fixed based on the assigned responsibilities and time commitment, with the variable component linked to meeting attendance, contribution in board meetings, ability to stay abreast of industry and company developments and performance as measured by objective board evaluations.

  - As per voluntary guidelines, companies might be allowed to pay stock options with delayed vesting rights to non-executive directors including independent directors.

  - Companies may seek shareholders prior -approval on 'director remuneration policy' before making any payments towards compensation.

- The most important aspect with respect to remuneration is the level of accountability and transparency when it comes to determining the compensation practices for independent directors. In order to achieve this, companies should be encouraged to make adequate disclosures not only on director remuneration policies in terms of the components of remuneration but also on the established processes for determining director remuneration.

7.2 Appointment of independent directors

- We suggest that the firms need to adopt a professional, independent, and transparent approach for appointing independent directors. The pre-requisite should be to align their strategic priorities to skills required in their boardroom. This would ensure that the appointed independent director justifies the skill gap on the board. For instance, a company, which has embarked on a strategy of inorganic growth through mergers and acquisitions, will require a board member with hands on experience in pre-and post-acquisition integration. In the similar manner, company aiming to list abroad might prefer a candidate with experience in international business.

- In addition, Indian firms might like to explore the election of directors through the process of cumulative voting. This ensures greater participation by minority shareholders in director's election. This way of electing directors is permitted in Philippines and China and allowed under Indian Companies Act (on an optional basis), but remains unutilized.

- In case of controlled company, the proportion of independent director might be increased to 75% to increase the independence quotient at the board level.

- To address the frequent call for scarce competent independent director, the problem needs to be addressed immediately by conducting training for these roles. This problem might be partially addressed after inclusion of women director, which enhances the pool for selection of independent director. Existing independent director should also be encouraged to take at least one such training in a financial year.

7.2.1 Community and Friends

- Although there is a preference among firms to choose acquaintances on the boardroom, transparency in selection process can be encouraged.

- Additionally, full profile of the appointed independent director should be publicly disclosed on the stock exchanges websites with justification for considering his/her candidature.

- Also, there can be networking meeting conducted by industry bodies to encourage firms to meet professionals desirous of independent director roles. There are enough independent director repositories created by the three professional statutory bodies (namely The Institute of Chartered Accountants of India, The Institute of Company Secretaries of India, and The Institute of Cost Accountants of India) under the guidance of Ministry of Corporate Affairs to accomplish this growing need.

7.2.2 Database and Headhunter

- There is a need to devise and promote a professional body of qualified and experienced persons to venture out as professional independent directors who would primarily make a career out of being independent directors, besides serving as advisers and consultants, with due care to avoid conflicts of interest. These independent directors should be acquainted with firms in networking meetings and might be appointed through proper appointment procedure of the firm.

- In order that the independence of individual directors is protected and promoted, decisions relating to their appointment, performance, and separation are publicly disclosed. The non-controlling shareholders would be better informed if they have access to appropriate background information and periodical feedback.

7.3 Role Clarity

- The nomination committee in consultation with board might specify the profile of the independent director. Director search should be initiated based on these clearly established criteria. The director skill matrix can be utilized to define the existing skill set and those, which are required. This would ensure that the new independent director on the board fills this weak area and enhance the overall board profile.

- The board should ensure mechanisms to have enough representation of the independent director at board meetings. Accordingly, quorum of independent director should be mandated for meetings where flexibility to participate through video – conferencing is allowed.

- Matters involving key board decisions should be approved by majority vote. In this case, the majority should be constituted including majority independent director present/participating.

7.3.1 Willingness

- Intending and incumbent independent director should be encouraged to have the will and drive to act independently in the interests of the company and its stakeholders including absentee shareholders.

- In order to ensure independent board functioning, regulators might ensure that the individual directors concerned share the mission and drive to render their trusteeship service in the spirit it is expected to be exercised.

- The quintessential point to note is that service as independent directors has a large underlying public interest component (concerning absentee shareholders and other stakeholders) involving fairness and justice to concerned constituencies. Therefore, in electing independent directors, shareholders will largely have to be guided by the proposed individual's record of accomplishment and reputation.

7.3.2 Qualified

- Regulators should specify minimum educational qualification of the independent directors. They must also encourage training programs for the independent directors to address any shortfall in their required area of operation.

7.3.3 Performance Review

- It may be worthwhile to offer guidance on evaluating board's performance as a whole. Nomination or Governance Committee of the companies may have the flexibility to design their own evaluation formats. This evaluation becomes even more necessary since outside directors' including independent director performance may largely depend upon the information inputs and board processes adhered. More timely and relevant information will help independent directors to exercise their judgment on a better-informed and more objective basis.

- Independent Board Chair's performance to be carried out in confidence by all the board members. Similarly, performance of committee chairs to be carried out in confidence by all members of the respective committees.

- Each director individually and in confidence should be provided feedback on his or her performance evaluation on an aggregated basis, to protect evaluators' identities.

- Additionally, boards may also provide for individual counselling and mentoring sessions, led by the board chair or another senior board member with help from an external facilitator where one is engaged for the purpose. In addition, performance evaluation criteria should be publicly available in the annual report.

7.4 Resignation

- Regulators should encourage independent directors to explain the reason for resignation followed by detailed discussion in certain special cases.

- In addition, companies should encourage practice of dissent notes, practice of directors disclosing reason of resignation to regulators and shareholders. This will instil confidence in the non-controlling shareholders about these independent directors as they might have raised uncomfortable questions for the cause of company and minority shareholders.

- Stringent regulations should be in place to ensure that independent director is not removed/asked to resign before the end of their tenure. In case need, be there should be sufficient reason to do the same with respective right to the resigning independent director to be heard in the meetings.

7.5 Willingness to join

- All directors, when agreeing to join the board, explicitly or implicitly accept to commit required time and attention to the duties the position entails. In case of independent directors, the shareholders of the company employing them expect such directors to devote their full time or a substantial part of it to monitoring the business with full commitment and promote the interests of all the shareholders.

7.5.1 Acquaintance

- Boards need to take into account factors such individual accountability and responsibility on the part of directors when it comes to their selection on board.

- Commonly, director recruitment occurs in a relatively informal fashion. Personal networks form the basis for identification of additions to the board. Thus, this can also act as an excellent means for identifying competent, qualified, and interested individuals.

- Another issue that recommends use of personal networks is that established relationships between some subset of the board and a director candidate provide the board with a high level of information about the candidate, resulting in some measure of efficiencies in determining an appropriate fit.

7.5.2 Inexperienced

- Independent directors on the board of a company come from diverse backgrounds and more often than not, they are not from the same industry. Therefore, a formal on-boarding program for new directors is most helpful in getting new board members up to speed quickly and enabling them to contribute sooner.

- It is essential to educate the independent directors on the company's business model, industry, competitive landscape, as well as its recent history of successes or problems with financial reporting. A leading practice is to create a director manual for on-boarding purposes. Among others, the manual could provide a broad overview of the board's oversight processes as well as the company's critical financial, operational, and other risks.

7.6 Others

7.6.1 Time Constraints

- Independent director is pressed for time especially when they are engaged in multiple directorship. Therefore, during board meetings, rather than have managers walk them through presentations slide by slide, providing directors copies of the presentation slides and any supporting documents, at least two weeks prior to meetings allows management to operate on the assumption that directors will have carefully reviewed these materials in advance and negates the need for reading the presentations at the actual board meeting.

- A far more effective approach from a process standpoint is to have managers provide an executive summary of their presentation to get the conversation started and then utilize the board meeting time for constructive dialogue between management and directors

7.6.2 Transparency

- The management should be forthcoming in providing any document or information that the independent directors ask for.

- Institutional investors have been playing a complementary role and there is scope for this role to be strengthened.

- Media attention to companies' governance is drawn only when there is a big fraud or governance failure, because they make attractive headlines. The media needs to also highlight the achievements of competent boards.

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9 Appendices

A.1: Ownership classification by number and percentage of companies

Ownership Group	No. of Companies	Percentage of companies
Central Govt. - Commercial Enterprises	50	10
Joint Sector	1	0.2
NRI	1	0.2
Private (Foreign)	35	7
Private (Indian)	108	21.6
State and Private sector	1	0.2
Total	500	100

Source: Authors computation based on prowess classification

A 2: Industry classification by number and percentage of companies

NIC Range	Industry Classification	Number of Companies	Percentage of companies
0-3	Agriculture, Forestry, Fishing	7	1.40
3-9	Mining	6	1.20
9-33	Manufacturing	241	48.20
33-35	Electricity, gas, steam and air conditioning supply	14	2.80
35-39	Water supply; sewerage, waste management and remediation activities	0	0.00
39-43	Construction	25	5.00
43-47	Wholesale and retail trade; repair of motor vehicles and motorcycles	27	5.40
47-53	Transportation and storage	20	4.00
53-56	Accommodation and Food service activities	3	0.60
56-63	Information and communication	48	9.60
63-66	Financial and insurance activities	79	15.80
66-68	Real estate activities	3	0.60
68-75	Professional, scientific and technical activities	7	1.40
75-82	Administrative and support service activities	2	0.40
82-84	Public administration and defence; compulsory social security	0	0.00
84-85	Education	0	0.00
85-88	Human health and social work activities	5	1.00
88-93	Arts, entertainment and recreation	2	0.40
93-96	Other service activities	0	0.00
96-98	Activities of households as employers; undifferentiated goods- and services producing activities of households for own use	0	0.00
98-99	Activities of extraterritorial organizations and bodies	0	0.00
	Diversified	11	2.20
	Total Companies	500	100

Source: Authors computation based on National Industry Classification

A 3: Demographic of the sample respondents

Sl. No.	Gender	Experience (years)	Educational Qualification	Experience as an ID (years)	Directorships held in companies	International Experience
1	M	49	B. Tech	17	4	Yes
2	M	37	Ph.D.	10	5	Yes
3	F	35	Ph.D.	4	3	Yes
4	M	26	MBA	5	2	Yes
5	M	40	MBA	4	4	Yes
6	F	43	Ph.D.	7	4	No
7	F	16	CA	2	2	No
8	F	25	Ph.D.	2.5	1	No
9	M	35	MBA	6	3	Yes
10	F	26	MBA	4	1	Yes
11	F	25	CA	10	1	No
12	M	33	MBA	5	2	Yes
13	M	48	MBA	4	2	Yes
14	M	52	MS.C.	3	2	Yes
15	M	25	M.A.	5	2	Yes
16	F	15	MBA	2	2	Yes
17	F	23	Ph.D.	5	2	Yes
18	F	15	Ph.D.	3	3	Yes
19	M	38	MBA	6	2	Yes
20	M	41	MBA	2	2	Yes

A.4: CG Codes Development: International Scenario

Year	Name of Committee/ Body	Areas/Aspects Covered
1992	Sir Adrian Cadbury Committee, UK	Financial Aspects of Corporate Governance
1994	Mervyn E. King's Committee, South Africa	Corporate Governance
1995	Greenbury Committee, UK	Director's Remuneration
1998	Hampel Committee, UK	Combine Code of Best Practices
1999	Blue Ribbon Committee, US	Improving the Effectiveness of Corporate Audit Committees
1999	OECD	Principles of Corporate Governance
1999	CACG	Principles of Corporate Governance in Commonwealth
2003	Derek Higgs Committee,UK	Review of role of effectiveness of Non-executive Directors
2003	ASX Corporate Governance Council, Australia	Principles of Good Corporate Governance and Best Practice Recommendations

Source: Economic India info services

A.5: Move towards corporate board: selected developed countries

Board composition (Mix of inside & outside directors) Recommendations/Regulations	Recommending body/regulatory authority
• Majority/substantial majority independent directors	- General Motors Board Guidelines - IFSA Guidelines (Australia) - IAIM Statement (Ireland) - CaIPERS Core Principles and Guidelines (USA) - NYSE Listing Standards (2004) - ASX Corporate Governance Council (Australia) - Higgs Review (2003) (UK) - The Combined Code on Corporate Governance, 2003 (UK)
• Majority non-executives with majority independent	- PIRC Guidelines (UK)
• Minimum number of outside/independent directors	- Hellebuyck Commission (at least two outside members) - Cadbury Committee (at least three independent directors) - NYSE Old Listing Standards (at least three independents)
• Sufficient number of independent directors	- Panel on Corporate Governance (Germany) - OECD Principles of Corporate Governance

Source: Sarkar and Sarkar, 2012

A.6: Move towards an independent board: selected emerging economies

Board composition (Mix of inside and outside directors) Recommendations/Regulations	Recommending body/regulatory authority
• **Minimum percentage of independent directors**	- **China Securities Regulatory Commission (at least one – third independent)** - **Companies Act, 2013, India in line with SEBI –Listing Agreement Clause 49 (at least one – third independent)** - **IBGC Guidelines of Code of Best Practice of CG (Brazil) (majority independent directors)** - **Czech Securities Commission (at least 25 per cent independent directors)** - **HKEx Main Board Listing Rules (Hong Kong) (at least three independent non-executive directors)** - **Code of Corporate Governance (Singapore) (at least one – third independent directors).**
• **Some/sufficient number of independent directors**	- **The Polish Governance Forum (at least two members of supervisory board independent)** - **The Co-ordination Council for Corporate Governance, Russia.** - **National Stock Exchange of Lithuania.**

Source: Adapted from Sarkar and Sarkar, 2012

A.7: Independent directors: comparisons of definitions under various corporate governance regulations/codes

• **NYSE Listing Standards, 2004 (USA)**	**Affirmative determination** **'No director qualifies as "Independent" unless the board of directors affirmatively determines that the director has no material relationship with the listed company (directly or as a partner, shareholder or officer of an organization that has a relationship with the company). Companies must identify which directors are independent and disclose the basis for that determination.'** **In addition, lists conditions which lead to automatic disqualification as an independent director.**
• **Corporate Governance Principles and Recommendations, ASX Corporate Governance Council, 2007 (Australia)**	**Affirmative determination. Lists relationship which requires mandatory justification. Should be disclosed in the corporate governance statement.** **An independent director is a non-executive director who is not a member of management and who is free of any business or other relationship that could materially interfere with – or could reasonably be perceived to materially interfere with – the independent exercise of their judgement.**
• **The Combined Code on Corporate Governance, 2003 (UK)**	**Affirmative determination. Lists relationships or circumstances which require mandatory justification. '… The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement. The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination…'**

• **SEBI (LODR) Regulation 2015, (India) and Companies Act, 2013 (India)**	**Specifies a list of conditions, which lead to automatic disqualification. Non - violation of these conditions leads to presumption of independence.**
• **Guidelines of Code of Best Practice of CG, IBGC, 2003 (Brazil)**	**Specifies a list of conditions, which lead to automatic disqualification. Non-violation of these conditions leads to presumption of independence. Should a director identify pressures or constraints from the controlling owner affecting the performance of his/her duties, he/she should have an independent attitude when voting, or tender his/her resignation, as the circumstances may warrant.**
• **Code on Corporate Governance Practices, Main Board Listing Rules, HKEx, 2005 (Hong Kong)**	**Affirmative determination. Lists conditions, which lead to presumption of non-independence. Independent directors required to submit written confirmation of their independence with respect to the specified conditions and any other factors, not listed, that might hamper independence. Subject to continuous updating.** **The Exchange may take account of other factors relevant to a particular case in assessing independence. Allows companies to appoint an independent director who fails one/more of the independence tests by giving adequate prior justification to the exchange and making disclosures to this effect.** **Codes** **Serving more than nine years could be relevant to the determination of a non-executive director's independence. If an independent non-executive director serves more than nine years, any further appointment of such independent non- executive director should be subject to a separate resolution to be approved by shareholders.**

• **Code of Corporate Governance, 2005 (Singapore)**	**There should be a strong and independent element on the board, which is able to exercise objective judgment on corporate affairs independently, in particular, from management. No individual or small group of individuals should be allowed to dominate the board's decision-making.** **An 'independent' director is one who has no relationship with the company, its related companies or its officers that could interfere, or be reasonably perceived to interfere, with the exercise of the director's independent business judgement with a view to the best interests of the company. Lists conditions, which lead to presumption of non-independence. Mentions that the list is not exhaustive. Allows companies to appoint an independent director who fails one/more of the independence tests by giving adequate prior justification to the exchange and making disclosure to this effect.**

Source: Adapted from Sarkar and Sarkar, 2012