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RESEARCH REPORT ON 'DISCIPLINE OF INDEPENDENT DIRECTORS: FROM CODE TO CONTRIBUTION'

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Executive Summary

The present study 'Discipline of Independent Directors: From Code to Contribution' analyses the financial implications of presence, independence and involvement of Independent Directors on Board. Section 149 (1) of Companies Act, 2013 requires that every company shall have a minimum number of three directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company. However, presence on Board impacting the financial performance of the company is a big question. The purpose of the study is, therefore, to identify the presence, independence and involvement of Independent Directors on Board and assess its impact on the financial performance of the company. Also, the study aims to highlight the effectiveness of the provisions introduced in the Companies Act, 2013.

The study uses primary (survey questionnaire) and secondary data (raw data from Ministry of Corporate Affairs refined) to analyse the association between presence, independence, involvement of Independent Directors on Board and firm performance (Turnover, Return on Assets and Return on Equity).The collected data was analysed using statistical tools like MS Excel and SPSS (Statistical Package for Social Sciences). Statistical methods such as Descriptive analysis, Crosstabulation and Chi-Square test of association have been used to analyse the collected data. The limitation for the study was extracting the data from Annual Report regarding Return on Assets (ROA) and Return on Equity (ROE) as Annual reports of certain companies were not accessible online and also, firm performance is interpreted differently by different corporates leading to difficulty in analysing the data.

Even after certain limitations, the study was conducted and following interesting insights are drawn –

- The presence of Independent Directors on Board has positive financial implications on the company.
- There is significant association of independence given to IDs to present their views with firm performance implying that independence to present views by IDs can have a positive impact on firm's financial performance (Return on Assets and Return on Equity).

- There is a significant association between effectiveness of Board Evaluation Process and firm performance. That is, higher effectiveness of Board Evaluation process can have higher firm performance (Return on Equity).
- A significant association of involvement of IDs with Stakeholders and Auditors with Firm Performance was also found.
- It was found that there is a significant association of support by law to IDs and firm's performance (Return on Assets and Return on Equity) implying that more the support provided to IDs by the law, higher is the ROA and ROE of the company.

Based on the analysis, the study presents the following recommendations:

- *Creation of a Neutral database of Independent Directors*
- *Liability of Independent Directors needs to be reduced*
- *Authority, Independence and Involvement of Independent Directors must be increased*
- *Improvement in the method of Appointment in the Boards is recommended*
- *Check the overlapping regulations*
- *Encouragement of Women Participation in Board*
- *Ensure compliance of the law*

Chapter -1 Introduction

1.1 Background

India has always been known for the rich culture and unity in diversity. The same values and culture are being expected from the corporate world in the form of Corporate Governance. The concept had its roots since ancient times when the verbal agreements were entered into with the presence of independent person. It was rightly provided in the report of Cadbury Committee that Corporate Governance is the system by which companies are directed and controlled (Gordon, 2006).

Over the period of time, corporate governance in the management of the Company has gained its importance. Merely managing and administering the affairs of the Company by the Board of Directors is not sufficient; it must be in an efficient and effective manner in order to consider Board of Directors as strategic Asset for the Company. Independent Directors, an indispensable part of the Board, are not only responsible for guiding the Board for betterment of the Company but also to ensure the interest of the stakeholders and public at large.

The concept of Independent Directors has been discussed since long but it was first introduced voluntarily as a measure of good governance in the United States (U.S.) in the 1950s before they were mandated by law. Thereafter, owing to sustained efforts by the Delaware courts and stock exchanges in deferring to decisions of independent boards, independent directors took on greater prominence. The literature shows that until corporate scams come into the media spotlight or in judicial proceeding, researchers tend to ignore the inner dynamics of the board (Vallabh & Dadhich, 2016).

As mentioned in Report on Company Law by committee headed by J. J. Irani (2005), independent directors would be able to bring an element of objectivity to Board process in the general interests of the company and thereby to the benefit of minority interests and smaller shareholders. Independence, therefore, is not to be viewed merely as independence from Promoter Interests but from the point of view of vulnerable stakeholders who cannot otherwise get their voice heard.

Considering the recommendations of various committees, Independent Directors have been defined under Listing Agreement and Companies Act, 2013 by specifying the attributes to be possessed by the person in a way that the person does not have any pecuniary relationship with the company.

In India, most of the companies, including the listed companies, are family businesses and majority of shares are being held or indirectly controlled by one large group of shareholders. Thus, these majority shareholders are virtually operating and managing the companies in their own interest. Although, there is a stake of general public in the company but the actual involvement of general public in the management is limited as the numbers of shares are being largely diffused and such shares, even collectively, are not sufficient to affect the decisions of the large group/ majority shareholders. Further, because of their control over the company, the appointment of Board members including Independent Directors is completely in the hands of the majority shareholders. Therefore, it becomes more important for the regulators to intervene and ensure that the companies must have people in the management to protect the interest of the minority shareholder. (Article on Evolution and Effectiveness of Independent Directors in Indian Corporate Governance by Faculty of Law, National University of Singapore)

In Human Resource Management, it is always emphasised that corporates must have the right person at the right position and at the right time. As the Independent Directors have the major responsibility of safeguarding the interest of the shareholders and the company, selecting the right person is crucial. It was recommended by the Naresh Chandra Committee in 2009 that "the letter stating the terms and conditions of appointment of any NED or independent director should form a part of the disclosure to shareholders at the time of the ratification of his/her appointment or re-appointment to the Board (Chandra, 2009)." It has been observed from the past cases of Enron, Satyam, etc. that the Independent Directors are more like brand ambassadors rather than managers and thusthe qualification; experience and expertise were not given due consideration during the appointment of Independent Directors (Mehra, 2005).

The Companies Act, 1956 prevailing in India till 2014 does not talk about the Independent Directors. Although it was made compulsory for listed companies to appoint Independent Directors by virtue of Clause 49 of Listing agreement, there were no relevant provisions under the Companies Act. Considering the corporate frauds like Satyam and the reports of various committees, the concept of Independent Director was introduced in the Companies Act, 2013.

The Companies Act, 2013 not only defines the Independent Director but also specifies the Code of Conduct, Duties, Roles and Responsibilities, Number of meetings to be held, etc. through Schedule IV of the Act. The Act has extended the power of analysing the performance of the executive directors and has made them responsible for the acts being done with their connivance. However, the true meaning of Independence can only be practiced as Independence is state of mind and depends upon the individual's ability to challenge and ask the questions. Thus, it becomes important to create an environment where the Independent Directors can actually practice the independence.

1.2 Legal Framework

The concept of Independent Director was introduced in Clause 49 of Listing Agreement vide circular dated February 21, 2000 and was amended from time to time. On October 29, 2004, a master circular was issued superseding all earlier circulars with respect to Clause 49 of Listing Agreement. The definition of Independent Director was elaborated during the various circulars in order to promote corporate governance.

The Companies Act, 1956 never provided for the concept of Independent Director and thus, the concept was restricted to listed companies only. However, with the introduction of Companies Act, 2013, the concept of Independent Director has emerged and painted a new picture of corporate governance.

The Companies Act, 2013 vide Section 149 sub-section 6 has provided the criteria to be fulfilled to be an Independent Director of the Company. Independent Directors is a person who, including his relatives, is not a managing director, whole time director, nominee director and also does not have any pecuniary relationship with the Company or its holding company or subsidiary company or promoters or directors of the Company. The person must be of integrity and possess the relevant experience and expertise for providing useful insights to the Company.

The Act further specifies the professional conduct to be adhere to, roles, responsibilities and duties to be undertaken by the Independent Directors vide Schedule IV. The Schedule also provides for separate meetings of Independent Directors and for the performance evaluation of IDs by the Board. This is done with a vision of enhancing the involvement of IDs and to make them responsible for the decisions of the Board.

1.3 Objective of Study

The purpose of the study is to identify the level of the independence experienced by the Directors and to understand the effectiveness of the provisions introduced in the Companies Act, 2013. The objective of the Companies Act, 2013 to introduce this concept was to have such persons on board who are experts and experienced in their fields and does not have any interest in the company so that they can involve themselves in the management of the affairs of the Company to protect the interest of general public.

The focus of the study is to analyse the financial implications on the Company based on the involvement of Independent Directors. The experiences and challenges of Independent Directors in the Companies were also studied. The purpose was to assess whether they actually carry out proper due diligence and adequate deliberations during the meetings of the Company or not. Survey method has been used to ascertain the level of involvement of Independent Directors in the Company and challenges being faced by them while raising queries to the Company.

The overall objective is to understand the applicability of intent of the law and to contribute towards the measures for effective implementation of the objective for introducing the said provisions.

Chapter - 2 Literature Review

2.1. Background of the Research

Effective Board of Directors is vital for well-functioning governance structure and well governed corporation. Independent Directors play an important role in the Board to ensure effective governance. Functioning as an internal monitor, the boards are meant to improve the governance structure and corporate credibility. The Board directs the long-term business strategy, puts efforts to implement the strategy and monitors the achieved performance with set standards. The board when not fulfilling its responsibilities; leads to poor financial performance and corporate governance. Therefore, it is perceived effectiveness of Board members is associated with firm performance. This chapter discusses the importance of corporate governance, theories of corporate governance and scholars' view of the impact of role of independent directors on firm performance.

2.2. Importance of Corporate Governance

Corporate boards are an integral part of the corporate governance mechanism and acquire a dominant position in the internal corporate governance process (Brennan, 2006; Rose, 2005). The board maintains balance among the interests of managers and key stakeholders. Boards are responsible for due diligence, providing strategic guidelines to management and ensuring effectiveness of financial controls. Boards have the responsibility to review and revise management proposals and monitor their activities to ensure that the decisions protect the interest of shareholders (Jonsson, 2005). Corporate governance is the responsibility of the board which involves acting on behalf of the shareholders. However, there is a constant debate concerning the ability of boards to monitor management (Braun & Sharma, 2007).

The general structure of a corporate provides that the Boards of directors are responsible for the governance of their companies and the shareholders' role is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. As per the first version of the UK Corporate Governance Code (the Code), produced in 1992 by the Cadbury Committee, stated in report published by Financial Reporting Council (2014), the responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting.

Various theories of corporate governance define the code of conduct of Independent Directors and therefore, some of the theories are discussed as follows.

2.3. Theories of Corporate Governance

There exist divergent and at times conflicting objectives between managers and shareholders which has given rise to development of mechanisms in order to ensure that the cost associated with such divergent and conflicting interests is minimal. One of the proposed arrangements to this dilemma is corporate governance and agency theory has been the dominant paradigm in the corporate governance literature which is not surprising. Apart from agency theory, many other theories have attempted to highlight the ways in which a firm can respond to its different obligations. Some of the theories have been discussed below:

2.3.1. Agency theory

Based on the classical thesis on *The Modern Corporation and Private Property* by Berle and Means (1932), the principle-agent theory has emerged which is generally considered the starting point for any debate on the issue of corporate governance. According to the theory, major agency problems in modern firms arise due to the separation of finance and management aspects. Modern firms are seen to suffer from separation of ownership and control and therefore are run by professional managers (agents) who cannot be held accountable by dispersed shareholders. In this regard, the fundamental question is how to ensure that managers follow the interests of shareholders in order to reduce cost associated with principal-agent theory? The principals are confronted with two main problems. Apart from facing an adverse selection problem in that they are faced with selecting the most capable managers, they are also confronted with a moral hazard problem: they must give agents (managers) the right incentives to make decisions aligned with shareholder interests.

In further discussion of agency relationships and cost (Jensen and Meckling, 1976) describe agency relationship as a contract under which "*one or more persons (principal) engage another person (agent) to perform some service on their behalf, which involves delegating some decision-making authority to the agent*". In this scenario, there exists a conflict of interests between managers or controlling shareholders, and outside or minority shareholders leading to the tendency that the former may extract "*perquisites"* (or perks) out of a firm's resources and be less interested to pursue new profitable ventures. Agency costs include monitoring expenditures by the principal such as auditing, budgeting, control and compensation systems, bonding expenditures by the agent and residual loss due to divergence of interests between the principal and the agent. The share price that shareholders (principal) pay reflects such agency costs. To increase firm value, one must therefore reduce agency costs. The following represent the key issues towards addressing opportunistic behaviour from managers within the agency theory:

- *Composition of board of directors*: The board of directors is expected to be made up of more non-executive directors (NEDs) for effective control. It is argued that this reduces conflict of interest and ensures a board's independence in monitoring and passing fair and unbiased judgement on management.

2.3.2. Stakeholder theory

The agency theory is considered to be too narrow and strict since it identifies shareholders as the only interest group of a corporate entity. This necessitates further exploration. The stakeholder theory, on the other hand, considers a wider spectrum of interested parties. It stipulates that a corporate entity invariably seeks to provide a balance between the interests of its diverse stakeholders in order to ensure that each interest constituency receives some degree of satisfaction (Abrams, 1951). The stakeholder theory, therefore, appears better in explaining the role of corporate governance than the agency theory by highlighting the various constituents of a firm. Thus, creditors, customers, employees, banks, governments, and society are regarded as relevant stakeholders. Related to the above discussion, John and Senbet (1998) provide a comprehensive review of the stakeholders' theory of corporate governance which points out the presence of many parties with competing interests in the operations of the firm. They also emphasize the role of non-market mechanisms such as the size of the board, committee structure as important to firm performance.

Stakeholder theory has become more prominent because many researchers have recognized that the activities of a corporate entity impact on the external environment requiring accountability of the organization to a wider audience than simply its shareholders. For instance, McDonald and Puxty (1979) proposed that companies are no longer the instrument of shareholders alone but exist within society and, therefore, has responsibilities to that society. One must however point out that large recognition of this fact has rather been a recent phenomenon. Indeed, it has been realized that economic value is created by people who voluntarily come together and cooperate to improve everyone's position (Freeman *et al.*, 2004).

2.3.3. Stewardship theory

This theory, arguing against the agency theory posits that managerial opportunism is not relevant (Donaldson and Davis, 1991; Davis, Schoorman and Donaldson, 1997; Muth and

Donaldson, 1998). According to the stewardship theory, a manager's objective is primarily to maximize the firm's performance because a manager's need of achievement and success are satisfied when the firm is performing well. One key distinguishing feature of the theory of stewardship is that it replaces the lack of trust to which agency theory refers with respect for authority and inclination to ethical behaviour. The stewardship theory considers the following summary as essential for ensuring effective corporate governance in any entity:

- *Board of directors*: The involvement of non-executive directors (NEDs) is viewed as critical to enhance the effectiveness of the board's activities because executive directors have full knowledge of the firm's operations. Thus, it is believed that the appointment of NEDs will enhance decision-making and ensure the sustainability of the business.
- *Leadership*: Contrary to the agency theory, the stewardship theory stipulates that the positions of CEO and board chair should be concentrated in the same individual. The reason being that it affords the CEO the opportunity to carry through decision quickly without the hindrance of undue bureaucracy. We must rather point out that this position has been found to create higher agency costs. The argument is that when governance structures are effectively working, there should not be undue bureaucratic delays in any decision-making.
- Finally, it is argued that *small board sizes* should be encouraged to promote effective communication and decision-making. However, the theory does not stipulate a rule for determining the optimal board size and for that matter what constitutes small?

2.3.4. Resource dependency theory

This theory introduces accessibility to resources, in addition to the separation of ownership and control, as a critical dimension to the debate on corporate governance. Again, the theory points out that organizations usually tend to reduce the uncertainty of external influences by ensuring that resources are available for their survival and development. By implication, this theory seems to suggest that the issue of dichotomy between executive and non-executive directors is actually irrelevant. How then does a firm operate efficiently? To resolve this problem, the theory indicates that what is relevant is the firm's presence on the boards of directors of other organizations to establish relationships in order to have access to resources in the form of information which could then be utilized to the firm's advantage. Hence, this theory shows that the strength of a corporate organization lies in the amount of relevant information it has at its disposal.

In the light of the foregoing analysis, it is clear that governance mechanism seeks to protect the interest of all stakeholders of a firm. In recent times, the structure of laws and accountability issues regarding corporate governance is changing worldwide and directors are being held responsible every day for the success and failures of the companies they govern. Corporate boards are responsible for major decisions like changing corporation bylaws, issuing of shares, declaring of dividends, etc. This explains to some extent, the reason why discussions of corporate governance usually focus on boards. The board of directors is the "apex" of the controlling system in an organization and is there to monitor the activities of top management to ensure that the interests of shareholders are protected (Jensen, 1993). It acts as the fulcrum between the owners and controllers of the corporation (Monks and Minow, 2001) and regarded as the single most important corporate governance mechanism (Blair, 1995). The board of directors is the institution to which managers of a company are accountable before the law for the company's activities.

Studies have shown that boards of directors are effective mechanism for effective monitoring of managers (Byrd and Hickman, 1992; Fama and Jensen, 1983). Again, Fama and Jensen (1983) extend the argument that boards will be able to effectively monitor management when there are more non-executive directors (NEDs). According to Tricker (1984) the reasons for the need for regulation of companies is to prevent the abuse of corporate power and make the board of directors effective. Apart from the duty of loyalty to the company's shareholders, the board is also responsible for exercising due diligence in decision making. Specifically, it selects, evaluates and if necessary, replaces the CEO based on performance. Is there a link between corporate governance and corporate performance?

2.4. Corporate governance and Firm performance

Various scholars have studied the relationship between corporate governance and firm performance and found a positive impact of good corporate governance on firm's performance (Brickley*et al*, 1994; Brickley and James, 1987; Byrd and Hickman, 1992; Chung *et al*, 2003; Hossain *et al*, 2000; Lee *et al*, 1992; Rosenstein and Wyatt, 1990; Weisbach, 1988). In spite of the widely acclaimed notion that effective corporate governance enhances firm performance, various studies have found a negative relationship between corporate governance and firm performance (Bathala and Rao, 1995; Hutchinson, 2002) or reported to have not found any relationship (Park and Shin, 2003; Prevost *et al.* 2002; Singh and Davidson, 2003; Young, 2003). Several explanations have been given to account for these apparent inconsistencies. Some have argued that the problem lies in the use of either publicly available data or survey data as these sources are generally restricted in scope. It has also been pointed out that the nature of performance measures (i.e. restrictive use of accounting-based measures such as return on assets (ROA), return on equity (ROE), return on capital employed (ROCE) or restrictive use of market-based measures (such as market value of equities) could also contribute to this inconsistency (Gani and Jermias, 2006). Furthermore, it has been argued that the "theoretical and empirical literature in corporate governance considers the relationship between corporate performance and ownership or structure of boards of directors mostly using only two of these variables at a time" (Krivogorsky, 2006). For instance, Hermalin and Weisbach (1991) and McAvoy *et al.* (1983) studied the correlation between board composition and performance, whiles Hermalin and Weisbach (1991), Himmelberg *et al.* (1999), and Demsetz and Villalonga (2001) studied the relationship between managerial ownership and firm performance.

In their research, Dah, et al., (2012) portrayed opinions and findings on both positive and negative effect of Independent Directors on value of the firm. The statistical data utilised in the mentioned research shows that the observations had a mean of around 70% independent directors. The research concluded the existence of a significant negative relation between outsiders and firm value. Moreover, when the management is highly entrenched, an increase in outsiders will lower the negative impact of percentage independent directors on the firm value. There are studies to prove the idea that a board consisting mostly of outsiders can harm shareholders. However, in accordance to the research by Dah et al., (2012), in relation to the study post the implementation of Sarbanes Oxley Act, an increase in independent directors positively affected the firm value. Specifically, the negative marginal impact of the percentage of independent directors on firm value prior to Sarbanes Oxley Act has turned to positive after SOX.

Reguera-Alvarado & Bravo (2017) explained the effect of independent directors' characteristics on firm performance by assessing Tenure and multiple directorships characteristics of the board. The study concluded that the board's independence positively influences the firm's performance. However, this relationship exists only under certain values of directors' tenure and external directorships. It shows that these variables determine the effectiveness of independent directors. The authors suggested more specific approach, based on the personal characteristics of independent directors, in order to study their influence on corporate decisions, strategy and outcomes.

Khosa (2017), in his study on “Independent directors and firm value of group-affiliated firms” founded an inverse relationship between board independence and firm value of group-affiliated firms. The study was conducted in Indian context. The study considered a sample of 317 listed firms comprising 1,350 firm-year observations for the period 2008-2012. The observations illustrated that effective monitoring by outside directors is largely influenced by the institutional setting and ownership structure. The study does not find any evidence of different valuation when comparing non-family CEOs and family CEOs. However, it also provided that Independent directors play an important role to stop abusive use of related-party transactions in an environment where principal–principal conflict exists.

In spite of different studies providing for favourable effect on Company financial position, there are studies negating the concept. Further, in the present ecosystem, the financial benefits are not sufficient. The corporate world is heading towards good corporate governance and responsible business where the Independent Directors have a major role to play.

In accordance to the research undertaken by Institute of Public Enterprise, Hyderabad on “Duties of Directors – International Comparison viz-a-viz India”, the duties defined by USA, UK, Australia, Singapore, Malyasia and India are similar in nature. However, the Board Structure and appointment of Directors differs in the German Model and the Japanese Model. All the countries provide for committees of Board for better governance like Audit Committee, Nomination Committee, Remuneration Committee and Risk Management Committee. The audit committee is headed by an independent director in all the countries under reference. The composition of independent directors in the audit committee is 100 percent in the case of US and UK. Whereas, India holds at 66 per cent and Australia, Malaysia and Singapore composes 50 per cent independent directors as members in audit committees.

The research further depicted the views of committees and councils formed for analysing the law in their respective countries. The recommendations of such councils, be it ASX, Australia or SGX, Singapore or FRC, UK, has extended a focus on independence of the Directors in making their judgements and on the concept of Independent Directors. The Corporate Governance Policy is not very effective in Malaysia and for betterment of governance, seven

CG principles was outlined as a guideline to corporate sector. Out of these seven principles, 3rd principle talks about the policies and procedures Board is required to have to ensure effectiveness of independent directors.

Although, the recommendations suggest having independent directors, there is not much literature or research supporting the positive linkage between presences of independent Directors and enhanced corporate governance. In a study by Cohen et al., (2012), it was concluded that the past track records and backgrounds of all board members (beyond simply independent vs. inside) may be a useful way to identify cross-sectional variation in firm governance quality. With respect to the correlation of independence of Boards and benefit to shareholders, the researchers suggested to conduct more research to determine the true nature of "independence" within corporate boards, which begins with an understanding of the true independence of directors.

Although all the jurisdictions have been heading towards inclusion of independent directors, the scandals in the corporate world makes the effectiveness of such provisions questionable.

Balasubramanian (2013), in his study, discussed about strengthening Corporate Governance in India by reviewing Legislative and Regulatory Initiatives in 2013-2014, wherein the concern was raised with respect to the number of directorships an individual can hold according to the Act. Arthur Levitt, former SEC Chairman once estimated that some 22 working days were required to do justice to an independent directorship of a large US listed corporation. The American average of board positions hovers between two and three. But there will always be a limited few who are in much greater demand. In India, in 2010 for example, highly boarded directors (defined as sitting on five or more NSE 100 company boards) were 71 (6%) of the total 1104 director positions and controlled 66% of market capitalisation of all NSE listed companies.

It was further deliberated that improvements to promote the importance and contribution of independent directors, some would argue the Act has overreached itself in making the institution of independent directors very difficult for the directors to do justice to as they are mostly dependent on the executive management for information. It was also observed some of the provisions of the Act tend to tilt the balance towards the latter structured format of do's and don'ts which may hinder rather than help independent directors efficient functioning. The overall impression of the paper provides that there was lot of opportunity to improve the governance to higher standards. This provides a scope to understand the improvements after the Act being implemented and effective for a period of more than 2 years.

A study by Haldar (2017), in association with National Foundation for Corporate Governance, discussed the data on financial performance measures and control variables (such as leverage, book- market ratio, firm size, age) of 500 large listed companies from the period 2004 to 2016. The objective of the research was to analyse the composition of independent directors, their role along with relationship with other functional directors in firm's policy decisions to ensure growth and shareholders' value for the firm and to identify major constraints for effective implementations of independent directors' guideline in the interest of each stakeholders of firm.

After the analysis of the data, it was 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. At Board level, the findings indicated that ID's presence in social gatherings within the community members gave them the opportunity to build networks. 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. Analysis of multiple directorships 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, 2015).

This study gives a base to the further research to identify the level of independence being experienced. Although the Independent Directors are coming from social circles, the Act provides for stringent provisions to behave in responsible manner which may force the IDs to undertake due diligence and protect the interest of general public.

There is a need to identify the challenges being faced by the IDs and the corporates in executing the intent of the law. It also extends the scope of the study to understand the incentives available to the Independent Directors for making the regress efforts to comply with the intent of the law.

In one of the studies undertaken by analysing the large sample of US companies for the period 1997 to 2013, it was showed that within-board heterogeneity among independent director's individual incentives affects monitoring effectiveness (Osma et al., 2017). Osma et al. (2017) revealed that monitoring directors significantly reduce real earnings manipulation. The final conclusion of the study is consistent with the possible influence of managers over the nominating process of independent directors, and following Levitt and Malenko's (2016) predictions, which showed that monitoring directors have the incentives to relax their vigilance over the financial reporting process when the level of governance worsens. This is consistent with the idea that independent directors have the incentives to create reputations that will provide them with rewards in the labor market.

2.5. Conceptual Framework

The study of literature pertaining to the role of independent directors in the board and its impact on firm's performance suggests that corporate governance and its relation with firm performance should be assessed using both qualitative as well as quantitative approach. The present study adds to the literature by exploring the relationship of financial performance measures such as return on assets and return on equity with selected governance variables. In addition to board characteristics, the study considers governance variables like appointment of directors, their time involved in various aspects, behavioural aspects, experiences and challenges faced by them as well as their opinion about the prevailing law. The study combines survey and publicly available governance data to broaden the scope of governance variables.

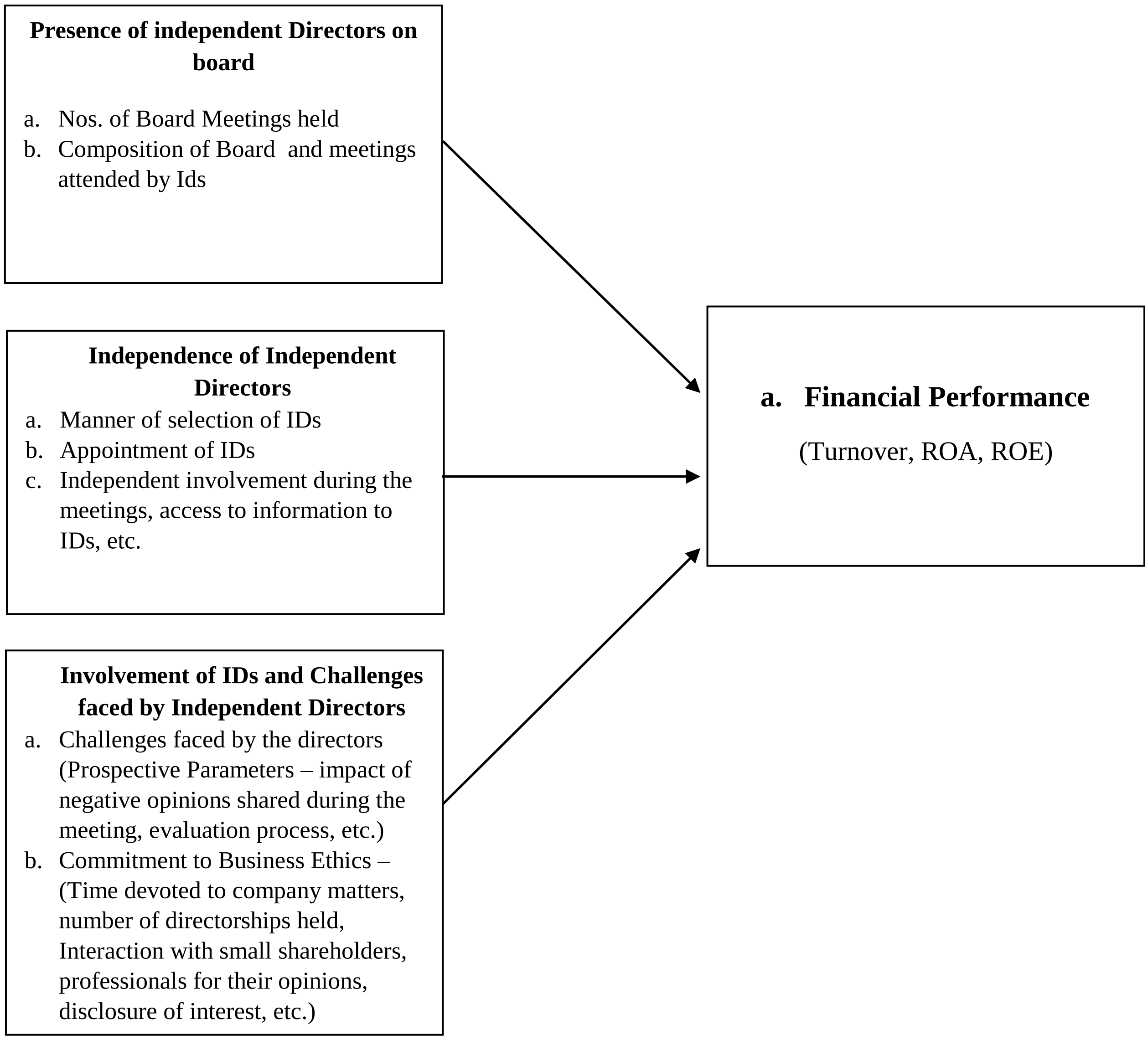


Figure 2.1 Research Framework

Chapter - 3 Research Methodology

The study focused on the conduct of Independent Directors in India and its impact on the performance of the board of the company/ companies they are a part of. The research has been conducted with the following objectives:

- To study the presence of independent directors on board and its impact on financial performance of the company.
- To assess the impact of Independence of Independent Directors on financial performance of the company.
- To explore the involvement of Independent Directors and analyse the challenges faced by them and their impact on financial performance of the company.

3.1 Research Approach

The study used a deductive research approach which is concerned with testing a theory. The purpose of the study, to assess the impact of conduct of Independent Directors on firm's performance, can be fulfilled using a deductive and top down approach. Deductive approach uses stating and proving a hypothesis. Top down approach involves decomposition of information. It is applied where knowledge base is present and analysis is done by creating, manipulating and linking data.

3.2 Data Collection Methods

The study used both qualitative as well as quantitative research design to fulfil the objectives. Both primary and secondary data collection methods were used to collected data. The data collection tools used were survey questionnaires and databases from MCA, DPE, NFCSR with information about Independent directors were utilised. The questionnaire involved questions regarding the following aspects:

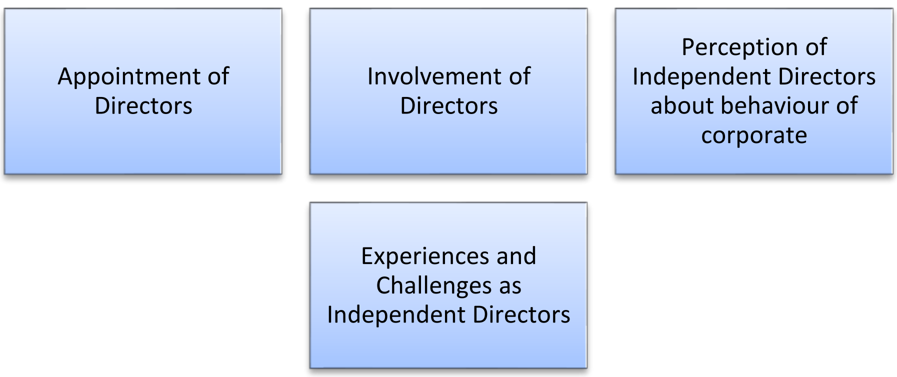


Figure 3.1 Questionnaire Structure

The questionnaire included Multiple choice, Likert scale and open-ended questions to highlight the discipline and perception of Independent directors.

3.3 Variables and Measures

The study aims at exploring the impact of presence, Independence and Involvement of Independent Directors on form's performance. The dependent and independent variables considered in the study are as follows:

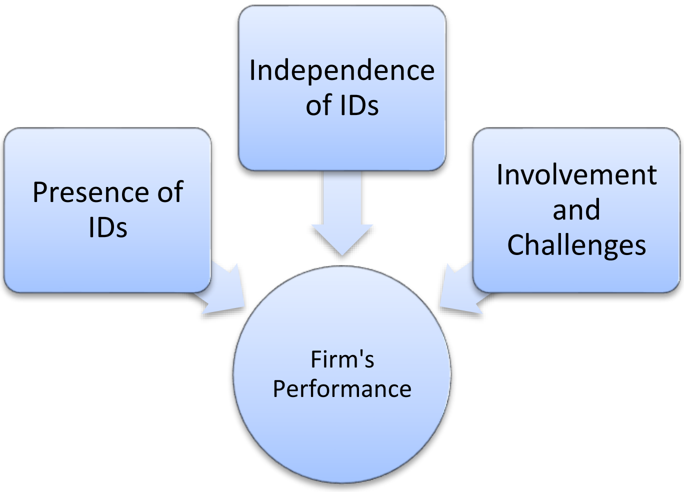


Figure 3.2 Independent and Dependent Variables of the Study

3.4 Sampling Methods

The research uses primary data of 113 respondents (Independent Directors) collected using survey questionnaires and secondary data of 100 companies. Survey questionnaires were distributed to several Independent Directors. Convenience sampling method was used to derive the sample. The responses received in stipulated time period of research were all considered for analysis.

3.5 Data analysis

Exploratory analysis would be conducted in the research followed by hypothesis testing. Exploratory analysis is conducted to understand the characteristics of the data beyond what hypothesis testing can tell about the data. Data analysis has been conducted using MS Excel and Statistical Software for Social Sciences (SPSS).

3.6 Ethical Assurance

It has been ensured that the participants are well informed about the aim of the study and their consent is taken for the use of their responses. The research is ethically reliable as it has been assured that no ill-acts have been conducted to collect the data. The respondents of the questionnaire were well informed about the purpose of the data and know where the data is going to be used.

General questions related to appointment of the respondent in the organization, experience of the respondent, number of meetings attended, perceptions of respondent about the behavior of board and applicable law and it was their discretion whether to answer personal details or not.

Chapter – 4 Data Analysis

In the previous chapter, the design of the whole research was discussed which helped in collecting the data and selecting tools for analyzing it. With the help of appropriate statistical methods and tools, the data have been analyzed. The current chapter of data analysis will help us in gaining insights about the data. It will assist us in extracting useful information from the data. The data has been tested and results have been drawn using various statistical techniques. Qualitative and quantitative data analysis forms the framework for the data analysis portion. In the initial portion, qualitative analysis is discussed, followed by secondary data analysis and finally the data analysis of primary responses collected through survey questionnaires.

4.1. Qualitative Analysis

To analyse the impact of independence and conduct of independent directors on firm performance, a qualitative analysis was conducted using the opinion of independent directors. Independent directors of 100 companies were approached and were asked about their appointment, time devoted by them in the company, experiences and challenges faced by them. They were also asked whether Companies Act, 2013 enables you to effectively discharge their duties as an independent director. Moreover, their opinion about the Companies Act, 2013 was also solicited.

Companies Act, 2013 enables you to effectively discharge your duties as an independent director. Do you agree?

When asked whether Companies Act, 2013 enables independent directors to effectively discharge their duties, majority of them agreed to the fact that laws prescribed in Companies Act, 2013 promotes performance of independent directors.

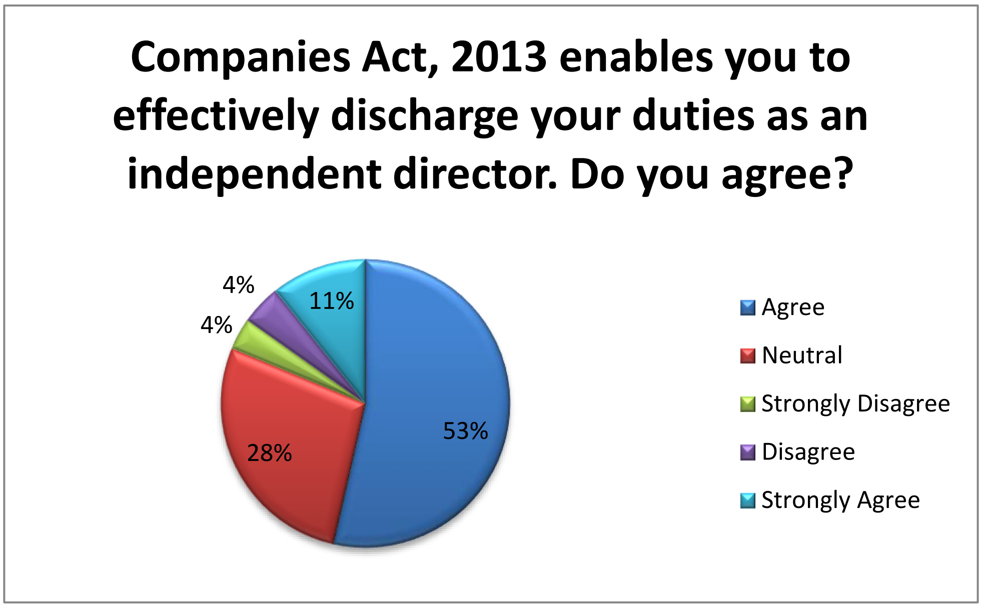


Figure 4.1 Opinion of respondents about support provided by Companies Act 2013

57% of the independent directors believe that Companies Act, 2013 is helpful for them in effectively fulfilling their responsibilities. Some of them (26%) were neutral about their opinion about Companies Act, 2013 and its impact on performance of independent directors. On the other hand, a few of the respondents (11%) strongly believe that Companies Act, 2013 is a hindrance for independent directors to effectively discharge their duties.

What is your opinion in regard to the applicable law on Independent Directors?

Majority of the respondents showed interest in expressing their opinion regarding the applicable law on independent directors. Many respondents are positive about the applicable law on Independent Directors. Very few have negative opinion about the law while majority (67%) have suggested improvements in the law for better applicability and enhancement of performance of Independent Directors.

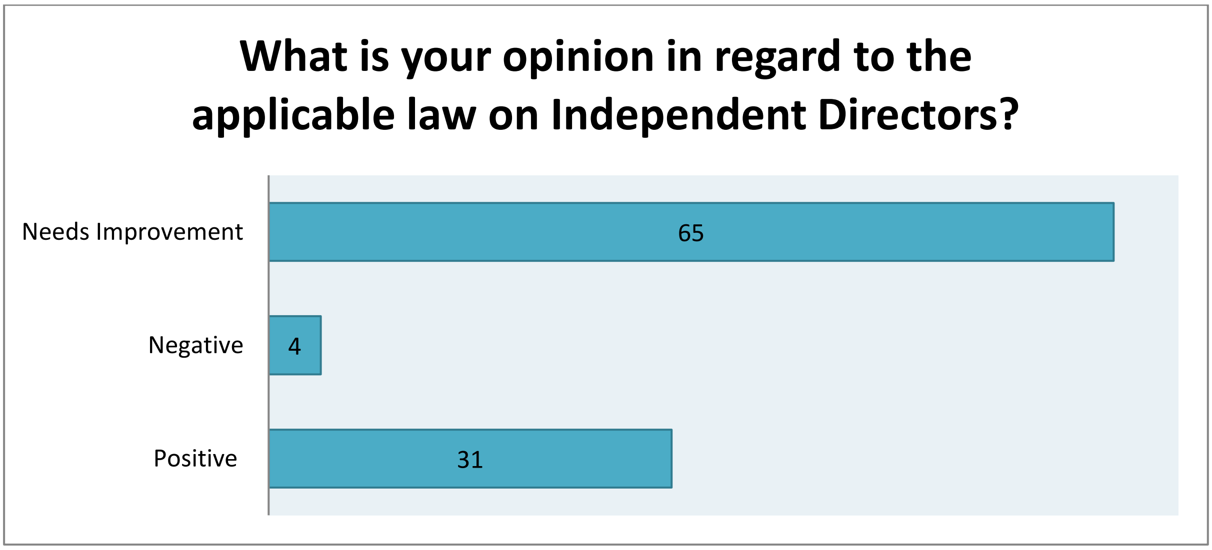


Figure 4.2 Opinion of respondents about the effectiveness of applicable law

Various positive and negative reviews of Independent Directors have been discussed below:

Positive

Many positive reviews about the applicable law have been submitted by the respondents. Some of them are:

"It is evolving and expected it to be better after Kotak Report and amendments to the Act"

"Satisfactory", "Relevant", *"Excellent", "Reasonable", "Adequate"*

"The law has become more specific. It is good as it improves the sense of responsibility of the independent director"

"It has led to good corporate governance practices and ensuring that the interest of minority shareholders is protected"

"The existing law is quite comprehensive."

"Applicable Law serves well"

The overall perception of the Independent Directors is positive. They believe that the applicable law is adequate and has led to good governance practices. It has generally benefitted the interests of Independent Directors.

Negative

Apart from the positive comments, Independent Directors have pointed out the problems they face with respect the responsibility, accountability and regulations of the applicable law. Moreover, some of the respondents have even mentioned about the complications of the law. Some of the negative comments have been mentioned below:

"Accountability & responsibilities On Independent Directors Have Increased"

"Since independent Director is not fully aware of the day to day decisions and processes, the liability specially for financial and strategic decisions should be limited"

"Too many regulations. Need to keep it simple"

Suggestions

The responses of Independent Directors have majorly been positive about the applicable law; however, they have not hesitated to provide suggestions for improvement. The major suggestions are related to the enhancement of the authority given to the Independent Directors, lowering the liability and responsibilities of them and change in the method of appointment of Non-Executive Directors. As per the Independent Directors, the law needs to be relooked at in terms of practical effectiveness from both companies as well as ID's point of view.

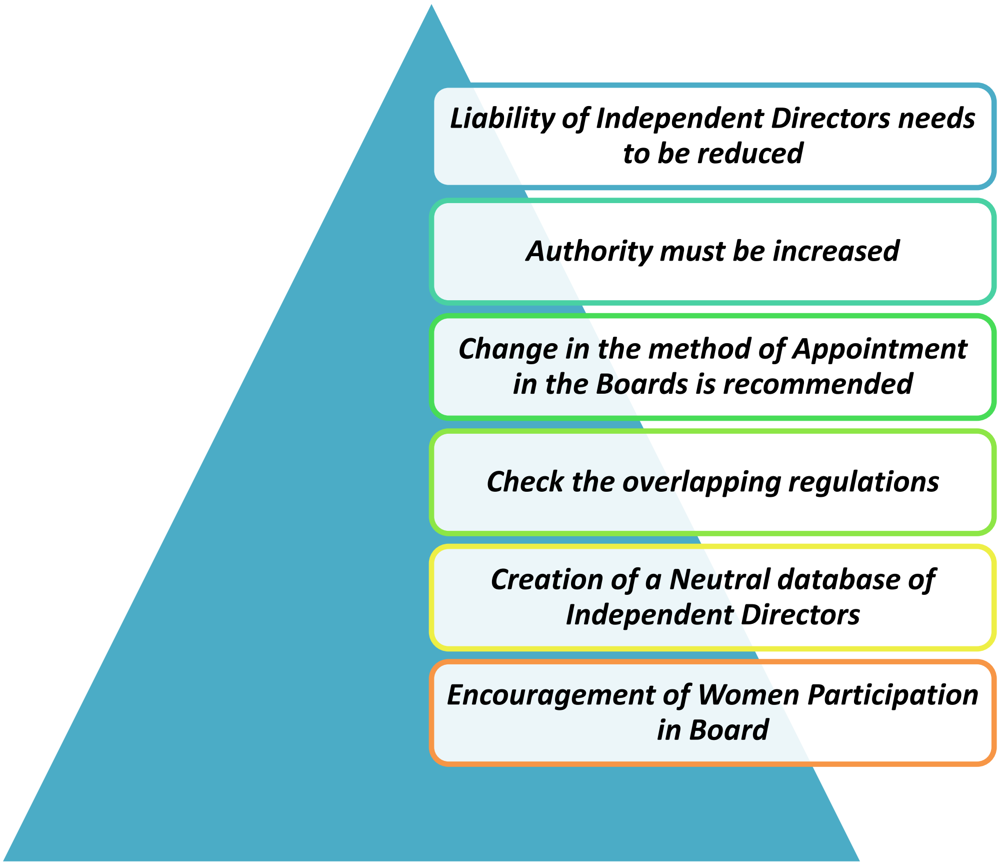


Figure 4.3 Recommendations given by respondents for improvement in applicable law

The comments of respondents have been stated below:

1. ***Liability of Independent Directors needs to be reduced***

Many of the respondents were of the opinion that putting onus for any act of commission or omission upon the Independent Director, almost as much as on Executive Director, is unfair. The Independent Director is involved only in the Board Meetings to evaluate the performance of the company on the basis of the material placed before him and that too only at the macro level.

Since the day-to-day decisions of financial management are not known to them, nor do they have any association while preparing Audit Reports that cover many financial transactions,

payments, taxes and other various compliances in micro details, Independent Directors, at times, are compelled to sign it along with the CEO/CFO of the company. In case any irregularity is noticed later, the Independent Directors, sometimes, have to face legal consequences and acute embarrassment. It is difficult for the Independent Director to know the exact details.
Therefore, their role should mainly include evaluation of the performance of the company, good governance, ensuring compliances and transparency, following ethics and formulating strategies for improvement of the performance. They can play important role if serious financial irregularities come to the notice. They should also ensure that objectives of the company are not compromised and nothing is attempted to be kept under the carpet.

Some of the excerpts showing that IDs liability should be reduced are as follows:

"Since independent Director is not fully aware of the day to day decisions and processes, the liability specially for financial and strategic decisions should be limited"

"Section 149 gives a strong protection to independent directors of companies with public sharehoding. However twice arrest warrants have been issued against me under 138 of NI act because of dispute on some cheque issued by some executive and I have been required to travel and take bail. I have also received summons for appearance in some court for a company whose board I resigned in 2011. There must be clear guidelines about protection from it and criminal laws "

"Pecuniary/financial liability of any kind should not be there on Ind Director"

"Law is OK. Lots of Improvements have happened over the last few years. However the recent instances of Independent Directors Bank accounts and assets being frozen and CBI chargesheet, SFIO actions without adequate investigation of the Independent Directors role or involvement is very unfortunate and it will dissuade many good people from taking up the Independent Directorships"

"Independent Directors should be not dragged to liability on account of company's default"

2. ***Authority must be increased***

As per the respondents, the flow of information is controlled by the management. However, Independent directors are held equally responsible even if he/she was not involved in a decision or action. This creates feeling of insecurity. Hence more than value addition, concern is to save oneself from any future implications.

With this respect, the respondents consider that their authority must be increased.

"Independent Directors need more authority. They should not be close associates of Management"

"Management controls the flow of information. However, Ind. director is held responsible even if he was not involved in a decision or action. This creates feeling of insecurity."

"The applicable law on Independent Directors needs to be tightened to ensure that bonafide decisions take by them, based on the information provided to them by the Company management, does not lead to punishment. In some recent cases, such bonafide decisions have landed IDs in trouble. Unless this lacuna is addressed immediately, Corporate Governance standards will plummet because competent Independent Directors will be unwilling to join any Board"

3. ***Improvements in the method of Appointment in the Boards is recommended***

There is a lack of clear and defined appointment process of Independent Directors in India (Varottil, 2010). The selection of Independent Directors is mostly based on recommendations from promoters, company, acquaintances or on nominations. This method does not assure selection of the right fit. Moreover, there is scope for transparency in the appointment procedure. Apart from the appointment, the evaluation process also needs improvement.

"Highly skilled, experienced, committed and sincere senior professionals are available and have also registered themselves in the panel maintained by GOI and various professional bodies. But, unfortunately the Independent Directors are appointed by companies and PSUs/PSBs only through their known sources or there is no transparency in the selection of Independent Directors. Unless this situation improves, the law will continue to be ineffective"

"The selection of Independent Directors for PSUs have not remained independent. Instead of experienced domain experts preference is being given to ex -IAS or recently to political affinity so the whole idea of ID has been vitiated"

"For GOI appointments, there is no proper evaluation system of IDs. The only meaningful evaluation can be by asking the IDs to submit a summary of their viewpoints / contributions quarterly to the respective departments of GOI with a copy to DPE / Corporate Affairs Ministry."

4. ***Check the overlapping regulations***

The respondents complained about the complexity of rules and regulations and overlapping provisions with regulatory authorities.

"Overlapping provisions in Companies Act, SEBI / RBI / IRDA guidelines need to be addressed"

"Complicated as SEBI rules and Companies Act prescribe different things/thresholds on the same matter. Example quantum of pecuniary interest"

5. *Creation of a Neutral database of Independent Directors*

The respondents have encountered compromises and biasedness in their appointment procedure. It has been witnessed that Independent directors are rarely chosen based on qualification and/ or experience of the candidate, but mostly through close associates or nomination basis. One reason for such biased appointment is absence of a neutral database of information about IDs from where the companies can appoint the Independent directors.

A neutral repository having the credentials of Independent Directors needs to be introduced by the authority. This can serve as a database of Independent Directors' basic details (personal and professional information, past and current directors) for fair and just appointment of Independent directors on Boards of the corporates and PSUs. The repository also allows proper evaluation of performance and achievements of Independent Directors.

The repository needs to be developed to facilitate individuals who are eligible and willing to act as Independent Directors and to facilitate Companies to appoint people who are eligible to act as an Independent Director for their Board under Companies Act, 2013. This would help in mapping of right expertise and competency with the requirement of the Board.

The global best practices of appointment and evaluation of Independent directors on Board are discussed as follows:

Malaysia	The Malaysian Directors Academy (MINDA) is mandated to establish a Directors Registry for Nomination Committees to select Independent Directors/ Board members. The directory has information about retired professionals and public officers from the MOF regarding their leadership experience, national and regional background.
China	As per the Regulations on State-owned Assets of Enterprises, Independent Directors should have professional knowledge and competency. Also,

	‘character’ is an important aspect for appointment on Board.
Korea	As per the Article 30 of the “Act on the Management of Public Institutions”, to be an Independent Director, good knowledge, experience, and competent ability is essential.
Morocco	As per the Moroccan Code of Good Governance Practices of the Public Enterprises and Establishments, the board of directors of State Operating Enterprises are appointed on the basis of their professional competency and expertise.
UK	The UK Corporate Governance Code allows setting up of a nomination committee, a majority of whose members should be independent non-executive directors, to select and appoint the Independent Director.
Thailand	The State Enterprise Policy Office (SEPO) is designated with developing a profile of board skills called “Skill Matrix” in order to identify skilled and potential members. The candidates with appropriate knowledge, competencies and expertise, as indicated by the questionnaire responses by Thai authority, are chosen. The authority uses age, educational qualifications, relevant work experience and Thai nationality as the qualification criteria for the pool.
Viet Nam	The Decree 97/2015/NĐ-CP dated 19/10/2015 and the Decree 106/2015/NĐ-CP dated 23/10/2015 provide guidelines and regulations on the board nomination criteria and an official nomination and appointment procedure. Specialty and management skill are a prerequisite qualification for board member nomination and the board is responsible for identifying its skills needs and communicating them to the relevant decision makers. The Prime Minister decides and promulgates general qualification criteria and the line ministries and provincial committees issue a detailed instruction regarding SOE business characteristics.
India	Qualification criterion is developed by the line ministry overseeing the State Operating Enterprise in consultation with the concerned SOE and it usually varies with the functional role of the concerned Director. In addition to education and relevant expertise, the DPE guidelines lay down maximum age

	as 65 years for independent directors. It can be relaxed on a case-by-case basis by the government, according to the questionnaire responses by the Indian authority.

Some of the responses validating this recommendation are as follows:

"The law is very stringent on liabilities of Independent directors while the reward is very low in Government sector. There is no insulation for recommending honest decisions by Independent Directors. Much after retirement also, questioning by agencies for genuine decisions based on information provided to the Board is not a good practice. For GOI appointments, there is no proper evaluation system of IDs. The only meaningful evaluation can be by asking the IDs to submit a summary of their viewpoints / contributions quarterly to the respective departments of GOI with a copy to DPE / Corporate Affairs Ministry. All other methods will lead to conflict of interest. Evaluation of independent directors does not take place in GOI companies since it will be a conflict of interest to evaluate a director by other directors, especially by the Executive Management. Only for the sake of facilitating submission of the above form, less than 15mins is filled in as an option for the respective question."

"Selection of independent directors should be done through a neutral database which is not happening today. Present appointment of Independent of directors is highly compromised and independence of independent directors is suspect"

"Presently, Independent Directors are NOT being appointed by the Companies in accordance with the provisions of Section 150(1) of the Companies Act,2013 as appointments are not being made from the Panel/Website notified by MCA as required under Section 150(1)"

6. Encouragement of Women Participation in Board

Gender diversity in board is considered to be an important aspect in corporate governance. The effectiveness of board of directors depends upon many factors such as experience, qualification and level of involvement of directors. Many scholars have suggested that apart from these factors, gender diversity and composition of Board are also important factors that enhance board effectiveness (Campbell and Vera, 2007). However, it has been observed that women participation is low on Boards in Indian companies. Women participation needs to be encouraged to enhance diversity and firm performance.

"*There should not be a cap or a ceiling on the number of companies that women can become Independent Directors. If Diversity and Inclusion has to be encouraged, women should be free to take on as many companies as they desire since they are capable and merit counts"*

Conclusion

In view of the recent developments regarding the role of IDs, it is advisable that the duties and responsibilities of IDs are elaborated clearly. Selection of IDs must be made more transparent and objective in all Companies, both Govt PSUs and private sector to ensure that the best talent is utilized for the purpose and role of IDs. Independent Directors position must have endorsement by the Company Law Board so that they acquire legitimacy and are not dependent on the promoters/ company/ other directors for their selection in the board.

Apart from ensuring fair and strict appointment methods, liability and responsibilities of the Independent Directors must also be checked. Independent Directors should not be held responsible for the day to day management but given charge of the strategic decisions and ensuring fair implementation of the policies. Overlapping provisions in Companies Act, SEBI / RBI / IRDA guidelines should also be addressed and a neutral database with profiles of Independent Directors must be generated to ensure an easy and fair appointment procedure. Finally, women participation in Board must be increased.

4.2. Quantitative Data Analysis

Qualitative data analysis is divided into two parts: Secondary and Primary Data Analysis. This section begins with secondary data analysis that provides that provides information about the compliance status of the company with respect to Provisions of Independent Directors. Secondary data analysis is followed by primary data analysis that attempts to show the association of independence and experience of Independent Directors with firm's performance.

4.2.1 Compliance of Provisions of Independent Directors-Status of Companies

The compliance status of companies with respect to Provisions of Independent Directors has been discussed as follows:

Directors: 14184. (Listed=6588 and Unlisted=7596)

A. Number of Companies Complying with the Provisions of Independent Directors: -

a) Listed= 5268
b) Unlisted= 5778

B. Number of Companies Defaulting the Provisions of Independent Directors: -

a) Listed= 1298
b) Unlisted= 1825

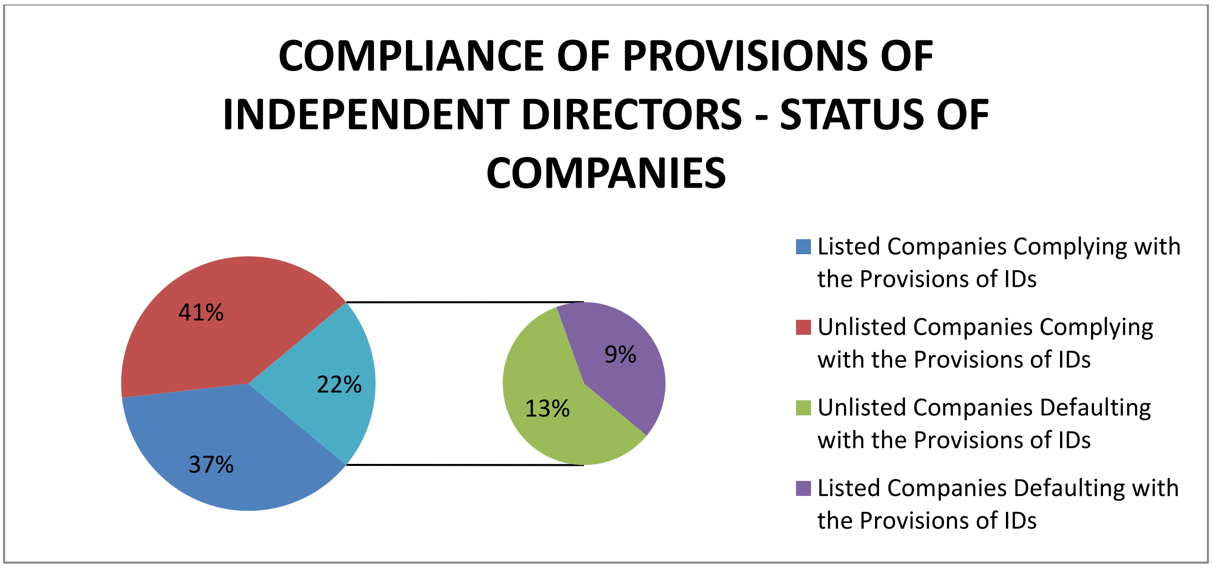


Figure 4.4 Compliance of Provisions of Independent Directors- Status of Companies

4.2.2. Presence of Independent Directors and Turnover of company

The presence of Independent Directors in a company has been measured using average attendance of IDs in Board meetings and average number of Board meetings conducted in sample 100 companies. Their association with company turnover has been presented in this section using correlation and frequency analysis.

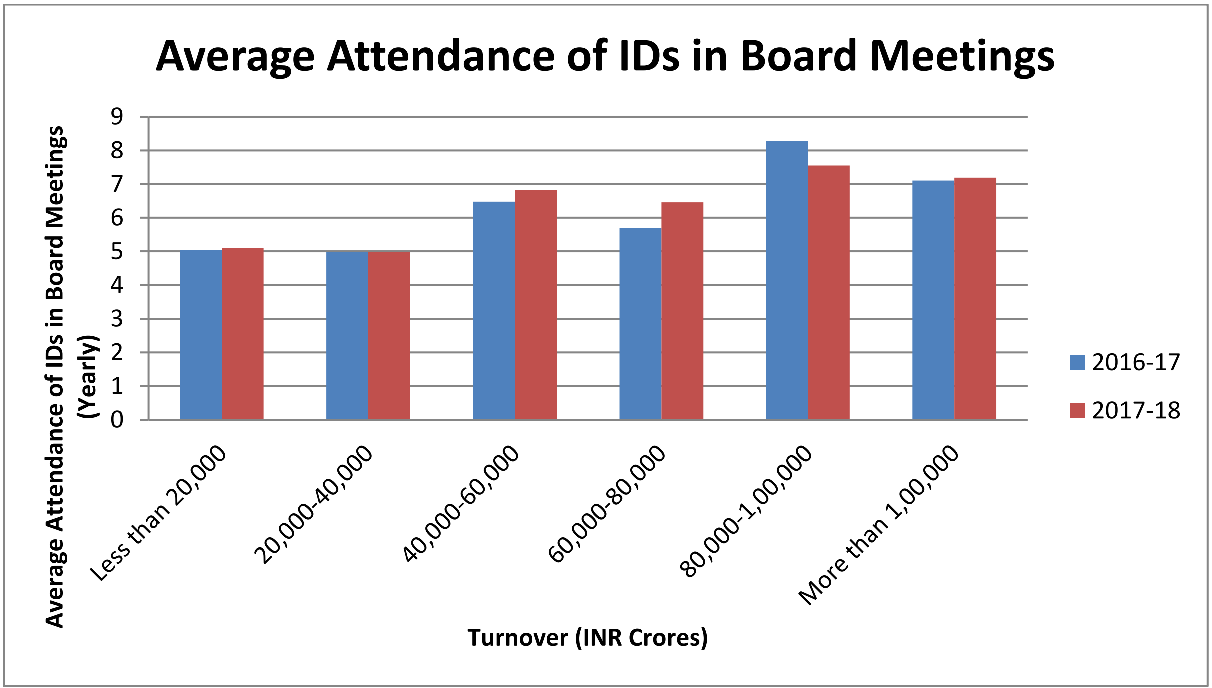


Figure 4.5 Average attendance of IDs in Board Meetings

Table 4.1 Correlation between Average Attendance of IDs in Board and Turnover (2016-17)

	Turnover	***Average Attendance of IDs in Board***
Turnover	1	
Average Attendance of IDs in Board	0.411022	1

Table 4.2 Correlation between Average Attendance of IDs in Board and Turnover (2017-18)

	Turnover	***Average Attendance of IDs in Board***
Turnover	1	

Average Attendance of IDs in Board	0.365423	1

The data shows that the average attendance of Independent Directors in Board is moderately but positively associated with company turnover. This implies that an increase in average attendance of Independent Directors in Board increases the company turnover and vice-versa.

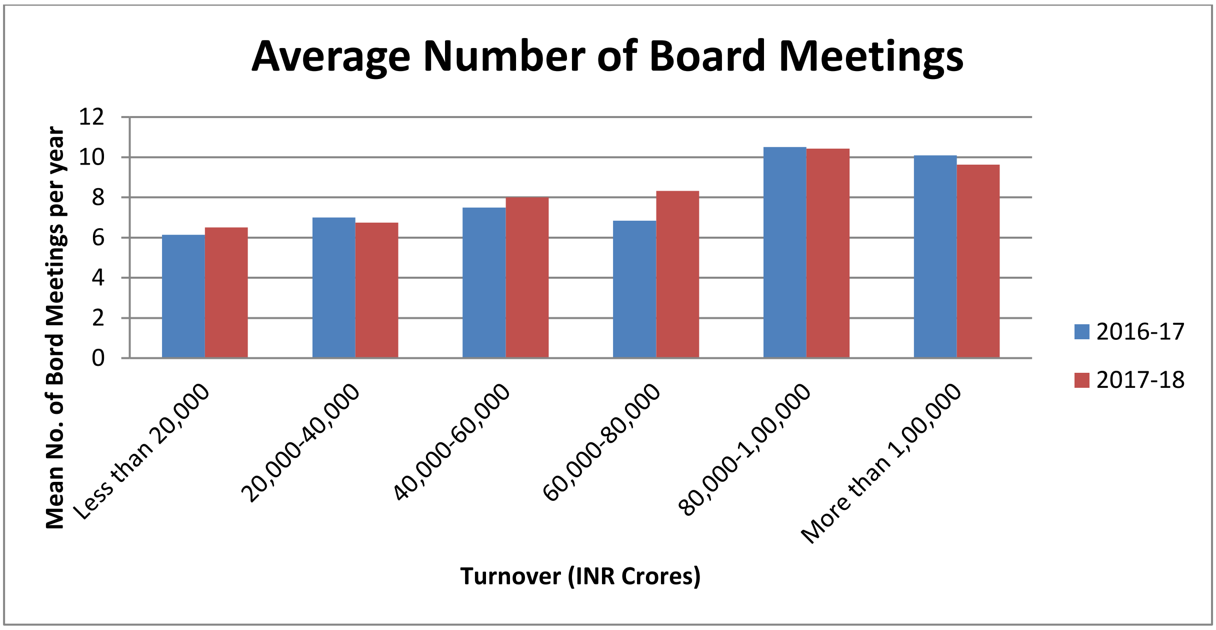


Figure 4.6 Average number of Board Meetings

Figure 4.3 Correlation between Number of Board Meetings and Turnover (2016-17)

	Turnover	*No. of Board Meetings*
Turnover	1	
Board Meetings	0.385069	1

Figure 4.4 Correlation between Board Meetings and Turnover (2017-18)

	Turnover	*Board Meetings*
Turnover	1	

No. of Board Meetings	0.358779109	1

The data shows that the average number of board meetings is moderately but positively associated with company turnover. This implies that an increase in number of board meetings increases the company turnover and vice-versa.

4.2.3. Appointment of Independent Directors

The appointment of Independent Directors has been a point of discussion in many researchers (Sarkar & Sarkar, 2009; Varottil, 2010). The study explores the appointment method of Independent Directors to derive factors important for them to join a company and the most common way in which they get proposal to join the company.

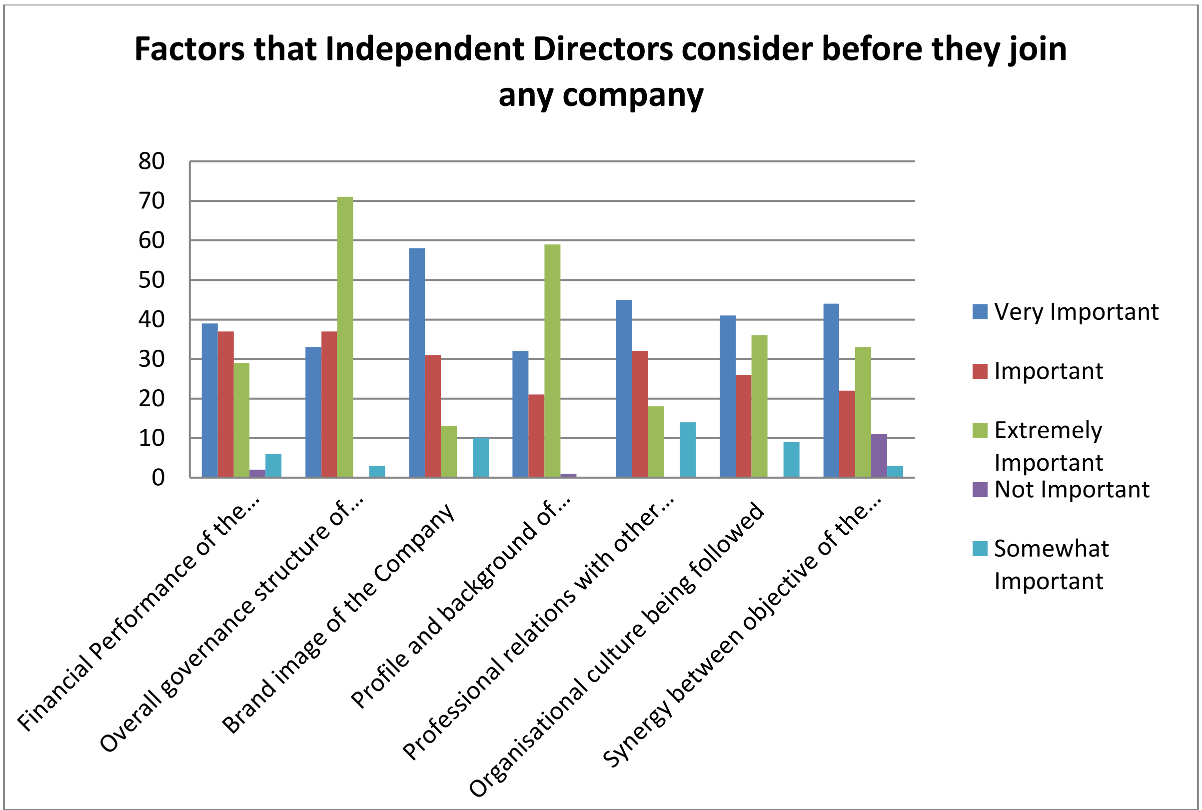


Figure 4.7 Factors IDs consider before joining a company

Table 4.5 Descriptive Statistics of Factors IDs consider before joining a company

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation	Variance
Financial_performance	113	1	5	3.77	.954	.911
Overall_governance	113	2	5	4.52	.721	.520
Brand_Image	113	2	5	3.66	.797	.636
Profile_and_Background_of_Promoter_and_board	113	1	5	4.31	.835	.698
Professional_relations_with_others	113	1	5	3.52	1.019	1.037
Organizational_Culture	113	1	5	3.90	.973	.946
Synergy_btw_Objective_and_profile	113	1	5	3.82	1.046	1.093
Valid N (listwise)	113					

Before joining any company as an independent director, there are several aspects things an Independent Director considers. The factors they consider extremely important before joining a company are overall governance of the company and profile and background of the promoters and Board. This was followed by organizational culture and synergy of objectives and profile of the respondent. These factors are also very important for the respondents to take the joining decision. Also, financial performance and brand image of the company are important for Independent Directors for joining a company.

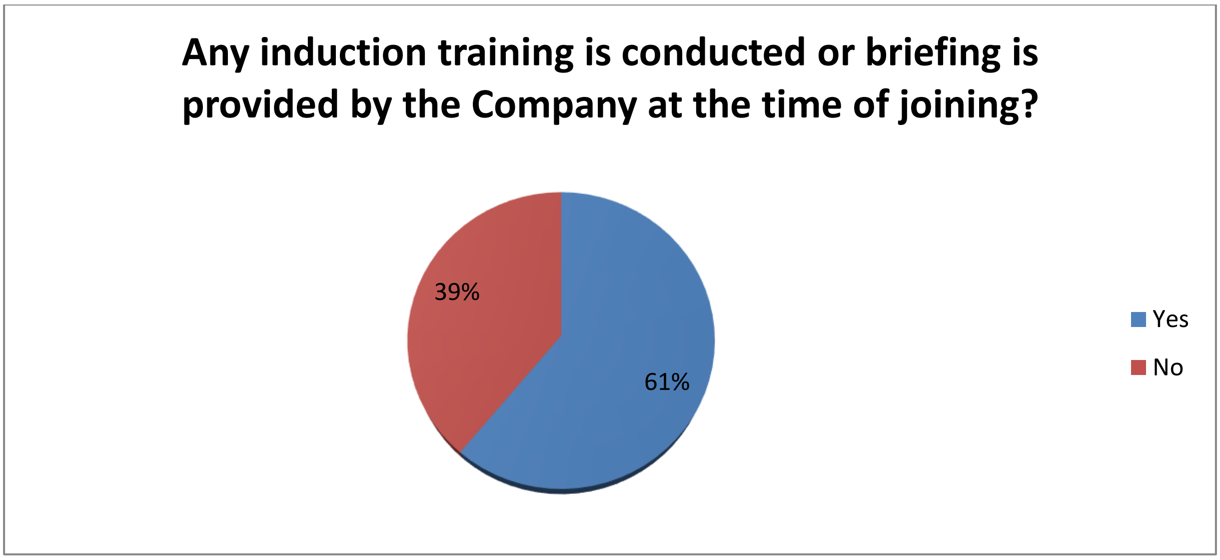


Figure 4.8 Information regarding induction training

Respondents revealed that induction training is provided to them by the company at the time of joining. This familiarises them with the procedures of the company and allows them to understand the functioning of the company.

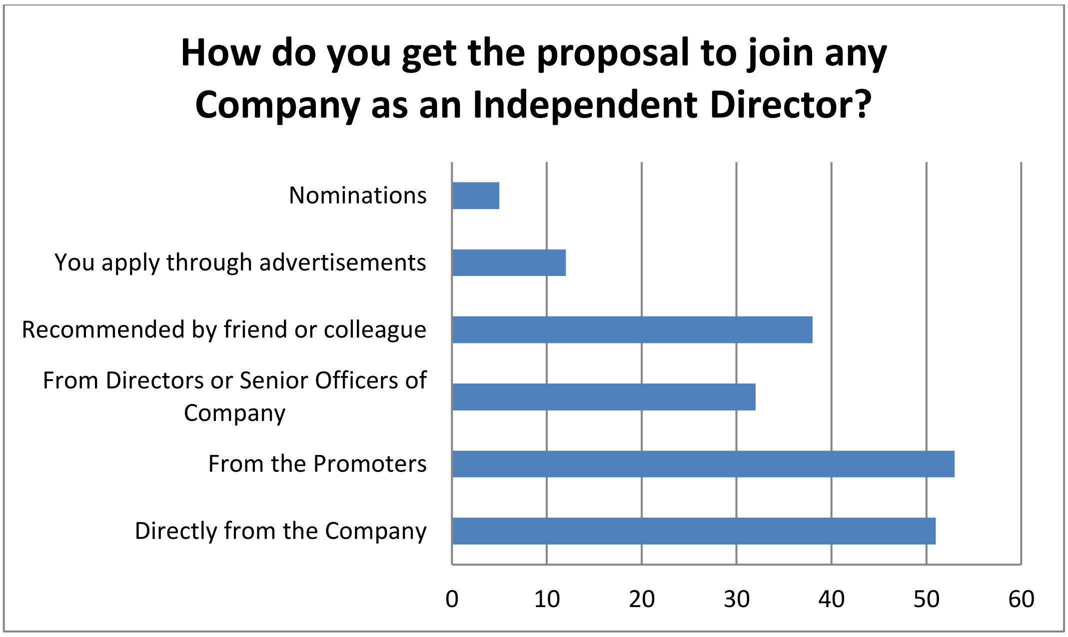


Figure 4.9 Appointment ways of IDs

Generally, the Independent Directors receive the proposal to join a company from the promoters or directly from the company. Apart from this, they are most likely to get a recommendation by a friend or colleague or even from the directors or senior officers of the company. Independent Directors rarely receive a proposal when they apply through advertisements.

Major dependence on recommendation of promoters, friends or other directors leaves the system with limitations and biased appointments. Creation of a neutral database of information about Independent directors would assist in fair appointment of IDs.

4.2.4. Time Devoted by IDs and Remuneration

The time devoted by Independent Directors and Remuneration earned are two important aspects of discipline of Independent Directors.

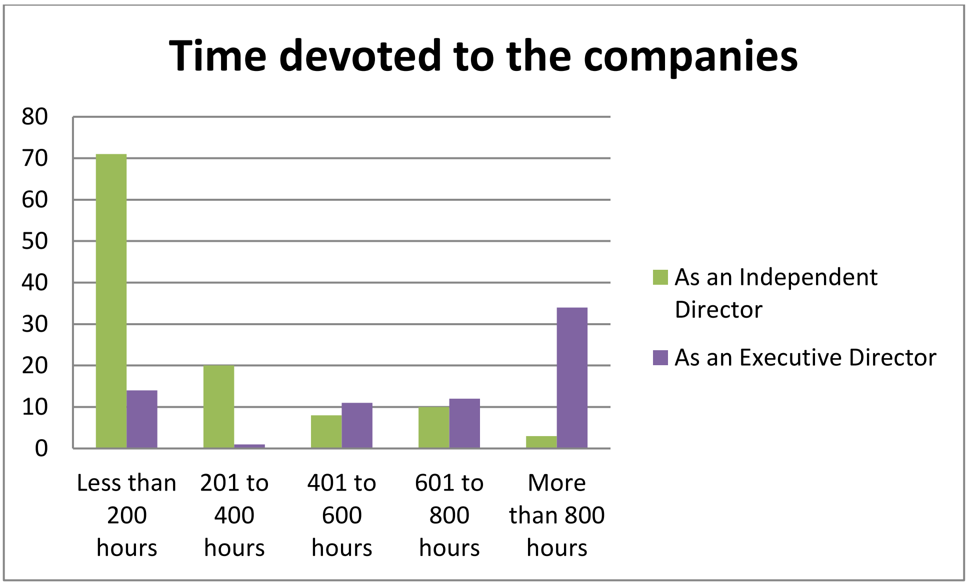


Figure 4.10 Time devoted to the companies

The time devoted as Independent Directors in companies is usually less than time devoted by the respondent as an Executive Director. The respondents revealed that Independent Directors spend less than 200 hours a year. This is because their time is distributed to more than one company, they are serving either as Independent /Full-time director. As Executive Directors, people devote more time (approximately more than 800 hours/ year).

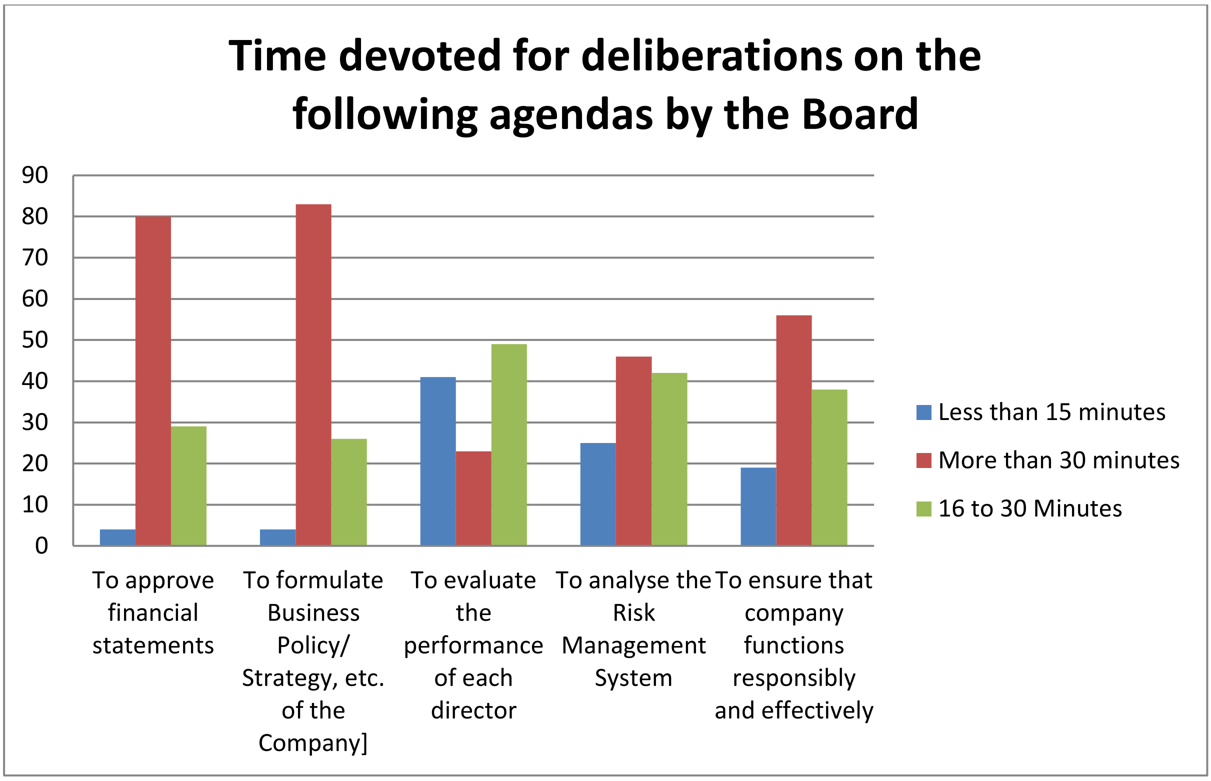


Figure 4.11 Time devoted for deliberations on the following agendas by the Board

Table 4.6 Descriptive Statistics of Time devoted for deliberations on the following agendas by the Board

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation	Variance
Approve_financial_statement	113	2.00	3.00	2.7434	.43872	.192
Formulate_Business_Policy	113	1.00	3.00	2.6991	.53260	.284
Evaluate_Performance_director	113	1.00	3.00	1.8407	.73880	.546
Analyse_risk_mangement	113	1.00	3.00	2.1858	.77400	.599

ensure_company_functions	113	1.00	3.00	2.3274	.74931	.561
Valid N (listwise)	113					

In board meetings, majority of the time is devoted (more than 30 minutes) to approve financial statements and to formulate business policy. On the other hand, the least time is devoted to evaluate the performance of director.

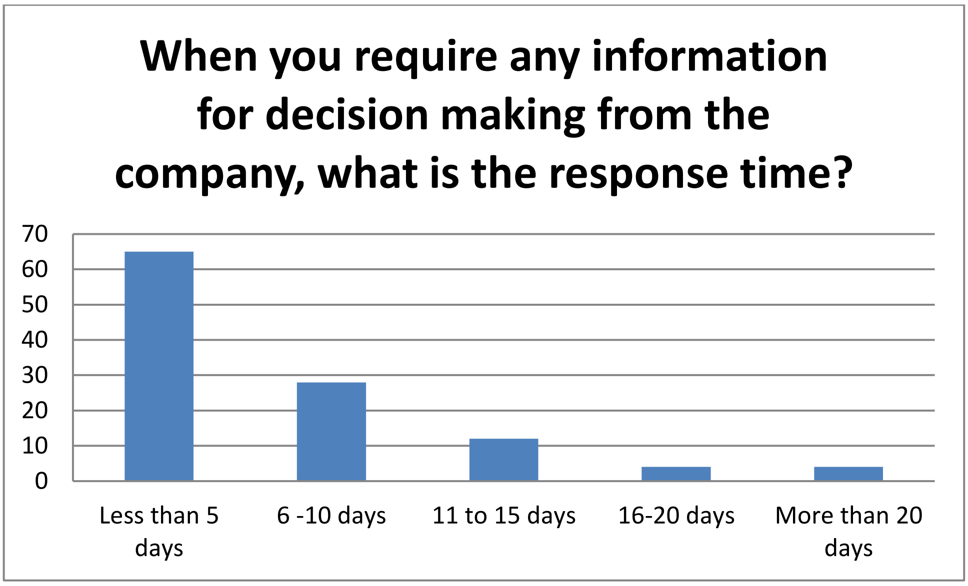
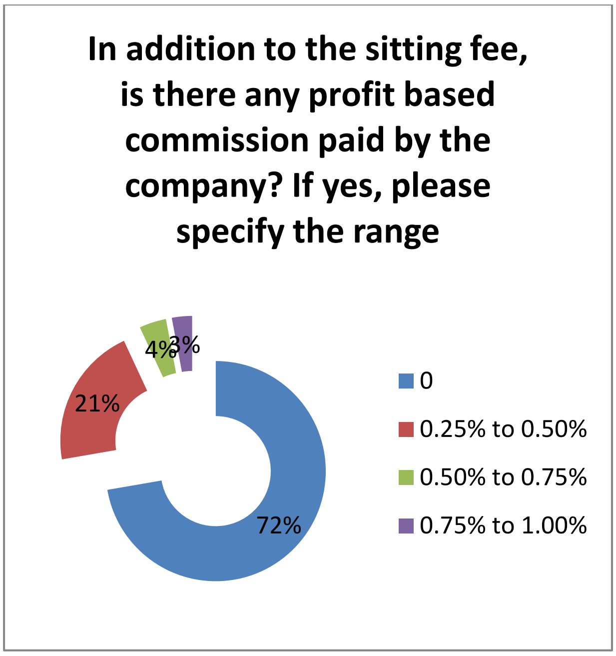


Figure 4.12 Response time for acquiring information from the Company

The figure depicts that majorly, the response time for acquiring any information required for decision making is less than 5 days. Sometimes, it takes 6-10 days. In very few cases, it takes longer than 10 days.



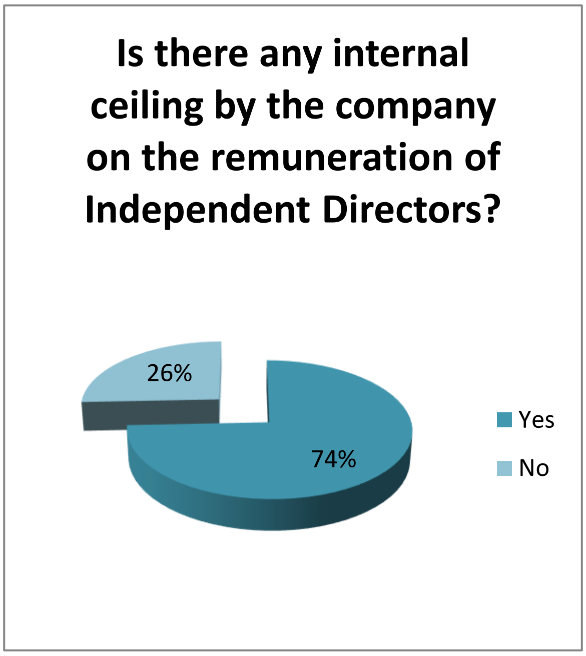


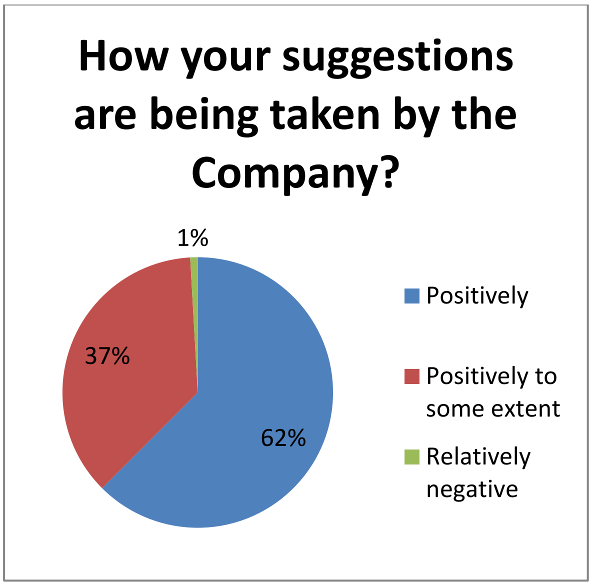
Figure 4.13 Profit based commission

Figure 4.14 Internal ceiling by the company

Apart from the sitting fee, sometimes the Independent Directors are paid profit based commission. However, majority (72%) of the respondents revealed that they do not receive profit-based commission, some of those who receive ranges between 0.25% and 0.50%. Also, there is usually an internal ceiling by the company on the remuneration of Independent Directors.

4.2.5. Experiences and challenges of Independent Directors

The experiences and challenges of Independent Directors were explored using survey. They were asked about their experiences like how their suggestions are being taken by the company, whether or not their queries have an impact on their evaluation and the repercussions of the dissent note they provide in meetings.



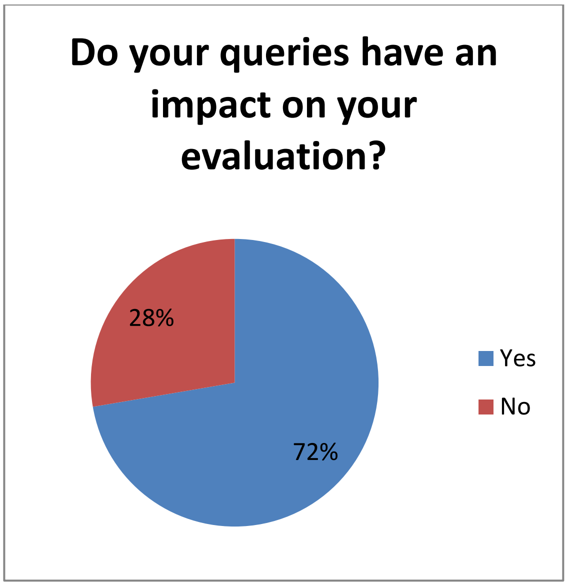


Figure 4.15 Reactions to Suggestions made by IDs Figure 4.16 Impact of queries of IDs on their evaluation

The figure depicts that the suggestions of Independent Directors are taken positively most of the times. There might be incidences where improvements would be suggested but largely, all suggestions are accepted positively. Only 1% suggestions are taken negatively.

Also, the queries put up by Independent Directors have impact on their evaluation most of the times.

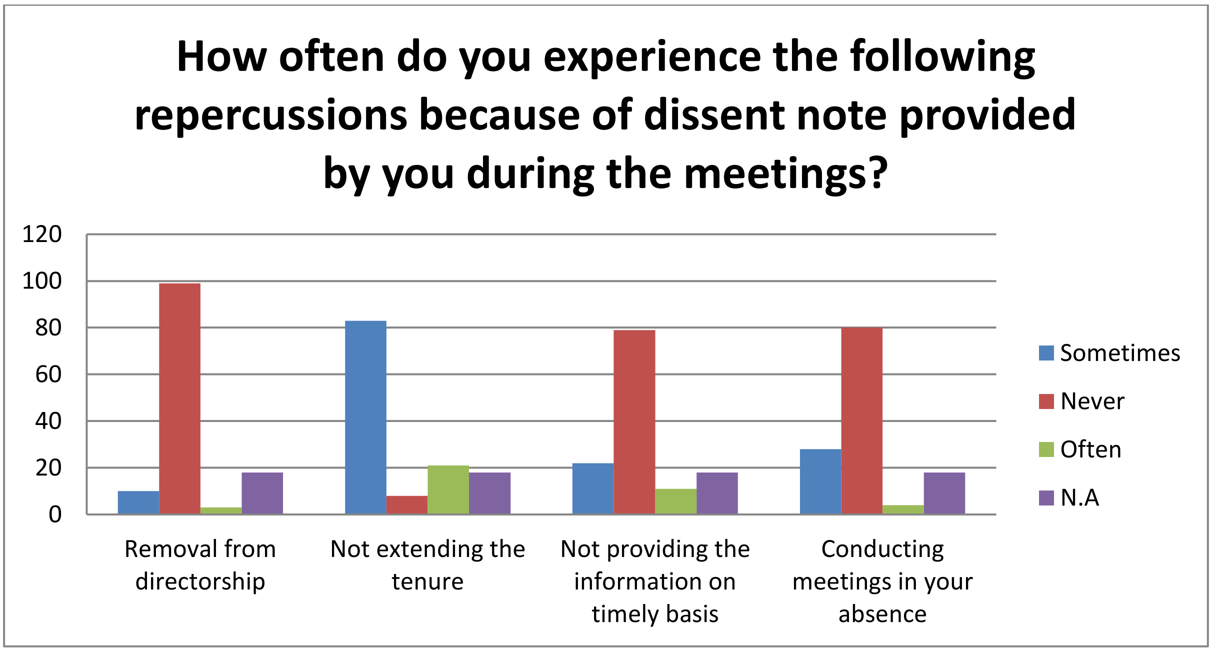


Figure 4.17 Repercussions of IDs presenting a dissent note during meetings

The Independent Directors were asked about the repercussions of them presenting a dissent note during meetings and it was revealed that the most common repercussion was not extending the tenure.

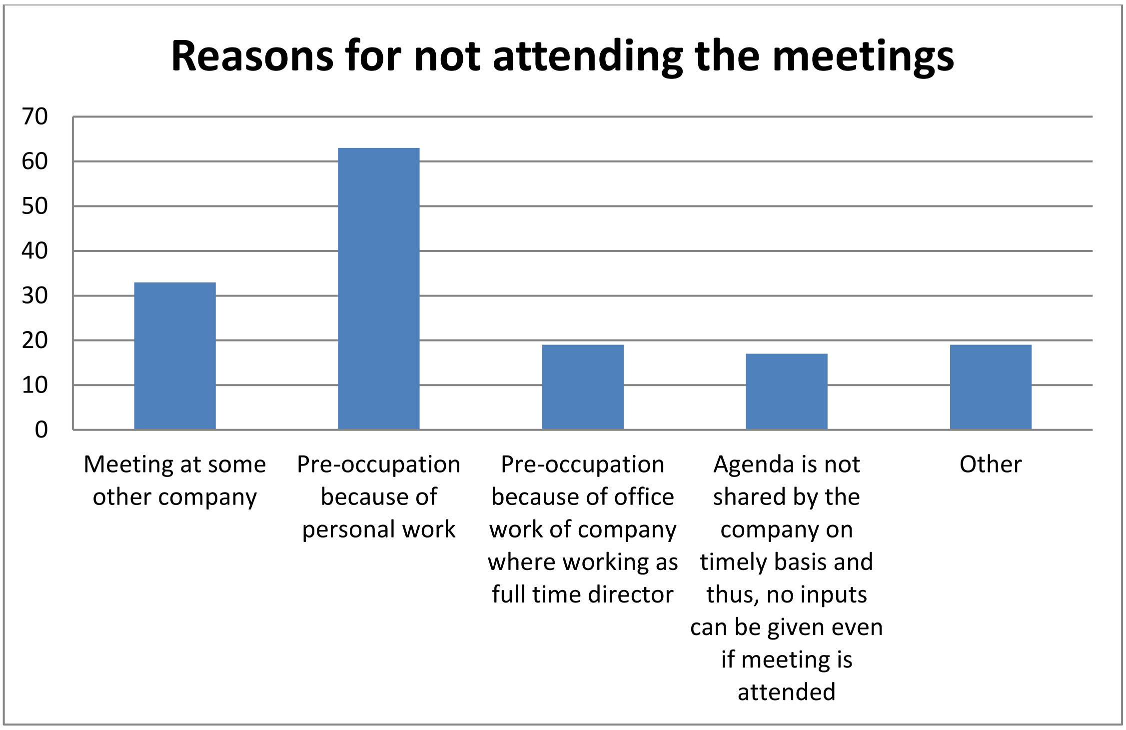


Figure 4.18 Reasons given by IDs for not attending the meetings

The most common reason identified for not attending the meetings is pre-occupation of Independent Directors because of some personal work. Other than this, the Independent Directors are found busy in meetings at some other company due to which the meetings are neglected.

4.3. Association of Discipline of Independent Directors with Firm Performance

4.3.1. Association of Independence to present views and Firm Performance(Return on Assets)

The Independence of Independent directors to present their views in board meetings has been assessed to analyse whether it has an impact on firm's performance (ROA).

Table 4.7 Crosstabulation of Independence of IDs and ROA (Firm Performance)

ROA_2016_17 * Independence_to_present_views Crosstabulation						
	Independence_to_present_views					
	Low/Nil	Slightly	Moderate	Very	Extremel	Total

			high	ly high	high	y high	
ROA_2016_17	Less than (0.1)	0	0	1	0	1	2
	(0.5) to 0	0	0	1	0	5	6
	0 to 0.5	1	1	2	5	11	20
	0.5 to 1.0	0	0	0	7	9	16
	More than 1	0	0	1	3	8	12
Total		1	1	5	15	34	56

Table 4.8 Chi-Square test (Independence and ROA)

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	13.914[a]	16	.005
Likelihood Ratio	15.618	16	.480
N of Valid Cases	56		

a. 21 cells (84.0%) have expected count less than 5. The minimum expected count is .04.

The data revealed that there is a significant association of independence of Independent Directors to present their views and firm's performance (Return on Assets) [χ (1) = 13.914, p <0.05]. This implies that independence to present views by IDs can enhance the ROA of the company.

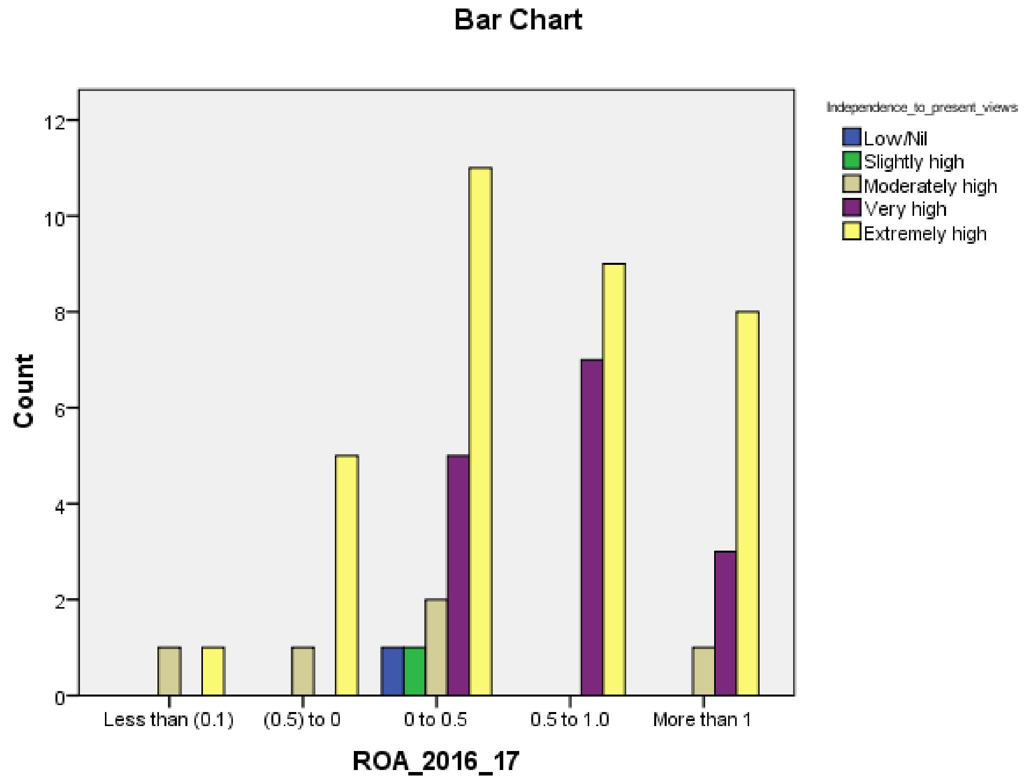


Figure 4.19 Crosstabulation of Independence of IDs and ROA (Firm Performance)

The independence of IDs to present their views has been observed to be higher in companies with high firm performance (that is, with high Return on Assets) depicting that there is an association of independence to present views with firm performance.

4.3.2. Association of Independence to present views and Firm Performance (Return on Equity)

The Independence of Independent directors to present their views in board meetings has been assessed to analyse whether it has an impact on firm's performance (ROE).

Table 4.9 Crosstabulation of Independence of IDs and ROE (Firm Performance)

ROE_2016_17 * Independence_to_present_views1 Crosstabulation							
		Independence_to_present_views1					
		Low/Nil	Slightly high	Moderately high	Very high	Extremely high	Total
ROA_2016_17	Less than (0.1)	0	0	1	0	3	4

	(1.0) to (0.5)	0	0	0	0	1	1
	(0.5) to 0	0	1	1	0	2	4
	0 to 0.5	1	0	1	4	8	14
	More than 1	1	0	1	10	18	30
Total		2	1	4	14	32	53

Table 4.10 Chi-Square test (Independence and ROA)

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	20.483[a]	16	.049
Likelihood Ratio	14.972	16	.527
N of Valid Cases	53		

a. 22 cells (88.0%) have expected count less than 5. The minimum expected count is .02.

The data revealed that there is a significant association of independence of Independent Directors to present their views and firm's performance (Return on Equity) [χ (1) = 20.483, p <0.05]. This implies that independence to present views by IDs can enhance the ROE of the company.

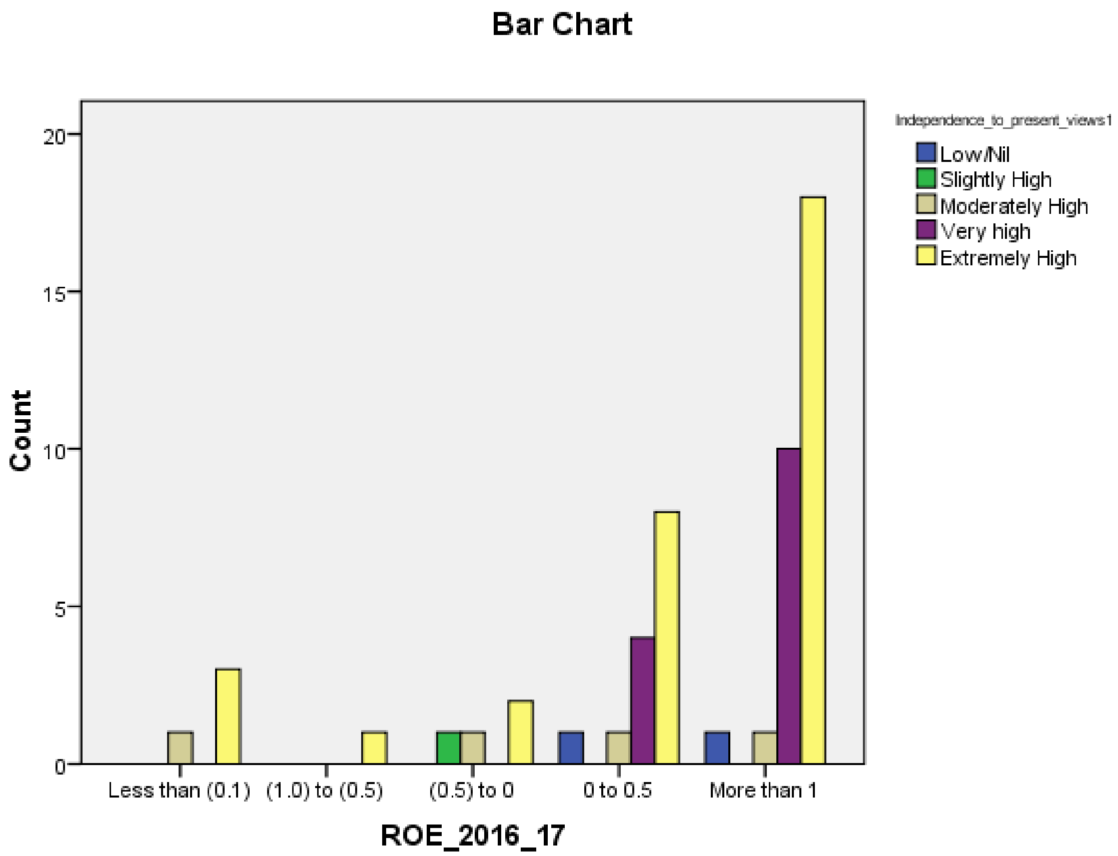


Figure 4.20 Crosstabulation of Independence of IDs and ROE(Firm Performance)

The graph shows that independence of IDs to present their views is higher in companies with high firm performance (that is, with high Return on Equity) depicting that there is an association of independence to present views with firm performance.

4.3.3. Association of Effectiveness of Board Evaluation Process and Firm Performance (Return on Equity)

The level of effectiveness of Board Evaluation Process has been assessed and its association with firm performance has been analysed.

Table 4.11 Crosstabulation of Effectiveness of Board Evaluation and ROE (Firm Performance)

ROE_2016_17 * Effectiveness_of_board_Evaluation1 Crosstabulation						
	Effectiveness_of_board_Evaluation1					
	Low/Nil	Slightly	Moderate	Very	Extremel	Total

			high	ly high	high	y high	
ROE_2016_17							
	Less than (0.1)	1	2	0	1	0	4
	(1.0) to (0.5)	0	0	1	0	0	1
	(0.5) to 0	0	0	2	1	0	3
	0 to 0.5	0	2	4	5	3	14
	More than 1	0	0	6	18	10	34
Total		1	4	13	25	13	56

Table 4.12 Chi-Square test (Effectiveness of Board Evaluation and ROE)

Chi-Square Tests			
	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	37.627[a]	16	.002
Likelihood Ratio	27.760	16	.034
N of Valid Cases	56		
a. 21 cells (84.0%) have expected count less than 5. The minimum expected count is .02.			

The results show that there is a significant association of effectiveness of board evaluation process with firm's performance (Return on Equity) [χ (1) = 37.627, p <0.05] implying that an effective board evaluation process can enhance the ROE of the company.

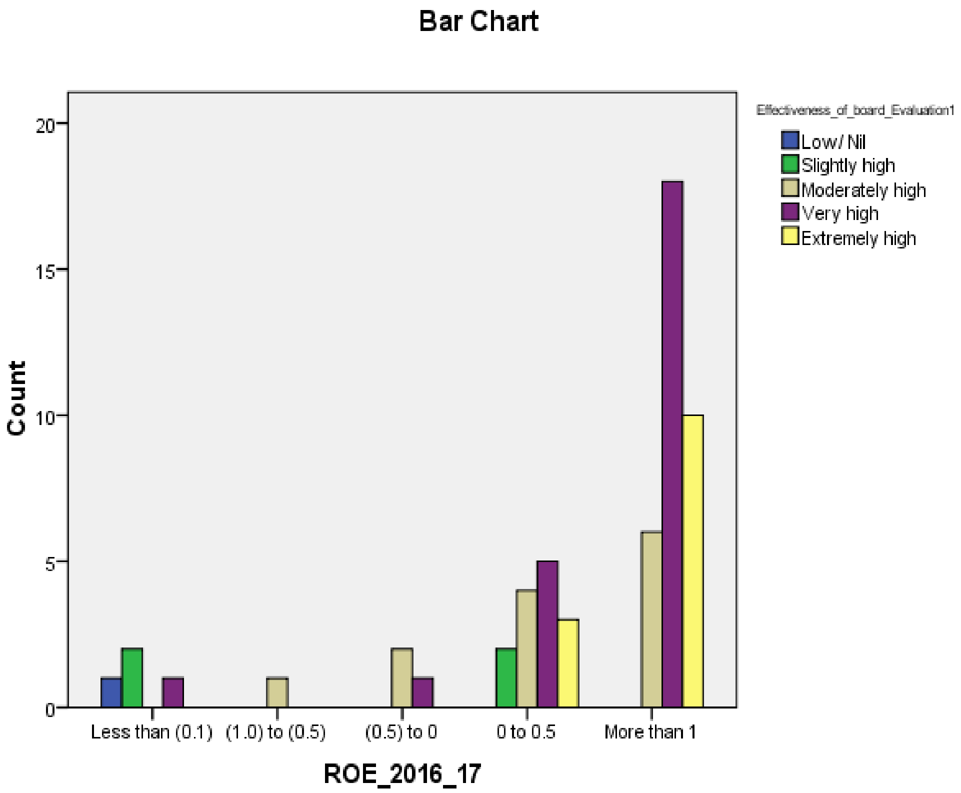


Figure 4.21 Crosstabulation of Effectiveness of Board Evaluation and ROE (Firm Performance)

Effectiveness of board evaluation process has been observed to be higher in companies with high firm performance (that is, with high Return on Equity) depicting that there is an association of effectiveness of board evaluation with firm performance.

4.3.4. Association of Level of Interaction of IDs with Stakeholders and Firm Performance (Return on Assets)

The association between the level of Interaction of Independent Directors with stakeholders and firm performance has been analysed and the results have been presented below.

Table 4.13 Crosstabulation of Interaction with stakeholders and ROA (Firm Performance)

ROA_2016_17 * Interaction_with_stakeholders Crosstabulation							
		Interaction_with_stakeholders					
		Low/Nil	Slightly high	Moderately high	Very high	Extremely high	Total
ROA_2016_17							
	Less than	0	1	0	0	1	2

	(0.1)						
	(0.5) to 0	1	0	3	1	1	6
	0 to 0.5	6	5	3	4	2	20
	0.5 to 1.0	2	3	8	3	0	16
	More than 1	1	0	4	4	0	9
Total		10	9	18	12	4	53

Table 4.14 Chi-Square test (Interaction of IDs with stakeholders and ROA)

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	21.798[a]	16	.050
Likelihood Ratio	24.141	16	.086
N of Valid Cases	53		

a. 23 cells (92.0%) have expected count less than 5. The minimum expected count is .15.

The data results show that there is a significant association between the level of Interaction of IDs with Stakeholders and firm's performance (Return on Assets) [χ (1) = 21.798, $p \leq 0.05$] implying that higher the level of Interaction of IDs with Stakeholders, higher is the ROA of the company.

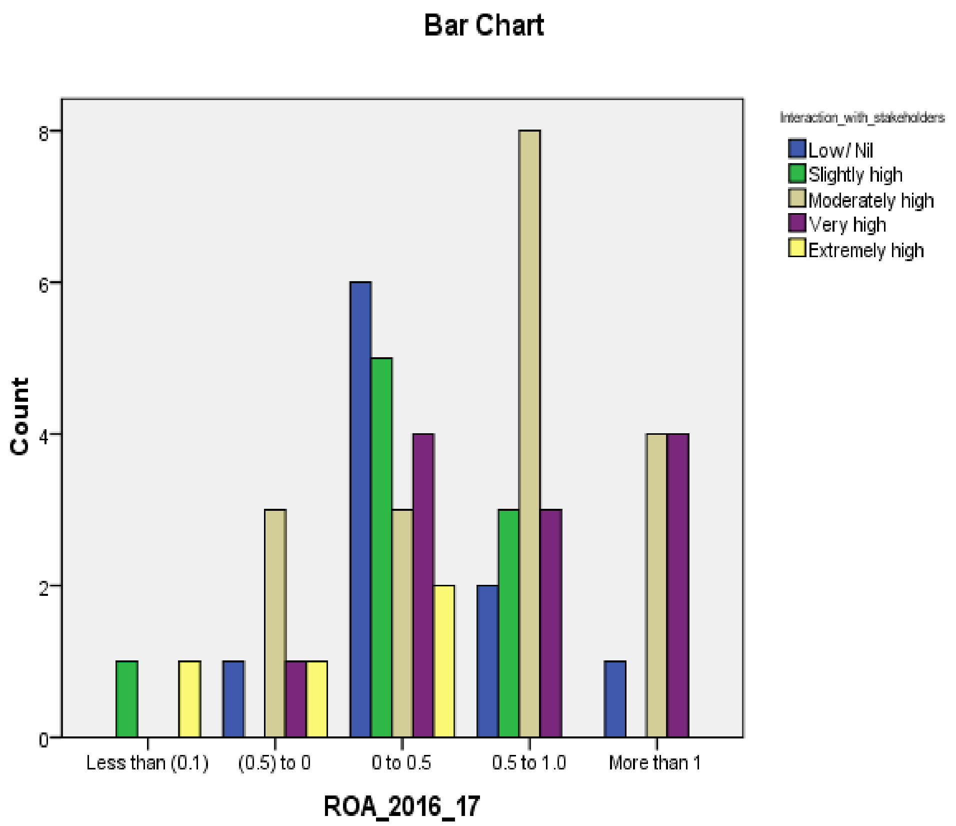


Figure 4.22 Crosstabulation of Interaction with stakeholders and ROA (Firm Performance)

The level of interaction of IDs with Stakeholders has been observed to be higher in companies with high firm performance (that is, with high Return on Assets) depicting that there is an association of interaction of IDs with Stakeholders with firm performance.

4.3.5. Association of Level of Interaction of IDs with Auditors and Firm Performance (Return on Equity)

The level of Interaction of IDs with the Auditors has been assessed and its association with firm performance has been analysed. The results have been presented below:

Table 4.15 Crosstabulation of Interaction with Auditors and ROE (Firm Performance)

ROE_2016_17 * Interaction_with_auditors1 Crosstabulation							
Count							
		Interaction_with_auditors1					Total
		Low/Nil	Slightly high	Moderately high	Very high	Extremely high	

ROE_2016_17	Less than (0.1)	0	0	3	1	0	4
	(1.0) to (0.5)	0	0	0	0	1	1
	(0.5) to 0	0	1	1	1	1	4
	0 to 0.5	2	0	2	3	7	14
	More than 1	0	0	6	9	15	30
Total		2	1	12	14	24	53

Table 4.16 Chi-Square test (Interaction of IDs with Auditors and ROE)

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	27.025[a]	16	.041
Likelihood Ratio	20.118	16	.215
N of Valid Cases	53		

21 cells (84.0%) have expected count less than 5. The minimum expected count is .02.

The results of the analysis show that there is a significant association between the level of Interaction of IDs with Auditors and firm's performance (Return on Equity) [χ (1) = 27.025, $p \leq 0.05$] implying that higher the level of Interaction of IDs with Auditors, higher is the ROE of the company.

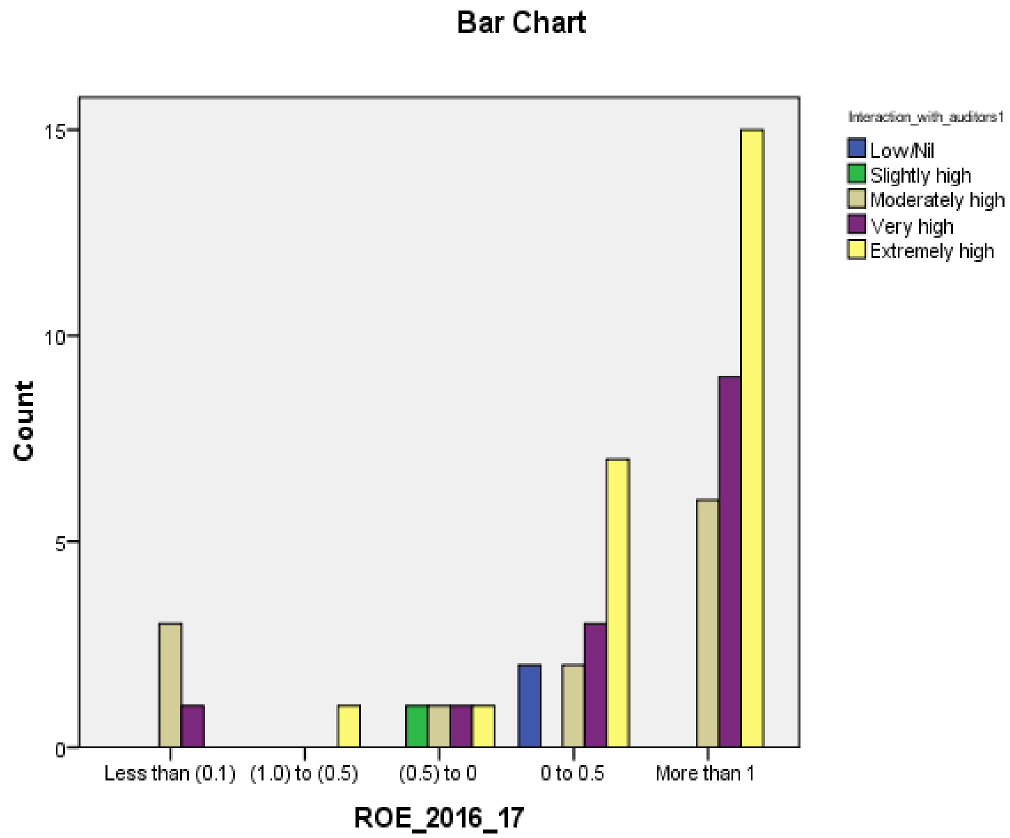


Figure 4.23 Crosstabulation of Interaction with auditors and ROE (Firm Performance)

It has been observed from the graph presented above that interaction of IDs with auditors is higher in company with high ROE (highest in companies with ROE more than1). This implies that interaction of IDs with auditors can enhance the form performance.

4.3.6. Association of Support by Law to IDs and Firm Performance (Return on Assets)

The respondents were asked whether Companies Act, 2013 enables you to effectively discharge your duties as an independent director and majority of them responded that the law has been supportive for them in discharging their duties. The perception of IDs whether the law is supportive and its association with firm performance has been analysed. The results have been presented below:

Table 4.17 Crosstabulation of Support by Law and ROA (Firm Performance)

ROA_2016_17_ * Support_by_law Crosstabulation							
Count							
		Support_by_law					
		Strongly	Disagree	Neutral	Agree	Strongly	Total

		Disagree				Agree	
ROA_2016_17_							
	Less than (0.1)	0	0	0	1	1	2
	(0.5) to 0	0	0	2	3	0	6
	0 to 0.5	0	1	1	15	2	21
	0.5 to 1.0	0	1	5	7	1	16
	More than 1	1	0	3	5	1	14
Total		1	3	14	37	6	59

Table 4.18 Chi-Square test (Support by Law and ROA)

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	1.235E2[a]	25	.000
Likelihood Ratio	115.273	25	.000
N of Valid Cases	157		

a. 30 cells (83.3%) have expected count less than 5. The minimum expected count is .01.

The chi-square test results show that there is a significant association of support by law to IDs and firm's performance (Return on Assets) [χ (1) = 1.2352, $p \leq 0.05$] implying that more the support provided to IDs by the law, higher is the ROA of the company.

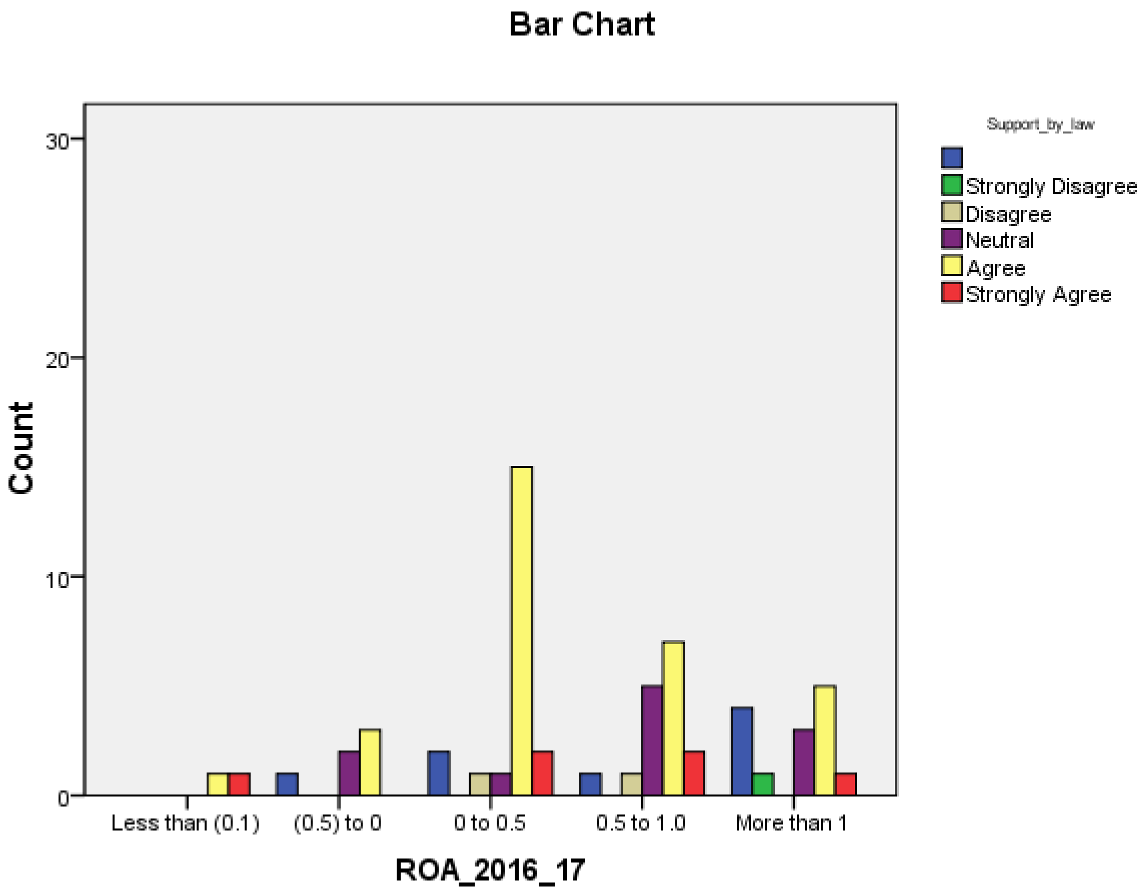


Figure 4.24 Crosstabulation of Support by Law and ROA (Firm Performance)

The graph presented above shows that the companies where support provided to IDs by law is higher have higher ROA.

4.3.7. Association of Support by Law to IDs and Firm Performance (Return on Equity)

The association between support provided to IDs by the law and firm performance has been analysed. The results have been presented below:

Table 4.19 Crosstabulation of Support by Law and ROE (Firm Performance)

Count	**ROE_2016_17_ * Support_by_law Crosstabulation**							
		Support_by_Law1						Total
			Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	
ROE_2016_17	Less than (0.1)	1	0	0	1	1	1	4

	(1.0) to (0.5)	0	0	0	0	1	0	1
	(0.5) to 0	0	0	0	1	2	1	4
	More than 1	7	1	2	7	17	2	36
	0 to 0.5	0	0	0	2	10	2	14
Total		8	1	2	11	31	6	59

Table 4.20 Chi-Square test (Support by Law and ROE)

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	1.460E2[a]	25	.000
Likelihood Ratio	165.719	25	.000
N of Valid Cases	59		

a. 30 cells (83.3%) have expected count less than 5. The minimum expected count is .01.

The chi-square test results show that there is a significant association of support by law to IDs and firm's performance (Return on Equity) [χ (1) = 1.4602, $p \leq 0.05$] implying that more the support provided to IDs by the law, higher is the ROE of the company.

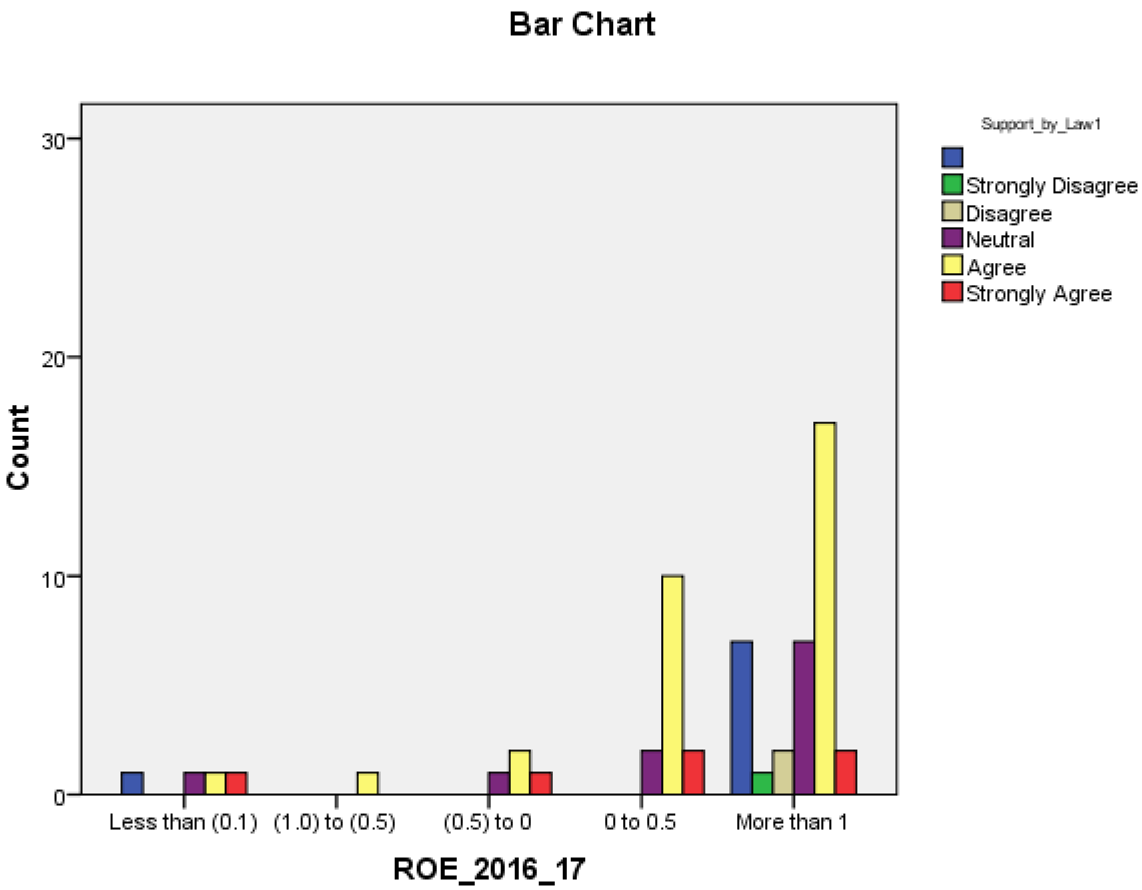


Figure 4.25 Crosstabulation of Support by law and ROE (Firm Performance)

The graph presented above shows that the companies where support provided to IDs by law is higher have higher ROE implying a significant relationship between the two variables.

Chapter – 5 Conclusion

The purpose of the study was to examine the financial implications on the company based on the involvement of the Independent Directors. The experience, challenges and commitment of IDs to business ethics have also been studied using survey method. Keeping the observations and results of analysis in mind, the major findings of the study are as follows:

- The presence of Independent Directors on Board has positive financial implications on the company.
- The involvement of Independent Directors in Board has positive implications on the company.
- The findings of the analysis suggest that 78% (41% listed and 37% unlisted) of the companies comply the provisions of Section 149 of Companies Act, 2013.
- The presence of Independent Directors on Board (No. of Board meetings held and average attendance of IDs on Board) has a positive relationship with Turnover.
- The most important factors Independent Directors consider before joining a company are Overall governance structure of the company and profile and background of Promoters and Board.
- The most common way the Independent Directors receive a proposal to join a company is through Promoters or directly from the Company.
- In board meetings, majority of the time is devoted (more than 30 minutes) to approve financial statements and to formulate business policy. The least time is spend to evaluate the performance of each director (less than 15 minutes).
- The Independent Directors usually devote 200 hours a year to a company and about 800 hours as executive directors.
- Usually, apart from the sitting fee, the Independent Director’s (72%) do not receive any profit-based commission. Only 21% of the respondents admitted that they receive 0.25% to 0.50% profit-based commission over and above the sitting fee. Also, in most of the cases, there is internal ceiling by the company on the remuneration of Independent Directors.
- About the experiences and challenges of Independent Directors, the suggestions of Independent Directors are taken positively and their queries have an impact on their evaluation.

- As a result of their presenting a dissent note during meetings, the Independent Directors face repercussions like non-extension of their tenure. Harsh actions like removal from directorships are almost never experienced by the respondents.
- By examining the data-set, following inferences may be drawn:
  - There is significant association of independence given to IDs to present their views with firm performance implying that independence to present views by IDs can have a positive impact on firm's financial performance (Return on Assets and Return on Equity).
  - There is a significant association between effectiveness of Board Evaluation Process and firm performance. That is, higher effectiveness of Board Evaluation process can have higher firm performance (Return on Equity).
  - A significant association of Level of Interaction of IDs with Stakeholders with Firm Performance (Return on Assets) was also found.
  - Level of Interaction of IDs with Auditors and Firm Performance (Return on Equity) was also found to be associated.
  - It was found that there is a significant association of support by law to IDs and firm's performance (Return on Assets and Return on Equity) implying that more the support provided to IDs by the law, higher is the ROA and ROE of the company.

Association between Variables	
Presence of Independent Directors (No. of Board meetings and average attendance of IDs)	Turnover
Independence of IDs	Return on Assets and Return on Equity
Effectiveness of Board Evaluation Process	Return on Equity
Level of Involvement of IDs (Interaction with Stakeholders and Auditors)	Return on Assets and Return on Equity
Support by Law	Return on Assets and Return on Equity

The findings of qualitative analysis reveal that ***Companies Act, 2013 enables the independent directors to effectively discharge their duties and have a positive opinion in***

regard to the applicable law on Independent Directors. *Moreover, many of the Independent Directors participated in providing suggestions to improve the applicable law and make it more efficient and effective. The recommendations are as follows:*

- ***Liability of Independent Directors needs to be reduced and Authority must be increased***

  The liability of Independent Directors for any commission or omission similar to that of the Executive Directors is considered to be unfair as the Independent Directors are not involved in the day-to-day operations of the organization. Since the day-to-day functions and decisions of the company are not known to them, they must not be compelled to face the consequences of such decisions.

  As per the responses, it was highlighted that the Independent Directors have high responsibility and the authority given to them is comparatively low. Therefore, there is a need to enhance the authority given to the IDs.

- ***Improvement in the method of Appointment in the Boards is recommended***

  It has been observed that the Non-Executive Directors/ Independent Directors are appointed mostly on the basis of recommendations from promoters, acquaintances or nominations. There is a lack of clear, transparent and defined method of appointment to ensure selection of the right candidate. The absence of a specific procedure for appointment of IDs unlike the appointment of Executive Directors makes it difficult for IDs to achieve the purpose of protecting the interest of minority shareholders. With the current matrix of IDs' appointment, renewal and removal procedure, it is difficult to achieve the purpose of Independent Directors working in the company (Varotill, 2010). Moreover, the evaluation process of the performance of IDs also needs to be improved.

- ***Check the overlapping regulations***

  The respondents complained that the rules and regulations concerning their role and interests are complex and the provisions of different regulatory authorities are overlapping. There is a need to review the provisions and revise in case there is any overlapping. Moreover, a training program to acquaint the Independent Directors with the rules of regulatory authorities is also recommended.

- ***Creation of a Neutral database of Independent Directors***

A reliable dataset with credentials of Independent Directors is recommended to be introduced by the authority. This would help in mapping of right expertise and competency as required by the Company Board. The directory should have personal and professional information about the Directors, competent and willing to join Boards as Independent Directors. This practice is already followed by some of the countries globally. With this repository, the Independent Directors can benefit with training facilities, regular updates of changes in laws and would be provided with self-learning tools for professional development. This would add value to the Board performance and individual performance of the prospective Directors.

- ***Encouragement of Women Participation in Board***

  Literature showed that gender diversity and composition of Board are important factors that enhance board effectiveness (Campbell and Vera, 2007). Also, it has been observed that women participation is low on Boards in Indian companies. Women participation needs to be encouraged to enhance diversity and firm performance.

Based on the results of the analysis, it can be concluded that presence of Independent Directors, Independence of IDs, Effectiveness of Board Evaluation Process, higher Involvement of IDs (Interaction with Stakeholders and Auditors) in the company have positive financial implications on the company. Also, higher Support by Law to the Independent Directors in effectively discharging their duties can enhance firm performance. Therefore, it is recommended that the company should ensure the following:

- Presence of Independent Directors on Board in compliance with the Law
- Higher Independence to present views and Participation of Independence Directors in Board
- Higher involvement of Independent Directors in Board such as interaction with stakeholders and auditors.
- Effective Board Evaluation Process

From the foregoing analysis, it is evident that corporate governance has an influence on a firm’s performance. Indeed, while some of our findings are revealing, clear policy implications should not be lost. For enhanced performance of corporate entities, it is important to ensure presence, independence and involvement of Independent Directors on Board. We would however like to indicate that, in trying to examine the link between corporate governance and firm performance, it would have been appropriate to use a broader spectrum of variables. The data set could also be expanded in future researches. We would however wish to state that, these limitations do not compromise on the validity of conclusion drawn based on the results.

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Appendix A

RESEARCH ON INDEPENDENT DIRECTORS – FROM CODE TO CONTRIBUTION

QUESTIONNAIRE FOR INDEPENDENT DIRECTORS

Indian Institute of Corporate Affairs is undertaking a research on "Independent Directors: From Code to Contribution" with an objective of analysing the independence experienced and challenges faced by the Independent Directors and to conclude the effectiveness of Code of Conduct introduced under Companies Act, 2013.

In order to complete the research, we request your support by filing the form below. All the information provided will be kept confidential and only analysed results will be published.

Director Identification Number (DIN) ("DIN" is required with the intent to verify the authenticity of the survey; all the information will be kept confidential and only analysed results will be published)

____

1. What do you consider before you join any company as Independent Director? Kindly rank the following in the order they are being considered while making the decision – (Extremely important-5, Very Important-4, Important-3, Somewhat import-4 and Not Important-1)
    a. Financial Performance of the Company
    b. Brand image of Company
    c. Profile and background of Promoters of the Company
    d. Profile and background of Board of Directors of the Company
    e. Professional relations with other directors and Independent Directors
    f. Organisational culture being followed
    g. Overall governance structure of management
    h. Synergy between objective of the company and your profile/ experience/ interest
2. How do you get the proposal to join any Company as an Independent Director?
    a. Directly from the Company
    b. From the Promoters
    c. From Directors or Senior Officers of Company
    d. Recommended by friend or colleague
    e. You apply through advertisements
    f. Others, please specify ______________________________
3. In addition to the sitting fee, is there any profit based commission paid by the company? If yes, please specify the range:

a. 0.25% to 0.50%
b. 0.50% to 0.75%
c. 0.75% to 1%
d. Other:______________________________

4. Is there any internal ceiling by the company on the remuneration of Independent Directors?
    a. Yes
    b. No
5. Any induction training is conducted or briefing is being provided by the Company at the time of joining?
    a. Yes
    b. No
6. When you require any information for decision making from the company, what is the response time?
    a. Less than 5 days
    b. 6 to 10 days
    c. 11 to 15 days
    d. 16 to 20 days
    e. More than 20 days
7. During the Board Meetings, how much time is devoted for deliberations on the following agendas by the Board –
    a. To approve financial statements
        i. Less than 15 minutes
        ii. 15 to 30 Minutes
        iii. More than 30 minutes
    b. To formulate Business Policy/ Strategy, etc. of the Company
        i. Less than 15 minutes
        ii. 15 to 30 Minutes
        iii. More than 30 minutes
    c. To evaluate the performance of each director
        i. Less than 15 minutes
        ii. 15 to 30 Minutes
        iii. More than 30 minutes
    d. To analyse the Risk Management System?
        i. Less than 15 minutes
        ii. 15 to 30 Minutes
        iii. More than 30 minutes
    e. To ensure that company functions responsibly and effectively
        i. Less than 15 minutes
        ii. 15 to 30 Minutes
        iii. More than 30 minutes
8. On an average, how many working hours are devoted in a year to the companies
    a. where you are appointed as Independent Director
        i. Less than 200 hours

ii. 201 to 400 hours
iii. 401 to 600 hours
iv. 601 to 800 hours
v. More than 800 hours

b. Where you are appointed as Executive Director
    i. Less than 200 hours
    ii. 201 to 400 hours
    iii. 401 to 600 hours
    iv. 601 to 800 hours
    v. More than 800 hours

9. Based on your experience as Independent Director, indicate the level of the following (1 being lowest/nil and 5 being highest/complete) –
    i. Level of Independence to present your views and raising queries
    ii. Response time for resolving queries
    iii. Level of effectiveness of Board evaluation process
    iv. Level of updates provided by the company about its functioning
    v. Level of access to information of company and professional advice
    vi. Level of your direct interaction with shareholders and key stakeholders
    vii. Level of your interaction with internal and statutory auditors
10. How the suggestions are being taken by the Company?
    a. Positively
    b. Positively to some extend
    c. Relatively Negative
    d. Negative
11. Do your queries have an impact on your evaluation?
    a. Yes
    b. No
12. How often do you experience the following repercussions because of dissent note provided by you during the meetings? (Never, Sometimes, Often)
    a. Removal from directorship
    b. Not extending the tenure
    c. Not providing the information on timely basis
    d. Conducting meetings in your absence
13. What are the common reasons for not attending the meetings? (You can mark more than one option).
    a. Meeting at some other company
    b. Pre-occupation because of personal work
    c. Pre-occupation because of office work of company where working as full time director
    d. Agenda is not shared by the company on timely basis and thus, no inputs can be given even if meeting is attended
    e. Others, please specify ______________________
14. Companies Act, 2013 enables you to effectively discharge your duties as an independent director. Do you agree?

a. Strongly Disagree
b. Disagree
c. Neutral
d. Agree
e. Strongly Agree

15. What is your opinion in regard to the applicable law on Independent Directors?

____
____
____

Number of Directorship as an Independent Director –

Number of meetings held for all companies –

Number of meetings attended for all companies –