International Journal of Business and General Management (IJBGM)
ISSN(P): 2319-2267; ISSN(E): 2319-2275
Vol. 3, Issue 2, Mar 2014, 47- 56
© IASET

International Academy of Science, Engineering and Technology
IASET
Connecting Researchers; Nurturing Innovations

ACCENTUATING ROLE OF BOARD FOR CORPORATE GOVERNANCE IN LISTED INDIAN COMPANIES

TWINKLE PRUSTY[1] & SHWETA MEHROTRA[2]

[1]Associate Professor, Faculty of Commerce, Banaras Hindu University, Varanasi, Uttar Pradesh, India

[2]Research Scholar, Faculty of Commerce, Banaras Hindu University, Varanasi, Uttar Pradesh, India

ABSTRACT

India has large number of listed companies, and the efficiency and well-being of the companies involved in economic activities is critical for the economic growth and development in particular and the society as a whole. It has been realized that good corporate governance is vital for better management of any companies. It includes the structures, processes, cultures and systems that engender the successful operation of companies. The one of key actors in corporate governance mechanism to ensure the success of the operations of any company is the board of directors as it guides long-term corporate strategy, puts the key agents in place to implement it, and monitors performance against the strategy set out. An optimum size and composition of board is essential for well-functioning and effective governance of the companies and to support exercise of independent and objective judgments which eventually turns into good company performance. In this paper an effort has been made to examine the relationship between board effectiveness and firm performance through corporate governance mechanisms. For this purpose the two board attributes i.e., total board size and board composition i.e. total number of non-executive independent directors on board and ROA (return on assets) as a proxy for measuring the company performance has been considered. This study could not find any tangible relation between board size and composition and company financial performance, however, the role of board could be emphasized in involving more of rational qualitative decisions which may help in enhancing the long- term sustainability of company and its goodwill for the sake of existing and potential investors and stakeholders as well in order to attract more investment opportunities globally.

KEYWORDS: Corporate Governance, Board of Directors (BOD), Board Size and Composition, Clause 49 of SEBI, Independent Directors, ROA

INTRODUCTION

Corporate Governancerefers to the system of laws, regulations, and institutions that is intended to oversee the conduct of managers and their companies on behalf of investors, including both equity holders and lenders. This framework ensures the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders. Cadbury (1993) states that "it is the ability of boards of directors to combine leadership with control and effectiveness with accountability that will primarily determine how well. companies meet society's expectations of them."Corporate boards worldwide have attracted a great deal of attention because of corporate failures and concerns about the performance of corporations and the way they are governed. East Asian financial crisis of 1997, world famous corporate scandals in Enron, WorldCom, Tyco International in U.S.A., HIH Insurance in Australia, Paramalat in Italy and Air New Zealand became evidence of lack and ineffective monitoring

mechanisms and governance practices together with failure of Board of Directors (BOD) (Lockhart, 2004[1]). The board of directors is one of a number of internal governance mechanisms that are intendedto ensure that the interests of shareholders and managers are closely aligned, and to disciplineor remove ineffective management teams. Among the most significant governance issuescurrently faced by the modern corporation are those relating to board size and composition to ensure the independence of board. An optimum size and composition of board isessential for well-functioning and effective governance of the companies and to support exercise of independent and objective judgments which eventually leads to better company performance. The structure of the Board of Directors is one of the key elements of CG because the effectiveness of BOD in fact decides the future of the firm (Abdullah, 2004[2]). Director board has to perform many responsible tasks within their capacity. Boards are expected to perform different functions, for example, monitoring of management to mitigate agency costs (Shleifer & Vishny, 1997[3]), hiring and firing of management (Hermalin & Weisbach, 1988[4]), provide and give access to resources and providing strategic direction for the firm. Boards also have a responsibility to initiate organisational change and facilitate processes that support the organisational mission. There are number of issues that relate to the efficient functioning of the board of directors, especially in the case of emerging economies including India, where family owned corporations belonging to business groups dominate the corporate landscape. These issues relate to the influence that owners can potentially exert through their presence on corporate boards, often through having substantial equity ownership in the company as well as by holding important managerial positions.

Corporate Governance Mechanism and Role of Boards of Directors

The Cadbury Committee Report (1992) defined it as “the system or process by which firms are directed or controlled”. This system or process consists of internal and external corporate governance mechanism that leads better company performance and includes the ways in which suppliers of finance to firms assure themselves of getting a return on their investment (Shleifer & Vishny, 1997[5]). In this sense, a good corporate governance covers the laws, rules, and factors that control the operations of a firm as well as the relationships between different people who are involved in the system, i.e. management, boards of directors, shareholders and other stakeholders (OECD, 1999). In essence, a corporate governance system provides the structure through which the objectives of the firm are set and the means by which these objectives are attained and monitored.

In the Figure, a simple diagram showing the relationships between good corporate governance, board effectiveness and company performance. in a firm’s typical corporate governance system is presented. On the left-hand side are the basics of the firm’s internal governance system which includes the management and the board of directors. Here, management acts as an agent of shareholders in deciding which assets to invest and how to finance these investments, either through debt or equity. The board of directors, which is located at the apex of the internal control system, is charged with the oversight role of advising and monitoring and control management, including the responsibility

1. Lockhart, J. 2004. Kicked for Touch: How Compliance Killed Strategy at Air New Zealand and NZRFU. Director, 51(4), 8.
2. Abdullah, S. 2004. Board Composition, CEO Duality and Performance amongMalaysian Listed Companies. Corporate Governance, 4 (4): 47-61.
3. Shleifer, A., &Vishny, R. W. (1997). A Survey of Corporate Governance. Journal of Finance, *52*(2), 737-783.
4. Hermalin, BE & Weisbach, MS 1988, 'The Determinants of Board Composition', RAND Journal of Economics, vol. 19, no. 4, pp. 589-606.
5. ibid

to hire, fire and compensate managers to safeguard their roles as effective agents of shareholders (Jensen, 1993[6]). On the right-hand side are the external elements of the firm's corporate governance system. The two main external elements are the firm's debt holders and shareholders and they arise from the firm's need to raise capital from external sources. Inevitably, this situation leads to the separation between capital providers and those who manage the capital in firms. This is the essence of corporate governance (Gillan, 2006[7]; Jensen, 1993[8]), through which, the suppliers of finance to the firm (debt-holders and shareholders) are assured of getting a return on their investment (Jensen & Meckling, 1976[9]; Shleifer & Vishny, 1997[10]). Arguably, the most important one is the board of directors (Kang *et al.*, 2007[11]; Shleifer & Vishny, 1997[12]).

Therefore, effective board performance is perceived as a requirement for sound firm performance based on the assumption that effective boards are likely to positively influence firm performance. In essence, there is concurrence that board effectiveness occurs through the execution of a set of roles (Lipton & Lorsch, 1992[13]; Maassen, 1999[14]). Various research show that boards perform at least three critical roles namely, monitoring and control roles, service roles, and strategic roles (Gopinath*et al.*, 1994[15]; Lipton & Lorsch, 1992[16]; Maassen, 1999[17]; Zahra & Pearce, 1989[18]) which are as follows:

Monitoring and Control Roles

In many cases, the board's failure to exercise effective monitoring and control over management and the assets of the firm was identified as the root cause. For instance, the US senate report on Enron revealed that the board failed in its fiduciary duty by not questioning management regarding complicated financial transactions in which the company was involved (Adams, 2008[19]). The control role of the BOD refers to the fiduciary duty and responsibility of directors to monitor managers on behalf of shareholders in order to improve firm performance (Zahra and Pearce, 1989[20]). The primary role of the BOD is to monitor thebehaviour and performance of managers (Jensen and Meckling, 1976[21]; Fama and

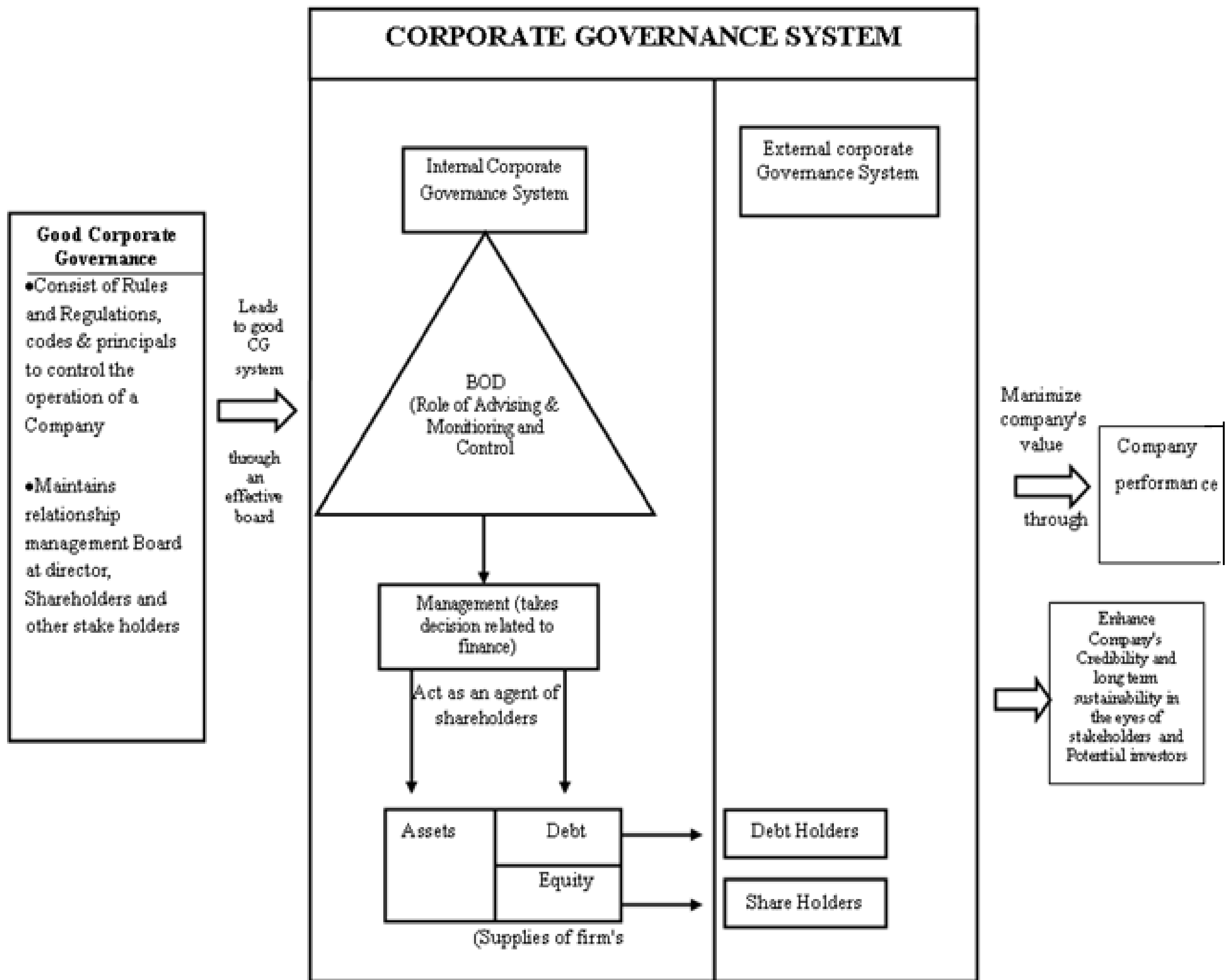
6. Jensen, M.C. (1993), 'The Modern Industrial Revolution, Exit, and the Failure of the Internal Control Systems', Journal of Finance, vol. 48, no. 3, pp. 831-80.
7. Gillan, S.L(2006). Recent Developments in Corporate Governance: An Overview. Journal of Corporate Finance, 12(3), 381-402.
8. Jensen, M.C. (1993), 'The Modern Industrial Revolution, Exit, and the Failure of the Internal Control Systems', Journal of Finance, vol. 48, no. 3, pp. 831-80.
9. Jensen, M. C. &Meckling, WH (1976), 'Theory of Firm: Managerial Behaviour, Agency Costs and Ownership Structure', Journal of Financial Economics, vol. 3, pp. 305-50.
10. Ibid1
11. Kang, H., Cheng, M., & Gray, S J. (2007). Corporate Governance and Board Composition: Diversity and Independence of Australian Boards. Corporate Governance: An International Review, 15(2), 194-207.
12. Ibid1
13. Lipton, M. &Lorsch, J. 1992. A modest proposal for improved corporate governance. Business Lawyer, 48: 59–77.
14. Maassen, G.F. (1999). An International Comparison of Corporate Governance Models. (Third. Ed.) Amsterdam: Spencer Stuart
15. Gopinath, C., Siciliano, J. C., &Murrag, R. L. (1994). Changing Role of the board of directors in search of new strategic identity. The Mid- Atlantic Journal of Business, 30(2). 175-185.
16. Ibid5
17. Ibid6
18. Zahra, SA & Pearce, JA 1989, 'Board of Directors and Financial Performance: A Review and Integrative Model', Journal of Management, vol. 15, pp. 291-334.
19. Adams, R. B. (2008). Communication in the Boardroom, Stockholm. Swedish Institute for Financial Research.
20. Ibid7
21. Ibid4

Jensen, 1983[22]). The BOD is the ultimate internal monitor and is perhaps the most central internal governance mechanism (Fama, 1980[23]; Daily, Dalton and Cannella, 2003[24]). Thus, the control role stresses on the effectiveness of board which mainly lies on board characteristics such as board size and composition. How the board size and composition assist in performing the monitoring the control functions has been discussed a follows:

Board Size

The size of corporate boards has received much attention particularly given prominent business failures of large companies. Board size refers to the number of directors on board. Board monitoring and controlling activities can increase as more directors are added. However, there are different views about the size of board. In complex environments, larger boards are usually more powerful and have necessary expertise in their composition. Larger boards usually help to create relationships between corporations and their environments, provide guidance in strategic decision making and play a crucial role in creating corporate identity (Pearce & Zahra, 1992[25]). However some researcher showed the preference for smaller board size stems from technological and organizational change which ultimately leads to cost cutting and downsizing. Prior studies supported for optimum board size (Jensen, 1983[26]) suggested that a board should have a maximum of seven to eight members to function effectively.

22. Fama, EF & Jensen, MC 1983, 'Separation of Ownership and Control', Journal of Law and Economics, vol. 26, pp. 301-25.
23. Fama, EF 1980, 'Agency Problem and the Theory of the Firm', Journal of Political Economy, vol. 88, no. 2, pp. 288-307.
24. Daily, CM, Dalton, D R & Cannella, AC 2003, 'Corporate Governance: Decades of Dialogue and Data', Academy of Management Review, vol. 28, no. 3, pp. 371-82.
25. Ibid7
26. Ibid2



Model: Relationship between Corporate Governance, Role of Board and Company Performance

Board Composition and Directors 'Independence

Another device that the BOD employs to strengthen its monitoring role is the use of outside independent directors. Dalton et al. (1999)[27] argued that it is not the size that is important, rather it is the number of outside directors (also known as independent directors). Independent director act as effective monitors of top managers to protect shareholder interests. The presence of outside directors enables the boards to perform their proper monitoring role (Coles and Hesterly, 2000[28]). From a legal aspect, the responsibilities of executive and non-executive directors are the same. However, executive directors have an active role in leading thecompany and its affairs for the best interests of stakeholders. The non-executive directors play supervisory and balancing roles,controlling the activities of the executive directors and the board in general. Policy statements, namely the Cadbury Report (1992), the Greenbury Report (1995) and the Hampel Report (1998) emphasize the board monitoring responsibility of non-executive directors. Non-executive

27. Dalton, D. R., Daily, C. M., Johnson, J. L., &Ellstrand, A. E. (1999). Number of Directors and Financial Performance: A Meta-Analysis. *Academy of Management Journal, 42*(6), 674-686.
28. Collis, J & Hussey, R 2003, Business Research, Second Edition, Palgrave Macmillan, London.
Daily, CM & Dalton, DR 1994, 'Bankruptcy and Corporate Governance: The Impact of Board Composition and Structure', Academy of Management Journal, vol. 37, pp. 1603-17.

directors help to ensure managerial accountability of shareholders (Young, 2000[29]). The Higgs Report (2003) suggests that non-executive directors should comprise the majority of a board. In India, as per Clause 49 of Listing Agreement, the board of a company should have an optimum combination of executive and non-executive directors with not less than fifty per cent of the board comprising the non-executive directors. The number of independent directors would depend on the nature of the chairman of the board. In case of a non-executive chairman, at least one-third of board should comprise of independent directors and in case of an executive chairman, at least half of board should be independent.

Service Roles

Board is regarded as an important source of expertise which compliments management with their experience, knowledge and skills, and therefore, it provides a critical competitive advantage for company. The board through the professional and personal qualifications of its members supports the management in providing appropriate advice and counsels in areas where inside knowledge of the firm is limited or lacking. According to Mintzberg (1983), boards perform at least four specific service tasks. Boards perform the task of co-opting of external influencers as a device to secure connections to important stakeholders in their business. Also, boards must be active in establishing contacts and in raising funds for the firm. This task deals with the control firms have over the availability of important external resources, hence, it concentrates on establishing contact between the board and outsiders to secure and obtain critical resources required by the firm, i.e. fundraising (Maassen, 1999[30]). Boards must also act to enhance and maintain the reputation of the firm. This includes representing the interest of the firm in the community, performing ceremonial functions on behalf of the firm, presiding over shareholder's annual meetings and representing the firm at press conferences and public meetings. Lastly, boards should provide quality advice and counsel to management through involvement in the formulation and implementation of decisions.

Strategic Roles

Strategic roles of board have mainly focused on the activities of overseeing and ratifying strategies, ignoring the board's participation in the formulation of strategies (Maassen, 1999[31]). Responsible and effective boards should require management to initiate corporate strategies, be involved in the review of these strategies on a periodical basis, use strategies as a point of reference for board decisions in general, and discuss the risks related to the strategy adoption with management. Hence, boards should not depend entirely on management to initiate strategies but they should participate in defining and guiding the firm's mission through involvement in the development of strategies as well as the implementation and monitoring of these strategies (Gopinath*et al*., 1994[32]).

Objectives of the Study

The following are the objectives of the study:

- To study the role of board of directors in corporate governance mechanism.
- To examine the relationship between board size and composition and company performance.

---

29. Young, S. (2000). The increasing use of Non-executive directors: Its impact on UK board structure and governance agreement. *Journal of BusinessFinance and Accounting, 29*(9 7 10).

31. Ibid6
32. ibid

Hypotheses

H0a: There is no relationship between board size and company performance of listed Indian companies.

H0b: There is no relationship between the board composition and company performance of listed Indian companies.

RESEARCH METHODOLOGY

The study covers the period of five financial years viz.2008-09, 2009-10, 2010-11, 2011-12 and 2012-13. To carry out the study 100 BSE (Bombay Stock Exchange) listed companies from various sectors have been selected which consists of 10% pharmaceutical industry, 9% Energy & Power, 8% banks, 8% FMCG, 7% Engineering & Construction, 7% Information Technology, 5% Electrical equipment's, 5% Automobiles, 4% Broadcasting & Media and remaining belongs to other sectors like Telecom, Mining & Minerals, Real Estate, Textiles, Consumer Electronics, Cement, Chemical, etc. Among all companies 12 per cent companies are government-owned companies and rest 88 per cent are private companies. Out of total sample 45% companies are those with more than Rs 25,000 crores market capitalization and 55% companies have less than Rs. 25, 000 crores but not less that Rs.1000 crores market capitalization as on 30th March, 2012. The rationale for selection of these companies is that being listed and reputed companies; they should have same Corporate Governance standards (as required by Clause 49 of Listing Agreement). Data was collected from the annual reports of the companies. The above mentioned hypotheses have been tested by employing the correlation technique.

Analysis and Findings

Table 1: Descriptive Statistics

Years	Board Attributes	Minimum	Maximum	Median	Mean	Standard Deviation
2012-12	Board Size	05	19	11	10.92	3.14
	ID	02	13	06	5.93	1.92
	ROA[33]	-15.70	34.43	5.80	8.61	8.89
2011-12	Board Size	05	20	11	10.95	3.27
	ID	02	10	06	5.99	1.83
	ROA	-21.20	36.52	6.97	8.56	8.95
2010-11	Board Size	05	20	11	10.90	2.96
	ID	02	10	06	5.80	1.75
	ROA	-4.33	128.62	9.08	11.11	14.57
2009-10	Board Size	05	20	11	10.89	3.02
	ID	02	10	06	5.70	1.74
	ROA	-24.43	35.11	9.55	10.34	9.10
2008-09	Board Size	05	21	11	11.11	3.27
	ID	02	12	06	5.74	1.89
	ROA	-12.11	39.86	8.02	10.13	9.84

The Table 1 presented above describes the minimum and maximum board size and composition as well as return on assets (ROA) during the study period. The mean values tell about the average size of board and its composition and average value of ROA and median gives the middle position in the array of data. Here, to analyze the variations in the

33. All values of ROA are in percentage.

board size and composition as well as in ROA standard deviation has been used. It is important to note that here, board composition means total number of independent directors on board.

As shown in the above table the minimum board size during the study period is same i.e. 5 whereas the maximum board size during the study period is being same in every year except in 2012-13 and 2008-09. In 2008-09 the maximum board size is 21 which is the highest maximum board size value and in 2012-12 it is 19 i.e. the lowest value during the study period. It indicates that the maximum value of board size declines from 21 to 19 that is 10 per cent approximately. The median value provides the middle value in an ordered array of numbers, is 11 throughout the study period. Moreover, the average size of board ranges from 10.89 to 11.11. It indicates that there is no obvious change in the average board size during study period. The variation as shown by SD, in board size ranges from 2.96 to 3.27. Here, it is to be noted that the value of SD is not more than 40% of the mean value in any year. In case of total number of independent directors on board, the minimum value of total number of ID remains constant at 2 during the study period.

The maximum value of increases from 2009-10 to 2012-13. However, in 2008-09 the maximum value of ID is more than from 2009-10 to 2011-12.The median value of total number of IDs remains constant at 6 in the study period. The average number of ID ranges from 5.70 to 5.99 which signals that there is no huge change in the total number of ID during the study period. The values of SD do not exceed more than 40% in any year of study period. Here, ROA has been taken as a proxy measure for company performance. The minimum value of ROA is negative and ranges from -4.3% to -24.43% and the maximum value ranges from 34.43% to 128.62% which indicates the huge variations. The median value ranges from 5.8% to 9.55 and showing decreasing trend over the time period. The average value ranges from 8.61 to 10.13 and has been decreased over the time period. The SD values indicate that there is a huge variation in the ROA and it remains almost nearby the mean value during the study period.

Correlation Matrix

The following Table 2 presents correlation matrix to test the relationship between board attributes and company performance:

Table 2: Correlation Matrix

Year	Variables	ROA	Board Size	ID
2012-13	ROA	1		
	Board Size	0.020	1	
	ID	0.124	0.7555	1
2011-12	ROA	1		
	Board Size	0.118	1	
	ID	0.101	0.851***	1
2010-11	ROA	1		
	Board Size	0.008	1	
	ID	0.074	0.798***	1
2009-10	ROA	1		
	Board Size	0.042	1	
	ID	0.003	0.795***	1
2008-09	ROA	1		
	Board Size	-0.102	1	
	ID	-0.186	0.783***	1

***** denotes Correlation is significant at 0.001 level.**

The above correlation matrix shows that total number of independent directors on boards has a positive coefficient and is statistically significant at 0.001 level in all three years from 2008-09 to 2010-11, indicating the total number of independent directors on board positively related to the board size. It could be because as the board size increases, the proportion on independent directors also increases or vice-versa. Except this there is no any kind of relationship between any variables. Moreover, no any kind of relationship between board size and ROA; and total number of independent directors on board and ROA has been shown by this. Thus, both null hypotheses rejected. And, it can be said that there is no correlation between board size and composition and firm performance. The above analysis suggests that there could be other factors directly contributing to the company performance.

CONCLUSIONS

This study aims at study the role of board of directors in corporate governance mechanism and examine the relationship between corporate board size and composition and firm performance in listed companies in India. The findings suggested that the minimum size of board and number of independent directors on board remains constant during the study period. The maximum size of board and independent directors has been reduced slightly. However, the mean value of board size and composition is almost constant during the study period as the year-wise variations in the mean values are not statistically significant and it can be said that there is no obvious change in the size and composition of board of listed Indians companies during the study period.

This may be because most of the listed companies are seriously complying the codes and principles of corporate governance. The findings reveled that board size and composition is not related with the company performance. Although the study could not find any tangible relation between board size and composition and company financial performance, the role of board in taking qualitative decisions may help in enhancing the long- term sustainability of company and its goodwill in the eyes of shareholders and other stakeholders.

REFERENCES

1. Abdullah, S. 2004. Board Composition, CEO Duality and Performance among Malaysian Listed Companies. Corporate Governance, 4 (4): 47-61.
2. Adams, R. B. (2008). Communication in the Boardroom, Stockholm. Swedish Institute for Financial Research.
3. Ahmed KHM, Duellman AM (2006). The effects of board composition and Board size on the informativeness of annual accounting earnings, Corp. Gov., 14 (5):418-431.
4. Bhagat S, Black B (2002).The uncertain relationship between board composition and firm performance. Bus. Lawyer, 54(3): 921-63.
5. Black BS, Hasung J, Woochan K (2003). Predicting Firm‟s Corporate Governance Choices: Evidence from Korea, Stanford Law School, and John M. Olin Program in Law and Economics.
6. Brickley JA, Coles JL, Jarrell G (1997). Leadership structure: separating the CEO and chairman of the board. J. Corp. Finance., 3 (3): 189-220
7. Cadbury Committee (1992), Report of the Committee on the financial aspects of Corporate Governance, Gee & Co. London

8. Dalton DR, Johnson JL, Ellstrand AE (1999). Number of Directors and Financial Performance: A meta- analysis. Acad. Manage. J., 42 (6): 674-686.

9. Fama, E. F. & Jensen, M. C. 1983, 'Separation of Ownership and Control', Journal of Law & Economics., vol. xxvi, pp. 301-325.

10. Hermalin, B. E. & Weisbach, M. S. 1991, 'The Effects of Board Composition and Direct Incentives on Firm Performance', *Financial Management,* vol. 20, pp. 101-112.

11. Jensen, M. C., & Meckling, W. 1976. Theory of the firm: Managerial behaviour, agency costs and ownership structure. Journal of Financial Economics, 3(4):305–360.

12. K. Keasey, S. Thompson and M. Wright (1997), 'Introduction: The corporate governance problem - competing diagnoses and solutions,' Corporate Governance: Economic, Management, and Financial Issues. Oxford University Press: Oxford

13. Lockhart, J. 2004. Kicked for Touch: How Compliance Killed Strategy at Air New Zealand and NZRFU. Director, 51(4), 8

14. Lipton, M. & Lorsch, J. W. 1992, 'A Modest Proposal for Improved Corporate Governance', *Business Lawyer,* vol. 48, no. 1, pp. 59-77.

15. Lorsch, J. & MacIver, E. (1989). Pawn or Potentates: The reality of America's Corporate Boards Bostan, MA: Harward University Press.

16. Pfeffer J (1972). Size and Composition of Corporate Boards of Directors: The Organization and its Environment, Administrative Science Quarterly, 17(2): 218-228.

17. Pfeffer J, Salancik GR (1978).The External Control of Organizations: A Resource Dependence Perspective. New York; Harper and Row.

18. Rhoades, D. L., Rechner, P. L., & Sundamurthy, C. (2000). Board Composition and Financial Performance: A Meta-analysis of the Influence of outside directors. *Journal of Managerial Issues, 12*(1), 76-91.

19. Shleifer, A. & Vishny, R. W. 1997. June. A Survey of Corporate Governance. Journal of Finance, 52(2):737–783.

20. Weir, C., & Laing, D. 1999. Governance Structures, Size and Corporate Performance in UK Firms. Management Decision, 37(5):457–464.