INFLUENCE OF BOARD SIZE AND INDEPENDENCE ON FIRM PERFORMANCE: A STUDY OF SELECTED INDIAN COMPANIES

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SUBJECT:
KEYWORDS:

INTRODUCTION

Corporate governance issues have attracted a good deal of public interest because of their apparent importance for the economic health of corporations and society in general, especially after the plethora of corporate scams and debacles in recent times. Corporate governance issues flow from the concept of accountability and governance and assume greater significance and magnitude in the case of corporate form of organisation where the ownership and management of organisations are distanced. And, it is in this context that the pivotal role played by the board of directors in maintaining an effective organization assumes much importance. A major part of the debate on corporate governance centres around board composition especially board size and independence. Various committees have mandated a minimum number of independent directors and have given guidelines on board composition. However, the relationship of board characteristics such as composition, size, and independence with performance has not yet been established.

In India, guidelines on the composition of the boardof directors have been issued along the similar lines asabroad, mandating the appointment of a certain percentageof independent directors. The guidelines on independentdirectors pose a series of questions concerningtheir independence and the relationship of the boardcomposition and independence with the firm's performance.The justification of inferring a relationship betweenboard composition and performance is implied bythe impact of the decision-making authority of the boardon firm performance. The question how the board characteristicssuch as composition or size or duality arerelated to profitability has remained unresolved basedon the studies done abroad.

This paper addresses this question: Does the board size and independence really matter in terms of influencing firm's performance?

REVIEW OF LITERATURE AND RESEARCH GAP

A number of empirical studies have been conducted in the US on whether there is any link between independent directors and corporate performance. Some researchers have looked for a direct evidence of a link between board composition in terms of independence and corporate performance. They have studied the correlation between the independent directors and the firms' performance as reflected by the accounting numbers.

Hermalin and Weisbach (1991) have found that a high proportion of independent directors do not predict a better future accounting performance. Using accounting measures Agrawal and Knoeber (1999) found a negative relationship between board independence and firm's performance.

On other hand Hambrick and Jackson (2000) found evidence for the proportion of independent non-executive directors to be positively correlated with the accounting measure of performance.

Jensen (2001) opines that large boards can be less effective than small boards. He says that when boards get beyond seven or eight people, they are less likely to function effectively and are easier for the CEO to control.

The inverse relationship between board size and performance has been reported by Mak and Kusnadi (2003), Alshimmiri (2004), and Andres,Azofra and Lopez (2005). Balasubramanian (2008) documents that our own ancient texts have laid down sound principles of governance,which are very relevant to the modern day corporate requirements. But, in India, the policy-makers are aping the Western models and forming policies and regulations based on them without checking their applicability in the Indian context. From 2008 to 2011 various studies have shown conflicting results

The question how are board characteristics such as composition or size or duality related to profitability still remains unresolved.There is a need for stronger tests to discern whether board composition has any effect on a firm's performance. Hence this study examines the question whether or not board composition has an impact on the firm's performance.

RESEARCH DESIGN

1. Methodology

To study the relationship between board independence,board size, and firm performance, the following variables were used.

A. Firm Performance

Following variables were used to measure the firm performance

No.		Measurement
1		Obtained by computing net profit as a proportion of equityvalue
2		Data obtained directly from the BSE so no calculation was performed.
3	e	Market value per share – Face value per share
4		Net profit attributable to equity share holders / number of equity shares

B. Director Independence

The directors of the companies were classified into four categories namely executive (inside) directors, outside (independent) directors, directors who are non-executive but non-independent, and nominee directors (directors who are nominees of financial institutions). The measure for board independence was taken as the number of independent directors as a percentage or proportion of total directors. Also, to see the differences between boards that have 30 per cent independent directors or boards that have 60 per cent independent directors, the board independence was categorized as follows:

Category 1	Where the proportion of independent directors with respect to the total board size was 33.33 percentor more but less then 50 per cent.
Category 2	Where the proportion of independent directors with respect to the total board size was 50 per centor more but less then 60 per cent.
Category 3	Where the proportion of independent directors with respect to the total board size was 60 per cent or more.

C. Board Size

The measure for board size was the total number of directors on the board. Also, there was a need to see the differences between different board sizes. The board was categorized as follows:

Category A: if board size was of 3 to 6 members.
Category B: if board size was of 7 to 9 members.
Category C: if board size was of 10 to 12 members.
Category D: if board size was more than 12 members.

2. Data

Clause 49 of Listing agreement relating to Corporate Governance is applicable and is mandatory only for the Companies listed either with the BSE or NSE , So Various Companies listed with BSE having different board size and falling in different above mention categories of directors independence , was taken for the study. all data for three financial years from FY 2008-09 to FY 2010-2011 were included in the analysis. The data sources were the Annual Reports of the companies, and the reports filed by the companies with the NSE and the BSE as part of the listing requirements.

3. Method of Analysis

Descriptive method of data analysis was used for the study, which provides some frequencies, averages of relevant variables .

On the basis of above mention variables, performance score of the Companies was derived and in order to derive the performance Score of the sample Companies, weights was allotted to each variable as follow:

1) Average of ROE -25% 2) Average of EPS – 25% 3)P/E Ratio-40% 4) Market Valueadded per share-10% performance of companies was found by using following formula:

Performance Score = (Average of ROE x 25%) + (Average of EPS x 25%) + (P/E Ratio x 40%) + (Market value added per share X10%)

On the basis of Performance Scores, performance level was allotted to each Company in following manner:

SCORE	LEVEL
NEGATIVE	BAD
1-400	VERY POOR
401-1000	POOR
1001-1500	GOOD
1500 -2000	VERY GOOD
2001 &ABOVE	EXTRA ORDINARY

4. Data Anlaysis

Category -1: Where the proportion of independent directors with respect to the total board size was 33.33 percent or more but less then 50 per cent.

Board Size	Name of the Company	ROE (average)	EPS (average)	P/E RATIO	MARKET VALUE ADDED	PERFORMANCE SCORE	PERFORMANCE LEVEL
Category A: if board size was of 3 to 6 members.	ALEMBIC LTD	0.51	0.37	-17.14	13.75	3.98	VERY POOR
Category B: if board size was of 7 to 9 members.	FAME INDIA LTD	-1.24	-0.23	-23.54	40.00	-11.56	BAD
Category C: if board size was of 10 to 12 members.	DIAMOND POWER INFRASTRUCTURE LIMITED	21.02	23.11	-23.54	83.60	581.95	POOR
Category D: if board size was more than 12 members.	MARUTI SUZUKI LIMITED	17.77	69.28	19.58	1103.00	1854.58	EXTRA ORDINARY

Category 2 :Where the proportion of independent directors with respect to the total board size was 50 per cent or more but less then 60 per cent.

Board Size	Name of the Company	ROE (average)	EPS (average)	P/E RATIO	MARKET VALUE ADDED	PERFORMANCE SCORE	PERFORMANCE LEVEL
Category A: if board size was of 3 to 6 members.	ANKIT METAL & POWER LTD	11.57	5.23	3.87	3.50	135.54	VERY POOR
Category B: if board size was of 7 to 9 members.	ALEMBIC PHARMACEUTICALS LTD	32.66	14.82	8.40	51.70	387.20	VERY POOR
Category C: if board size was of 10 to 12 members.	GARWARE POLYESTER LTD	24.18	55.12	7.95	110.00	1398.31	GOOD
Category D: if board size was more than 12 members.	IDEA CELLULAR LTD	6.85	2.50	44.19	67.00	88.51	VERY POOR

Category 3:Where the proportion of independent directors with respect to the total board size was 60 per cent or more.

Board Size	Name of the Company	ROE (average)	EPS (average)	P/E RATIO	MARKET VALUE ADDED	PERFORMANCE SCORE	PERFORMANCE LEVEL
Category A: if board size was of 3 to 6 members.	RELIANCE POWER LTD	0.85	1.05	88.84	88.45	70.84	VERY POOR
Category B: if board size was of 7 to 9 members.	VIDEOCON INDUSTRIES LTD	6.29	19.90	9.62	163.00	519.22	POOR
Category C: if board size was of 10 to 12 members.	ABC INDIA LTD	9.48	6.70	14.08	115.00	186.92	VERY POOR
Category D: if board size was more than 12 members.	INFOSYS LTD.	26.28	120.28	17.08	2515.00	3271.99	EXTRA ORDINARY

5.Descriptive Results

Above analysis shows that if size of the Board of the company is of 3 to 6 members it has given very poor performance at any level of Independence Irrespective of sector or group of the company , this result suggest that very small size of board is not preferable because it gives very poor performance, even though the proportion of independent directors is more then 60 percent of total size of the board

If board size is small means board is having 7 to 9 directors than also it gives bad or very poor peformance of the compnyirrespective of industry , group or sector of the company.

The study found mixed evidence that independent directors add value and improve the performance of the firm. In fact the results of the study shows that there is no relation ship between the firms performance and size of the Board. But one thing is clear that the firms performance is extra ordinary when the the size of the board is 12 or more then 12 but it depends over the role played by the independent directors in decision making. The study shows the result that there is no relation ship whether positive or inverse between board size, independence of directors & Firm's performance.

Companies having large board size, means having member more then 12 has shown extra ordinary performance irrespective of the level of independence but it has also shown poor performance when the proportion of independent directors in board are more then 50 percent but less then 60 percent, means we cant conclude that large size of board gives batter performance every time.

In our study two companies has shown best performance namely 1) Maruti Suzuki Limited 2) Infosys limited, similarity in both companies is that both are have large board size ,having number of directors more than 12 but level of independence is differ and there are many companies whose performance is bad or poor having same size of board this thing proves that , the best performance of above mention two companies is is not a result of the Board size and its independence but it is due to other factors that affects to the performance of the company, like quality of goods and services sold or provided by the company and its brand value and value of company in the eyes of the its stake holders.

It is pertinent to mention that there was no conflicting evidence that they destroy value. These results suggest that independent directors have so far failed to perform their monitoring role effectively. This can be attributed to the fact that 'board independence' is something that has just started getting importance and is catching on in India.

It will take some time for the effects to come.Another reason for this can be that there is a limitedpool of talent from where the independent directors canbe taken. This is exhibited by the presence of the sameperson as the independent director on the boards ofmany companies.

Lack of training to function as independent directors,and ignorance of the procedures, tasks, and responsibilitiesexpected of them, can be other reasons why thestudy did not find independent directors contributingtowards the performance of the firms. There is thus aneed for training programmes for independent directors.Merely adding such persons to the board mayincrease the proportion of independent directors withwithout
improving the performance.

FINDINGS:

- There is no association between board size and firm performance.
- Different proportions of board independence have dissimilar impact on firm performance.
- The impact of board independence on firm performance is effective when the boardindependence is between 50 and 60 per cent.
- larger boards are more efficient than the smaller ones
- Independent directors have so far failed to perform their monitoring role effectively andimprove the performance of the firm.
- Larger boards are prefered by only sucessful Companies and well qulified Independent directors are redy to work on the board of sucessful Companies
- Lack of training to function as independent directors and ignorance of the procedures,tasks, and responsibilities expected of them could be reasons for the independentdirectors' non-performance.

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INTRODUCTION OF SECRETARIAL STANDARDS- A NEW ERA OF CORPORATE GOVERNANCE

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The Ministry of Corporate Affairs accorded its approval under Section 118(10) of the Companies Act, 2013 to Secretarial Standards (SS-1 relating to Meetings of the Board of Directors and SS-2 relating to General Meetings) issued by the Institute of Company Secretaries of India (ICSI). The Secretarial Standards seek to harmonize, incorporate and standardize diverse secretarial practices followed by Companies throughout the Country, which when uniformly and consistently applied, would result in the establishment of best practice in the world and also advocate good governance practices in certain areas where definite law is not feasible.

Secretarial Standards – Corporate Governance Benchmark

India is the first country to issue Secretarial Standards. India is the pioneer in having Secretarial Standards as no other country in the world has yet adopted the Secretarial Standards. Therefore, it is a proud achievement for our Country. These Secretarial Standards become international benchmark for Board and General Meetings for all the countries and benchmark for counterparts to follow.

India Inc. would make a new benchmark of Secretarial Standards (SS) to foothold its corporate governance practice in the global arena. This will bring lots of challenges and provide opportunities for the profession of Company Secretaries. When India Inc. was facing multitude of Corporate Governance practices whereby two activities particularly Board and shareholders decision(s) are crucial, the introduction of SS pertaining to these areas is timely, apt and need of the hour

Presently Companies have crossed the borders and have presence in many countries with gradual opening up of the global economy, international financial market and liberalization; there is a growing reorganization for effective corporate governance. In such scenario, there is definitely a need of universally accepted governance standard to be followed by each organization or firm.

The Board of Directors as an institution plays a prominent role in Corporate Governance. By this pivotal role of the Board, Directors are considered as fiduciaries in that they are required to act in the interest of various constituencies in a company such as shareholders and other stakeholders. Board room governance will receive sharper focus with the release of Secretarial Standard on Meetings of Board of Directors.

SS will foster corporate governance and reduce litigation as the steps on how to conduct a Board Meeting and a General Meeting have been very clearly specified. The adoption of secretarial standard by the Corporates will have substantial impact on the quality of secretarial practice being followed by the Companies, making them comparable with the best practice in the world.

Good corporate governance involves a commitment of a Company to run its business in a legal, ethical and transparent manner and runs from the top and permeates throughout the organization.

Purpose / Role of Secretarial Standards

Secretarial standard is set of some good practices and procedures. Adherence to a standard brings in uniformity, transparency and objectivity. Adherence to the Standards also indicates that the Company concerned is alive to the hygiene factor and takes care to have it embedded in the organizational practices and procedures.

Secretarial Standards play the role of assisting / supplementing (and not supplanting) the extant company law regulation. Wherever there are issues in practically implementing the provision, i.e. where there is no appropriate solution in Companies Act & Rules, the SS provides an adequate guidance to the corporates and professionals for ensuring compliance of the Companies Act, 2013.

Secretarial standards are intended to reduce ambiguity in law and adopt best practices of the industry followed over decades conventionally. They do not seek to substitute or supplant any existing laws or the rules and regulations framed there under but, in fact, seek to supplement such laws, rules and regulations.

Laws framed by the legislature are founded on reason and is obvious to common sense. However, no legislation can be framed to cover all possible questions. Law can't be specific in many areas which gives scope to varied interpretations. Mischief mongers use this flexibility to interpret the laws for their own benefit and not for common good as is the intention of the legislature.

Advantage/Value Creation by Secretarial Standards

The adoption of Secretarial standards would bring following advantages to the Corporate Sector:

1. Consistent, unambiguous and uniform board room practices as well as better transparency and disclosure norms including timely flow of information, will lead to better protection of minority interest.
2. Increase in confidence of Investors like; JV Partners, foreign investors, non-executive directors as well as independent directors. They will get reassured that no director attempts to achieve any undue gain or advantage to himself or to his associates.
3. All the important business decisions like: financial, economical and operational etc. taken at Board Meetings and General Meetings. Standardization of processes and adoption of best practice will enhance in credibility of the decision making process.

PROVISION UNDER COMPANIES ACT, 2013

Every Company shall observe Secretarial Standards with respect to General Meetings and Board Meetings specified by the Institute of Company Secretaries of India, constituted under the Company Secretaries Act, 1980 (56 of 1980), and approved as such by the Central Government.

Applicability & Non Applicability of Secretarial Standards

- Applicable to all the Board meeting of all kind of Companies except one person Company.
- Applicable to all Committee meeting of All the Companies.

The Standards clearly state that if at any time any amendment is made to the Companies Act and it is contrary to the Secretarial Standards, the provisions of the Act will prevail over the Standards.

SECRETARIAL STANDARD I- MEETINGS OF THE BOARD OF DIRECTORS

This Standard prescribes a set of principles for convening and conducting Meetings of the Board of Directors and matters related thereto. The principles enunciated in this Standard for Meetings of the Board of Directors are also applicable to Meetings of Committee(s) of the Board, unless otherwise stated herein or stipulated by any other applicable guidelines.

A. NOTICE, AGENDA AND NOTES ON AGENDA

Notice, Agenda and Notes on Agenda in writing of every Meeting shall be given to every director by hand or by Speed Post or by Registered Post or by Courier or by facsimile or by Email or by any other electronic mode

Address for the Notice, Agenda and Notes on Agenda

Postal address or e-mail address, registered by the Director with the company; or in the absence of such details or any change thereto, on the addresses appearing in the director identification Number (DIN) registration of the Director. If the director specifies the mode of delivery of Notice, Agenda and Notes on Agenda, the same shall be given to him by such means.

Responsibility to Issue of Notice, Agenda and Notes on Agenda

Notice, Agenda and Notes on Agenda shall be issued by the Company Secretary or where there is no Company Secretary, by any Director or any other person authorized by the Board for the purpose. The Proof of sending Notice and its delivery shall be maintained by the Company.

Specification of Notice, Agenda and Notes on Agenda

The Notice, Agenda and Notes on Agenda shall specify the Serial Number, Day, Date, Time and Full Address of the venue of the Meeting.

Time Period for Issue of Notice, Agenda and Notes on Agenda

- Notice, Agenda and Notes on Agenda convening a Meeting shall be given at least SEVEN clear days before the date of the Meeting, unless the Articles prescribe a longer period.
- In case the company sends the Notice, Agenda and Notes on Agenda by Speed Post or by registered post or by courier, An Additional Two Days Shall be Added for the service of Notice.

Notice of Adjourned Meeting

- Shall be given to all Directors including those who did not attend the Meeting on the originally convened date.
- Unless the date of adjourned Meeting is decided at the Meeting, Notice thereof shall also be given not less than seven days before the Meeting.

Notice, Agenda and Notes on Agenda to Alternate Director

The Notice, Agenda and Notes on Agenda shall be sent to the Original Director also at the address registered with the company, even if these have been sent to the Alternate Director.

CALLING OF MEETING ON SHORTER NOTICE

To transact urgent business, the Notice, Agenda and Notes on Agenda may be given at shorter period of time than stated above,

- If at least one Independent Director, if any, is be present at such Meeting.
- If no Independent Director is present, decisions taken at such a Meeting shall be circulated to all the Directors and shall be final only on ratification thereof by at least one Independent Director, if any.
- In case the company does not have an Independent Director, the decisions shall be final only on ratification thereof by a majority of the directors of the company, unless such decisions were approved at the Meeting itself by a majority of Directors of the company

B. NOTES

Each item of business requiring approval at the Meeting shall be supported by a note.

Notes on Agenda shall include the following:

- Details of the proposal.
- Relevant material facts that enable the Directors to understand the meaning.
- Scope and implications of the proposal.
- The nature of concern or interest, if any, of any Director in the proposal, which the Director had earlier disclosed.

C. FREQUENCY OF MEETING

Meetings of the Board of Directors :(Except Small Company, One Person Company and Dormant Company)

- The Board shall meet at least once in every calendar quarter.
- Maximum interval between two board meetings 120 days.
- At least 4 (four) Board Meetings in a calendar year.
- In case of Newly Incorporated Company "First Meeting" should be held within 30 days of Incorporation of Company.

D. QUORUM

The Quorum for a Meeting of the Board shall be One-third of the total strength of the Board or Two Directors whichever is higher.

Important Points relating to Quorum

- Fraction: Any fraction contained in the above one-third shall be rounded off to the next one.
- Higher Quorum in AOA: Where the Quorum requirement provided in the Articles is higher than one-third of the total strength; the company shall conform to such higher requirement.
- Total Strength: Total strength for this purpose, shall not include Directors whose places are vacant.
- Two thirds of Interested Director: If the number of Interested Directors exceeds or is equal to two-thirds of the total strength, the remaining Directors present at the Meeting, being not less than two, shall be the Quorum during such item.
- No quorum in Adjourned Meeting: If there is no Quorum at the adjourned Meeting also, the Meeting shall stand

Presence of Quorum

- Quorum shall be present throughout the Meeting. (Quorum shall be present not only at the time of commencement of the Meeting but also while transacting business).
- Directors participating through Electronic Mode in a Meeting shall be counted for the purpose of Quorum.

E. ATTENDANCE OF MEETING

- Every company shall maintain separate attendance registers for the Meetings of the Board.
- Every company shall maintain separate attendance registers for the Meetings of the Committee.
- The pages of the respective attendance registers shall be serially numbered.
- If an attendance register is maintained in loose-leaf form, it shall be bound periodically.

F. CHAIRMAN

The Chairman of the company shall be the Chairman of the Board. If the company does not have a Chairman, the Directors may elect one of themselves to be the Chairman of the Board

G. PROCEDURE OF MAINTENANCE OF MINUTES

a) The pages of the Minutes Books shall be consecutively numbered. This shall be followed "irrespective of a Break" in the book arising out of periodical binding in case of the Minutes.

b) If maintained in loose-leaf form, shall be bound periodically depending on the size and volume and coinciding with one or more financial years of the company.

c) Minutes of the Board Meeting shall be kept at the Registered Office of the company or if the Company wants to maintain at any place other than Registered Office of the Company, then it will Pass a Board Resolution for the same in the Meeting of Board of Directors.

H. SIGNING AND DATING OF MINUTES

A. Who is authorized to sign Minutes

- Minutes of the Meeting of the Board shall be signed and dated by the Chairman of the Meeting or by the Chairman of the next Meeting.
- Minutes of the previous Meeting may be signed either by the Chairman of such Meeting at any time before the next Meeting is held or by the Chairman of the next Meeting at the next Meeting

B. Time period for circulation of certified copy of Signed Minutes:
A copy of the "certified copy of" signed Minutes certified by the Company Secretary or where there is no Company Secretary, by any Director authorized by the Board shall be circulated to all Directors within 15 (fifteen) days after these are signed.

I. TIME PERIOD FROM MEETING TO CIRCULATION OF FINAL MINUTES

- Circulate Draft Minutes with in 15 days of conclusion of Meeting.
- Comment by Director on draft Minutes within 7 days of Circulation of Draft Minutes.
- Signing of Final Minutes by Chairman within 30 days of Conclusion of Meeting.

CONCLUSION

Secretarial Standards will create enormous confidence in the minds of investors particularly fund managers and overseas investors as these investors are very much concerned about good governance practices and sound procedures. This will lead to more flow of capital into India, new projects, more modernization and expansion. At the same time, there would be greater transparency and accountability by the Board of Directors. The Standards have opened plenty of opportunities for the Company Secretaries. As Standards are mandatorily required to be adhered to by all the Companies, except OPCs, all the 13 lakh plus companies, incorporated in India, will now have to follow uniform governance norms and practice to conduct Board and General Meetings.

References

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