Regulations on Board Composition of Indian Firms

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Corporate Governance (CG) has gained more attention particularly after the Enron, WorldCom and Satyam scandals. International organizations such as Organization for Economic Cooperation and Development (OECD) and International Corporate Governance Network have developed guidelines for corporate governance to protect the investors. A good corporate governance system results in better allocation of companies resources, prevents confiscation of the funds by managers and thereby ensures efficient management and better decision making.

The corporate governance initiatives in India are regulated by the Ministry of Corporate Affairs (MCA) and the Securities and Exchange Board of India (SEBI). The Companies Act, 2013, made significant changes in the way companies in India are governed. The key provisions relating to corporate governance include composition of the board, functioning of independent directors, enhancing board responsibilities on financial reporting, disclosure of related party transactions and compliance with the laws of the land and corporate social responsibility. SEBI has implemented Listing Obligations and Disclosure Requirements(LODR) to establish a framework on various matters concerning corporate governance, disclosure and transparency. In recent times, corporate governance has been receiving more attention, particularly in terms of compliance of several indicators of board composition such as board size, board independence, CEO duality, ownership structure, board diversity, board tenure, board meetings and board remuneration.

Board Size

There are different views on board size of a company. Larger board size indicates all the required competencies are present in the board and the strategic decision making capabilities of the board increases due to the knowledge and intellect brought by members coming from different backgrounds. Large board size encourages diversity in skills, gender, experience and race of board members. Though large board size is positively linked with company performance, it slows down the decision-making process. Smaller boards bring members closer together and enables ease of consensus in decision making. It reduces the possibility of free-riding and is more effective at monitoring managers due to lower coordination costs. The disadvantage of small boards is that it lacks the spread of expert advice and opinion. The question one may ask now is "what should be ideal board size?".As per SEBI LODR "there should be minimum 6 directors in the top 1000 listed entities by market capitalization by April 1, 2019 and in the top 2000 listed entities, by April 1, 2020.

Table 1: Board Size of Firms

Board Size	Number of Firms		
	2016	2017	2018
1-5	1146	1163	1040
6-10	290	280	244
11-15	90	81	53
16-20	17	18	16
21-25	8	5	8
26-30	4	7	7
Total no.of Firms	1555	1555	1368

Source: Authors Compilation from all listed firms in NSE

A survey of NSE listed companies indicate that three-fourth of the firms are having board size of less than 6. Many firms have to increase the board size to minimum 6 to adhere to the norms. There are many firms having a board size of more than 15, probably such firms want to have more diversified expertise in terms of knowledge and skills. Ideally, board size should be of significant size in relation to company's operations and members should be selected such that the Board will maintain its independence and integrity to realise the benefit of large or small board.

Board Meetings

The frequency of board meetings is a measure of board supervision and effectiveness of its monitoring ability. According to LODR, the board shall meet atleast four times a year, with a time gap of maximum four months between any two meetings. This regulation will be applicable for all listed companies in India from 1st April,2019. The more the number of times the board meets, there is more opportunities to discuss and review the firm's operations and performance. Frequent board meetings can result in higher quality of management monitoring which in turn impacts financial performance. A survey of 81 BSE listed companies for which the data on board meetings are available, the result shows that 40 percent of the firms have conducted four board meetings during 2016 and 2017, 59 percent of the firms have held 5 to 7 board meetings in 2016 and 52 percent of the firms have held 5 to 9 board meetings in 2017. During 2018, 35 firms have held 3 meetings; 27 firms have held four meetings and 21 firms have held 5 to 7 meetings. But 43 percent of the firms have not conducted any board meetings. Thus, many firms have to take conscious effort to conduct a minimum of four board meetings in a year to realise the benefits of better monitoring.

Gender Diversity

Boards are concerned with having right composition to provide diverse perspectives. The concept of board diversity suggests that boards should appropriately represent the gender, ethnicity and professional background. Diversity should not only ensure equitable representation but also provide for an expression of broadening the principle of merit. Diversity promotes a better understanding of market place, increases creativity, produces more effective problem-solving and leadership and promotes effective global relationships. Increase in board diversity leads to better boards and governance on the ground that diversity allows boards to tap on broader talent pool for the role of directors. Recognising the value of women directors, Companies Amendment Act, 2013 (Section 149(1)) has made it mandatory for companies having paid up capital of 100 crores, to appoint atleast one women director on the board. Women directors have an equal chance of serving on various corporate governance committees such as audit committee, remuneration committee and nomination committee. Recently, SEBI has proposed that all the listed companies should have atleast one women independent director on the board. The deadline is 1st April 2019 for top 500 listed companies and 1st April 2020 for top 1000 listed companies. A survey based on hand collected data on the presence of women directors on the board of 1555 NSE listed companies shows that 107 firms and 128 firms have women directors on board during the period 2017 and 2018 respectively. Based on the availability of data, we find that out of 48 companies, 23 firms have women independent directors in 2017 and 24 out of 44 firms have women independent directors in 2018. There seems to be a need for a pool of qualified women independent directors to cater to this compliance of women director /women independent director on boards of companies.

Educational Qualification

Board of directors combine a mix of competencies and capabilities that collectively represent a pool of social capital and adds value in executing the board's governance function. Board members with higher qualifications would ensure an effective board, which requires, "high levels of intellectual ability, experience, soundness of judgement and integrity". Monitoring role can be effectively implemented if the board members are qualified and experienced. Presence of more qualified members would extend knowledge base, stimulate board members to consider other alternatives and enhance a more thoughtful processing of problems. Educational qualifications are included in the index for evaluating corporations' adherence to corporate governance. Based on a survey of BSE listed companies, we find that more than 50 percent of the directors are post graduates and above, while one third of the directors are graduates. More qualified the directors and the more specialised in the domain area of the firm, better is the firm performance.

Board Independence

The board comprises executive directors and non-executive directors who are either independent or non-independent directors. The role of independent directors on a board is most debated topic whether they should be executive directors or non-executive directors. Non-executive directors are widely believed to a play a significant role in monitoring the management than executive board members. Firms with more outside directors have fewer propensities to commit fraud and it is often alleged that board of directors are more independent as the proportion of their outsider director's increases. The main function of outside or non-executive directors is to ensure that the executive directors are pursuing policies consistent with shareholders' interests. Greater the non-executive directors, greater the efficiency in decision making process due to better monitoring. Clause 49 of the Listing Agreement states that "where the chairman of the board is a non-executive director, atleast one-third of the board should comprise of independent directors and in case he is an executive director, at least half of the Board should comprise independent directors".

Higher proportion of independent directors on the board contribute to improved firm performance and information asymmetry is likely to reduce, as it would increase the transparency in the firm. A survey of NSE listed companies shows that 81 companies have 50 percent or more independent directors on the board in 2017, while 1473 firms have less than 50 percent independent directors. In 2018, 129 firms have 50 percent or more independent directors, while 1238 firms are yet to have atleast 50 percent of the independent directors on the board. Thus, many firms have to take significant efforts to fulfil this requirement of minimum independent directors on the Board.

Regulators consider board composition as the key mechanism of corporate governance, but a survey of the listed companies in India shows that many firms are yet to comply with the LODR and Companies Act, 2013 stipulations pertaining to board composition. Adhering to the stipulated regulations on board composition serve as a signal of better system of governance to the retail investors, institutional investors and other stakeholders. Hence, compliance officers need to develop a strategic approach to implement the board composition regulations and ensure better governance of the firms.

The views expressed are those of the author and do not reflect the opinion of the organization she represents.