

BOARD EFFECTIVENESS: AN EVALUATION BASED ON CORPORATE GOVERNANCE SCORE

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Abstract Growth, progress, and prosperity of any country depend highly on the corporate governance mechanism of that country. Good governance of a country helps it to sustainable growth and consistency in progress. The good governance should contribute towards the improvement in transparency, ethics, morality, and disclosure. The principles of good governance stand on honesty, trust, integrity, openness, and performance orientation. Our honorable Prime Minister Narendra bhai Modi had given the three “E” for good governance during his speech on Independence Day i.e. Effective Governance; Electronic Governance, and Ethical Governance. The fundamental concern of corporate governance mechanism is to ensure the protection of minority shareholders/owners of specific firms. Mechanism of a corporate governance specifies the relations among the shareholders, board of directors, and managers. The present paper is an attempt to evaluate the effectiveness of the board by calculating the corporate governance score. The mandatory and non-mandatory guidelines have been considered while assigning points to specific parameters of the corporate governance.

Keywords Board of Directors, Board Effectiveness, Independent Director, Corporate Governance

INTRODUCTION

The effective board demands culture of transparency and accountability. Study of Ana Dutra (2012) found the four phase continuum to progress of board from good to the great i.e. foundational, developed, advanced, and strategic. The effectiveness of board is determined based on the agreement and alignment of board on this continuum. The continuum indicates the corporate hierarchy of needs.

A foundational board provides basic compliance oversight, like basic needs of survival in Maslow’s need hierarchy. It focuses on the fulfillment regulatory requirement for compliance purpose only. Such boards are low performing, passive and play in safe. On the contrary, a strategic board provides futuristic outlook to the firms’ essential strategy. Such boards are high performing boards. Here, directors of the board take the risk to make significant contributions for sustainable grow of enterprise. Weak board is observed with lack of clarity, poor process management, lack of alignment and agreement on company strategy, and poor team dynamics. Effective boards are high performing boards. Composition of board and level of diversity in board suggest the “talent-centric” approach of the board. Here, diversity is not only in terms of age, gender, geographies, and race but also in terms of knowledge, experience, expertise, and backgrounds. Strategic directors are contributing in board by giving constructive inputs for the development of firm and personal development of other directors.

SIGNIFICANCE OF THE STUDY

Prior studies have analysed board effectiveness as relationship between board characteristics (size, composition, leadership, and independent directors) and a range of financial performance (ROA, ROE, market-to-book value). The present study contributes to the emerging interest in corporate governance by examining the board characteristics for effective board management. The result of this study is to contribute to the interest of business practitioners, investors, and academics by providing the picture of corporate governance practices in Indian corporates. The results can be further used by corporate decision maker in order to design the composition of their board. The present study contributes to the body of knowledge in this area through examining the board effectiveness of Indian public listed firms. Further, the study addresses the Indian corporate governance issues concerning the characteristics of members of board of directors. The study is also to contribute the understanding of the characteristics of board of directors in Indian firms. The study may become useful for helping nomination committees to select the best criteria while appointing their board members. Finally, the outcomes of this study may contribute to Indian regulators for formulating corporate governance policies in India.

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REVIEW OF LITERATURE AND METHODOLOGY TO ASSIGN SCORES TO SPECIFIC CORPORATE GOVERNANCE PARAMETERS

Extensive review of literature has been done to calculate the score for board effectiveness. Both, mandatory and non-mandatory guidelines provided in Clause 49 have been considered to assign the point to specific parameters of corporate governance. (See Annexure 1 for assigned points to every parameter)

Board Characteristics

Board characteristics include:

Board Leadership (CEO Duality)

CEO duality exists when the chairman of the board serve as the CEO of the firm. It provides the wider power base to the leader. Studies have found that the dual power helps a leader to make effective strategic decision and easily adapt to changing external environment. But, increase in corporate scandals demands separation of role of the CEO from that of the chairman. The regulators and reformers are demanding clear division of work and responsibilities at the top of the firm. Ultimately such practice establishes autonomy between the board and corporate management.

Board Size

Enormous researchers show the positive association of number board size and corporate performance. The large board size is likely to have increased pool of experience and knowledgeable expertise. It also results in reducing the dominance of CEO on board and increasing in monitoring and supervising capacity of the board. But, larger boards are hard to manage and are likely to increase coalitions and factorisation that will result in delayed strategic decision making processes. Therefore, a board should be small enough to have effective coordination of members and large enough to include a diversity of the expertise needed to perform its responsibilities. Well diversified board comprising a maximum of seven members as ideal board size.

Board Composition

Composition of a board states the division of inside and outside directors measured in percentage. A board is considered to be more independent as the number of independent directors increases proportionately. Proportion of independent directors in the board has been calculated

to assign the points. Independent directors do not have any kind of personal or business relationship with the firm. It is claimed that independent directors provide effective performance to the board as an effect of the independence from management of the firm. It provides independent supervision of the management of the firm. It is mandatory to have one-third of independent directors in case of executive chairman and half of the independent directors in case of non-executive chairman.

Annual General Meeting/ Number of Board Meetings and Attendance

Cornforth (2001) found the relevance of board attendance to the board performance. Board attendance as the part of board characteristics is measured by the percentage of directors who attend board meetings. Similarly, the board attendance in annual general meeting is also considered for the analysis.

Presence of Woman in the Board

The researchers found that the demographic diversity adversely affects the group dynamics, but improves the group decision making. Recent studies support that the presence of at least one female director in board reduces the risk of bankruptcy. The findings also confirm that gender diversity have positive impact on the performance of the firm. The presence of female directors and numbers of female directors in boards have been given special attention while assigning the points. Modern reforms and regulations clearly emphasise the importance of gender diversity in the boardroom.

Board Meetings

Walter (1969) proposed the board size between six and eight to be most effective for better governance of the firm. The number of directors and directorship of that director with other firms have also great implication on the number of board meetings. Some researchers also emphasise the quality of meetings over the frequencies of the meetings.

Board Committees

Following committee of the board have been considered for the study:

Audit Committee

The board effectiveness also depends on the quality of operational committees of the board. The best practice guidelines for corporate governance suggest that a firm should have at least Audit committee, Nomination/corporate

governance Committee, and Compensation/remuneration Committee. Major regulators and reformers advocates for the formulation of audit committees constituted of independent directors in public listed corporations. The modifications are likely to make in order to make audit committees more efficient and effective in executing their roles.

Other Committees of the Board

Remuneration, Nomination, Risk Management, shareholder grievance committees etc. are some other committees of the Board. Separately three elements mentioned in Table were considered to assign the points to the remuneration/compensation committee and shareholder grievance committee respectively. Furthermore the two points have been assigned to the formulation additional committees of directors.

Disclosure and Transparency

Disclosure and transparency of financial and corporation information is desirable and important for the credibility of the board. Firms are required to disclose the criteria and methodology of evaluation. For the study ten different disclosed items extracted to assign corporate governance score. Composite score has been assign to this category. The corporate governance mechanism should ensure the timely and accurate disclosure is made on all the matters concerning corporation. Mainly, disclosure of financial conditions, performance, ownership and governance of the firm is inevitable.

Non-Mandatory Provisions

This category also comprises the composite score, the guidelines by regulatory authorities stress, Constitution of Remuneration Committee, Dispatch of Half-yearly results, Training of Board members, Peer evaluation of Board members, Whistle Blower policy as the non-mandatory provisions for the effective governance. For the research purpose, non-mandatory provisions presented in Annexure 1 have been considered to assign corporate governance score.

Stakeholder's Rights and Information

Rights and information to the stakeholder become vital in current governance practice. Every firm tries to seek the returns more than the expectations of the stockholders in order to serve the stakeholders of the firm. Five percentage weightage have been given to this attribute.

FINAL EVALUATION OF FIRMS BASED ON CORPORATE GOVERNANCE SCORE

The firms with total corporate governance score 86-100 were considered as Excellent in board effectiveness. Here, exclusive intervals have been used i.e. end terms of the interval were not consider in frequency calculation. The firms with total corporate governance score below 41 are considered as poor Boards.

After calculating the corporate governance score, the firms have been categorised based on following criteria.

Table 1: Corporate Governance Score

Score	Evaluation
90-100	Excellent
80-90	Very Good
70-80	Good
60-70	Average
Below 60	Poor

OBJECTIVES OF THE STUDY

- To analyse the characteristics of Indian Corporate Board.
- To analyse how characteristics of Indian Corporate Board align with guidelines provided by regulatory bodies.
- To evaluate the Indian corporates based on corporate governance score.

SAMPLE SELECTION

All non-financial firms listed on the BSE-100 index were selected as the sample of study. As the research was based on the secondary data, the corporate governance reports from the annual report of 2012-13 of respective firms have been used to calculate the corporate governance score. Some of the non-financial firms were not included in sample because of non-availability of complete data. Therefore the sample size of the study includes 77 non-financial firms listed on BSE-100 index.

Evaluation of Boards across the Sample

The results in Table 2 show the picture of total corporate governance score across the sample. There was only one company i.e. Tata Constancy Service, which scores highest (91) among the sample. There were 11.7 % firms which are categorised as very good in terms of board effectiveness. Overall, high effectiveness of board is observed in very less

number of firms. About 12 percentage of firms scored less than 60 points of total corporate governance score. These firms were considered as poor in terms of board effectiveness. Respectively 40.3 % and 35.1 % of the firms were categorised as average and good in terms of board effectiveness. Hero Motors and Adani Ports were having minimum 53 and 55 point of total corporate governance score.

Table 2: Evaluation of Boards Based on Corporate Governance Score

Evaluation	Frequency	Percent
Excellent	1	1.3
Very Good	9	11.7
Good	27	35.1
Average	31	40.3
Poor	9	11.7
Total	77	100.0

Industry Specific Evaluation of Boards

Industry-wise categories of firms have been discussed in following tables.

Automobile Industry

Table 3: Evaluation of Automobile Industry

Evaluation	Frequency	Percent
Very Good	1	14.3
Good	3	42.9
Average	1	14.3
Poor	2	28.6
Total	7	100

Case Summaries

Automobile		
Evaluation of Boards Based on Corporate Governance Score	Very Good	Tata Motors
	Good	Mahindra & Mahindra
		Maruti Suzuki
		Bajaj Auto
	Average	Ashok Leyland
	Poor	Cummins India
		Hero Motor Corp

The results in Table 3 show that maximum (42.9 %) firms are categorised as good in terms of board effectiveness. No firm was found to be excellent in terms of corporate governance score. Two firms i.e. Cummins India and Hero Motors were categorised for poor board effectiveness. Tata Motors were the well managed firm in terms of good governance. Therefore, it is categorised as Very good in terms of board effectiveness. Hero Motors and Cummins India score very poor total corporate governance score.

Information Technology Industry

Table 4: Evaluation of Boards Information Technology Industry

Evaluation	Frequency	Percent
Excellent	1	11.1
Very Good	1	11.1
Good	2	22.2
Average	5	55.6
Total	9	100.0

Case Summaries

Information Technology		
Evaluation of Boards Based on Corporate Governance Score	Excellent	Tata consultancy services
	Very Good	Infosys
	Good	Tech Mahindra
		Wipro
	Average	Reliance Communication
		Bharti Airtel
		Zee Entertainment
Idea Cellular		
HCL		

From Table 4, it can be observed that majority of (55.6 %) firm scores “average” in terms of corporate governance. Tata Consultancy Services is highest in this industry. It is also highest across the sample. None of the firm has poor board effectiveness. Tech Mahindra and Wipro were categorised as good in terms of board effectiveness.

Chemical Industry

Table 5: Evaluation of Boards Chemical Industry

Evaluation	Frequency	Percent	
Valid	Very Good	1	11.1
	Good	2	22.2
	Average	5	55.6
	Poor	1	11.1
	Total	9	100.0

Case summaries

Chemical		
Evaluation of Boards Based on Corporate Governance Score	Very Good	Tata Chemicals
	Good	Ranbaxy Laboratory
		Dr Reddy's Lab
		GlenmarkPharma
		Lupin
		Cipla
		Divi'S Laboratory
Average	United Phosphor	
Poor	Sun Pharmaceutical	

Here also, a firm of Tata group of companies scores highest in board effectiveness i.e. Tata Chemical. Sun Pharma acquires less number of corporate governance score. It is categorised as the poor board. 55.6 percent of firms were average in corporate governance score. Ranbaxy, and Dr. Reddy’s Lab were found to be good in terms of total corporate governance score.

Housing and Development Industry

Table 6: Evaluation of Housing and Development Industry

Evaluation	Frequency	Percent
Good	6	50.0
Average	3	25.0
Poor	3	25.0
Total	12	100.0
Case Summaries		
Evaluation of Boards Based on Corporate Governance Score	Good	BSE 100
		Asian Paints
		DLF
		Larsen & Toubro
		Reliance Infrastructure
		ACC
		Ambuja Cement
		Ultratech Cement
		Unitech
	Average	GMR Infrastructure
		Jaiprakash Associates
		HDI
	Poor	Adani Ports

Half of the firms of this industry are categorised as good boards. Comparatively the board effectiveness of housing and development industries is poor. None of the firms was categorised as very good or excellent. Fifty percent of firms are observed as good board. Jaiprakash Associates, HDI and Adani Ports (25 % of firms of industry) were found in poor corporate governance score, whereas Ambuja cement, Ultratech Cement, and Unitech were found average in terms of corporate governance score.

Metals, Metal Product and Mining Industry

Results of Table 7 reveal that out of total 12 firms in industry, one firm (Tata Steel) is categorised as very good and one firm (Bharat Forge) is categorised as poor board while five firms are categorised as good and five firms are categorised as poor board. None of the firms got excellent category

for board effectiveness. Finally, firms belonging to Metal and Mining industry are said to be poor in performance of corporate governance.

Table 7: Evaluation of Metals, Metal Product and Mining Industry

Evaluation	Frequency	Percent
Very Good	1	8.3
Good	5	41.7
Average	5	41.7
Poor	1	8.3
Total	12	100.0
Case summaries		
Evaluation of Boards Based on Corporate Governance Score	Very Good	BSE 100
		Tata Steel
		Hindalco Industries
		Coal India
		Hindustan Zinc
	Good	JSW Steel
		NMDC
		Steel Authority
		Sterlite Industry
		Exide Industries
	Average	Sesa Goa
		Jindal Steel &
		Bharat Forge
		Poor

Power Industry

Table 8: Evaluation of Power Industry

Evaluation	Frequency	Percent	
Very Good	1	10.0	
Good	4	40.0	
Average	4	40.0	
Poor	1	10.0	
Total	10	100.0	
Case summaries			
Evaluation of Boards Based on Corporate Governance Score	Very Good	BSE 100	
		Tata Power Comp	
		Siemens	
		Power Grid Corp	
		Reliance Power	
	Good	NTPC	
		ABB India	
		Bharat Heavy El	
		Suzlon Energy	
		NHPC	
	Average	Adani Power	
		Poor	

Total 10 firms belong to this industry. Out of this, Tata Power got highest point for good corporate governance. Adani Power was found to be poor in corporate governance. None of the firm was categorised as Excellent. Forty percent of firms acquired the scores to be categorised as good governance. Average category was also acquired by forty percent of firms.

Consumer Product Industry

Table 9: Evaluation of Consumer Product Industry

Evaluation	Frequency	Percent
Very Good	3	25.0
Good	3	25.0
Average	5	41.7
Poor	1	8.3
Total	12	100.0
Case summaries		
Evaluation of Boards Based on Corporate Governance Score	Very Good	BSE 100
		ITC
		Tata Global Bev Nestle India
	Good	Colgate-Palmolive
		Hindustan Uniliver
		Titan Industries
	Average	Dabur India
		Godrej Consumer
		Crompton Greave
		Grasim Industries
		United Breweries
	Poor	Adani Enterprise

From Table 9, we observed that Tata Global Beverages, ITC, and Nestle India are categorised as very good in board effectiveness, while Adani Enterprise scores very less total corporate governance score. It is categorised as poor board. A maximum of 41.7 percent of firms are categorised as poor in terms of board effectiveness.

Oil and Gas Industry

Table 10: Evaluation of Oil and Gas Industry

Evaluation	Frequency	Percent
Very Good	1	16.7
Good	2	33.3
Average	3	50.0
Total	6	100.0
Case summaries		
BSE 100		

Evaluation of Boards Based on Corporate Governance Score	Very Good	Reliance Industries
	Good	Cairn India
		Hindustan Petro
	Average	Indian Oil Corp
		Bharat Petroleum
GAIL (India)		

Minimum six firms represent the industry. Half of the firms were categorised as average boards while half of the firms (combined) were categorised as very good and good boards. Reliance Industries was categorised as very good in terms of board effectiveness. It scores highest total corporate governance score across oil and gas industry.

CONCLUSION

This is a positive research therefore, summary of findings have been concluded as follows.

Results estimated that the Indian firms have to evolve a lot to improve the corporate governance practice. About 40 % of firms were categorised in board effectiveness. Most of these firms followed the criteria of corporate governance for the sake of compliance only. Only one firm i.e. Tata Consultancy Services with 91 points was categorised as excellent. 12 % of firms were poor performance in terms of board effectiveness. Industry specific results show that 14.3 % in automobile; 11.1 % in information technology; 11.1 % in chemical; 00.00 % in housing and development; 8.3 % in Metals & Mining; 10 % in power; 25 % in consumer products; 16.7 % in oil & gas industry were evaluated as very good in terms board effectiveness. On the other side, 28.6 % in automobile; 55.6 % in information technology; 11.1 % in chemical; 25 % in housing and development; 8.3 % in Metals & Mining; 25 % in power; 8.3 % in consumer products; 00.00 % in oil & gas industry were evaluated as poor in terms board effectiveness.

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APPENDIX 1

Table A1: Corporate Governance Scorecard

I	Board of Directors		Score	
	Composition of Board of Directors		Assign	Max.
A	Board Leadership (CEO Duality):			10
1	Promoter Executive Chairman cum CEO/MD		2	
2	Non-Promoter Executive Chairman cum CEO/MD		4	
3	Promoter Non-Executive Chairman		6	
4	Non-Promoter Non-Executive Chairman		8	
5	Non-Executive Independent Director as a Chairman		10	
B	Size of the Board:			6
1	3 to 7		2	
2	8 to 12		4	
3	More than 12		6	
C	Board Balance/Composition (ID):			6
1	1/2 for executive chairman		2	
2	1/3 for non-executive chairman		2	
3	More than ½ for executive chairman		4	
4	More than ½ for non-executive chairman		6	
D1	Attendance at the Board Meetings:			6
1	33 % to 50 %		1	
2	51 % to 80 %		3	
3	81 % to 100 %		6	
D2	Attendance at the Annual General Meetings:			6
1	33 % to 50 %		1	
2	51 % to 80 %		3	
3	81 % to 100 %		6	
E	Degree of Diversification			5
	Presence of a female directors in board		5	
F	Number of Board Meetings:			5
1	4-5		1	
2	6 to 8		5	
3	More than 7		3	
G	Average Number of Directorship with other Companies.			6
	5 >		2	
	3 to 5		4	
	3 <		6	
II	Board Committees:			15
A	Audit Committee			
	Transparency in independence of Audit Committee		6	
	Compliance with number of meeting in a year (Min. 3/4)			
	Attendance in Audit Committee meetings (>50%)			
	Transparency in qualification of Audit Committee			
	Brief description of terms of reference			
	Size of the audit Committee (>3)			

	B	Remuneration/Compensation Committee: Brief description of terms of reference, Information about number of committee, meetings and attendance, Compliance of minimum requirement of number of non-executive directors and the provision of independent directors as a chairman.	3	
	C	Shareholders' Grievance Committee: Transparency in Composition of the committee Information about nature of complaints & queries received and disposed Information about number of committee meetings and action taken	3	
	D	Risk Management Committee	1	
	E	Share Transfer Committee	1	
	F	Other Miscellaneous Committees of the board: Health, Safety and Environment Committee / Ethics and Compliance Committee	1	
III	A	Disclosure and Transparency of:		10
	1	Definition of Independent director	1	
	2	The Company's Corporate Governance Philosophy	1	
	3	Code of Conduct	1	
	4	Term of office non-executive directors(Tenure and Age Limit)	1	
	5	Remuneration policy	1	
	6	Criteria for election of the board and it's disclosure in the annual report	1	
	7	Are all the pecuniary relationships or transactions of the non-executive director vis-à-vis the company, described in the annual report?	1	
	8	Post-meeting internal communication system	1	
	9	Appointment of lead independent directors	1	
	10	Other provision as to the boards and committees	1	
	B	Disclosure and Transparency		10
	1	Basis of related party transactions	1	
	2	Accounting treatment	1	
	3	Subsidiary Companies	1	
	4	Proceeds from initial public offerings (IPOs)	1	
	5	Remuneration of Directors	1	
	6	Management discussion and analysis	1	
	7	Shareholders' rights and information	1	
	8	Compliance of Corporate governance and Qualified certificate	1	
	9	CEO / CFO Certification	1	
	10	Report on corporate governance	1	
IV	A	Non-mandatory provisions		10
	1	Whistle Blower Policy Training of Board Members Nomination Committee Mechanism for evaluation of Non-Executive Board Members	10	
V	A	Disclosure of Stakeholders' interests :		5
		Environment, Health & Safety Measures (EHS)	1	
		Human Resource Development Initiative (HRD)	1	
		Corporate Social Responsibility (CSR)	1	
		Industrial Relation (IR)	1	
		Disclosure of policies on EHS, HRD, CSR & IR	1	