The Role of Board of Directors in Corporate Governance

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Abstract: The series of corporate failures due to mis-governance and subsequent regulatory changes brought corporate governance into limelight. The corporate board of directors assists in corporate governance by supervising executive management and makes strategic decisions for the company. The board is generally supposed to govern the corporation on behalf of the shareholders, effectively acting as trustees for stockholder interests. Directors are elected by shareholders, and may even be shareholders or company employees themselves. The Board of Directors can play an important role in making sure that an outward looking approach – including transparency, integrity, and win-win relationship – is valued within a company and that these values are flourished at the company-wide perspective. Board members also have a responsibility to ensure that appropriate risk management systems are in place. The roles and responsibilities of a Board of Directors vary, depending on the nature and type of business entity and the laws applying to the entity. Similarly, the establishment of board committees is a means to channel the functions of a board into segregated and specialized groups of directors that focus on specific subject of the organization.

In this paper an attempt is made to review the working of Corporate Governance so far as the structure, size, composition and the functioning of Corporate Governance is concerned. Moreover, it also evaluate the role of various board committees viz., audit committee, compensation committee etc to ensure good Corporate Governance in the Indian Corporate.

Key Words: Corporate Governance, Board of Directors, Structure, Size, composition of BODs, Board Committees

1. Introduction

Corporate Governance is concerned with the functioning of Board of Directors (BODs) –its structure, styles, process, their relationships and roles, activities etc. Therefore, Boards of directors (BODs) is considered as a crucial part of the Corporate Governance. Directors are appointed by the shareholders of the company, who set overall policy for the company, and the board appoints one or more of them as managing directors/whole time directors/ executive directors to be approved by the shareholders. They are a link between the people who provide capital (the shareholders) and the people who use that capital to create value (the managers). The board’s primary role is to monitor management on behalf of the shareholders. Board of directors is the important element of Corporate Governance. As Tricker says, “Corporate Governance addresses the issues facing Boards of Directors”. In this view, the main responsibility of governing a company is upon the Board of Directors and, therefore, attention must be paid to their roles and responsibilities. The roles of the Board of Directors and shareholders are interactive and, therefore, the quality of governance depends upon the level of interface set up by them. The boards are accountable in many ways to the shareholders and stakeholders in a company. The directors are required to attain a balance between competing interests of shareholders, customers, lenders, promoters and directors. Preferably, the board should be the heart and soul of a company. Whether or not, the company grows or declines, depends upon the sense of purpose and direction, the values, the will to generate stakeholders’ satisfaction and the drive to achieve them. Section 2(13) of the Indian Companies Act 1956 defines a director as follows, “A director includes any person occupying the position of director by whatever name called. The important factor to determine whether a person is or is not a director is to refer to the nature of the office and its duties. It does not matter by what name he is called. If he
performs the functions of a director, he would be termed as a director in the eyes of the law, even though he may be named differently. A director may, therefore, be defined as a person having control over the direction, conduct, management or superintendence of the affairs of a company. Again, any person in accordance with whose directions or instructions, the board of directors of a company is accustomed to act is deemed to be a director of the company.” As per the Companies Bill, 2009 Section 2(1)(zi): “‘director’ means a director appointed to the Board of a company, and includes a deemed director”. Section 2(6) of the Indian Companies Act 1956 states that directors are collectively referred to as “Board of Directors” or simply the “Board”. As per the Companies Bill, 2009 Section 2(1)(j): “Board of Directors” or “Board”, in relation to a company, means the collective body of the directors of the company”.

A director may be a full time working director, namely managing or whole time director covered by a service contract. Managing and whole time directors are in charge of the day-to-day conduct of the affairs of a company and are together with other team members collectively known as “management” of the company. A company may also have non-executive directors who do not have anything to do with the day-to-day management of the company. They may attend board meetings and meetings of committees of the board in which they are members. As per clause 49 of the listing agreement, there is one more category of directors called Independent Directors. An Independent Director is defined as a “non-executive director who is free from any business or other relationship which could materially interfere with the exercise of his independent judgement. Another category of directors recognized in certain provisions of the Indian Companies Act 1956 are “Shadow Directors”. These so called “deemed directors” acquire their status by virtue of their giving instructions (other than professional advices) according to which “appointed” directors are accustomed to act. Board of directors is there for governance of the company and it performs the strategy making role. Hence, it should have a right mix of outsiders and people from the management so that people who execute the decisions have a say in decision making in parallel ensuring that the stakeholder’s interests are protected.

2. Objectives of the Study

1) To evaluate the role of Board of Directors for ensuring good Corporate governance;
2) To study the structure, size and composition of board of directors as per Indian regulations;
3) To study the role of various Board Committees to ensure good Corporate Governance in the Indian Corporate;
4) To draft the powers of board of Directors in the Indian Corporate.

3. Literature Review

By taking a sample of 92 Spanish firms, which involved the analysis of 276 observations for the time period 2004-06, Maria and Sanchez (2009) determine the effectiveness of Spanish corporate governance by analyzing the impact of five board characteristics on technical efficiency viz., board size, board independence, board reputation, board diversity and board activity. The results of this empirical study shows that business technical efficiency increases with a heterogeneous boards, with a limited number of directorships per director and with a limited activity specified in a reduced number of annual board meetings with a higher number of specialized committees. Spanish data as per this research paper is quite interesting because boards are dominated by executive directors, and as a result they are able to pursue their own interests by limiting the effectiveness of monitoring resources. This paper reviews that in relation to efficiency, a diverse board may constitute a better monitor of managers, because board diversity increases board independence. Similarly, the establishment of board committees is a means to channel the functions of a board into segregated and specialized groups of directors that will focus on specific subject of the organization. Thus, a greater number of committees would imply greater involvement of the board, members, which would lead to greater effectiveness of the board and further when boards develop hierarchal structures, several agency problems such as free-riding and co-ordinations costs have been alleviated. Bebchuk and Weisbach (2009) elucidate that the public and private decision-makers suggested that the only way through which we can make boards work better is to have independent boards. Directors’ independence is associated with improved
decisions with respect to CEO turnover, executive compensation decisions, and the incidence of fraud, and on the opportunistic timing of stock option grants. In this research paper, authors through some light on Executive compensation and affirm that public firms are managed by executives, not directors or shareholders; as a result Executives’ decisions are also affected by the incentives provided to them by their executive compensation arrangements. Consequently, under the optimal contracting view, the design of pay arrangements is presumed to be efficient. Adams, Hermalin and Weisbach, (2009) inform that due to increased pressure from institutional shareholders, more government regulations, greater threats of litigation, and new exchange requirements, boards have become more independent and diligent. Hence, boards are more willing to monitor, which raises the possibility they hire externally for the CEO position; and more monitoring directly raises the chance of CEO dismissal, less job security and in response of that CEOs work harder and thus, demand greater pay in compensation. Hence, a consequence of more independent boards over time could be upward pressure on CEO compensation. Further, these authors indicate that the role of board of directors has been the topic of research these days particularly due to the well-publicized failures and subsequent regulatory changes. Authors mention that “directors serve as a source of advice and counsel, serve as some sort of discipline, and act in crisis situations.” As per the directors view point, some believe that they have multifarious jobs to do in the organization like they set strategy, corporate policies, overall direction, mission, vision; while others believe that their job is to “oversee, monitor top management, CEO”; “succession, hiring/firing CEO and top management”; or serving as a “watchdog for shareholders, dividends.” Consequently, boards have become larger, more independent, have more committees, meet more often, and generally have more responsibility and risk. But, authors caution that directors with more directorships are more likely to have attendance problems at board meetings, which suggests that busy directors spend less time at each firm and as such additional directorships may hurt firm performance. Further having bankers on boards can be a double-edged sword as bankers can improve a firm’s access to capital market, but sometimes this improved access works to the benefit of the bank rather than the firm doing the borrowing.

Switzer, Lorne N. and Yu, Cao (2011) empirically test the hypothesis that the closer alignment of board of director members’ interests with shareholder interests improves the economic profitability of firms. The hypothesis is tested by examining the relationship between the economic value added of firms, reflected by the spread between operating earnings in excess of the cost of capital (ER) and firm grades based on the Clarkson Center for Business Ethics and Board Effectiveness (CC (BE2)) Index of Shareholder Confidence for Canadian firms from 2002-2006. The authors find that high shareholder confidence index values are generally associated with higher ER, although the relationship is not monotonic for higher graded boards. This suggests that while highly graded boards are generally beneficial, there may be diminishing returns to efforts to design “optimal” boards in the sense of their alignment with shareholder interests.

The new rules of NYSE for corporate governance require the audit committee to discuss and review the firm’s risk assessment and strategies; further, additional requirements are also put for the composition and the financial knowledge of the directors sitting on the board and on the audit committee. Dionne and Triki (2005) in the research paper investigate whether these new rules as well as those set by Sarbanes Oxley act lead to hedging decisions that are of more benefit to shareholders. The goal of this research was to study the effect of the board and the audit committee independence and financial knowledge on the firm’s risk management activity. The authors explore that the new requirements concerning the audit committee size and independence motivate firms to seek more hedging, whereas the requirement of a majority of unrelated directors on the board has no effect on the corporate risk management activity. The authors document that financially educated directors seem to encourage corporate hedging while financially active directors and those with an accounting background play no active role in such policy. The empirical findings also show that having directors with a university education on the board is an important determinant of the hedging level.

Al-Mudhaki and Joshi (2004) examine the composition, focus and functions of audit committees, the effects of meetings and the criteria used in the selection of members by Indian listed
companies. They find that only 56.2% of companies have established an Audit committee so far despite the fact that it is now mandatory. Of these companies which have Audit committees, 68.3% have between three and six members on Audit Committees. However, only 14.6% of companies have independent non-executive directors while 90.2% have non-executive directors on the committee. This shows a lack of independent representation on the committees. As far as the functions of Audit committees’ are concerned the authors state that they are quite diverse and are classified in three areas: financial statements and reporting, audit planning, and internal control and evaluation. The review of note disclosure and scope of external audit work are other important functions performed by Audit Committees. The most important areas of focus as the authors explain are compliance with the standards and regulatory bodies, probing material items and undisclosed liabilities. As per the Section 292A of the Indian Companies Act, companies having paid-up share capital of at least fifty million rupees (approximately US$1 million) shall set up an Audit Committee. The authors mention that the main criteria used for membership of an Audit Committee are: experience and knowledge of business, experience of holding similar positions and accounting and finance expertise. The survey reveals that the majority of companies’ Audit Committee meetings are held monthly or quarterly. However, MANOVA analysis reveals that the frequency of Audit committee meetings has an effect on the internal control functions. The study concludes that the concept of an Audit Committee is not new in India but their formation is slow and their composition lacks independence; its functions are still concentrated in the traditional areas of accounting and their role is not changing fast enough to make the corporate governance more effective.

4. The Board of Directors – Roles and Responsibilities

The Board’s key purpose is to ensure the company’s prosperity by collectively directing the company’s affairs, whilst meeting the appropriate interests of its shareholders and stakeholders. In India, there are many judgements on the role of directors and the responsibility of directors/ Board of Directors in any Company. In Private Limited Companies or the Public Companies, the role and responsibility of the Directors or the Board of Directors depend upon the regulations in the Articles of the Company and the provisions of the Companies Act, 1956. When it comes to listed Public Companies, other provisions like the SEBI guidelines, regulations, provisions in the listing agreement etc. deserve consideration. Private Limited Companies or the closely held Companies are actually run by the directors and we know as to how Annual General Meetings (AGM’s) are conducted in these companies in reality. It may not be the case when it comes to listed Public companies in view of various guidelines, regulations and the provisions of listing agreement entered into with the Stock Exchange. Directors or the Board of Directors has a very big role to play in any Company and they conduct the day-to-day affairs of the company and it may not be possible for the AGM to give directions to the Company from time to time though every company should act as per the provisions of the companies act 1956 and certain decisions can only be taken by the shareholders in the AGM.

Let us examine the role of Board of directors (BoDs) in terms of Companies Act and other legal provisions. Company is a legal personality and Board of Director acts as its body and mind. Under Section 291 of the Companies Act, BoD is authorized to do what the company is authorized to do, unless barred by restrictions on their power by the provisions of the Companies Act. It is well settled that directors, while exercising their powers, do not act as agents for the majority or even all the members and so the members cannot by a resolution passed by a majority of even unanimously, supersede the directors’ power and instruct them how they shall exercise their power. The powers of management are vested in directors and they alone can exercise these powers. The only way in which the General Body of a company can overrule the BoDs is altering the Articles and refusing to re-elect the directors, whose actions they disapprove. The shareholders cannot themselves usurp the powers, which by Articles are vested in the directors. Thus the relationship of BoDs with the shareholders is more of a federation than that of subordinate and superior. The Board of Directors can be greatly helped by focusing on four key areas: (i) by establishing vision, mission and values; (ii) by setting strategy and structure; (iii) by delegating
authority and responsibility to management; and, (iv) by exercising accountability to shareholders and be responsible to relevant stakeholders.

In India, it is common to find family-owned concerns being run by promoters as their personal fiefdoms. Though their investments may be meager, they manage the firms, holding positions of CEOs, managing directors, Chairman and members of the Board of Directors. In such a set-up, the board acts more like a rubberstamp, rather than shouldering large responsibilities. For better governance, the board should function as follows:

1) The Board should meet regularly, retain full and effective control over the company and monitor the executive management.
2) Directors should exhibit total commitment to the company. An efficient and independent board should be conscious of protecting the interests of all stakeholders and should attend and actively participates in the meetings.
3) Another important function of the directors is that they should steer discussions properly. They should set priorities and ensure that these are acted upon.
4) A director is expected to have the courage of conviction to disagree. Directors should also be alert to any deteriorating situations in functional areas of finance, stock market, sales, personnel, and especially those relating to moral issues.
5) Directors have great responsibility in the matter of employment and dismissal of the CEO. The Board as a whole, should recruit the best CEO they can hire, based on antecedents and market reports, evaluate objectively on a continuing basis his or her implementing effectively or otherwise the strategic planning devised by the board.
6) An efficient board should be able to anticipate business events that would spell success or lead to disaster if proper measures are not adopted in time. The directors should be alert to such ensuing situations and be ready with the strategy to meet them so that either way the company stands to gain.
7) The directors should always exercise their powers for a ‘proper purpose’ – that is, in furtherance of the reason for which they were given those powers by the shareholders.
8) Directors must act in good faith in what they honestly believe to be the best interests of the company, and not for any collateral purpose. This means that, particularly in the event of a conflict of interest between the company's interests and their own, the directors must always favour the company.
9) Board of Directors should provide counsel and oversight on the selection, evaluation, development and compensation of senior management.
10) Board of Directors should monitor corporate performance against strategic business plans, including overseeing operating results on a regular basis to evaluate whether the business is being properly managed.
11) Directors should ensure that processes are in place for maintaining the integrity of the company by way of the financial statements, compliance with laws and ethics, and integrity of relationships with customers, suppliers and other stakeholders.
12) Board of Directors should ensure that the company is in compliance with all applicable statutory and legal requirements.

5. Role of the Chairman

The Chairman’s role includes managing the board’s business and acting as its facilitator and guide. This includes;

1) Determining Board composition and organization;
2) Clarifying board and management responsibilities;
3) Planning and managing Board and Board Committee meetings;
4) Developing the effectiveness of the Board

6. Role of Independent Directors

The revised clause 49 stipulates that in companies which have executive chairmen, at least 50 per cent of the board is required to have independent directors. For companies with non-executive chairmen one-third of the board must comprise independent directors. An “Independent
director” is a non-executive director on the board of a company who has integrity, sense of accountability, track record of achievements, financial literacy, experience and the independence to balance the interests of various stakeholders, ability to think strategically, degree of commitment, sense of devotion.

Independent Directors play an active role in various committees to be set up by a company to ensure good governance. Listed Companies are required to set up audit committees of minimum three directors, on which, two-thirds should be Independent Directors. The audit committee chaired by an Independent Director shall inspect the company’s financial statements and can also recommend replacement of the statutory auditor.

Independent directors are responsible for formulating and implementing business strategies on behalf of shareholders and have to ensure that the business activities of the company are compatible with all legal requirements. They have to perform crucial governance functions. The presence of independent Directors on the Board, capable of challenging the decisions of the management, is widely considered as a means of protecting the interests of shareholders and other stakeholders.

7. Role of Board Committees

The Board of the Company has the following Committees:

1) **Audit Committee:** - Section 292A of the Companies Act, 1956 requires that every public limited company (whether listed or unlisted) having a paid-up capital of at least Rs.5 crore should constitute a committee of the board to be known as Audit Committee. The meetings of the Audit Committee shall at least be held four times a year and preferably on the day preceding the date of each of Board meeting. Being mandatory under Section 292A of the Companies Act, 1956 and Clause 49 of the listing agreement, the audit committee can be of facilitator of Board to implement, monitor and continue good corporate governance practices for the benefit of the company and its stakeholders. The main function of Audit Committee is to oversee the company’s financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible. The Audit Committee can recommend to the Board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees. The members of Audit Committee should have formal knowledge of accounting and financial management or experience of interpreting financial statements.

2) **Remuneration Committee:** - The remuneration Committee shall be held at least four times a year on the day preceding the date of every Board meeting. The Committee’s principle functions are to authorize the remuneration, business and other benefits of executive directors, including the CEO, and to grant awards under the Courtaulds Long-Term Incentive Scheme.

3) **Nomination Committee:** - The Nomination Committee shall be held at least twice in a year. The Committee’s functions are to make recommendations to the Board about the future appointments of non-executive directors and of the chairman and the chief executive, and to consider recommendations from the chief executive to the Board about the future appointments of executive directors.

4) **Shareholders’/Investors’ Grievance and Administrative Committee:** - The Shareholders’/Investors’ Grievance and Administrative Committee meetings shall be at least held thrice in a month. The Chairman of this Committee shall be a Non-executive Independent Director. This Committee shall approve transfer of shares, transmission of shares, issue of duplicate share certificate, etc. This Committee shall also review the queries/complaints received from the shareholders during the fortnight and responses given to the shareholders. In addition to above committees the board may constitute other committees,
8. Structure, Size and Composition of Board of Directors

Clause 49 of the listing agreement requires that the board of directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors and further that where the Chairman is a non-executive director, at least one-third of board should comprise of independent directors and in case he is an executive director, at least half of board should comprise of independent directors. The said Clause also sets out the principles for determining “independent director”. The said Clause also provides that nominee directors appointed by an investing or lending institution shall be deemed to be independent directors. The size of the Board should neither be too small nor too big. Experience indicates that smaller boards allow for real strategic discussion. At the same time, larger Boards provide the benefit of diverse experience and viewpoints. The board should strike a balance of executive and non-executive directors. Every board should consider whether its size, diversity and demographics make it effective. Diversity applies to academic qualifications, technical expertise, relevant industry knowledge, experience, nationality, age and sex. Diversity adds value, and adds to the bottom line. Gender diversity is an important aspect of board diversity and companies should have women representation on the Boards. Every board should consider whether its size, diversity and demographics make it effective. Diversity applies to academic qualifications, technical expertise, relevant industry knowledge, experience, nationality, age and sex. Diversity adds value, and adds to the bottom line. Gender diversity is an important aspect of board diversity and companies should have women representation on the Boards. Boards need to be regularly refreshed with new expertise, energy and experience. Independent directors should not have long tenure. A balance should be sought between continuity in board membership, subject to performance and eligibility for re-election and the sourcing of new ideas through the introduction of new board members.

9. Powers of the Board of Directors

Under the Indian Companies Act 1956, BoDs has powers to make calls on shareholders in respect of money unpaid on their share, power to authorize the buy-back, power to issue debentures, power to borrow moneys otherwise than on debentures, power to invest the funds of the company and power to take and make loans. There is no doubt that BoDs may, by a resolution passed at a meeting, delegate to any committee of Directors, the Managing Director, the Manager or any other principal officer of the company, the above powers. However the principal power still vests in BoDs and the Manager or Managing Director acts only as an agent of the BoDs. Apart from this, BoDs has power to form opinion about the solvency of the company in respect of buy back shares (Section 77A), power to fill up casual vacancies in the office of Directors (Section 262), power to constitute Audit Committee and specify terms of reference thereof (Section 292A), power to make donation to political parties [Section 293A(2)], power to accord sanction for specified contracts in which one or more directors are interested [Section 297(4)], power to receive notice of disclosure of director’s interest [Section 299(3)(c)], power to appoint or employ a person as Managing Director or Manager [Section 316(2)], power to invest in shares or debentures of any other body corporate (Section 372A), power to appoint or employ a person as its Manager [Section 386(2)], power to make a declaration of solvency, where it is proposed to wind up the company voluntarily [Section 488(1)], power to approve the text of advertising for inviting public deposits [Section 58A r/w Rule 4(4)]. Some of the powers can only be exercised by resolution passed at the meeting with consent of the Directors present at the meeting.
10. Conclusion

In the eyes of law, a company is an artificial person, who however, has no physical existence and has neither a body nor soul. Therefore, a company cannot act itself in its own person, it can only act through directors. The directors are a body to who has delegated the duty of managing the general affairs of the company. A board of directors (BODs) is considered as a crucial part of the Corporate Governance. Directors are appointed by the shareholders of the company, who set overall policy for the company. The corporate board of directors assists in corporate governance by supervising executive management and makes strategic decisions for the company. The board is generally supposed to govern the corporation on behalf of the shareholders, effectively acting as trustees for stockholder interests. The roles and responsibilities of a Board of Directors vary, depending on the nature and type of business entity and the laws applying to the entity. Similarly, the establishment of board committees is a means to channel the functions of a board into segregated and specialized groups of directors that focus on specific subject of the organization. In India, there are many judgements on the role of directors and the responsibility of directors/ Board of Directors in any Company. In Private Limited Companies or the Public Companies, the role and responsibility of the Directors or the Board of Directors depend upon the regulations in the Articles of the Company and the provisions of the Companies Act, 1956. When it comes to listed Public Companies, other provisions like the SEBI guidelines, regulations, provisions in the listing agreement etc. deserve consideration.

11. Reference


[7] Clause 49 of the listing agreement


[12] Indian Companies Act 1956


