The India Board Report 2007

FINDINGS, ACTION PLANS AND INNOVATIVE STRATEGIES

FOREWORD

Given the recent trend of globalization, the value of the core team that drives these vehicles of growth, the board of directors, has sharply grown in importance

The India Board Report – 2007 is the first of a series on the 'State of the Corporate Boards' in India. The report has been created through an in-depth two-tiered survey and structured interviews with a broad cross-section of the board members of the leading companies in India.

Given the recent trend of globalization, the value of the core team that drives these vehicles of growth, the board of directors, has sharply grown in importance. Given this equation it stands to reason that the evaluation of the board's performance is closely linked to the company's performance. Hence it becomes imperative to study how corporate boards measure their companies, and their own performance.

The report highlights several key findings, one of them being the need for board restructuring. Despite an increase in the number of non-executive/independent directors in India during 2005-06 (over the previous year), the effect of their value-add remains difficult to ascertain. An important question that arises, therefore, is whether the roles and responsibilities of non-executive directors are clearly defined and documented. Interestingly, the survey reflects that 62.5% of directors believe that roles and responsibilities of non-executive directors are clearly defined and documented. Additionally, a large number (60%) of directors strongly agree that the increase in time invested on board duties has led to an increase in the board's effectiveness and confidence. The report further highlights the increasing diversity on corporate boards in India, both in terms of foreign directors and women (although in a lower proportion) – an obvious outcome of the globalization of India Inc.

This study should prove to be an excellent guide for any organization looking to enhance the effectiveness of their board

With increasing competition, the role of the board becomes strategically more important, and this study should prove to be an excellent guide for any organization looking to enhance the effectiveness of their board.

Valuable inputs of eminent chairmen and directors have helped to shape the findings of the report, which have been grouped into the following broad areas:

1. Structure/composition of the board
2. Board priorities and responsibilities
3. Board effectiveness (executing to its defined objectives)
4. Board's ability to assess and monitor company performance
5. Compliance to corporate governance regulations
6. Compensation

The end result is an interesting compilation that highlights visible trends relating to board effectiveness. We look forward to your views and comments in making this endeavor a great success.

VIVEK GUPTA | SUNIT MEHRA | ZIA MODY

CONTENTS

Foreword 2
Scope and Methodology 6

CORPORATE GOVERNANCE IN INDIA 10
Corporate Governance Across the Globe 11
Emergence of Corporate Governance in India 12
Corporate Governance Becomes Imperative in 2006 13
Improved Corporate Governance Practices in India 13
Brief on J. J. Irani Committee Report 14
Brief on SEBI (N. R. Narayana Murthy) Committee Report 17
Audit Committee 17
Related Party Transactions 17
Risk Assessment and Management 17
Initial Public Offering (IPO) 17
Code of Conduct 17
Nominee Directors 18
Non-Executive Director Compensation 18
Whistle Blower Policy 18
Subsidiary Companies 18
Evaluation of Board Performance 18
Amendments to the Recommendations in N. R. Narayana Murthy Report 18
Definition of the Independent Director, part (i)(e) to Sub-Clause I.A 19
Non-Executive Director Compensation, sub-clause I B(i) 19
Audit Committee Meeting, sub-clause II.D(i) 20
Board Procedures, Sub-Clause I.D(iii) 20
Subsidiary Companies, Sub-Clause V 20
CEO/CFO Certification, Sub-Clause VIII(i)(f) 21

FINDINGS FROM THE SURVEY 22
Section 1: Are Directors and Institutional Investors satisfied with the current structure/composition of their boards? 22
Directors' Satisfied with Board Composition 23
Perceived Obstacles in Changing Board Structure 23
Possible Improvements to Board's Effectiveness by Altering Structure 23

Section 2: Board – Priorities and Responsibilities 24
Top Priority Goals/Objectives for the Board 25

Section 3: Board Effectiveness 26
Directors Believe their Board to be Reasonably Effective 27
Measures that can be Taken to Improve Board's Effectiveness 28
Directors Sit on Fewer External Boards in 2005-06 29
Boardrooms get Buzzing - Number of Board Meetings Increase in 2005-06 30
Time Spent on the Board v/s Benefits 30
What Further Steps can be Taken to Improve Quality of Discussions in Board Meetings? 30
How Useful is this Information for Directors? 32
Improving Information 32
Do Boards Measure their Own Performance? 32
Board Evaluation Process on the Backburner 33
Directors' Perspective on Board Evaluation Process 33
Are Independent Directors Really Independent? 33

Section 4: Board's ability to Assess and Monitor Company Performance 34
Key drivers Used by Boards to Evaluate Company Performance 35
Monitoring Performance Drivers .35
Impediments in Monitoring Business Performance 36
External Ratings Closely Monitored by Board 37

Section 5: Compliance to Corporate Governance Regulations 38
Boards Highly Involved in Meeting Compliance Requirements 39
Clause 49 appreciated by the Board 39
Steps Taken to Meet Compliance Standards/ Requirements and their Implications 39
Board Size Increased to 11 39
Share of Women Directors' Increased Slightly but Continued to Remain Low 39
Foreign Directors Occupied More Space on the Board . . .39
Chairperson, CEO/MD Tenure Increases in 2005-06 41
Boards Getting Older in India 41
Percentage of Non-Executive Chairperson/CEO Remained Constant 41
Number of Independent Directors Increases in 2005-06 42
Are Roles and Responsibilities for Non-executive Directors Clearly Defined? 42
Average Number of Executive Directors Reduces 42
Companies Introduce New Committees for Better Control 44
Corporate Social Responsibility (CSR) on Priority List 47
Companies Providing D&O Insurance Increase 47

Section 6: Compensation: 48
Board Remuneration on the Rise .49
Differential Fees Across Committees 51

ACKNOWLEDGEMENTS 52

SCOPE AND METHODOLOGY

The report aims at studying the composition of boards in India's public companies spread across different industry sectors, and evaluating their effectiveness in executing duties and responsibilities during the preceding years

The India Board Report - 2007 presents the results of A.T. Kearney, AZB & Partners and Hunt Partners' Board Composition and Effectiveness Survey 2006. The report aims at studying the composition of boards in India's public companies spread across different industry sectors, and evaluating their effectiveness in executing duties and responsibilities during the preceding years.

For the purpose of studying the board's composition, a survey was carried out on a cross-section of various public companies listed on the Bombay Stock Exchange and National Stock Exchange. Questionnaires were sent across to the company secretaries of each firm, which included the topics listed below:

- Number of each type of director on their board (executive, non-executive, independent)
- Tenure and age of directors
- Number of board meetings and related workload
- Number of different committees and their composition
- Process of board evaluation and procedure for selection of chairperson
- Board remuneration
- Presence of new committees such as Corporate Social Responsibility
- D&O insurance, process for selection of non-executive directors
- Company's financial performance for the fiscal years 2004-05 and 2005-06

For the purpose of studying the board's composition, a survey was carried out across various public companies listed on the Bombay Stock Exchange and National Stock Exchange

For measuring the effectiveness of boards, another survey was conducted, wherein responses from a number of chairmen and non-executive/independent directors were obtained

For measuring the effectiveness of boards, another survey was conducted with certain companies and responses from a number of chairmen and non-executive/independent directors were obtained. The topics covered under this survey are:

- Satisfaction levels of directors and institutional investors with the current structure/composition of their boards
- Key responsibilities and priorities for corporate boards in India
- The involvement level of directors in meeting compliance requirements
- Directors' feedback on the effectiveness of compliance requirements
- Process used for measuring company performance
- Process used for measuring board's performance
- Ratings on their board's effectiveness.

Apart from the results of these two surveys, the report also provides the dynamics of Corporate Governance in India, with respect to corresponding changes across the globe. It discusses the initiatives taken by the Securities Exchange Board of India (SEBI) and amendments to the Companies Act, 1956 (Companies Act). The role of international organizations such as the Organization for Economic Cooperation and Development (OECD), International Monetary Fund (IMF), Securities and Exchange Commission (SEC), and the Confederation of Indian Industry (CII) is also briefly highlighted.

The findings expressed in the report are based on the responses to the survey.

Needless to say, the sample size was small, covering mainly Indian listed companies and therefore could lead to some approximations in the conclusions.

Major corporate governance failures in cases such as Enron, Tyco International and WorldCom posed a threat to the reliability of financial markets and attracted the attention of governments, regulators, companies and investors across the world

Corporate Governance Across the Globe

Globally, many changes have taken place in the field of corporate governance over the past decade. Standardization of corporate governance across the globe gained momentum in 1999, when the OECD developed and issued Principles of Corporate Governance to guide governments in their efforts towards evaluating and improving the corporate governance frameworks.

These principles initiated discussions at regional roundtables held in cooperation with the World Bank in Asia, Latin America, Russia, Southeast Europe and Eurasia. However, major corporate governance failures in cases such as Enron, Tyco International and WorldCom posed a threat to the reliability of financial markets and attracted the attention of governments, regulators, companies and investors across the world.

To avoid such cases from recurring, the Sarbanes Oxley Act of 2002 was passed in the U.S. The legislation established enhanced standards for all U.S. company boards, management and public accounting firms. This Act requires the SEC to ensure compliance with law. Some important provisions under the law include:

- Creation of Public Company Accounting Oversight Board (PCAOB) to ensure proper disclosures in the company's financial statements
- Requirement for disclosure by public companies with regard to their internal controls relating to financial reporting and attestation of these disclosures by independent auditors for such companies
- Chief executive officers and chief financial officers need to certify their company's financial reports
- Independence of auditors
- Fully-independent audit committees to oversee the relationship between the company and its auditor
- Ban on most personal loans for executive officers and directors
- Faster reporting of insider trading
- Ban on insider trades for the period of pension fund black-out periods.

Also, to reinforce corporate governance norms, OECD ministers reassessed their Principles of Corporate Governance in 2004. The review process included the survey of corporate governance developments in OECD countries and about 25 meetings with non-OECD member countries. Modifications in the principles were focused on: ensuring the basis for an effective corporate governance framework, the effective exercise of ownership and dealing with conflicts of interest.

International Monetary Fund (IMF) and World Bank also continued to play a significant role in improving standards of corporate governance across the globe. As a part of their (World Bank and IMF) program on Reports on the Observance of Standards and Codes (ROSC), the World Bank assessed the application of OECD Principles of Corporate Governance across countries. ROSC's role was to identify weak links that could contribute to the country's economic and financial vulnerability. Most recent topics of discussion have been the role of independent directors, separation of the chairman and CEO, frequency of meetings, code of conduct for the board, limitation on board directorships and committee memberships, and role of audit committees. Some important suggestions in the World Bank's ROSC on India released in April 2004, include creation of a credible director training institution, and giving SEBI the power to extract a fine in case of corporate governance violations.

Apart from monetary benefits, good Corporate Governance also attracts global talent, which is essential for a company to survive in the fiercely competitive global scenario

Taking his own stand, David Larcker, director of new corporate governance program at the Stanford Graduate School of Business' (GSB) Center for Leadership Development and Research (with over 20 years of research experience in the field of corporate governance and executive compensation), believes that rules alone cannot force managers and board to do right things for the shareholders. Larcker with an interdisciplinary research team plans to carry out research that focuses on all areas of a corporation, including marketing, accounting and administration, which according to him is the key to good governance. Larcker is looking forward to developing a dynamic set of rules that are not universal and can be altered so as to best suit a class or a set of companies.

Emergence of Corporate Governance in India

Corporate Governance in India first gained significance in 1996, when the Confederation of Indian Industry (CII) took a special initiative to develop and promote a code for corporate governance. It was adopted and followed by Indian corporates including private sector, public sector, banks and financial institutions. In 1998, CII published a voluntary code named the Desirable Code of Corporate Governance. The code's recommendations stressed on the importance of independent directors, limitation on the number of simultaneous directorships, defined role and remuneration (including commission and stock options over and above sitting fees) for non-executive directors, key information to be reported to the board, setting-up of audit committees and disclosure norms.

The first formal corporate governance framework for listed companies was established in February 2000 by SEBI, following the Kumarmangalam Birla Committee's (set up on May 7, 1999) recommendations.

Corporate Governance becomes Imperative in 2006

Indian Economy experienced a GDP growth of 9.0% during 2005-06 to 9.4% during 2006-07. By 2025, the India's economy is projected to be about 60 per cent the size of the US economy. The growing economy has also had its impact on the capital market in India. In terms of market capitalization, the Bombay Stock Exchange (BSE) ranks 16 in the world market. Out of about 700,000 companies traded on the BSE, the Top 200 company promoters hold around 50% of equity. Dominant shareholders manage most of these companies. This remains to be an area of concern for foreign investors with regard to corporate governance.

More Indian corporations are raising capital overseas through listing on international stock exchanges. To become more effective in these exchanges, Indian companies have to make their operations and financial results more transparent; in short, improve corporate governance standards.

With globalization gaining momentum, after formation of the WTO, financial capital movement has improved further. In terms of foreign investments, India witnessed a $7.99 billion net inflow from the Foreign Institutional Investors (FII) in 2006. The growth story has led to net FII inflows touching $8.45 billion in 2007 (till the first half of July). The number of foreign institutional investors (FIIs) registered with SEBI has increased to 1,042 in June 2007 from 813 at the beginning of the calendar year 2006. Foreign Direct Investments (FDI) also increased by 184% to reach approximately $15.7 billion in 2006-07.

Again, apart from the company's competency, the investor's highly-rated companies follow sound corporate governance practices. Investors, thus want to invest in companies that not just create wealth, but also take business decisions in a way that is legal and do not cause a moral hazard. Underlying this fact was a presentation given by Anita Skipper, Head of Corporate Governance, Morley Fund Management, UK. In the speech, Anita emphasized that foreign investors were looking at long-term investments, which can give good consistent returns each year. She believes that even though India has laws and regulations such as the Companies Act, SEBI Codes and, Listing Rules in place, their implementation remains to be an area of concern.

Better Corporate Governance in India can not only considerably increase the amount of foreign investments coming into the country, but also enable Indian companies to raise more capital through international stock exchanges. Apart from monetary benefits, good Corporate Governance also attracts global talent, which is essential for a company to survive in the fiercely competitive global scenario.

Improved Corporate Governance Practices in India

To further raise the standards of corporate governance in India, the J. J. Irani Committee was set up to give recommendations on amending the Company Law, while the N. R. Narayana Murthy Committee was established by the SEBI to recommend amendments in SEBI's Clause 49 listing agreement.

Brief on J. J. Irani Committee Report

Important recommendations of the J. J. Irani Committee report with regard to board composition and effectiveness suggest:

- An appropriate basic framework should be created, to which companies having larger public potential need to comply.
- A company should have the obligation to constitute and maintain a board of directors as per the provisions of law and disclose particulars of the directors so appointed in the public domain through statutory filing of information.
- Minimum number of directors for different classes of companies should be prescribed in the law, and obligation to ensure compliance should lie with the board. There should not be any limit on the maximum number of directors.
- The company (shareholders) should have the final responsibility of appointing/removing directors. To help the company remain competitive, the appointment of a director irrespective of his/her nationality should be allowed.
- The law should not prescribe any age limit for directors; however appointment of directors beyond a prescribed age of, say 70, should be subject to a special resolution by shareholders. Every company should have at least one director based in India.
- The committee believes that independent directors can not only provide independence from promoters' interest but also put forward views of smaller shareholders and vulnerable stakeholders. Hence, law should recognize the principle of independent directors and define their roles, qualifications and liability. Also, the requirement of independent directors could vary depending on the size and type of the company. Therefore, the number of independent directors can be prescribed by rules that vary according to the different categories of companies. In general, the committee recommends one third of the total number of directors on the board of public companies (or companies accepting public deposits) should be independent directors, irrespective of the chairman being executive/non-executive. Nominee directors should not be treated as independent directors as they represent specific interests in the company.
- Subsidiary companies need not co-opt an independent director of the holding company as an independent director on its board.
- The definition of an independent director has to be incorporated in the law. The committee presented its definition of independent directors in the report.
- Appointment of independent directors should be amongst the persons who have integrity, relevant experience and expertise, and satisfies the criteria of independent director mentioned in the definition.
- The total number of directorships that any one individual may hold should be restricted to 15. The number of alternate directorships should also fall within this overall limit. An alternate director can be appointed as an independent director only if he/she is also an independent director. Liability structure for the independent director will apply to the alternate director as well.

- Remuneration of directors should be free from government interference and be left to company's (shareholders) discretion, to enable them to retain talented and motivated directors. However, there should be transparency regarding the same. The remuneration should be directly proportionate to responsibility and performance.
- There need not be any prescribed limit on the amount of sitting fees payable to non-executive directors including independent directors. The company may decide the amount payable with shareholder approval payable to such a category of directors and disclose the information in the Directors' Remuneration Report forming the annual report. The decision on remuneration regarding non-executive directors may include sitting fees for board and committee meetings attended physically or electronically and/or profit-related commissions.
- Committees: Law may mandate the constitution of an audit committee for accounting and financial matters, the remuneration committee and stakeholders' relationship committee. Majority of the directors in the audit committee have to be independent directors if the company is required to appoint independent directors. The chairman has to be independent as well. The Stakeholders Relationship Committee should be chaired by a non-executive director. All the public listed companies or a company accepting deposits need to constitute a remuneration committee of non-executive directors, and chaired by an independent director in companies where independent directors are prescribed.
- Duties and responsibilities of directors: Duties of the directors are care and diligence, exercise of powers in good faith, and have regard for the interest of employees.
- Resignation should be treated as a choice to be exercised by a director.

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It should be mandatory for the board of the company to lay down a code of conduct for board members and senior management, and post the code on the company's website

- Liabilities of independent and non-executive directors: Such a director should be held responsible only on occasion of the infringement of any provision of the Companies Act. Further, if he has erred by not acting upon diligently where it was required, he should be held accountable for it.
- D&O Insurance: The committee believes insurance encourages independence as the directors are not reliant on the company. Hence, S.201 of the Companies Act needs to be amended for providing insurance/indemnification in case no wrongful act is established. Insurance premium paid by the company for such a policy should not be considered as a perquisite or income, if no wrongful act is established against the director, and vice versa.
- Rights of independent/non-executive directors: These directors should be able to call upon board for due diligence or obtain records for seeking professional opinion of the board, to inspect records, to review legal compliance reports prepared by the company, and to record their dissent in the minutes, in cases of disagreement.
- Board of directors meeting via electronic means such as teleconferencing and videoconferencing should be allowed and counted for attendance, and form a part of Quorum.

The new company law is expected to stress on self-regulation and increased responsibility from companies in ensuring proper governance. With the help of company secretaries (in practice and employment), the law aims to develop a structure for fortifying the existing compliance system. This structure will help ensure that all companies meet with the requirements of the Companies Act. Also, in the new law, as recommended by the J. J. Irani Committee, the appointment and removal of the company secretary will require a resolution by the board of directors.

Brief on SEBI (N. R. Narayana Murthy) Committee Report

In 2002, as the corporate governance standards kept evolving across the globe, the SEBI felt the need to step up standards in India. Hence, it felt the need to evaluate the adequacy of then existing practices, and improve upon them. Hence, SEBI set up a committee on corporate governance comprising representatives from the stock exchanges, chambers of commerce, investor associations and professional bodies. Consequently, the SEBI Committee on Corporate Governance was constituted under the Chairmanship of N. R. Narayana Murthy. The issues broadly discussed by the committee were primarily related to audit committees, audit reports, independent directors, related parties, risk management, directorships and director compensation, codes of conducts and financial disclosures. The committee put forward its mandatory recommendations and suggestions.

Some of the committee's important recommendations include:

Audit Committee

- In public listed companies, the audit committees should review financial statements and draft audit reports, management discussions and analysis regarding financial performance, compliance reports, management letters, and records of related party transactions.
- All the Audit Committee members should be financially literate, and at least one of the members should have accounting or related financial management expertise.
- The Audit Committee shall meet at least three times in a year. One meeting shall be held before finalization of annual accounts and one every six months. The quorum shall be either two members or one third of the members of the audit committee, whichever is higher with a minimum of two independent directors.
- Audit Report. Wherever a treatment different than the one prescribed is given, the management should give proper justification.

Related Party Transactions

All transactions with related parties and reasons behind the same should be placed before the independent audit committee for formal approval/ratification. Management should provide justification for any transaction, which has not been carried out on an arm's length basis.

Risk Assessment and Management

Every quarter, the management should place a report before the board of directors reporting the business risks faced and measures taken to minimize such risks, and limitation to the risk-taking capacity of the corporation. The document should be formally approved by the board.

Initial Public Offering (IPO)

The uses/applications of funds raised by IPO should be disclosed to the Audit Committee on a quarterly basis. Annually, the company shall prepare the statement of funds used for purposes other than those stated in the offer document/prospectus. The statement should be certified by independent auditors of the company.

Code of Conduct

It should be mandatory for the board of the company to lay down a code of conduct for board members and senior management, and post the code on the company's website.

Nominee Directors

There shall be no nominee directors.

Non-Executive Director Compensation

- Total compensation paid to non-executive directors may be fixed by the board of directors and should be approved by shareholders in the general meeting.
- A limit should be set for maximum number and aggregate of stock options that can be granted to non-executive directors in a fiscal year. The stock options granted to these non-executive directors shall vest after a period of at least one year from the date such non-executive directors retire from the company's board.
- Statement of entitled compensation and compensation philosophy in respect to non-executive directors should be published by the company in their annual report.
- On an annual basis, companies should disclose the details of shares held by non-executive directors, including on an 'if converted' basis.

Whistle Blower Policy

Employees who observe an unethical or improper practice should be able to approach the Audit Committee without necessarily informing their supervisors.

Subsidiary Companies

Provisions relating to the composition of board of directors of the holding company should be made applicable to the composition of the board of directors of subsidiary companies. At least one independent director on the board of directors of the parent company should be on the board of directors of the subsidiary companies.

Evaluation of Board Performance

Non-executive directors' performance evaluation should be done by a peer group comprising the entire board of directors, but excluding the director being evaluated. On basis of this evaluation, non-executive directors' terms of appointment should be continued or extended.

Amendments to the Recommendations in N. R. Narayana Murthy Report

As per the recommendations put forward by the committee and public comments received, SEBI made certain amendments in Clause 49 of the Listing Agreement through a circular dated August 26, 2003. Subsequently, the SEBI received a number of feedbacks/representations. To deliberate on these comments, another meeting of the Narayana Murthy Committee was called on November 13, 2003. Post-discussion, SEBI directed further amendment to the Clause 49 through circular on October 29, 2004. Some important changes made to different sub-clauses within Clause 49 include:

Definition of the Independent Director, part (i)(e) to sub-clause I.A

In the definition of the independent director, part (i)(e) to Clause I.A was changed from: "is not a supplier service provider or customer of the company. This should include lessor-lessee type relationship also", to "is not a material supplier, service provider or customer or lessor or lessee of the company, which may affect independence of the director". The amendment was made on the basis that the clause should be restricted to material suppliers, service provider or customer only and not extend to any supplier, service provider or customer, even as the section (i)(a) of the definition doesn't disqualify a non-executive director who has an immaterial pecuniary relationship or transaction with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies from serving as an independent director.

Non-Executive Director Compensation, sub-clause I B

With regard to non-executive director compensation, it was suggested that a clarification be added to state that non-executive directors include independent director. Accordingly, the amendment was made and the Clause I.B(i) was changed to “All fees/compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and shall require previous approval of shareholders in a general meeting. The shareholders' resolution shall specify the limits for maximum number of stock options that can be granted to non-executive directors, including independent directors, in any financial year and in aggregate.”

Non-executive directors' performance evaluation should be done by a peer group comprising the entire board of directors, but excluding the director being evaluated

The word 'Indian' before subsidiaries was specifically included based on the fact that it might prove very expensive for a company if the independent director is required to attend board meetings of foreign subsidiaries

Audit Committee Meeting, sub-clause II.B

Amendment made regarding Audit Committee meeting i.e. Clause II.B was that the committee shall meet at least four times a year instead of three, and meetings should happen within four months. This change was made taking into account the fact that a listed company is required to publish quarterly financial results and annual financial statements.

Board Procedures, sub-clause I.C(ii)

Taking into consideration the shortage of independent directors, Clause I.C(ii) was altered. Even though the restriction on committee memberships remained 10, instead of three committees (Audit, Shareholders Grievance and Remuneration), only two committees (Audit and Shareholders Grievance Committee) shall be considered for the purpose of reckoning the limit. Remuneration Committee was excluded considering the fact: the formation of remuneration of the Committee is not mandatory and it meets occasionally.

Subsidiary Companies, sub-clause III

- In relation to the Clause V i.e. subsidiary companies, it was commonly believed that since the subsidiaries are usually small in size, it will overburden the subsidiary, if all provisions regarding the composition of the board as applicable to the holding company are made applicable to the subsidiary company. Hence, an amendment was made according to which the provisions will be applicable only to material Indian subsidiaries i.e. subsidiaries whose turnover or net worth (i.e. paid up capital and free reserves) is greater than 20% of the consolidated turnover or net worth respectively, of the holding company and its subsidiaries in the immediately preceding year. The word 'Indian' before subsidiaries was specifically included based on the fact that it might prove very expensive for a company if the independent director is required to attend board meetings of foreign subsidiaries.

- Similarly, provisions of sub-clause (i), which provide that at least one independent director in the holding company, shall be a director of the subsidiary company, shall apply only to material Indian subsidiaries.

CEO/CFO Certification, sub-clause V

The sub-clause according to the committees' initial recommendation read, "They have indicated to the auditors, the Audit Committee and in the notes on accounts, whether or not there were significant changes in internal control and/or of accounting policies during the year." It was believed after review that changes in internal control are not matters that are required to be disclosed in the notes accompanying the financial statements. Hence the sub-clause was split into two separate clauses as follows: "They have indicated to auditors and the Audit Committee (i) significant changes in internal control during the year; (ii) significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements."

With regard to the board composition, in case the proposed new Company Law when enacted is not in sync with that of Clause 49, the enacted law would come into force and SEBI would redraft the Clause 49 accordingly.

With many changes taking place on the corporate governance front in India, this report aims at measuring and evaluating the effectiveness of these changes happening in the regulatory framework. It also attempts to identify possible roadblocks in successful implementation of this new regulatory framework, and discuss how the boards can overcome them.

SECTION 1 Findings from the Survey

Most directors are reasonably satisfied with the composition of their boards

Are Directors and Institutional Investors Satisfied with the Current Structure/Composition of their Boards?

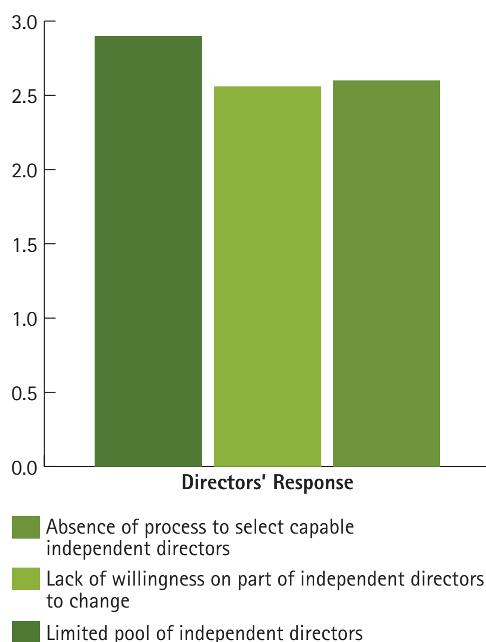
Directors' Satisfied with Board Composition

Broadly, directors surveyed across different companies were reasonably satisfied with the composition of their boards. The aggregate rating given by the directors on the satisfaction level with their current board was 3.91 on a scale of 5.

Perceived Obstacles in Changing Board Structure

According to directors, the greatest impediments in changing board structure include limited pool of independent directors, and lack of willingness on part of existing board members to change. Absence of a structured process to select capable independent directors was also perceived to be an impediment to a certain extent.

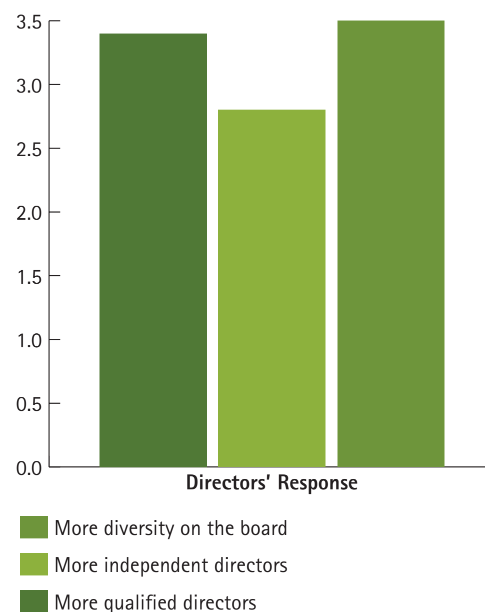
Figure 1: Impediments in Changing Board Structure



Possible Improvements to Board's Effectiveness by Altering Structure

Most of the directors believe that to improve the effectiveness of their board, more qualified directors should be inducted. Another high priority change they would like to incorporate for this purpose is increasing the board's diversity. There has been a widespread belief that diverse teams make better decisions, because they consider a broader array of risks and opportunities. Relatively few directors believe that adding more independent directors could add further value to the board.

Figure 2: Desirable Changes in the Board Structure/Composition



SECTION 2

Monitoring business and operating performance is the top priority for the board

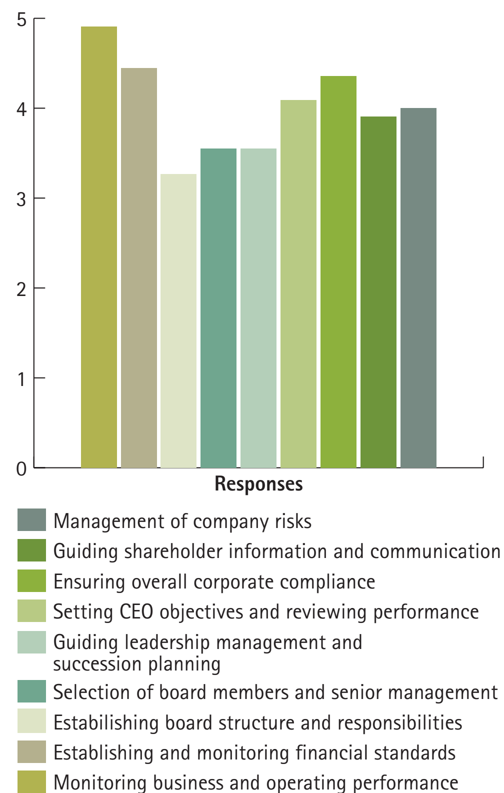
Board - Priorities and Responsibilities

Amongst the group, 62.5% believe that the roles and responsibilities of the non-executive directors are clearly defined and documented.

Top Priority Goals/Objectives for the Board

The highest priority for the board was to monitor business and operating performance. Other high priority objectives included establishing and monitoring financial standards, setting CEO objectives and reviewing performance, and ensuring overall corporate compliance.

Figure 3: Priorities of the Board (5= topmost priority)



SECTION 3

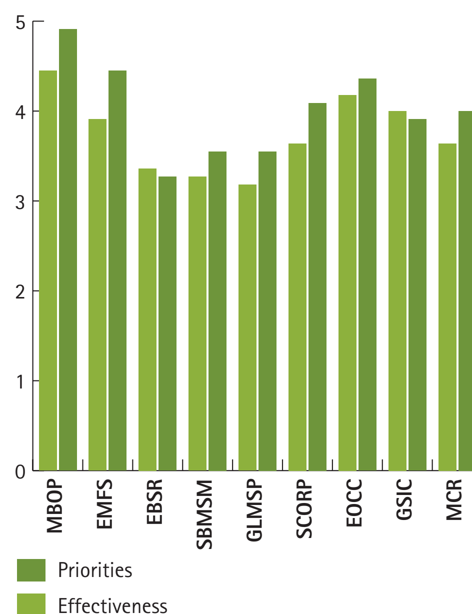
A majority of the directors believe their board to be very effective in monitoring business & operating performance, and this is their highest priority goal. Most of them also believe they are highly effective in ensuring overall corporate governance

Board Effectiveness

Directors Believe their Board to be Reasonably Effective

Directors gave an average rating of 3.73 on a scale of 5 across all aspects of performance of their boards. The effectiveness level can be considered to be 74.6%. A majority of the directors believe their board to be very effective in monitoring business and operating performance, in sync with their highest priority goal (Figure 3). Most of them also believe they are highly effective in ensuring overall corporate governance. The area they found lacking was establishing board structure and responsibility, which was also their lowest priority objective. Effectiveness ratings given in other areas also go hand-in-hand with their priorities as represented in the graph below.

Figure 4: Effectiveness v/s Priorities of the Board (5= very effective / topmost priority)



Note:

MBOP = Monitoring Business and Operating Performance

EMFS = Establishing and Monitoring Financial Standards

EBSR = Establishing Board Structure and Responsibilities

SBMSM = Selection of Board Members and Senior Management

GLMSP = Guiding Leadership Management and Succession Planning

SCORP = Setting CEO Objectives and Reviewing Performance

EOCC = Ensuring Overall Corporate Compliance

GSIC = Guiding Shareholder Information and Communication

MCR = Management of Company Risks

Minimum number of board meetings held by companies in 2005-06 was 4, and the maximum was 14

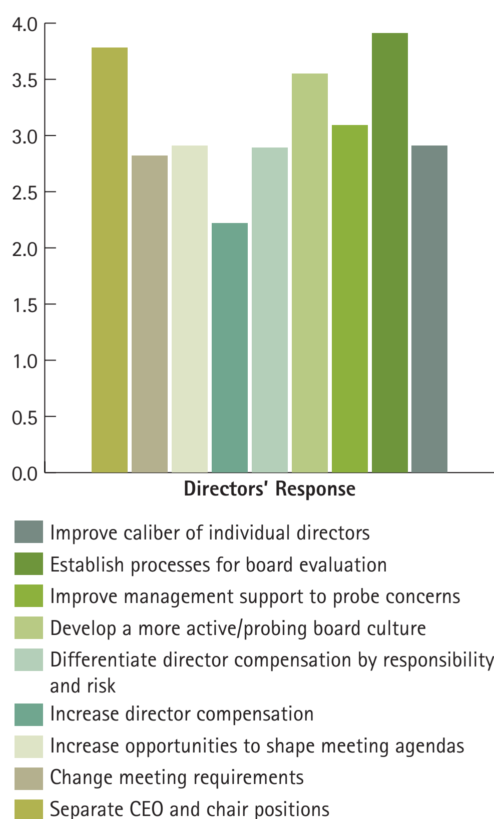
Measures that can be Taken to Improve Board's Effectiveness

According to the directors, establishing processes for board evaluation and developing a more active/probing culture can immensely help in improving board's effectiveness. Directors also strongly believe separation of CEO and Chairperson positions would help increase the board's effectiveness to a great extent.

Most importantly, there was consensus among directors that an increase in director compensation would have the least impact on improving the board's effectiveness.

Some of the directors interestingly suggested other ways of improving board effectiveness, which include interaction with management outside board meetings, better understanding of the business and engaging with and understanding views of all stakeholders.

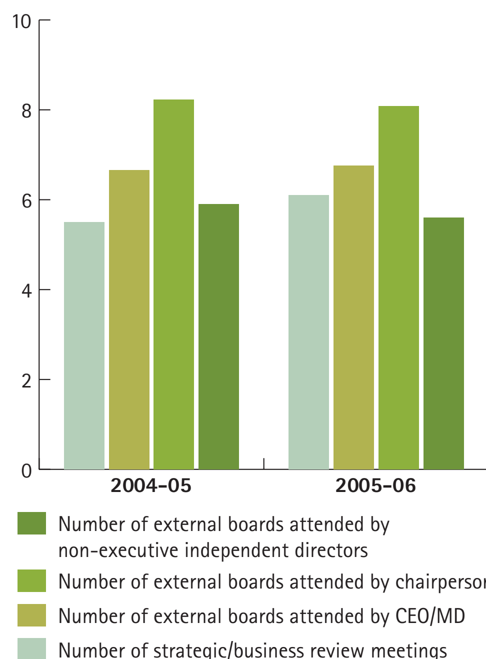
Figure 5: Possible Steps to Improve Board's Effectiveness (5= most impact)



Directors Sit on Fewer External Boards in 2005-06

With the number of board meetings and strategic/business review meetings on the increase in 2005-06 as compared to 2004-05, the executive chairman and CEO/MDs spent lesser time on external boards. On an average, the chairperson was on 8.0 external boards in 2005-06 as compared with 8.2 in 2004-05. Similarly, non-executive/independent directors on an average were on 5.6 external boards in 2005-06 as compared to 5.9 in 2004-05. CEO/MDs were on 6.7 external boards in 2005-06 compared to 6.8 in 2004-05.

Figure 6: Number of External Boards Attended by Directors

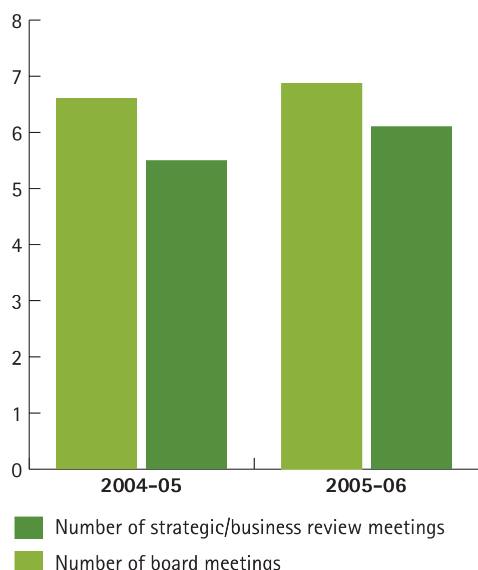


Boardrooms get buzzing - Number of Board Meetings Increase in 2005-06

An upsurge in the Indian economy during 2005-06 was apparent in the boardrooms, as the average number of board meetings held during the financial year 2005-06 increased to 6.6, citing a 3.9% increase over 6.4 in 2004-05. The average number of strategic/business review meetings also increased by 3.3% in 2005-06.

Consequently, the total time spent on preparing for board-related activities increased from 18.1 hours in 2004-05 to 18.9 hours in 2005-06. Minimum number of board meetings held by companies in 2005-06 was 4, and the maximum was 14.

Figure 7: Average Number of Board Meetings and Strategic/Business Review Meetings



Time Spent on the Board v/s Benefits

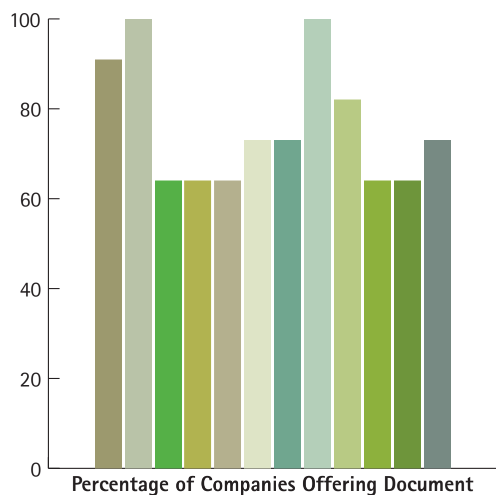
About 60% of directors participating in the survey believed that there was a significant increase in the amount of time invested on board duties in the last two years (2004-05 and 2005-06), while the remaining 40% believed there was only a moderate increase.

Interestingly, 60% of the directors strongly believed that the increase in time invested on board duties had led to an increase in the board's effectiveness and confidence. The remaining 40% agreed that the increase in time invested on board duties had led to an increase in the board effectiveness and confidence. None of the directors disagreed on this issue.

What Further Steps can be Taken to Improve Quality of Discussions in Board Meetings?

Availability of essential data required to prepare for a board meeting is extremely essential. The survey brought out the various documents that are typically made available to directors before a board meeting. Internal audit reports, annual plans and budgets, and details of JVs/collaborations were documents that were most commonly made available. It was interesting to note that some respondents felt that certain documents were not a part of the data provided, namely relating to labor issues, hiring and remuneration of senior company officers, default in payments (if any), materially important notices from the revenue department and accident and pollution issue. This would broadly imply a belief on the part of company management that the board need not be 'concerned', by such matters.

Figure 8: Documents Made Available to Directors before Meetings



- Quarterly detsails of foreign exchange exposure and the steps taken to limit the risks of adverse exchange rate movement
- Labor problems and their proposed solution
- Recruitment and remuneration of senior company officers
- Large payments towards goodwill, brand equity or intellectual property rights
- Details of JV/collaboration
- Any issue, which involves possible public or product liability claims of a substantial nature
- Non-payment/no receipt of corporate deposits, material default payment for goods sold
- Default in payment of interest/principal
- Accident and pollution issues
- Materially important notices from the Revenue Authorities
- Internal audit reports
- Annual implementation plan and budgets

About 60% of directors participating in the survey believed that there was a significant increase in the amount of time invested on board duties in the last two years (2004-05 and 2005-06)

Board evaluation helps ensure that directors keep a check on their own performance through a structured process, thereby ensuring that they effectively discharge their duties and stay focused on their core objectives

How Useful is this Information for Directors?

While the directors surveyed felt the information they received prior to board meetings was useful, there was a general view that the information provided could be improved upon.

Improving Information

Majority of the directors (55%) believed that a more useful, reader-friendly format would help improve the value of the information provided, while 36% of them believed more content/data and timely/proactive information would be of a greater help.

Around 27% felt that more interactive data would significantly help in improving the effectiveness of the information provided.

Do Boards Measure their Own Performance?

Board evaluation helps ensure that directors keep a check on their own performance through a structured process, thereby ensuring that they effectively discharge their duties and stay focused on their core objectives. Board evaluation has become an integral part of modern corporate governance. In November 2003, the U.S. Securities and Exchange Commission (SEC) introduced a new Corporate Governance Rule 303A (9) requiring each NYSE-listed company to adopt and disclose corporate governance guidelines that address the annual evaluation of board of directors. The rule was laid down for measuring effectiveness of the board and its committees. The evaluation process generally leads to the generation of new ideas from the directors that help improve compliance with the Corporate Governance requirements. Similar rules need to be laid down in India, to give board evaluation its due importance.

Board Evaluation Process on the Backburner

In India, only about 39% of the companies surveyed had a formal process of board evaluation in 2005-06. There was no standard procedure for board evaluation, as internal board review process varied across different companies. Some of the methods included self-evaluation of board, based on charters, the Nomination Committee carrying out the evaluation, lead independent director anchoring the process, and directors' discussions with respect to specific checklist.

Directors' Perspective on Board Evaluation Process

According to directors, 60% companies evaluated their board's effectiveness annually. About 6.7% companies evaluated their board's effectiveness every two years and the remaining ones did not evaluate their effectiveness at all.

Around 64% of boards self-assessed their effectiveness, and only 22.2% of the companies had regular third-party reviews of their governance practices.

Are Independent Directors Really Independent?

The ongoing cause for concern with regard to sound corporate governance practices in India and world over is better understood by studying the true independence of independent directors.

Only 39.1% companies followed a formal process for the selection of board directors in 2005-06. About 30% appointed new non-executive independent directors in 2005-06. A good 90% of the non-executive independent directors were appointed using CEO/chairperson's personal network/referrals, and the remaining 10% through executive search firms.

SECTION 4

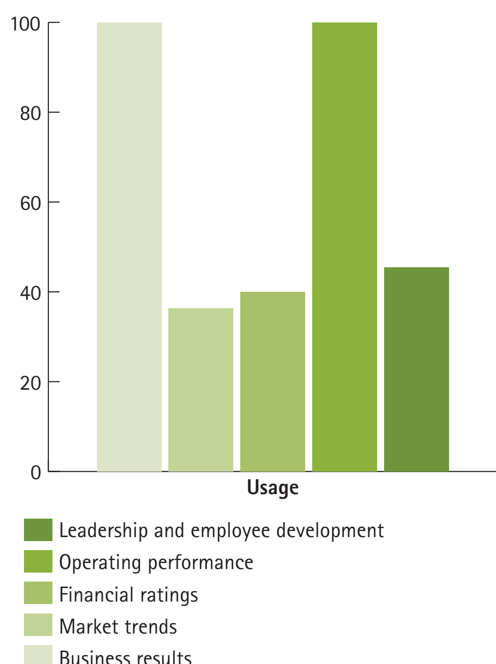
Company performance is a key determinant of board performance

Board's Ability to Assess and Monitor Company Performance

Key Drivers Used by Boards to Evaluate Company Performance

Evaluation of the board's performance is closely linked to the company's performance. Hence it becomes imperative to study how corporate boards measure company performance. With rapid developments in Corporate Governance reforms taking place in India, there has been a growing concern amongst shareholders/investors with regard to the role directors' play in ensuring compliance. Business results and operating performance received 100% votes from directors. Leadership and employee development received 45.5% of votes, whereas the market trends and financial ratings managed only 36.4% and 40% votes respectively.

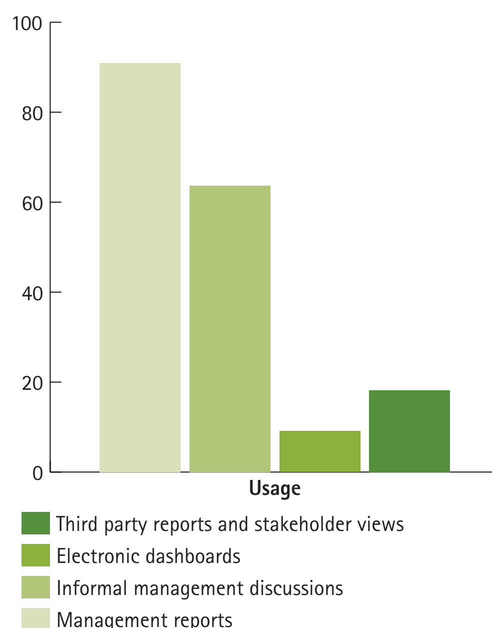
Figure 9: Key Drivers Used for Evaluating Company Performance



Monitoring Performance Drivers

To monitor these performance drivers, boards primarily use management reports and informal management discussions. Electronic dashboards, third party reports and stakeholder views are seldom utilized.

Figure 10: Tools Used by a Board to Monitor Performance Drivers

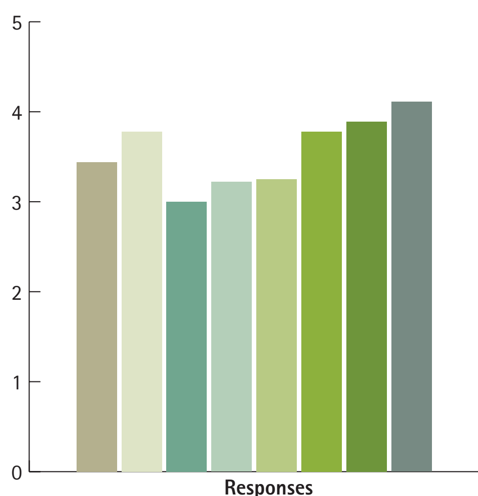


There doesn't seem to be any major concern/impediment for directors in their process of monitoring business performance. Inadequate company information from third party sources is the greatest impediment

Impediments in Monitoring Business Performance

There doesn't seem to be any major concern/impediment for directors in their process of monitoring business performance, as overall rating on impediments for the same was 3.16 on the scale of 5. Inadequate company information from third party sources was the greatest impediment with a rating of 3. Other significant impediments included lack of willingness of directors to change and lack of tools/processes to provide early warnings with ratings of 3.22 and 3.25 respectively. Lack of capabilities within director group was rated as the least impediment with a rating of 4.

Figure 11: Impediments in Monitoring Business Performance (1= greatest impediment)



- Lack of capabilities within the director group
- Directors lack sufficient time to devote to board responsibilities
- Absence of discussions with senior management
- Lack of tools/processes to provide early warnings
- Willingness of directors to change
- Inadequate company information from third party sources
- Lack of timely and transparent information from company
- Board culture

External Ratings Closely Monitored by Board

External ratings, when carried out by highly reputed organizations such as Standard & Poor's, and Moody's Investor Service, carry a lot of weight. Prospective investors and shareholders rely heavily on these ratings and their first impression about any company is often built upon this basis. Thus, it becomes imperative for companies to ensure that their rating remain high.

Most company boards (62.5%) monitor external ratings by outside organizations semi-annually. 12.5% monitor these ratings annually and one-quarter of the boards do not monitor external ratings at all.

SECTION 5

Boards are well involved in ensuring compliance with new regulations and the mandated changes

Compliance to Corporate Governance Regulations

Boards Highly Involved in Meeting Compliance Requirements

All directors gave high ratings on the involvement level of their boards in ensuring compliance with new regulations, such as Clause 49, SEBI Corporate Governance Code, CII Desirable Code of Corporate Governance and Listing Agreements. Average of their ratings was 4.18 on 5.

Clause 49 Appreciated by the Board

Are directors really pleased with all changes mandated by the new regulations? Half of the directors surveyed gave thumbs up. They believe Clause 49 is extremely useful and enhances shareholder value, while the other half feel the clause is moderately useful and only helps ensure financial control.

Steps Taken to Meet Compliance Standards/Requirements and their Implications

BOARD SIZE INCREASED TO 11

As the importance of corporate governance continued to grow, organizations took steps towards improving their governance practices. As a result, workload of the board increased and the size of the board on an average expanded 3.5% to 10.65 in 2005-06 from 10.29 in 2004-05.

Share of Women Directors' Increased Slightly but Continued to Remain Low

The concept of having women directors on the board gained importance on the global front, as many organizations believe diversity in leadership helps achieve better financial performance as compared to their competitors. In India, the percentage of women directors on the board increased from 3.77% in 2004-05 to 3.91% in 2005-06. In absolute terms there was a 7.1% growth in the number of women directors, however, this amount is less than half the average in developed nations such as the U.S. (where over 9% of the board is occupied by women).

At the 22nd annual session of the FICCI Ladies Organization (FLO) on Women Empowering India, Ashwani Kumar, Minister of State for Industry, said, "Women in corporate boardrooms are important because of their quest for excellence, grit and compassion". He also added: "Promotion of certain sections on the board is required and for the same purpose, reservation might be considered, however not at the cost of merit". In the same event, FLO President Usha Agarwal commented "A corporate ethos of diversity and inclusion, enhance a company's market-insight and consequently performance".

Depending on the amount of talented women available in an organization, the number of women directors on Indian boards is expected to increase in the future.

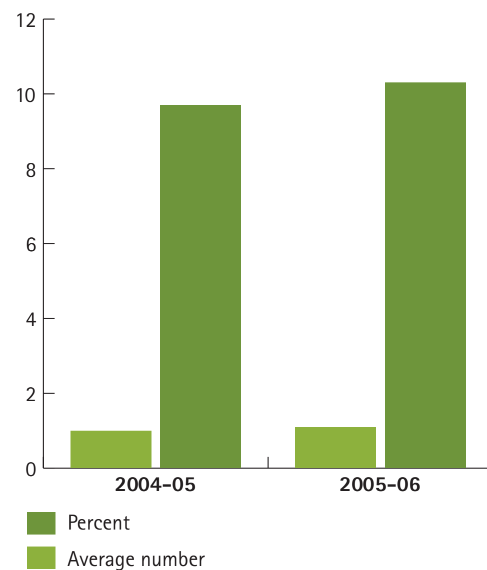
Foreign Directors Occupied More Space on the Board

With Indian companies growing across the globe and globalization on the whole gaining momentum, the need for foreign directors seems to be the order of the day. In absolute terms, there was a growth of 9.7% in the number of foreign directors on the Indian corporate board. Foreign directors in 2005-06 occupied 10.3% of the board as compared to 9.7% in 2004-05.

"American companies seeking to expand internationally ought to do a better job of placing non-Americans on their boards to help guide them"

In a Forbes article dated February 1, 2007 J. Frank Brown (newly appointed Dean of INSEAD, the International Business School, with campuses in France and Singapore) said that "American companies seeking to expand internationally ought to do a better job of placing non-Americans on their boards to help guide them". This further emphasizes the importance of foreign directors for companies aiming to become a global force.

Figure 12: Composition of Foreign Directors



Chairperson, CEO/MD Tenure Increases in 2005-06

The fiscal year 2004-05 turned out to be a very good year for companies in India as they posted strong financial results. The confidence in the company's chairpersons thus increased and most of them continued to hold their position in 2005-06 in their respective board, marking a 4.6% increase in their tenure as compared to 2004-05. Similarly, there was an increase of 4.2% in the CEO/MD tenure in 2005-06 over 2004-05.

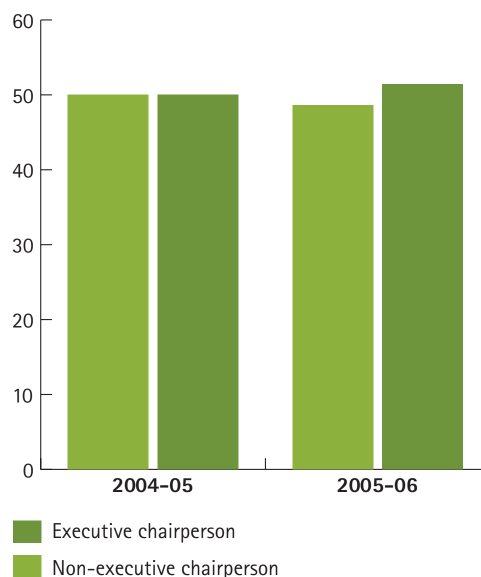
Boards Getting Older in India

The average age of the CEO/MDs in India was around 53.2 years in 2005-06, while the average age of chairpersons was 60.7 years, thus registering an increase of about one year as compared to 52.5 and 60.1 respectively in 2004-05. Average age of the non-executive/independent directors in India was 61.3 years in 2005-06, thus increasing 1.2 years over the 2004-05 value. On the whole, average age of the board of directors in India was below the average age of directors in developed nations such as the U.S. (average age of 60.5 years).

Percent of Non-Executive Chairperson/CEO Remained Constant

SEBI had set a deadline of December 31, 2005, under Clause 49 for listed companies to have a minimum one-third of their board as independent directors in case a non-executive director is the chairperson and minimum one-half of the board as independent directors in case an executive director is the chairperson. As a result of this deadline, either the number of non-executive chairperson or number of independent directors was expected to rise. The percentage of non-executive chairperson however remained almost unchanged in 2005-06 when compared to 2004-05. Thus to meet the deadline, companies increased the number of independent directors in 2005-06.

Figure 13: Chairperson being Non-Executive Director



In 2005-06, the minimum number of independent directors on the board was three and the maximum was 12. About 52.8% of companies in 2005-06 had independent directors in the range 5-7 on their board

Number of Independent Directors Increase in 2005-06

Number of independent directors on the board increased 5.1% in 2005-06 over 2004-05. In about 54.2% companies, the number of independent directors on the board was altered. In 34.7% of these companies, the number of independent directors increased and in the remaining 19.4% the number declined.

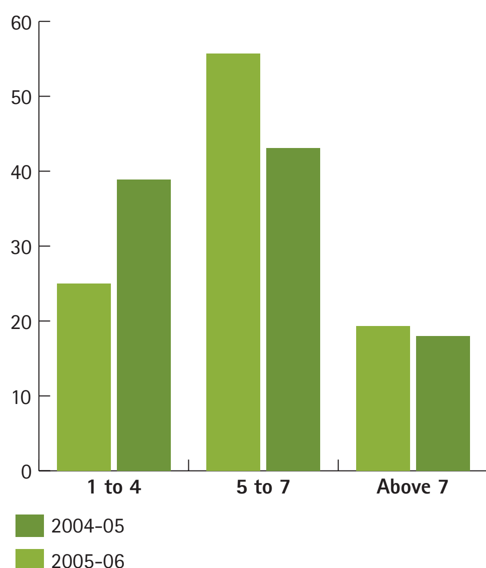
After the revision, the composition of independent directors in board of 'companies increasing the number of independent directors' and 'companies reducing the number of independent directors' was 61.4% and 50.4% respectively in the year 2005-06, when compared to 2004-05.

Figure 14: Companies Altering Number of Independent Directors in 2005-06

In 2005-06, the minimum number of independent directors on the board was three and the maximum was 12. About 52.8% of companies in 2005-06 had independent directors in the range 5-7 on their board. Thus, there was a clear shift from 2004-05, in which only 41.5% of the companies had independent directors in the range 5-7 on their board.

The percentage of companies with independent directors over seven remained almost the same. Thus, the decline in the percentage of companies having independent directors in the range 1-4, contributed to an increase in the number of companies having independent directors in the range of 5-7.

Figure 15: Spread of the Number of Independent Directors



Are Roles and Responsibilities for Non-executive Directors Clearly Defined?

Even though there has been an increase in the number of non-executive independent directors, and their composition has increased on the boards in India during 2005-06, the effect of their value-addition continues to be elusive. The question, therefore, is whether roles and responsibilities of the non-executive directors are clearly defined and documented.

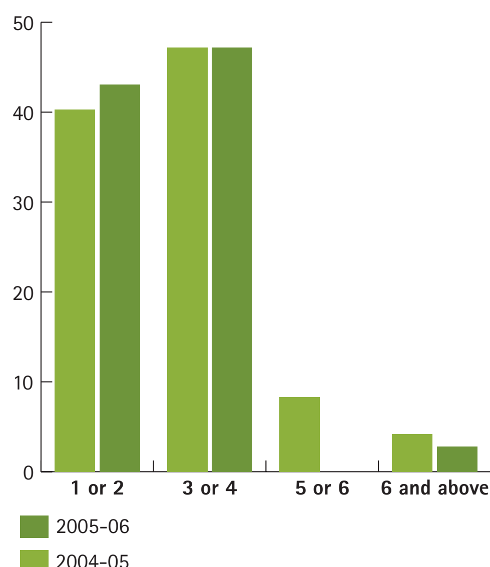
The survey reflects that 62.5% of the directors believed that the roles and responsibilities of non-executive directors are clearly defined and documented.

Average Number of Executive Directors Reduces

About 25% of the companies altered the number of executive directors on their board in 2005-06. Around 8.3% of the companies increased number of executive directors on their board, whereas 16.7% reduced the number. A primary reason for the reduction in the number was an increase in the independent directors resulting from the new SEBI Clause 49. The minimum number of executive directors in 2005-06 was one while the maximum was eight.

As a result, the composition of executive directors on the board in 2005-06 declined to 25.8% from 27.8% in 2004-05.

Figure 16: Spread of the Number of Executive Directors



Companies Introduce New Committees for Better Control

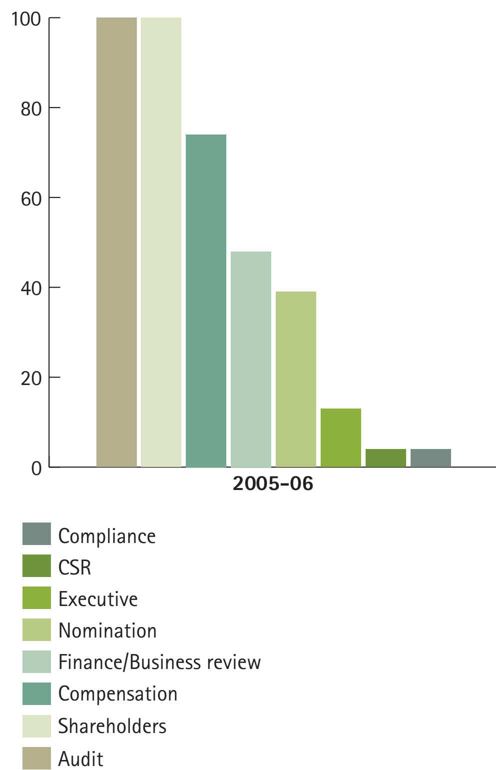
In 2005-06, the average number of committees in each company was 4.5. Minimum number of committees was three and the maximum number was eight. The Audit and Shareholders' Committee are mandatory under the SEBI's Clause 49 listing agreement, and hence all companies surveyed had these.

Although not mandatory, Clause 49 under its non-mandatory requirements recommends having a Remuneration Committee. About 74% of the companies surveyed had a Remuneration/Compensation Committee. It has been a commonly held belief that CEOs receive preferential treatment when insiders are members of the Remuneration Committee. To avoid such conflicts, Clause 49 recommends the Remuneration Committee to consist of at least three members – all non-executive and majority independent. Also, the chairman of the committee should be an independent director.

Apart from the above-mentioned committees, around 48% respondents had Finance/Business Review Committees, 39% had the Nomination Committee, and about 4% had CSR and Compliance Committees.

About 35% companies introduced new committees in the past two years (2004-05 and 2005-06). In 2005-06 alone, about 26% companies introduced new ones. In 2005-06, 61% of committee chairpersons across these companies were non-executive independent directors.

Figure 17: Representation of Primary Committees on India Board

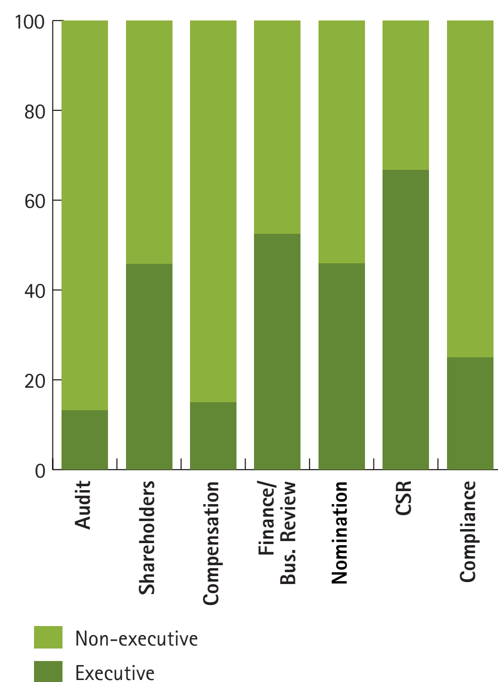


In 2005-06, the average number of committees in each company was 4.5

Clause 49 recommends the Remuneration Committee to consist of at least three members – all non-executive and majority independent. Also, the chairman of the committee should be an independent director

The average number of all directors per committee was around 3.6 in 2005-06. Of this, non-executive directors accounted for about 2.3 directors per committee in the same year, thus dominating committee's composition.

Figure 18: Composition of Directors on Each Committee



Corporate Social Responsibility (CSR) on Priority List

The number of companies having a CSR agenda increased to 77.8% in 2005-06 as compared to 75% in 2004-05. Similarly, the number of companies publishing CSR activities moved up to 69.4% in 2005-06 from 68.1% in 2004-05. None of the respondents had introduced a CSR committee in the last two years.

Companies Providing D&O Insurance Increase

Amount of companies providing D&O Insurance increased from 52.2% in 2004-05 to 60.1% in 2005-06. At the same time, the average D&O premium per company declined from INR 29 lakh p.a. in 2004-05 to INR 27.6 lakh p.a. in 2005-06. The reason for decline in the premium was on the basis of lesser number of claims made by the companies in 2005-06 as compared to 2004-05.

SECTION 6

Board compensation is on the rise. The average annual compensation increased from INR 3.97 lakhs in 2005 to INR 6.06 lakhs in 2006, an increase of 52.5%

Compensation:

Board Remuneration on the Rise

The annual compensation of a non-executive director was in the range of INR 16,000 to INR 13.87 lakhs in 2004-05, while it varied in the range INR 63,000 to INR 18.71 lakhs in 2005-06. The average annual compensation increased from INR 3.97 lakhs in 2004-05 to INR 6.06 lakhs in 2005-06, an increase of 52.5%.

Sitting fees, consultancy fees, commissions, profit shares and committee membership fees form the main components of the annual compensation. The average annual sitting fees for a non-executive director ranged from INR 16,000 - 2.86 lakhs in 2004-05, and from INR 47,500 - 4 lakhs in 2005-06. The average annual sitting fee increased by 39%, from INR 1.12 lakhs in 2004-05 to INR 1.55 lakhs in 2005-06.

Figure 19: Average Annual Compensation

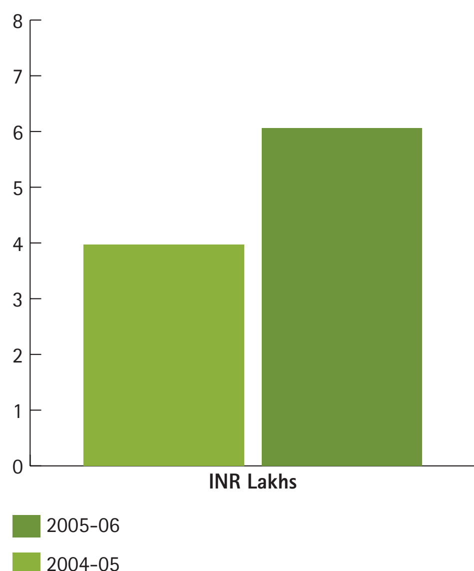
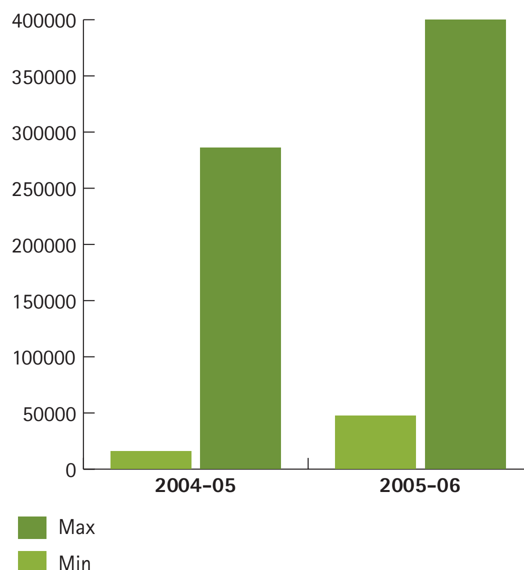


Figure 20: Change in Average Annual Sitting Fee



Of the total number of companies that participated in the survey, 50% paid additional remuneration for membership to a committee in 2004-05, which increased to 55.56% in 2005-06

Twenty seven per cent of the companies surveyed paid a part of the total remuneration by way of commission and 9% by way of consultancy. Profit Share was used as a means of remuneration by approximately 32% of the companies surveyed. The average profit share given to non-executive directors increased from INR 4.71 lakhs in 2004-05 to INR 8.96 lakhs in 2005-06, an increase of 47.4% over the previous year.

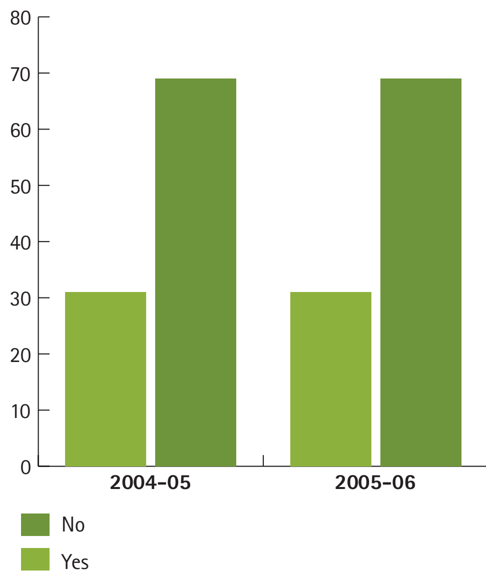
Additionally, companies have started paying a component of the total compensation to non-executive directors by way of ESOPs. For those that use this as a form of remuneration, the decision is taken by shareholder voting.

Of the total number of companies that participated in the survey, 50% paid additional remuneration for membership to a committee in 2004-05, which increased to 55.56% in 2005-06.

Differential Fees Across Committees

Thirty one per cent of the companies paid differential fees for various committee positions in 2004-05. This figure remained unchanged through 2006. Highest fees were paid for the Audit Committee.

Figure 21: Differential Fees Across Various Committees



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TATA CHEMICALS LIMITED

Nawshir H Mirza
Company Director
NAWSHIR H MIRZA

Praveen Kadle
Executive Director - Finance & Corporate Affairs
TATA MOTORS LIMITED

S Ramadorai
Chief Executive Officer and Managing Director
TATA CONSULTANCY SERVICES

Shailesh Haribhakti
Managing Partner & CEO
HARIBHAKTI GROUP

There were several other respondents of eminence, who prefered to remain anonymous.

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Dabur India Ltd
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DCM Shriram Consolidated Ltd
GlaxoSmithKline Pharmaceuticals Ltd
Godrej & Boyce Mfg. Co. Ltd
HDFC Ltd
Jagran Prakashan Ltd
JSW Steel Ltd
Kirloskar Brothers Ltd
Larsen & Toubro Ltd
Lupin Ltd
Matrix Laboratories Ltd
Mphasis Ltd
Pantaloon (Retail) India Ltd
Parry Ltd
Raymond Ltd
Ruchi Soya Industries Ltd
Shoppers' Stop Ltd
Tata Steel Ltd
Thermax Ltd

Additional list of companies surveyed:

Apollo Tyres Ltd
Arvind Mills Ltd
Ashok Leyland Ltd
Asian Paints (India) Ltd
Aurobindo Pharma Ltd
Bajaj Auto Ltd
Bharati Tele-Ventures Ltd
Blue Star Ltd
Britannia Industries Ltd
Cadila Healthcare Ltd
Cambridge Solutions Ltd
Eicher Motors Ltd
Escorts Ltd
Hero Honda Motors Ltd
Hindustan Unilever Ltd
Glenmark Pharmaceuticals Ltd
ICICI Bank Ltd
Indo Rama Synthetics (India) Ltd
Infosys Technologies Ltd
ITC Ltd
Jet Airways (India) Ltd
Jubilant Organosys Ltd
Mahindra & Mahindra Ltd
Marico Ltd
Maruti Udyog Ltd
Motor Industries Company Ltd
Moser Baer (India) Ltd
Nicholas Piramal India Ltd
Nirma Ltd
Nestlé India Ltd
Patni Computer Systems Ltd
P&G Hygiene and Health Care Ltd
Ranbaxy Laboratories Ltd
Siemens Ltd
Tata Chemicals Ltd
Tata Consultancy Services Ltd
Tata Motors Ltd
Tata Tea Ltd
Triveni Engineering & Industries Ltd
TVS Motors Company Ltd
Vedanta Resources Plc
Videsh Sanchar Nigam Ltd
Welspun Gujarat Stahl Rohren Ltd
Wipro Ltd
Wockhardt Ltd
Zuari Industries Ltd

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1st Floor, Unit no 101 - A
Peninsula Corporate Park
Ganpatrao Kadam Marg
Lower Parel, Mumbai - 400 013
Tel: +91 - 22 - 40970700
Fax: +91 - 22 – 40970725

AZB & PARTNERS
ADVOCATES & SOLICITORS

Corporate Address:
Express Towers
23rd Floor
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400 021
Mumbai
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Tel: +91 22 5639 6880
Fax: +91 22 5639 6888

Corporate Address:
412 B, Trade World,
Kamala Mill,
Mumbai - 400013,
India
Tel: +91-22 6660 3201