BOARD COMPOSITION
EFFECTIVENESS AND BEST PRACTICES

THE INDIA BOARD REPORT 2011

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FOREWORD

"The truth of the matter is that you always know the right thing to do. The hard part is doing it."
– General H. Norman Schwarzkopf

Corporate governance is a subject that attracts a lot of media attention, especially just after a scandal. This usually prompts governments and regulators to appoint committees to review and change laws. After a while, the hype fades and it's back to business as usual.

Regulation only ensures compliance. Unfortunately, compliance does not equal commitment to corporate governance. This has been one of the key findings of the third edition of our biennial India Board Report - 2011. Clause 49 of SEBI's listing agreement has been widely praised, in terms of the standards of corporate governance that it sets. However, only 38% of the respondents felt that it significantly contributed to improving governance!

There are other indications as well. More than half the respondents pointed out that their boards did not have a formal process to evaluate their effectiveness. Two-thirds of the independent directors surveyed said that the roles and responsibilities of non-executive directors were not defined clearly. Around 50% of them felt that the time spent by the board in completing the agenda of the meeting was inadequate.

This brings to mind several questions: How can there be improvement without measurement? Are independent directors appointed only to comply with regulations? Do companies even define what is expected of the board, and the role of directors? Little wonder then, that companies complain about the lack of talented individuals to fill these positions.

The best governed companies have a real commitment to corporate governance, and not just paper compliance. This implies a proactive, voluntary approach to make best practices integral to their functioning. Companies need to clearly define performance metrics for boards and directors, and evaluate this on an ongoing basis. The role of independent directors needs to be clearly spelt out. If this clarity is achieved, then the competencies or qualifications of directors can be better defined, making the selection process more focused.

The third edition of the India Board Report continues its focus on the functioning of corporate boards in India. As always, we seek to identify and compare trends in governance practices pursued by Indian companies. The report also highlights the implementation challenges faced and presents the views of independent directors on ways to improve board performance and effectiveness.

Jai Purandare | Sunit Mehra | Zia Mody

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SCOPE AND METHODOLOGY

The 2011 Report focuses on gauging the effectiveness of corporate boards, impact of regulations, and also identifies the best practices followed.

The India Board Report is a first of its kind, definitive survey on Board Composition, Effectiveness and Best Practices. Through the medium of in-depth surveys and questionnaires, the report aims to highlight the functioning of corporate boards in India. The India Board Report – 2011 (IBR - 2011) is the third edition of the report.

The study consists of a two-part survey across:

- Leading Indian companies (Survey I)
- Eminent independent directors (Survey II)

Survey I was aimed at studying statistical data around boards in India, and targeted over 500 companies. Selection of companies was based on the following criteria:

- The top 350 companies by market capitalisation listed on the Bombay Stock Exchange
- 100 emerging companies having high growth (measured by market capitalisation)
- 50 companies that have attracted large private equity investments

For every company, the survey included the following topics:

- Board demographics (age, size, diversity)
- Committees, board meetings and related workload
- Board evaluation and the procedure for selection of chairperson
- New committees including Corporate Social Responsibility (CSR)
- Selection of non-executive directors
- Directors' remuneration
- D&O insurance

Survey II was aimed at obtaining the views of over 150 eminent independent directors regarding the functioning of Indian boards, including compliance, independence, and overall management. They were also requested to rate their respective boards on effectiveness and identify the board's priorities. The topics covered in the survey include:

- Compliance and satisfaction levels of directors with the current structure/composition of their boards
- Time invested, and processes used for monitoring and evaluating board's performance
- Corporate issues reviewed by the board
- Accountability and accessibility
- Key responsibilities and priorities for corporate boards in India
- The extent of directors' involvement and effectiveness in meeting compliance requirements
- Effectiveness of corporate boards

IBR – 2011 is based on responses to both the above mentioned surveys. Around 75% of the directors participating in the survey have been independent directors for over six years and sit on an average of six company boards. Additionally, the report highlights recent changes in the regulatory environment in India and also discusses issues pertaining to corporate governance across the globe.

EXECUTIVE SUMMARY

The collapse of iconic financial institutions and the resulting global crisis made policymakers worldwide critically review existing governance practices. Several problems were identified as instrumental in bringing about the collapse, including the lack of risk management processes, skewed remuneration structures and low levels of shareholder involvement. This resulted in numerous regulatory changes over the past two years including the Dodd-Frank Act, recommendations by NASDAQ, NYSE (US), FRC UK, Basel Committee recommendations et al.

Along with the global crisis, a string of frauds resulted in the introduction of stricter corporate governance mechanisms in India as well. While these changes were expected to plug new holes found in the existing regulations, there was also growing realisation that the biggest challenge was effective implementation, and therefore most changes introduced have been voluntary.

The survey findings clearly highlight the limitations of regulatory compliance and the existing gaps in implementation.

KEY FINDINGS:

Risk Management

Risk management is increasingly seen as a key governance agenda, but needs more attention at the board level.

- 31% of companies do not have their board's involvement to systematically address corporate risk management.
- 61% of the directors felt that linking director compensation to risk and responsibility will have a high impact on improving board effectiveness.

Board Composition

Limited talent pool perceived as biggest impediment in changing board structure

- The average number of independent directors on a company's board increased to 5.2 in 2009-10 as compared to 4.8 in 2006-07.
- Around 25% of the companies did not have a fixed retirement age for their chairperson and non-executive directors.
- The percentage of women directors continues to remain low, and was a niggardly 4.6% for the year 2009-10.
- The most desired change in board structure is increased diversity.
- More than 60% of the boards have separate CEO/MD and chairperson positions. The percentage of companies that have separated these roles rose marginally (1.3%) from the year 2008-09 to 2009-10.
- 56% of the directors surveyed identified the limited talent pool as an impediment, with 38% perceiving it as a major hindrance. Yet, less than 10% used search firms or other 3rd party sources to locate suitable talent.
- Half the directors felt that a lack of willingness to change, by existing board members is not at all an impediment.
- The average chairperson was also a member of 9.5 external boards, including public and private companies. This has increased by 19% as compared to 2009.

Regulatory Compliance

How useful is Clause 49?

In our 2009 survey, 57% of the independent directors thought that Clause 49 was extremely useful and enhanced shareholder value. However, the percentage has reduced significantly in 2011 with only 38% of the respondents rating Clause 49 as extremely useful.

Accountability and Responsibility

Statutory compliance tops the board priority chart

- The top three board priorities indicated are – ensuring overall corporate and statutory compliance (90%), monitoring business and operating performance (87%), and establishing and monitoring financial standards and internal controls (82%). Leadership development, succession planning, CSR and risk management continue to be low on the board priority list.
- Two-thirds of the independent directors believe that the roles and responsibilities of non-executive directors are not defined clearly.
- Around 82% of the independent directors felt that their time commitment towards board duties has increased over the last two years. However, only 59% of them believe that the increased time has translated to an increase in board effectiveness.
- A vast majority of boards depend largely on management reports (90%) and informal management discussions (79%) for business information. Third party reports and stakeholder views are used as tools only by 23% of the companies.

Board Effectiveness

Boards not keen on measuring their own effectiveness

More than 50% of the directors surveyed said that their boards hardly ever evaluate their own effectiveness. Among the boards that do conduct evaluations, the majority opt for self-assessment.

Some of the key impediments to monitoring board performance are:

- Inadequate time spent by directors in completing the agenda of the board meeting
- Lack of tools/processes to provide early warning signs
- Board culture

The following factors are expected to be most effective in improving board performance:

- Establishing and defining processes for the board's evaluation
- Increasing director compensation and linking this to both responsibility and risk
- Developing a more active and questioning board culture

Compensation

Wide divergence in compensation patterns

- Non-executive director compensation ranged from INR 1 to 10 lakhs in more than half of the companies surveyed. Average compensation rose 20% to INR 9.9 lakhs in 2009-10 from INR 8.2 lakhs in 2008-09.
- The minimum compensation paid to non-executive directors was INR 15,000 whereas the maximum was INR 54 lakhs for 2009-10 from among the companies surveyed.
- The average compensation paid to non-executive chairmen rose from INR 15.7 lakhs in 2008-09 to INR 21.7 lakhs in 2009-10, an increase of 38%.
- Among the companies surveyed, the minimum compensation offered to the non-executive chairman was INR 16,000 and the maximum was INR 13 crores.

CORPORATE GOVERNANCE: AN UPDATE

Tightening of corporate governance regulations has resulted in greater compliance, but not necessarily made governance more effective.

Regulatory changes invariably tend to be reactive

GLOBAL SCENARIO

"Whenever an institution malfunctions as consistently as boards of directors have in nearly every major fiasco of the last forty or fifty years it is futile to blame men. It is the institution that malfunctions." – Peter Drucker

Every corporate disaster has led to tighter regulation, as newly discovered holes are plugged. This is not a new theme. Remember Enron, Worldcom and the dotcom bust?

However, the collapse of iconic financial institutions in 2008 precipitated one of biggest economic crises since the Great Depression of the 1930's. Numerous special provisions, acts and stimulus programs later[1], the health of the global economy is still uncertain. The last three years have seen a flurry of activity amongst regulatory bodies and governments across the world. Committees upon committees have deliberated the 'why and what's to be done'. Companies too are re-examining their governance practices to ensure that they are managing risks adequately. The resulting debate has centred on the following issues:

- What makes for good governance?
- How can laws be drafted to eliminate loopholes?
- How do we ensure that small minority shareholders have a voice?
- How can corporate boards and management ensure effective implementation?
- How do we ensure the "independence" and quality of independent directors?

Regulatory change usually tends to be reactive. Laws are typically revised only after scams or crises. And every time, there are diverse and specific causes for the failures – stemming from oversight, poor laws, inadequate controls or even outright fraud. However, the common refrain running through all major financial market crises is - 'corporate governance is not about laws, but how they are implemented!'

[1]Banking (Special Provisions) Act 2008
Economic Stimulus Act of 2008
Emergency Economic Stabilization Act of 2008
Housing and Economic Recovery Act of 2008
Troubled Asset Relief Program (TARP)
2008 European Union stimulus plan
2008 United Kingdom bank rescue package
China economic stimulus program
Anglo Irish Bank Corporation Act 2009
American Recovery and Reinvestment Act of 2009

IT'S NOT ABOUT TICKING BOXES

Persistent scams over the past decade reaffirm that regulations are only one part of the story. On paper all the defaulters did everything they needed to comply. In practice it was often quite different.

In the context of the Governance lapses over the last few years, some of the biggest problems have been identified as[2] :

- A complete failure of risk management: The shocker this time has been the lack of robust risk management processes. Direct channels of communication between risk managers and top management were non-existent. The former were often unaware of company strategy, and the latter didn't look at risk metrics. Meantime, the boards were happily ignorant of all of this!
- Skewed and non-transparent remuneration process: In many organisations, there was no real governance around how top managers were paid. Decision makers and recipients were not at arm's length, and boards were unable (or incapable) of judging remuneration decisions objectively. Interestingly, the link between performance and pay was found to be non-existent or weak (at best). In many instances, performance criteria were not merely lacking in transparency, but designed to be obscure or unnecessarily complex. Asymmetry in design meant limited downside but large upside, encouraging managers to take undue risk.

[2]Corporate Governance and the financial crisis – OECD
Corporate Governance and the financial crisis – conclusions - OECD

- The Boards and how they work: While it is easy to criticise the boards, this is not a problem that can readily be fixed by legislation. While genuine "independence" is an issue, equally, competence plays a role. How many people understood complex financial instruments? A related challenge was how to determine the competencies required by board members. A study[3] in the US found that financial knowledge of board members had no correlation with share prices.
- Shareholders involvement: Investors have few rights and the ones that do (large institutional investors) rarely voted against the management. Interestingly, institutional investors and management are both driven by short-term performance measures, a problem that will always undermine governance.

Most of these issues have their genesis in the gap between paper compliance and true belief in the benefits of good governance. In most cases, all the boxes were ticked!

This has also brought about the realisation that laws designed on a "one size fits all" approach will not work. Consequently, today's focus has shifted to effectiveness. Policymakers across the globe are trying to figure out how to make corporate governance practices more robust. Unfortunately, in most cases regulations foster merely compliance – a classic case of the dichotomy between the letter of the law, and its spirit!

[3]Corporate Governance in the 2007-2008 Financial Crisis: Evidence from Financial Institutions Worldwide

REGULATORY CHANGES GALORE

Various government agencies, regulators, stock exchanges and bodies such as the World Economic Forum (WEF), OECD, the G20 and the International Monetary Fund (IMF) have got into the act. Myriad committees have given their verdict and some new laws have been passed. Several others are likely. The Dodd-Frank Act (in the US) was one of the first off the block. That and other key post-crisis initiatives are summarised below[4]:

Dodd-Frank Wall Street Reform and Consumer Protection Act (USA, July 2010)

The Dodd-Frank Act is considered by some as one of the most comprehensive reforms in the US financial sector. While many of its provisions pertain to banks, this law will also have a significant impact on all listed companies. Some of the noteworthy provisions of the Act are:

- Executive compensation: Shareholders will be allowed to vote on executive compensation ("Say on Pay"). However, this will be a "non-binding" vote, meaning that even if shareholders do not approve, the company could still go ahead. Regardless, the new provision will enhance transparency as compensation terms for senior executives will now have to be made public. The correlation between compensation and financial performance will also have to be revealed.
- Hedging: Companies will have to disclose information about employees or directors that hedge against the company's stock.
- Claw back: This is an interesting one, and will enable companies to recover compensation already paid out. In cases where financial statements were misstated, and later re-stated – the company could take back compensation paid earlier.
- Proxy access: A rather controversial piece of the law relates to shareholders nominating directors that could vote on their behalf. There is still considerable confusion about minimum shareholding and length of holding needed, and on clubbing of shares by groups of investors.
- Independence of the compensation committee: The Act requires that compensation committees comprise only independent directors, and that even consultants hired by them should be independent. This is great in theory, but ensuring independence is likely to be hard.

The Act also encourages more whistle-blowing, and requires disclosures about why the board chairman and CEO is the same person (or not). Clearly, much thought has gone into the Act, but as they say, the proof of the pudding is in the eating!

Recommendations by NASDAQ and NYSE (USA, 2010)

Recommendations by NASDAQ and NYSE are focused on improving compliance. Both the exchanges are now asking companies to inform them if any instance of non-compliance comes to light. NYSE also recommends that all interested parties, including shareholders, be able to communicate directly with independent directors or the head of the non-management group. They also suggest that executive sessions of independent directors be held annually.

[4]Senate Committee on Banking, Housing, and Urban Affairs - Restoring American Financial Stability
The UK Corporate Governance Code, 2010
Principles for enhancing corporate governance issued by Basel Committee
King Report on Corporate Governance for South Africa

Financial Reporting Council Combined Code (UK, 2010)

The provisions of the Combined Code are aimed at improving board leadership, effectiveness, accountability, remuneration and the board's relationship with shareholders. The new code retains existing principles of "comply or explain". Some of the new provisions are:

- Risk management: The company's business models need to be clearly explained. Further, the board will be responsible for determining what risks (both nature and extent) the company should take.
- Performance-related pay: The code wants this to be aligned with the long-term interests of the company.
- Boardroom practice: Several principles have been laid down. These mainly relate to the role of the chairman and independent directors (who are expected to "constructively" challenge management decisions). They've also laid down norms on the time commitment expected of directors. The chairman will now have to hold reviews with each director, and large companies will require external "effectiveness" reviews.
- Boardroom composition: Principles around the selection and composition of the board have been laid down, including an objective selection criteria based on merit. The code also encourages diversity, especially gender diversity.

Basel Committee on Banking Supervision (2010)

The Basel Committee has issued a set of principles for improving corporate governance in banks, which cover the following:

- The role of the board must include approval and oversight of the risk strategy of the bank.
- Board members need to have knowledge and experience related to all major business activities, including risks.
- Greater importance for the risk management, compliance and internal audit functions, each of which must have more authority and access to the board. Large banks will now need a CRO or chief risk officer.
- Norms on monitoring and managing risks for individual entities and on a company-wide basis have been laid down.
- Boards must actively oversee compensation structures and process.

The King III Report (South Africa, 2010)

In an interesting change of approach, King III moves from a "comply or explain" to an "apply or explain" approach. Companies may therefore deviate from suggested practice but still comply with the overarching corporate governance principles. Compliance requires an explanation of how the principles and recommendations were applied, or if not applied, the reasons for not doing so.

The report applies to all legal entities irrespective of their manner or form of incorporation and listing status.

A significant feature of the new Companies Act was the formal extension of the application of "directors' duties" to persons other than directors. This was done by introducing the concept of a prescribed officer. The term "director" was defined to include "prescribed officers", on the basis that prescribed officers are subject to the same duties and liabilities as directors.

SPIRIT AND INTENT OF IMPLEMENTATION IS MORE IMPORTANT

The real issue is about ensuring alignment with the idea or spirit of corporate governance. Mandatory laws and voluntary self-regulation need to go hand in hand.

These regulations have evoked a mixed response. Critics say that the provisions do not go far enough in terms of ensuring transparency and accountability. At the same time, companies are not too happy with some of the provisions. US companies are upset over financial incentives for whistle-blowers in the Dodd-Frank Act. In the UK, the clause related to annual director re-election has been criticised as encouraging short-termism. The guidelines mandating diversity and gender diversity on boards too, have come under fire. Others feel the rules are too onerous and will hurt profitability.

But no law can please everybody. Overall, there is a consensus that the regulations will enhance governance standards, even though specific clauses are opposed by different lobbies.

Despite all this, there is a growing realisation that effective implementation is the biggest challenge. Past experience shows that those intent on finding loopholes will do so, even as they maintain paper compliance. Even if they do get caught, it will always be after the damage has been done. The real issue is about ensuring alignment with the idea or spirit of corporate governance. If managements believe this is in their interest, they will work hard to build a robust governance framework, identify risk areas and effectively implement best practices. Mandatory laws and voluntary self-regulation need to go hand in hand.

Making blanket
changes in regulation
is not the solution

CORPORATE GOVERNANCE IN INDIA

POLICY MAKERS SHIFT FOCUS FROM LEGISLATION TO A VOLUNTARY APPROACH

While the global economy is still numb in the post Lehman era, India continues to be rocked by one scam after another. Both public and private companies across sectors are being tainted with unflagging regularity. Policymakers who re-assessed existing corporate governance regulations concluded that making blanket changes was not the solution. They felt that what was really required was a set of voluntary guidelines that companies could adopt to suit their specific circumstances.

The role played by independent directors and the extent of their liability in the recent governance failures has been widely debated. The lawsuits, CBI inquiries and widespread media criticism left several independent directors of corporate India perturbed. The month of January 2009 alone saw more than 150 resignations from independent directorships, triple that of the normal figure. More than 1500 independent directors have quit in the past two years, exacerbating the short supply of eminent and qualified people. The general view currently held is that independent directors should be exempt from vicarious liability. They should not be held accountable for lapses for which they are not directly responsible. While the jury is still out over the role of independent directors, a few changes have been introduced by the regulators to improve overall governance.

The Ministry of Corporate Affairs (MCA), the Securities and Exchange Board of India (SEBI), industry associations Confederation of Indian Industries (CII) and National Association of Software and Services Companies (NASSCOM) have recommended stricter corporate governance mechanisms. Some of the key recommendations are summarised on the next page[5]:

[5]A Brief Overview of Corporate Governance Reforms in India - The Conference Board Director Notes No. DN-020

Report of the CII Task Force on Corporate Governance

MCA Corporate Governance voluntary guidelines

NASSCOM Corporate Governance and Ethics Committee Report

CII Task Force (February 2009)

- Set up fixed contractual remuneration for non-executive directors, which is not linked to profits. Companies should have a choice between paying a commission on profits and fixed contractual remuneration.
- Set up nomination and audit committees with independent directors constituting the majority. Independent directors should meet separately (without management present).
- Issue letters of appointment that specify the board's expectation from directors, the fiduciary duties that come with such an appointment, the accompanying liabilities, including whether the director is covered by any directors and officers (D&O) insurance; and the remuneration.
- For listed companies, the audit partners and at least half the audit team should be rotated every six years, but this should be staggered so that the partner and the team are not changed at the same time.
- Companies should set up mechanisms for whistle-blowers to report violations and protect them from victimisation.

NASSCOM Corporate Governance and Ethics Committee (April 2010)

- The role of board of directors should move from traditional advisory to strategic oversight of company affairs.
- The report also provides pointers to tighten risk management mechanisms and enable shareholder empowerment.
- Companies should create ombudsman positions and set up whistle-blower policies.
- Best practices for transactions and relationships with all other stakeholders including customers, competitors, employees and vendors.

Ministry of Corporate Affairs (MCA) Guidelines (December 2009)

- The MCA voluntary guidelines address matters related to independence of the board of directors, responsibilities of the board, the audit committee and auditors; and whistle-blowing provisions.
- Formal appointment letters for directors, with remuneration, fiduciary duties, etc. have been spelt out.
- Separation of the posts of chairman and CEO.
- Other suggestions include limiting (to seven) the number of companies in which an individual can become director, guidelines on tenure and remuneration of directors and director training, plus provisions related to independence and rotation of statutory auditors.

SEBI amends the listing agreement (April 2010)

- SEBI amended the listing agreement to add provisions related to the appointment of the chief financial officer (CFO) by the audit committee, after an assessment of qualifications and background.
- Other amendments related to financial disclosures included interim (half-yearly) disclosure of balance sheet figures with audited figures for major heads, and voluntary adoption of International Financial Reporting Standards (IFRS).

The government also hopes to enhance corporate governance through a simpler and more transparent company law. However, lobbies and parliamentary shenanigans have delayed its passing. The final shape of the Companies Act is still far from clear. Interestingly, the recommendations of the CII, NASSCOM and MCA have several common features; with respect to whistle-blowing, rotation of auditors, remuneration to directors and so on.

Revision of Companies Bill

The MCA is working on a comprehensive revision of the Companies Bill to replace the half-century old Companies Act. The new bill focuses on stricter corporate governance norms and is ready to be submitted to the Cabinet. The Bill, if passed, will protect the rights of minority shareholders, bring about responsible self-regulation with adequate disclosure and accountability,

The MCA voluntary guidelines address matters related to independence of the board of directors, responsibilities of the board, the audit committee and auditors; and whistle-blowing provisions.

Audit firms argue that they understand the functioning of the company better over time. So, rotating auditors might be counter-productive.

and lesser government control over internal corporate processes. The highlights of the bill include provisions that seek to:

- Limit the number of subsidiaries a company can have,
- Earmark two per cent of a company's net profit for CSR activities,
- Guide managerial remuneration, and
- Stipulate rotation of auditors.

The Bill also proposes that no independent director can be on the board of a company for more than six consecutive years, and cannot be on the board of more than seven companies. While some of the provisions have attracted strong industry criticism, it remains to be seen how many of the proposed provisions are actually passed to form the Act.

Mixed Reactions

However, a few recommendations such as audit partner rotation and limits on the number of directorship positions held by individuals have evoked mixed responses. Audit firms argue that they understand the functioning of the company better over time. So, rotating auditors might be counter-productive. On directorship limits, critics claim that there is already a dearth of qualified people.

Interestingly, most of these recommendations are still "voluntary", so the onus is still on positive intent by company owners and management. While some recommendations have received a fairly positive response from Indian companies, provisions for tighter risk management systems, whistle-blower policies and nomination committees, have seen a relatively lacklustre response.

EFFECTIVE IMPLEMENTATION IS THE KEY

Despite all the attention that corporate governance has received over the past couple of years, much remains to be done. Companies are currently complying with legislation to avoid penalisation. There is an apparent lack of willingness to proactively devise means of better governance. Instances, globally and in India, indicate that despite stringent transparency, disclosure and risk management systems, governance mechanisms fail to detect the early signs of an approaching crisis. This is because legislations are adopted at a superficial level rather than integrating them across the organisation and customising them to strengthen internal controls and governance.

"I think from a corporate governance point of view, from the existing regulations side, we are pretty much there. It is how effectively they are implemented that is the real question – whether they have been implemented in the right spirit or just for compliance."

Former Minister of Corporate Affairs,
Mr. Salman Khursheed, quoted in dnaindia.com

BEST PRACTICES

In corporate governance there is no 'one' right way. What is required is to look around the world for best practices, and ask, 'How can we bring this together?' A few examples of companies with widely acclaimed governance practices are presented below. These companies are known for integrating risk management, compliance and governance practices to make them more effective and efficient. Above all, the boards and management of these organisations are highly committed towards ensuring good governance.

ROYAL DUTCH SHELL GROUP (THE NETHERLANDS)

Royal Dutch Shell, listed on the London Stock Exchange, is a group of energy and petrochemical companies, which reported annual sales of USD 278 billion in FY09. Royal Dutch Shell led the IR Global Rankings for Corporate Governance Practices in 2010.

In addition to the generally implemented governance practices, the company has established the Shell Global Helpline, a 24/7 helpline operated by a third party. Employees can report concerns related to ethics and compliance through this helpline. The operation of the helpline by a third party ensures that the process is not influenced by the management.

Critical issues such as strategy and management, financial reporting and controls, structure and capital, board membership and other appointments, contracts, communication and corporate governance are reserved for the board.

DR. REDDY'S LABORATORIES (INDIA)

Dr. Reddy's Laboratories, an Indian pharmaceutical company, is listed on the Bombay Stock Exchange, National Stock Exchange and the New York Stock Exchange.

The company has implemented a Code of Business Ethics and the Ombudsman Procedure in compliance with the Sarbanes-Oxley Act of 2002 for ensuring ethical business conduct by management and employees. An independent director is appointed as the Chief Ombudsperson, who facilitates the ombudsman procedure and compliance with the code of business ethics. Reports and complaints submitted under this code are submitted to the audit committee of the board.

The Board is regularly updated about the enterprise-wide risk management system and risk assessment and minimisation procedures. Apart from this, the company has established a compensation and governance committee that is in-charge of director recruitment, skill assessment and assessment of performance of executive directors.

Dr. Reddy's was honoured with the Golden Peacock Award 2009 for excellence in Corporate Governance. It was awarded the 'Company with Best CSR & Sustainability Practices' in 2008 by the Asian Center for Corporate Governance & Sustainability and the Indian Merchants Chamber. In December 2010, the company received another honour, the ICSI National Award in Corporate Governance.

CISCO SYSTEMS, INC. (USA)

Cisco Systems, a global player in networking, is listed on the NASDAQ and reported net annual sales of USD 40 billion in FY10. Cisco has been ranked 5th in the IR Global Rankings of Corporate Governance.

Members of the key Cisco board committees – audit committee, nomination and governance committee and compensation and management committee are independent. The board has adopted majority voting for uncontested elections of directors. Independent members of the board meet frequently without the presence of the management.

Cisco has also adopted a senior executive compensation recoupment policy. In case of restatement of incorrect financial results, the compensation and management development committee reviews cash incentives awarded to executive officers for performance periods beginning after a certain date. The company has also established an ethics office which can be approached by all Cisco employees through a hotline.

LARSEN & TOUBRO LIMITED (INDIA)

Larsen & Toubro Limited (L&T), a manufacturing, construction, technology and engineering company, is listed on the Bombay Stock Exchange and National Stock Exchange and recorded net sales INR 43,500 cr in FY10.

The governance structure at L&T is based on four tiers, which are as follows:

- Strategic supervision by the board of directors, which consists of executive and non-executive directors
- Executive management by the corporate management consisting of executive directors and two senior managerial personnel
- Strategy and operational management by the operating company boards in each operating division
- Operational management by Strategic Business Unit (SBU) heads

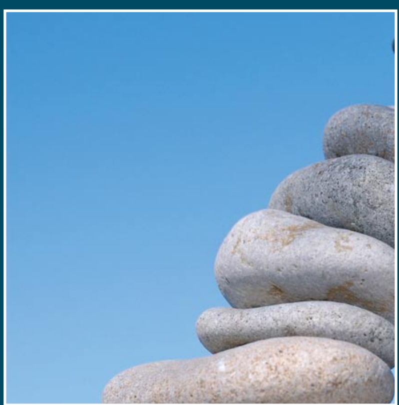
Site/factory visits are organised for directors on the board. Independent directors can interact with the management formally or informally. Apart from this, L&T has established a remuneration committee comprising three non-executive directors. This is part of the non-mandatory requirement under Clause 49 of the Listing Agreement.

L&T was awarded the ICSI National Award for Excellence in Corporate Governance in 2010. The Social and Corporate Governance Awards presented by the Bombay Stock Exchange (BSE) honoured L&T with the Best Corporate Social Responsibility Practice award in 2009.

SURVEY FINDINGS

RISK MANAGEMENT

Risk management is increasingly seen as a key governance agenda, but needs more attention at the board level.



69%

of the boards rate management of corporate risk as top priority

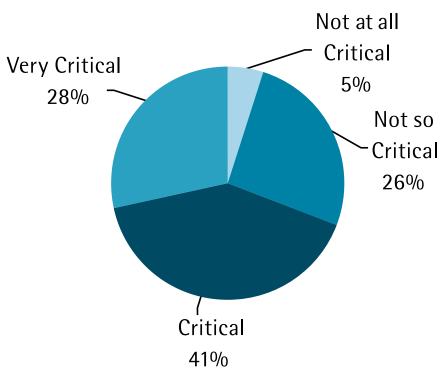
The lack of robust risk management systems has been the key factor in precipitating the global financial crises. Though the impact on the Indian financial system was relatively muted as compared to the developed economies, the crisis has brought risk management to the forefront of the governance agenda of Indian companies. But, is India Inc. doing enough to address this issue?

RISK MANAGEMENT IS BECOMING A PRIORITY, BUT STILL NOT "VERY CRITICAL"

Sadly, our survey found that risk management is not considered "very critical" by over 70% of the respondents. Lessons from various governance failures tell us that there needs to be an alignment between corporate strategy and risk taking. Risk management thus needs to be tackled at the board level. However, 69% of the independent directors surveyed said that management of corporate risk is currently the board's top priority. However, given that almost a third do not view this as critical nor the top priority, this is an area of concern.

An integral part of a company's risk management system is the usage of tools and processes that provide early warning signals of impending trouble. The absence of such tools to monitor risk was found to be a major impediment by 42% of the directors surveyed. This again emerges as a major concern area.

Figure 1 - **Around One-Third of the Boards Don't Rate Managing Corporate Risks as Critical**



LINKING INCENTIVES TO RISK TAKING

61% of the directors said that linking director compensation to risk and responsibility will have a high impact on improving board effectiveness.

61% of the directors said that linking director compensation to risk and responsibility will have a high impact on improving board effectiveness. The ongoing debate on linking compensation to risk has many implications. To implement such a system, companies need to develop a robust framework to understand the balance between risk and reward. For instance, compensation structures with very high variable pay components that could dilute company earnings constitute a risk that needs to be counterbalanced. It is also important to ensure that the matrices or models used to evaluate performance are appropriate and do not encourage short-term behaviour.

INFORMATION SHARING

The surveyed independent directors were satisfied with the extent of information sharing on risk and return with analysts. 79% of the directors said that senior management regularly meet with analysts, and discuss issues related to risk/return as well as guide market expectations in the right direction.

With very few Indian companies having a separate board risk committee, the risk management function is performed by the audit committee. A vast majority (87%) of the directors said that formal updates on the company's risk management status are provided to the audit committees.

This is reassuring, as it indicates that companies are increasingly focusing on taking proactive steps to manage risks. However, it is important that this area gets more attention at the board level as well. Perhaps, the creation of separate Risk Committees may help establish robust frameworks to define the tools and processes that provide early warning signals to pre-empt a crisis.

79% of the directors said that senior management regularly meet with analysts, and discuss issues related to risk/return as well as guide market expectations in the right direction.

87% of the directors said that formal updates on the company's risk management status are provided to the audit committees.

BOARD COMPOSITION

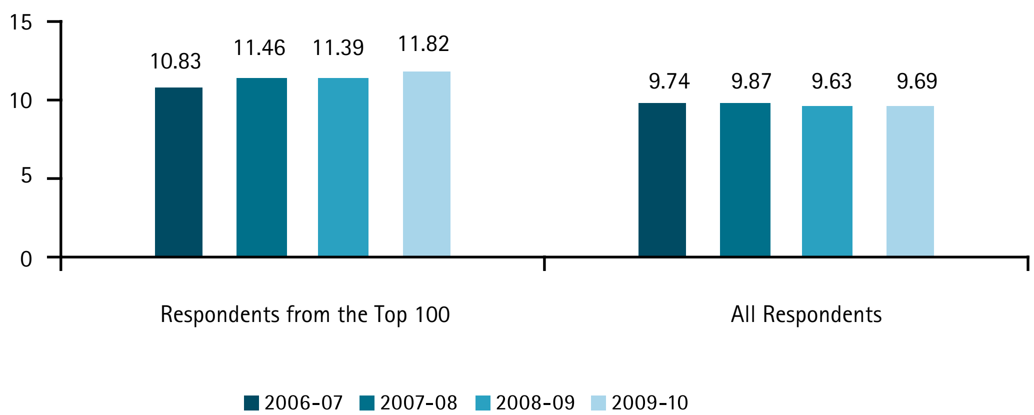
Limited talent pool of independent directors is perceived as the biggest impediment in changing board structure.


Only 4.6%
of directors on boards
are women

On the whole, directors are happy with the current board structure in India, with 87% indicating a high level of satisfaction. Directors would like to see more diversity on the board, but find the limited talent pool a major constraint.

The average board size remained nearly unchanged with an average of 9.69 directors in 2009-10, as compared to 9.63 in 2008-09. The board size increased in about a third of the companies during the same period.

Figure 2 - **Average Board Size Remains Constant**



As seen in the chart, the average board size in the top 100 companies segment, has moved up from 10.83 in 2006-07 to 11.82 in 2009-10.

BOARDS GET MORE INDEPENDENT DIRECTORS

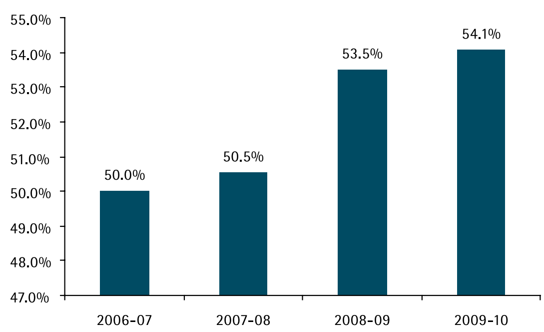
The average number of independent directors on a company's board increased to

5.2 in 2009-10 as compared

to 4.8 in 2006-07.

The average number of independent directors on a company's board increased to 5.2 in 2009-10 as compared to 4.8 in 2006-07. This figure may have been higher but for the shakeout over the past two years, on account of the numerous scandals that have continued to rock the corporate world.[6]

Figure 3 - **% of Independent Directors on a Board**



Interestingly, non-executive directors dominate, with an average of 71% representation on boards. However, only 54% of the directors are independent. Current regulations state that in case the chairman of the board is non-executive, one-third of the board should comprise of independent directors. If the chairman is in an executive role, at least half of the board should comprise of independent directors. It is also interesting to note that only 16% of the total directors in companies surveyed were related to the promoter or promoter's spouse.

[6]Board Independence and Fiduciary Role – Rajesh Chakrabarti (ISB)

On the face of it, therefore, Indian companies are compliant. The issue really is one of defining and then ensuring "true" independence. Independent directors play two important roles on the board. The first is to monitor the executive management; and the second is to enrich board room deliberations leading to objective decisions. The real challenge is that many so-called independent directors are not genuinely independent of owners or management.

Despite the oft repeated grouse about the lack of qualified people, 92% of the directors surveyed said that more than half of the board's non-executive directors have strong management and governance backgrounds. However, given that our survey was focused on the largest companies, we believe the problem will be much more acute in smaller companies.

The survey revealed that only 30% of the companies have appointed a "Lead" independent director. The percentage did not change for companies having an executive chairman. In contrast, about 96% of the boards of Standard & Poor's 500 (S&P 500) companies had a lead or presiding independent director in 2008.

The survey revealed that only 30% of the companies have appointed a "Lead" independent director.

TENURE, AGE AND RETIREMENT

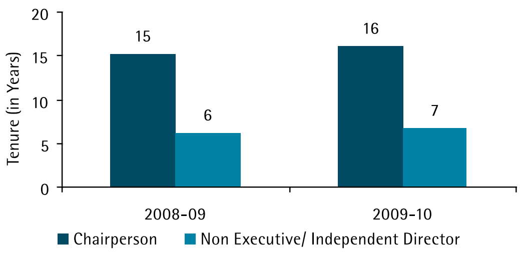
For companies that had a fixed retirement age, the average retirement age for non-executive directors and chairpersons is

65 years, while that for executive directors is

62 years.

The average tenure of the chairperson was found to be 16 years in 2009-10, which is a marginal increase of a year from 2008-09. In comparison, the average tenure of non-executive/independent directors was much lower at 7 years in 2009-10, up from 6 years in 2008-09.

Figure 4 - **Average Tenure Increases**



The findings also reveal that the average age of chairpersons has risen from 60 years in 2007-08 to 61.5 years in 2009-10. However, it remained constant at 61 years for non-executive directors during the same period.

Around 23% and 26% of the companies did not have a fixed retirement age for their chairpersons and non-executive directors, respectively. About 20% of the companies have not fixed a retirement age for executive directors. For companies that had a fixed retirement age for these positions, the average for non-executive directors and chairpersons is 65 years, while that for executive directors is 62 years.

The average percentage of women directors on boards was extremely low at 4.6% for the year 2009-10

PERCENTAGE OF WOMEN AND FOREIGN DIRECTORS STILL VERY LOW IN INDIA

Indian companies are expanding their operations globally, and at a rapid pace. Apart from organic growth and rising exports, Indian companies have been extremely aggressive when it comes to acquisitions. Foreign directors can bring in global best practices and an international perspective to board discussions. They also boost the company's image and brand value, which is especially relevant for companies that earn significant revenues from overseas markets, or are listed abroad.

A mere 6% of the surveyed companies had foreign directors on their boards in 2009-10. However, this was higher by 11% as compared to 2008-09 (5.4%).

The average percentage of women directors on boards was extremely low at 4.6% for the year 2009-10. Even more worrying is that this has remained relatively constant over the past four years.

The Standard Chartered Bank report 'Women on Corporate Boards in India 2010' also had similar findings. According to the report, only 5.3% of directorships on BSE-100 companies are held by women. While this is symptomatic of a global problem, India's percentages are lower than countries such as Canada, US, UK, Australia and Hong Kong, where the ratio of women directors ranges between 8% and 15%.

Interestingly, a revolutionary bill was recently introduced in the French Parliament which, if passed, will mandate 40% of board seats for women. This seemingly bold move is in line with a global realisation that having more women on boards makes good business sense. It is increasingly acknowledged that boards should better reflect their customers and employees, a substantial chunk of who happen to be women. Women bring a collaborative leadership style that can benefit boardroom dynamics through a win-win approach to problem-solving. They also bring fresh viewpoints to boardroom discussions thereby including the perspectives of multiple stakeholders. Women tend to see problems and solutions differently from men. Studies have also shown that women tend to have relatively higher moral standards and are more conscious of ethics and integrity.

INDEPENDENT DIRECTORS WOULD LIKE BOARDS TO BE MORE DIVERSE

72%

rated need to increase diversity as a concern area with

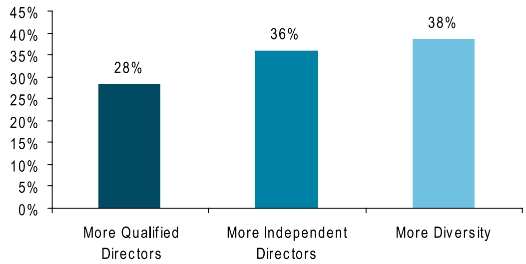
38%

rating it as a major concern area.

A 2009 report by the California Public Employees' Retirement System revealed that companies with a high diversity in board representation, exceeded average returns on the Dow Jones and NASDAQ indices over a five year period.

Independent directors surveyed also felt that increasing diversity is important; with 72% rating it as an area of concern. 38% of them rated increasing diversity as a major concern, more than those who believed that more qualified or independent directors was more important. More than 50% believed that boards currently have a sufficient number of qualified and independent directors, rating these as areas of least concern.

Figure 5 - **Desired Changes in Board Structure**



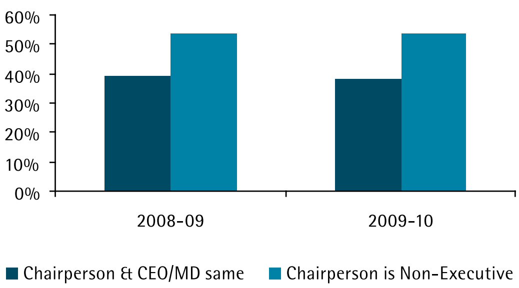
This was in sync with the survey findings of 2009 when around 65% directors felt that board diversity should be increased. Even though this aspect continues to be rated as important, sadly, very little progress has been made. It is important to note that diversity need not be restricted to gender or nationality, but could also covers skill sets or background.

SEPARATE CEO AND CHAIR POSITIONS

The Corporate Governance Voluntary Guidelines laid down by the Ministry of Corporate Affairs suggest that these positions should be held by different individuals. While it may appear encouraging that more than 60% of the companies surveyed have separate CEO/MD and chairperson positions, more than a third do not!

Just over half the companies (54%) have chairpersons who are non-executive directors.

Figure 6 - **Separation of CEO/MD and Chair Position**



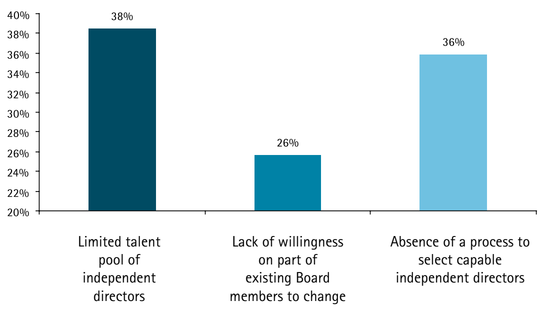
This issue is one that has sparked much debate, and all over the world. Most experts and regulators have advocated the separation of these positions. According to a 2009 report by Millstein Center for Corporate Governance and Performance (Yale School of Management), nearly 37% of companies on the Standard & Poor's 500-stock index in the US and nearly 79% of the large corporations in the UK had separate chairpersons and CEOs. Splitting the two roles is more common in Belgium, Canada, Brazil, Australia, Singapore, Germany, South Africa and the Netherlands. However, some critics feel that splitting of the two roles can create undue stress between the chairperson and CEO, which may be counterproductive to the growth of the organisation.

LIMITED TALENT POOL: A MAJOR IMPEDIMENT FOR SELECTING BOARD MEMBERS

56% of the directors surveyed identified the limited talent pool as an impediment, with 38% saying it was a major hindrance.

Independent directors continue to believe that a limited talent pool acts as the largest impediment in enhancing board composition. 56% of the directors surveyed identified the limited talent pool as an impediment, with 38% saying it was a major hindrance. The 2009 survey also found that the limited talent pool was the biggest impediment. However, in a country as large as India, this is hard to believe. More likely than not, this belief might well be fuelled by the lack of structured and focused methods to find and recruit independent directors.

Figure 7 - **Impediments to Changing Board Structure**



In fact, 36% of respondents cited the absence of a process to select capable independent directors, as a major hindrance to enhancing board composition. About half the directors felt that the lack of willingness on the part of existing board members to change is not at all an impediment, but over a quarter of them believed it was a major hindrance.

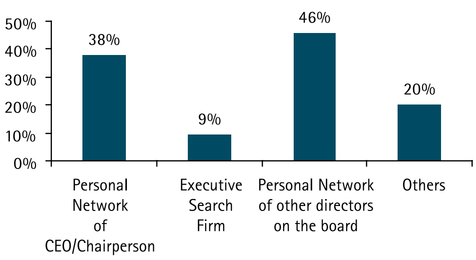
Of the total independent directors actually selected in 2009-10, the highest percentage were selected via personal networks of the CEO/Chairperson (37%)

ARE INDEPENDENT DIRECTORS REALLY INDEPENDENT?

Finding independent directors can be both easy and difficult. As there are no prescribed eligibility criteria for independent directors; many companies tend to take the easy way out by recruiting "friendly" people. While this helps companies comply with the requirements of Clause 49, most of these directors are unlikely to take positions that oppose the management view. However, if companies are serious about corporate governance, finding quality independent directors can be more difficult. To attract 'good' independent directors, companies need to not only provide adequate compensation, but also empower them and put in place an efficient institutional framework for them to work.

Around 59% of the companies surveyed have a formal process for selection of independent directors. Despite this apparently formal process, the most used channel is personal networks of existing directors. 46% of the respondents cited board networks as the preferred channel for selection, while 38% used the personal network of the CEO/Chairperson. Selection via a Nomination Committee is far less used.

Figure 8 - **Avenues Used for Independent Director Selection**



Of the total independent directors actually selected in 2009-10, the highest percentage were selected via personal networks of the CEO/Chairperson (37%).

Even though a 'limited talent pool' continues to be perceived as the biggest impediment in changing board structure, only 9% of the companies surveyed used executive search firms to find suitable directors. This has however increased by 50% over 2007-08, when 6% confirmed using this avenue. Interestingly, this is in stark contrast to countries like the US and UK where more than 50% of the companies use executive search firms for director level appointments. Companies in India need to expand their search horizons if they are really keen to bring on board a larger number of high calibre independent directors.

BOARD MEMBERSHIPS OF INDIVIDUAL DIRECTORS ON THE RISE

On an average board chairpersons were members of

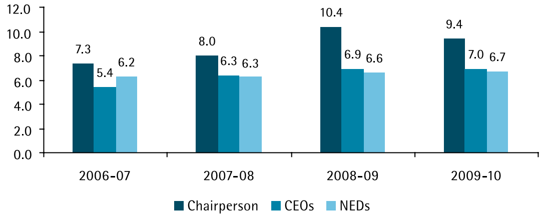
9.5 external boards, including public and private companies.

On an average board chairpersons were members of 9.5 external boards, including public and private companies. This is higher by 19% as compared to the average of 8 memberships in 2007-08. Interestingly, the vast majority of these (an average of 7.5) were memberships on boards of private companies. There has been a continuous rise in the number of average external board memberships over the last four years. From the companies surveyed, the maximum public board memberships held by an individual was 12, and the maximum private board memberships a whopping 37.

On the other hand CEOs/MDs are members of 7 external boards on an average. This is up by 11% as compared to the average 6.3 for the year 2007-08. In terms of break-down between public and private boards, again most of these (an average of 6) were on the boards of private companies. The highest number of public company board memberships held by a CEO was 10, whereas it was 32 for private company boards.

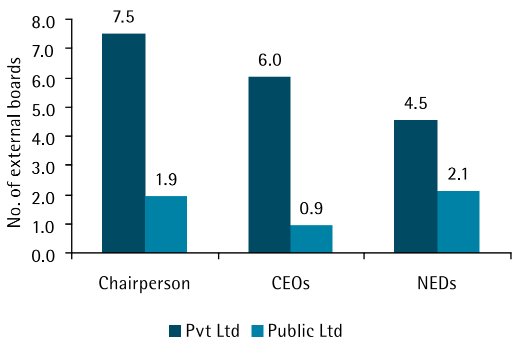
Non-executive directors, on an average held a total of 6.7 total board memberships, with 2.1 public and 4.6 private memberships. The average number of board memberships for non-executive directors have also shown an upward trend from 5.4 in 2006-07 to 6.7 in 2009-10.

Figure 9 - **Membership on External Boards**



About 20% of the companies limit the number of boards non-executive directors can sit on, and the maximum limit is 15. The Companies Act states that no person can be a director on the board of more than 15 public companies.

Figure 10 - **External Directorships on Pvt & Public Boards**



Our survey found that the average number of external public board memberships held by chairpersons, CEOs and non-executive directors is less than two. This is much less than the new MCA guidelines which suggest a limit of seven. Among those surveyed, less than 5% held more than seven external public company board seats. While this appears to be a positive sign, the large number of private board memberships held is a cause for concern.

NON-EXECUTIVE DIRECTORS DOMINATE BOARD COMMITTEES

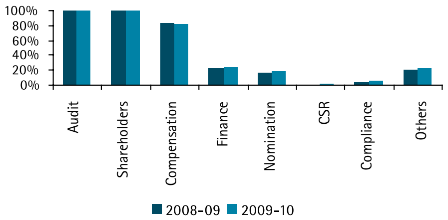
There were an average of

3.8 directors per board committee, and the average number of non-executive/independent directors in each committee was nearly

2.5 in 2009-10.

All the companies surveyed have an audit and a shareholders' committee, in compliance with Clause 49 of the Listing Agreement. More than 80% of the companies have a compensation or remuneration committee, while 23% have a finance/business review committee. However, only 18% have a nomination committee.

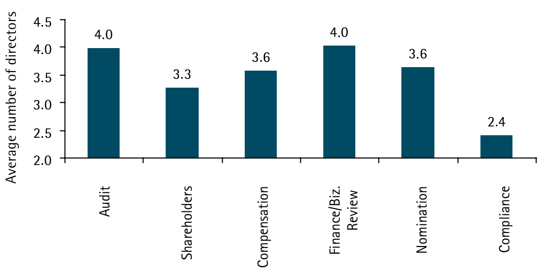
Figure 11 - **% of Companies Having Various Committees**



Around 21% of the companies had other committees such as regulatory committee, QIP committee, special committee for monitoring of large value frauds, governance committee, management committee, share transfer committee, board committee, etc. On an average, 8% of the companies introduced a new committee in the last two years.

There were an average of 3.8 directors per board committee, and the average number of non-executive/ independent directors in each committee was nearly 2.5 in 2009-10.

Figure 12 - **Average Number of Directors on Committees**

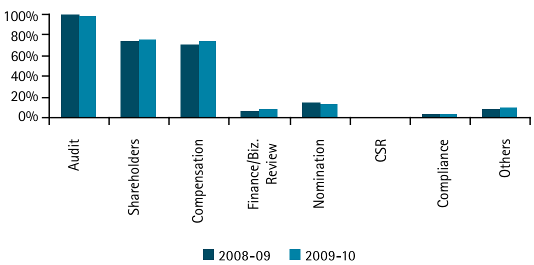


Audit, compensation and nomination committees are primarily dominated by non-executive directors. This is in compliance with Clause 49, which requires audit committees to have two-thirds representation by independent directors. On average, only the finance/ business review committees had more than 50% representation by executive directors.

Figure 13 - **Breakup of Non-Executive & Executive Directors on Committees**

Among companies surveyed, all the audit committees and a majority of shareholders (75%) and compensation committees (74%) were chaired by independent directors. On the flip side, only 8% of the finance/business review and 6% of compliance committees were headed by independent directors.

Figure 14 - **Committees Chaired by Independent Directors**



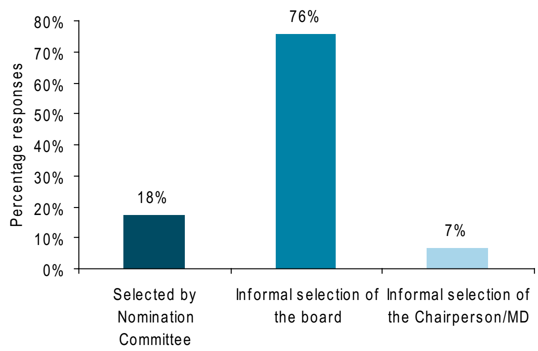
COMMITTEE CHAIRPERSONS SELECTED INFORMALLY

In

76% companies, committee chairpersons are selected informally by the board.

Chairpersons on various committees are generally (76%) selected through an informal process, by the board. In 18% of the cases, the chairpersons are selected by a nomination committee. Interestingly, in 7% of the companies surveyed, the decision to elect a committee chair is directly made by the chairperson or MD.

Figure 15 - **Process of Selection of Committee Chairpersons**



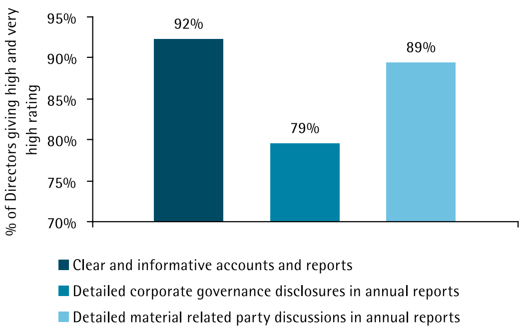
REGULATORY COMPLIANCE

92% of the responding directors said that their company is highly involved in ensuring compliance with new regulations.

38% of companies present accounts as per International GAAP

Indian companies have followed high standards of financial reporting over the years. Global aspirations - expanding international operations and the need to raise capital abroad - have influenced the adoption of internationally accepted disclosure and reporting norms, thereby further improving the disclosure and transparency of financial reporting. 38% of the directors we spoke to said that companies' accounts are presented as per international GAAP. Reporting standards in India are expected to become more closely aligned with international norms when 300 large companies adopt IFRS (w.e.f. April 2011).

Figure 16 - **Clear & Detailed Disclosures**



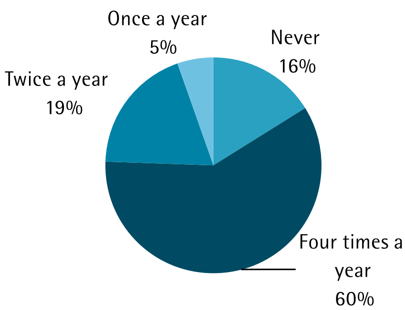
Directors overall felt that their company's disclosures were adequate, with 92% saying that the accounts and reports are clear and informative. Directors also thought that there was sufficiently detailed disclosure on the implementation of corporate governance principles (79%) and material related party discussions (89%) in annual reports.

CONSISTENCY IN INFORMATION SHARING

Around 89% of the directors surveyed said that their company consistently makes disclosure of all market sensitive information. A slightly lower 77% said that the company's website was updated frequently to provide the latest results and other announcements.

We found that 84% of the companies have a policy of sharing information through frank discussions with analysts post announcement of financial results. In fact, 60% of the companies hold analyst meets once every quarter.

Figure 17 - **Frequency of Senior Management Meets with Analysts**



D&O INSURANCE

The number of companies providing D&O insurance increased from 56% in 2008-09 to 60% in 2009-10. A similar trend was reported in IBR – 2009. However, the average D&O premium paid has remained constant at 11.2 lakhs per annum over the two year period.

CLAUSE 49 LOSING ITS SHEEN

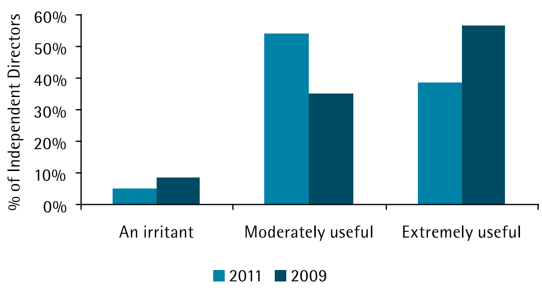
While

57% of the independent directors in 2009 believed that Clause 49 was extremely useful and enhanced shareholder value, the percentage fell significantly in 2011 with only

38% of the respondents citing Clause 49 as extremely useful.

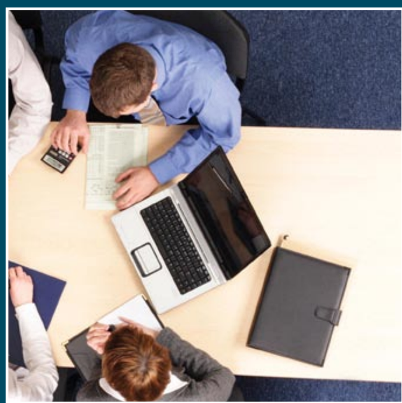
The 2011 survey indicated that around 92% of the companies are highly committed to ensuring compliance with new regulations such as Clause 49, the SEBI Corporate Governance Code and CII Desirable Code of Corporate Governance. However, while 57% of the independent directors in 2009 believed that Clause 49 was extremely useful and enhanced shareholder value, the percentage fell significantly in 2011 with only 38% of the respondents citing Clause 49 as extremely useful. Clause 49 was relatively new during the last IBR (2009) survey, but two years down the line, directors find it less effective than originally expected.

Figure 18 - **Clause 49 Seen as Less Useful**



ACCOUNTABILITY AND RESPONSIBILITY

Over two-thirds of the directors are of the opinion that the roles and responsibilities of non-executive directors are not clearly defined and documented.



90% of the boards rate statutory compliance as the top priority

UNCLEAR PERFORMANCE EXPECTATIONS

Two-thirds of the independent directors believe that their roles and responsibilities are not defined clearly. Though this is an improvement over 2009, when 82% said this, the situation is still alarming. In today's already complex business environment, absence of clear expectations makes the independent directors' task even more difficult. This in turn brings us back to the question of whether governance is being followed in letter or spirit. Are independent directors generally appointed only to comply with regulations?

Most non-executive directors do not meet without management being present

Only 31% of directors said that non-executive directors meet regularly without the presence of management. This percentage has remained relatively constant over the past four years. Meetings in the absence of management executives allow non-executive directors to discuss their concerns in a more open and unbiased manner. This also enables them to validate their concerns with other non-executive directors before putting them across to the management. More companies need to adopt this practice, which is prevalent in US and Europe.

BOARD MEETINGS

The companies' boards met on an average of 6.5 times in a year, and this frequency has been fairly steady over the last four years. The minimum number of board meetings held by any company was 4, whereas the maximum was 19.

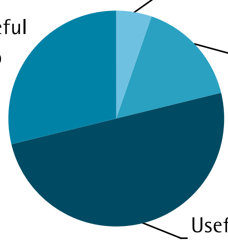
On an average, the boards met three times during the year for a strategic and business review.

The minimum number of board meetings held by any company was

4, whereas the maximum was

19.

Figure 19 - **Usefulness of Documents Provided Before Meetings**



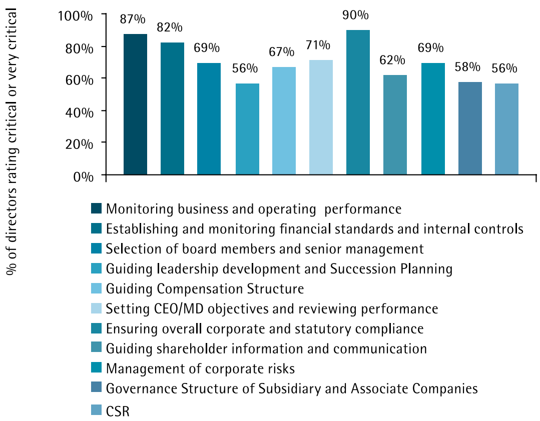
While 95% of the directors said that documents pertaining to the key meeting agendas were made available prior to the board meetings, only 79% found these documents to be useful. The most common grouse was that these documents are usually provided only one to two days in advance, thus allowing very limited time for review.

STATUTORY COMPLIANCE IS THE TOP BOARD PRIORITY

Leadership development, succession planning, CSR and risk management continue to be low on the board priority list.

Ensuring overall corporate and statutory compliance emerged as the topmost priority for boards, with 90% directors rating it as critical or very critical. This was closely followed by monitoring business and operating performance (87%). Capital and revenue budgets receive significant attention in performance monitoring followed by strategic planning, M&A and raising of resources.

Figure 20 - **Board Priorities**



Leadership development, succession planning, CSR and risk management continue to be low on the board priority list. Setting goals and reviewing performance of the CEO; selection of board members and senior management; and guiding compensation structure are a few other areas that require a more systematic approach from the boards. The lack of focus on these issues are a clear reflection of the fact that India Inc. has a significantly large percentage of promoter managed companies.

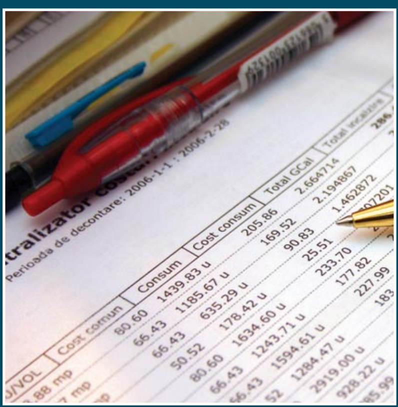
CORPORATE SOCIAL RESPONSIBILITY

CSR is increasingly getting more attention from corporate India. Around 72% of the companies surveyed publish their CSR activities on the website or in the annual report. This has increased by 11% from 2009, when 65% of companies published their CSR information.

However, the area is still not getting the required attention at the board level. Only 56% of the independent directors said that CSR is considered as a critical issue by the board (50% in 2009). These companies adopt a planned process to systematically address CSR issues. Even though as many as 82% of the companies included CSR on the board's priority list, only 44% believed the board had effectively taken this agenda forward over the last two years. Though there is an increased realisation of the importance of CSR, on-the-ground implementation is sorely lacking. Barely 2% of the companies surveyed have a separate CSR committee.

BOARD EFFECTIVENESS

More than 60% of the directors think that regular evaluations will improve board effectiveness.

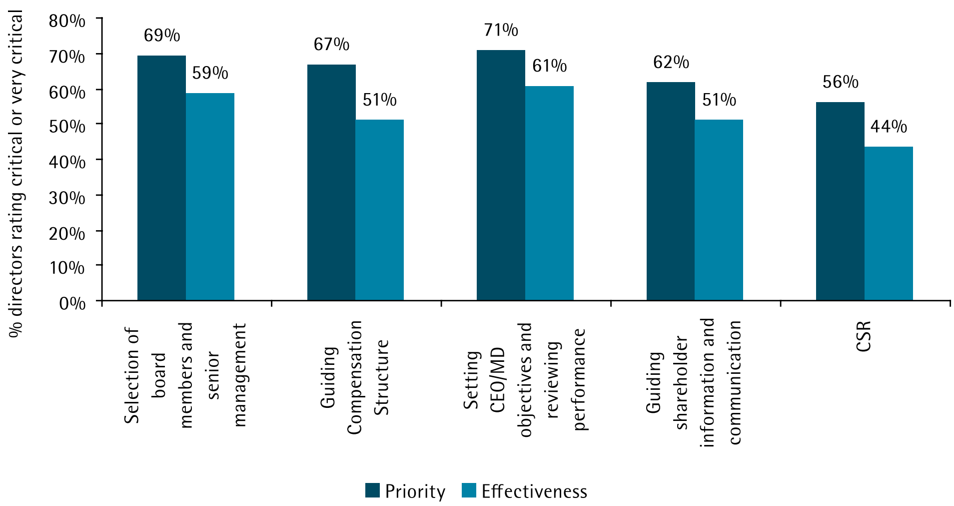


23%
companies use third party reports for performance monitoring

HOW BOARDS FARED ON THE TOP PRIORITY ISSUES

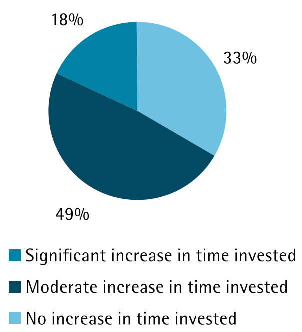
When asked about board's effectiveness, a majority of directors felt their boards were effective in critical areas, including statutory compliance and monitoring business and operating performance. However, among the companies that rated issues like selection of board members and senior management, guiding compensation structure, setting CEO objectives and performance review, shareholder information and CSR as critical, lack of effectiveness remains an area of concern.

Figure 21 - **Issues Ranked Critical But Not Effectively Tackled by all Boards**



GREATER TIME COMMITMENT NOT RESULTING IN EFFECTIVENESS

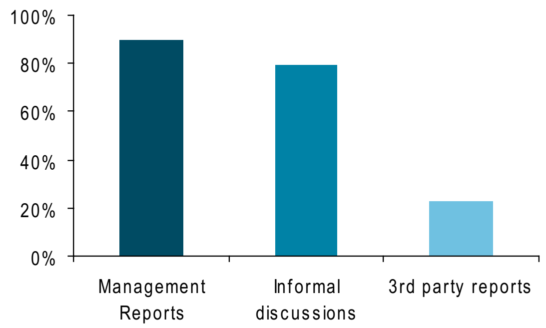
Figure 22 - **Time Commitment for Board Duties Increases**



Around 82% of the independent directors felt that their time commitment towards board duties has increased over the past two years. Interestingly however, only 59% of them believe that the increased time has translated to an increase in board effectiveness.

PERFORMANCE MONITORING

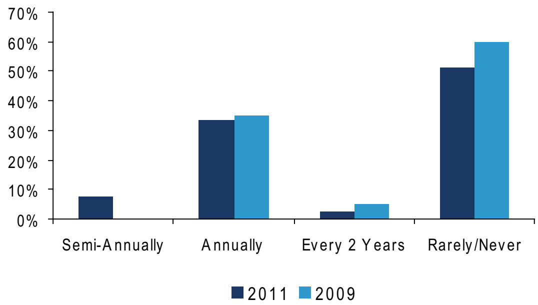
Figure 23 - **Over Dependence on Management Reports**



The vast majority of boards depend largely on management reports (90%) and informal management discussions (79%) for business information. Third party reports and stakeholder views are used as tools only by 23% of the companies. Third parties and other stakeholders can give an unbiased and external view of performance and take into consideration the impact on all stakeholders. Relying mainly on management views provides a one-sided perspective, and this must change if corporate governance standards have to improve in India.

BOARDS NOT INCLINED TO EVALUATE THEIR OWN PERFORMANCE

Figure 24 - **Board Evaluation Frequency**



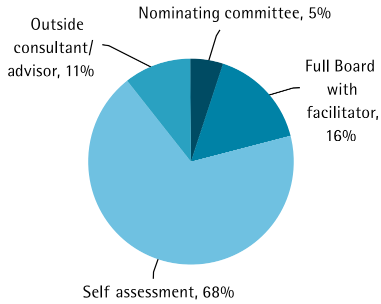
More than half of the directors surveyed said that their board hardly ever evaluates its own effectiveness. Not much has changed since 2009, when 60% of the directors said that the board never assesses its performance.

Of the boards that do evaluate themselves, a majority (68%) use an informal process of self-assessment. The other methods used for board evaluation include:

- Evaluation by full board with a facilitator - 16%
- External consultant or advisor - 11%
- Evaluation by Nomination Committee - 5%

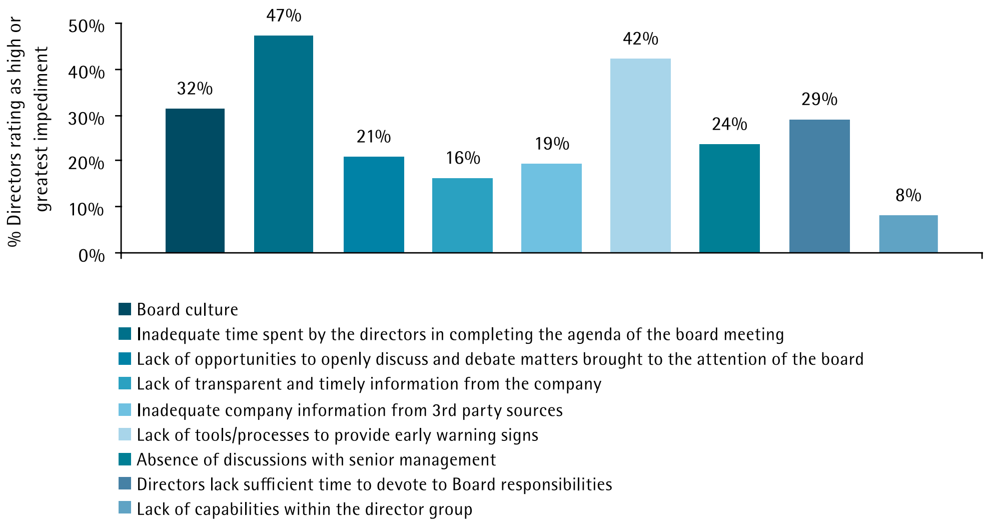
Given that effectiveness is rarely measured, and even when it is, the absence of a formal process indicates the lack of seriousness. Well defined formal processes, ideally driven by external consultants or independent people, are a must if company boards are to meet the expectations of today's investors and regulators.

Figure 25 - **Methods Used for Board Evaluation**



IMPEDIMENTS TO MONITORING PERFORMANCE

Figure 26 - **Impediments to Monitoring Business Performance**



Some of the key impediments to monitoring business performance as highlighted through the survey are -

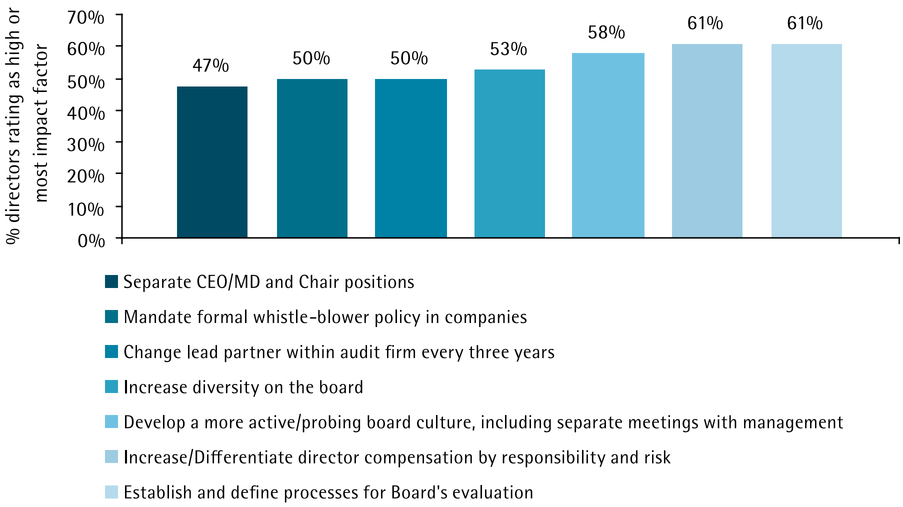
- Inadequate time spent by the directors in completing the agenda of the board meeting
- Lack of tools/processes to provide early warning signals
- Board culture
- Directors lack sufficient time to devote to board responsibilities
- Absence of discussions with senior management

While the lack of time is cited as a big problem in terms of completing the agenda of the meeting, this is arguably more of a culture issue than just about time.

Lack of member capabilities, inadequate information from the company and third party sources are interestingly not considered to be impediments.

IMPROVING BOARD EFFECTIVENESS

Figure 27 - **Changes to Improve Board Performance**



Respondents believe that the following factors can be most effective in improving board performance –

- Establishing and defining processes for the board's evaluation
- Increasing/differentiating director compensation by responsibility and risk
- Developing a more active/probing board culture, including separate meetings with management
- Increasing diversity on the board

As high as 61% of the directors felt that establishing and defining processes for board evaluation would have a large impact on improving their board's effectiveness.

Directors surveyed also felt that setting up government regulated rating agencies, to monitor and evaluate governance and actively publicise negative information to stakeholders, will not bring much improvement in the board's performance.

COMPENSATION

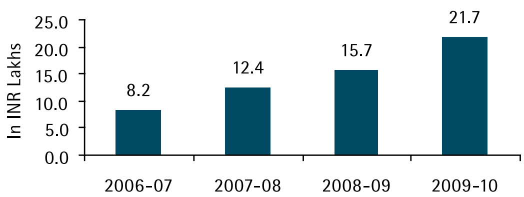
From the companies surveyed, the minimum compensation offered to non-executive chairmen was INR 16,000 and the maximum was INR 13 crore.

72% boards do not pay additional remuneration for committee membership

RISING BOARD REMUNERATION

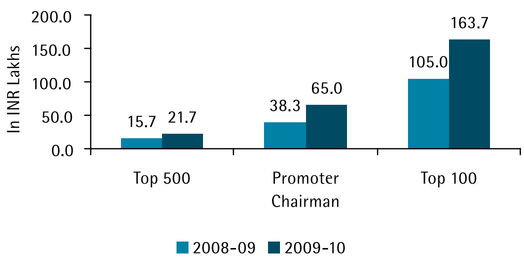
The average compensation paid to non-executive chairmen rose from INR 15.7 lakhs in 2008-09 to INR 21.7 lakhs in 2009-10, an increase of 38%. The rise was largely driven by commissions or profit share, as earlier. Interestingly, this has gone up more than two and a half times over a three year period.

Figure 28 - **Average Chairman Compensation on the Rise**



The average compensation for companies with non-executive promoter chairmen was much higher at INR 65 lakhs for 2009-10 as compared to the average of INR 21.7 lakhs for all the companies surveyed. The average compensation for companies from the Top 100 was dramatically higher at INR 163.7 lakhs, as compared to the total sample.

Figure 29 - **Average Non-Executive Chairman Compensation**



Around 10% of the non-executive chairmen received compensation greater than INR 1 crore, while 39% received between INR 1 lakh to INR 10 lakhs for the year 2009-10.

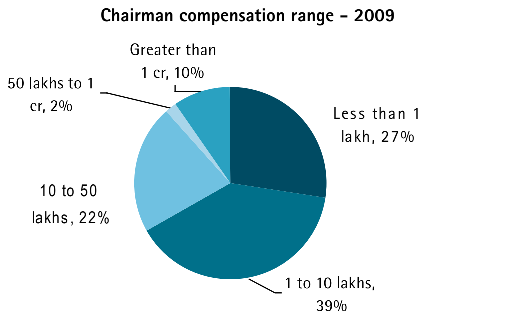
The average compensation for companies with non-executive promoter chairmen was much higher at INR 65 lakhs for 2009-10 as compared to the average of INR 21.7 lakhs for all the companies surveyed.

The average compensation paid to non-executive directors also showed an increasing trend. It rose

20%

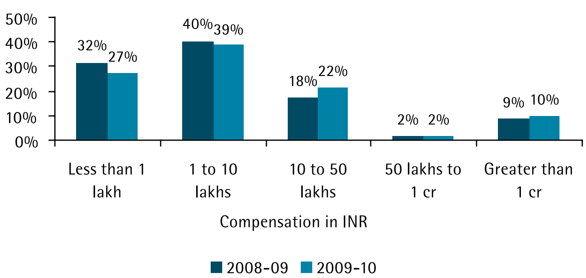
to INR 9.9 lakhs in 2009-10 from INR 8.2 lakhs in 2008-09.

Figure 30 - **Two-Thirds of the Chairmen were paid less than INR 10 Lakhs**



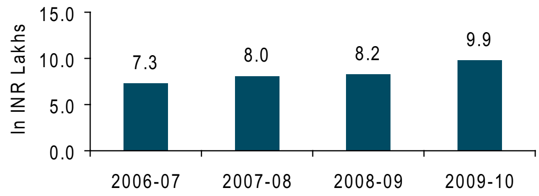
The percentage of companies offering compensation greater than INR 10 lakhs to the non-executive chairman increased from 28% in 2008-09 to 33% in 2009-10. The minimum compensation offered to Non-Executive Chairman was INR 16,000 and the maximum was INR 13 crore from among the companies surveyed.

Figure 31 - **% of Chairmen in Higher Compensation Range Increases**



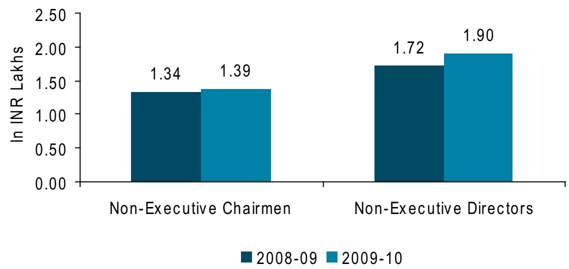
The average compensation paid to non-executive directors also showed an increasing trend. It rose 20% to INR 9.9 lakhs in 2009-10 from INR 8.2 lakhs in 2008-09. The minimum compensation paid to non-executive directors was INR 15,000, whereas the maximum was INR 54 lakhs for 2009-10.

Figure 32 - **Average Non-Executive Director Compensation Increases**



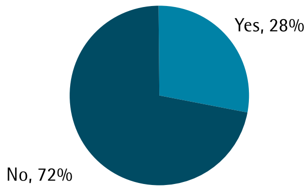
The average annual sitting fee rose by 3% for non-executive chairmen from 1.34 lakhs in 2008-09 to 1.39 lakhs in 2009-10. On the other hand, it rose by 11% for non-executive directors from 1.72 lakhs in 2008-09 to 1.9 lakhs in 2009-10.

Figure 33 - **Average Annual Sitting Fee**



COMPENSATION FOR COMMITTEE MEMBERSHIP

Figure 34 - **Companies Providing Additional Remuneration for Committee Membership or Chairperson Position**

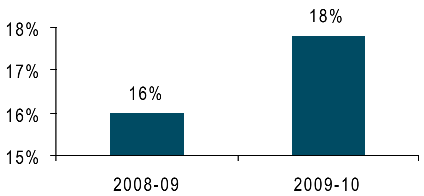


The survey findings reveal that 72% of the boards do not pay additional remuneration to their directors for assuming committee membership or chairperson positions.

DIFFERENTIAL FEES FOR COMMITTEE MEMBERSHIPS

The percentage of companies offering differential fees across various committees increased from 16% in 2008-09 to 18% in 2009-10.

Figure 35 - **% of Companies Offering Differential Fees Across Committees**



The average differential fee given to non-executive directors across committees was INR 14,389 in 2009-10, an increase of 10% over INR 13,076 in 2008-09. The maximum differential fee was paid to the members of the audit committee.

The average differential fee given to non-executive directors across committees was INR 14,389 in 2009-10, an increase of 10% over 2008-09.

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Bajaj Hindustan Ltd.

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DCM Shriram Consolidated Ltd.

DCW Ltd.

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Eicher Motors Ltd.

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EIH Ltd.

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HT Media Ltd.

India Glycols Ltd.

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Info Edge India Ltd.

IRB Infrastructure Developers Ltd.

ISMT Ltd.

ITD Cementation India Ltd.

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Tata Steel Ltd.

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