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Board Structures in India, Evidence from Automobile and IT Companies

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Abstract: **Board of Directors have become central focus for every business due to their vital role of bridging the interest of shareholders and managers. With particular look at some Automobile and IT companies, this paper has analysed the board structures in terms of size, independency, chairmanship and promotership on the board. Using purposive sampling, 10 companies each were selected from Automobile and IT sectors and 10 years time series trend and cross sectional analysis was used to achieve the objective.**

The study points out that, board size of selected companies did not change significantly over the period especially in the Automobile companies with about 80% maintaining same size over the decade. The Automobile companies had a median board size of 10-12 members while the IT companies had 10-11 members. 8 out of 10 companies never change their chairmanship in terms of person and category of director in both industries. 80% of the selected companies have non-independent chairmanship usually promoters meaning 50% of board members are independent. Few companies still have dual chairmanship over the period.

All companies have fulfilled the statutory requirement of clause 49 of the listing agreement over the period.

Keywords: **Board of Directors, Chairman, Independent Directors and Promoters.**

1. INTRODUCTION

Since the inception of the concept of separation of ownership from management through joint stock companies, the flag of agency has never rest down and even flags high. Various attempt of internal and external structures such as laws, ethics corporate governance and ownership dispersion has been developed to address this agency problem. Corporate governance mechanism such as Board of Directors and ownership dispersion has proven to be dominating tool to arrest agency problem, hence it has become vital field of study in the business world.

Corporate governance is the system by which companies are directed & controlled (Cadbury report 1992). Corporate Governance is the system of control mechanisms, through which “the supplier of finance to corporations assures themselves of getting a return on their investment,” (Shleifer and Vishny (1997))

The centre of attraction of corporate governance is the board of directors because their basic duties toward the company are same globally. As supervisors on management and trustees of shareholders, Board of Directors gives the direction to the company by approving strategies and enhancing performance with the ultimate goal of achieving the best interest of shareholders and other stakeholders (Deliotte 2013)

2. OBJECTIVES OF STUDY

It is a cliché that India is dominated by family and promoter owned business. Since its shareholders who appoint Board of Directors, there is high possibility of promoter dominance on the board especially in the case of India. On the basis of this assumption, this study seeks to achieve the following objectives;

- To determine the trend of promoter ownership in selected companies in Automobile and IT sector in India
- To find out the board size of Indian selected companies for the decade
- To know the independent directorship of Indian companies board over the period
- To know the number of promoter/promoter group on the company's board.

3. CORPORATE GOVERNANCE MODELS

The Anglo-American Model

Proposed in America and practiced by America, England, Canada and Commonwealth countries. It is a single board tier system where all executive and non-executive directors participate in varying corporation. The ownership of the companies is more or less equally divided between individual shareholders and institutional shareholders. Directors are rarely independent of shareholders because shareholders appoint them. Most institutional investors are reluctant activist. They don't take active part in the day to day activities of the business. The major players are the shareholders, BOD and Management

Japanese Model (Business Network Model)

This is based on the Japanese's cultural network called Keiretsu (industrial groups linked by trading relationships as well as cross-shareholdings of debt and equity) The reality of power in the enterprise lies in the relationships between top management in the companies in the keiretsu. The shareholders appoint 50% and financial institutions such as banks appoint 50% of the BOD. There is two tier board system supversory and subsidary with President linking both boards by rectifying and consulting among the boards financial institutions and corporations firmly hold ownership of the equity market. The four key players are: main bank (a major inside shareholder), affiliated company or *keiretsu* (a major inside shareholder), management and the government

Germany Model

Originated from Germany and practice mostly in Europe It involves two boards the upper (supervisory board) and lower (management board) **supervisory board** (composed of labour/employee representatives and shareholder representatives) **management board** (composed entirely of insiders, that is, executives of the corporation). The two boards are completely distinct; no one may serve simultaneously on a corporation's management board and supervisory board. The size of the supervisory board is set by law and cannot be changed by shareholders. The upper board supervises the lower board on behalf of the shareholders. It is societal model because it gives some roles to the society such as labour unions. Labour unions appoint 50% of the supervisory board and shareholders appoint 50% thought shareholders have 100% ownership. German banks, and to a lesser extent, corporate shareholders, are the key players. German banks and corporations are the dominant shareholders in Germany.

Indian Model

The few studies that have been conducted to evaluate the corporate governance model of India shows the dominance of Anglo- American model. Notwithstanding this assumption India has exceptional features especially in terms of ownership and board composition. Most of the researchers concluded with the following features.

- Dominance of promoter shareholding
- Promoter Chief Executive Officer (CEO)
- Dominance of promoter/promoter group on the board
- Diluted-principal agent relationship

4. REVIEW OF PRIOR STUDIES

Ownership

Promoters/promoters group are all individuals, families, corporate bodies or institutions who founded or promoted the company and are presently in control of the company and their relatives. In control means owing more than 20% in equity of the company. For the sake of this study promoters/promoters group includes both Indian based and foreigners

The predominance ownership concentration nature of Indian companies can be traced back to the days of the British Managing Agencies. (Balasubramanian, 2010)

In a different study conducted by Balasubramanian and Ramasway (2014) in to the ownership pattern of NIFTY companies, it was find out that, promoter in domestic private sectors are increasing holdings as well as institutional investors. On the other hand retail/non-institutional shareholders especially individuals recorded a high decrease in holdings. The study was conducted using time series analysis of decade data collected from National Stock Exchange. Some of the findings are;

Concentrated ownership entities marginally decrease from 44 in 2001 to 42 in 2011 of the fifty companies. But the median dominate shareholders has gone up to 56.24% in 2011 from 42.9% in 2001. This confirms the common assertion that concentrated ownership is predominance in India.

Composition of Board of Directors

Board composition is defined as the number of directors and its categories into outsider and insider directors. Insider includes the top management, promoters/promoter group, shareholders and employee who have direct benefit or interest in the company. Outsiders on the other hand are those without direct monetary interest in the company.

Board of Directors of a company are the most important internal corporate governance mechanism that provides strategic guidance and leadership as well as exercise overall responsibility over the company at the same time been accountable to the shareholders (Subramanian and Swaminaathan 2008)

There has been a contradicting conclusion on various studies conducted on Board Size. Some researchers are of the view that there is positive relationship between board size and firm performance. The basis for argument is, there is varied knowledge and intellect with large size which increase the strategic decision capability of board (Dhawan (2006), Dwinedi and Jain (2005)). The opposing scholars which argues of a negative relationship are of the view that, the larger the board the less effective they become by group dynamics and psychology theory. As board size increase its associated cost such as remuneration, communication and coordination also increase (Raleja 2005, Ghosh 2006).

Notwithstanding the two opposing thoughts, Vetaas (1999) opines an optimum board size which has positive relationship and negative relationship with performance. This is the “U” theory of board size and performance relationship. The basic assumption of theory is minimum number is necessary but if it crosses the sufficient number, performance is adversely affected. What is the optimum size is the question which is yet to be answered by academician and professionals.

Board Independence

Globally various committee reports such as Sarban Oxly Act , Cadbury report, Kumar Birla report, among others stress on the inclusion of independent directors on the board. Clause 49 of the listing agreement of Securities Exchange Board of India (SEBI) defines an independent director as‘independent director’ shall mean a non-executive director of the company who apart from receiving director’s remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the director”

Four major perspectives are frequent in the studies of independent directorship. Legalistic, class, hegemony, resource dependence and agency theory are the four perspectives. One thing which is common to all these perspectives is that, outsider (independent) directors are inevitable for board effectiveness (Zahra and Pearce 1989).

Till today there has not been any concluding evidence on the optimum size of independent directors and their contribution to firm performance.

While studies such as (Perce and Zahra 2002) claims a positive relationship between firm performance and presence of outside directors using some fortune 500, companies, Banahar et al (2005) concludes a negative correlation between board independence and firm performance.

Hermalin and Weishach (2006) argues that though there is no relationship between board composition and firm performance, the presence of independence directors help CEO to maximise value by bringing in expertise and unbiased eyes on the board. Independent directors bring brand credibility and better governance (Prasana 2006)

5. RESEARCH METHODOLOGY

Data Collection

The study is based on secondary data. The main source of data is audited published annual reports of selected companies, journal and articles. 10 listed companies each were selected from Automobile and IT industry in India. Companies under the Automobile industry are Ashok Leyland, Bajaj Motors, Eicher, Escorts, Herocorp, Mahindra & Mahindra, Majestic SML Isuzu, Tata Motors and TVS.

The IT companies include HCL, Hexware, Infosys, Infotech, Mphasis, NIIT, TCS, Techmahindra, Wipro and Zensar.

Sampling

Purposive sampling was used based on the National Stock Exchange (NSE) market capitalization as that July 15, 2014. Priority was given companies with Indian origin indigenous companies. The study covers a period of 10years ending 2013 accounting year for both industries. Companies with inadequate data were not considered for the study.

Data Analysis

The data was analysed using time series trend analysis cross sectional data analysis. To achieve the objectives 200 observations were used and descriptive statistics were adopted to analyse the data over the 10 years period.

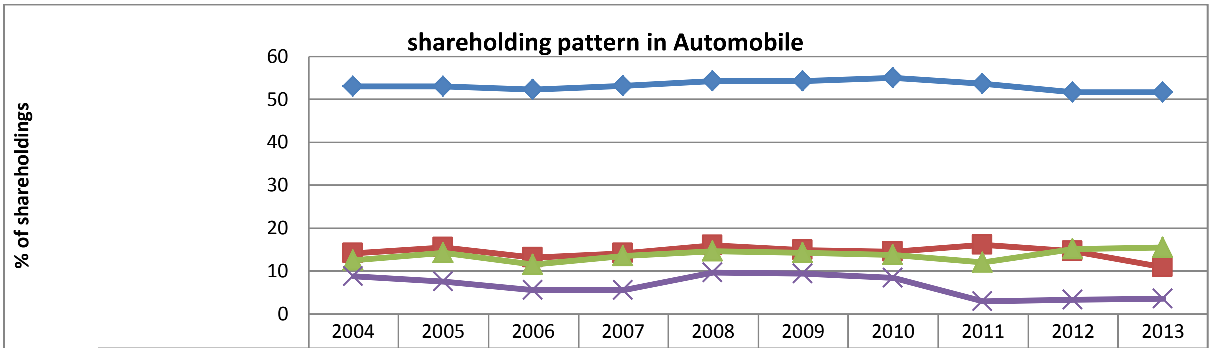
6. ANALYSIS AND DISCUSSION

Automobile Industry

The automobile industry is one of the oldest and the dominating industry of the Indian economy. The industry is made of manufactures of all kinds of automobile from two wheelers to heavy duty and trains.

Ownership Structures

From *figure 1* below, it can be seen from the trend that, promoters hold more than 50% of ownership in the automobile industry making it high promoter concentrated industry. The other category of shareholders had less than 15% shareholdings. This means that, the bulk of the ownership rights and control are in the hands of the promoters and promoter group. Individuals and institution hold almost the same percentage of ownership right in the industry which is about 13% and 14% respectively. Both categories has oscillating pattern over the period with highest percentage been 16.1% in 2011 and lowest 10.8% in 2013 for institutional investors. Individual investors were high in 2013 giving a percentage of 15.5% and least in 2006 of 11.4%.



	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
PROMOTERS	52.945	52.945	52.275	53.095	54.24	54.24	54.96	53.585	51.595	51.595
INSTITUTIONAL	14.045	15.45	13.155	14.15	16	14.86	14.43	16.14	14.64	10.89
INDIVIDUALS	12.45	14.28	11.46	13.485	14.645	14.185	13.785	12.01	15.095	15.525
GOVERNMENT	8.72	7.52	5.54	5.55	9.57	9.43	8.34	2.94	3.25	3.48

Figure 1 shareholding pattern of Automobile companies

Board Size

From the *figure 2* below, it can be seen that, the median board size of the selected companies is around 12 members. This shows that the strength of board has not change significantly over the decade. Most of the companies have maintained a constant board size. The highest board strength is 16 which is Herorp (then Hero Honda) from 2005 -2010 while Escort had the lowest size of 6. Herocorp which had a significant change in the size from 16 in 2005 to 11 in 2013 is due to demerge between Hero and Honda. It can also be seen from the study that, the marginal changes in board strength is one member at time. This gives an average between 11-12 member board sizes of selected companies.

Independent Directors

The *figure 2* shows a median of about 50% independent directorship in relation to board size. This means that the chairmanship of the boards are dominated by non-independent directors mostly promoters. The mean average also confirm this assertion with a membership of 5-6 which represent 50% over the decade. The result reveals that majority of companies does not go beyond the minimum requirement of clause 49.

Mahindra and Mahindra is the only company which has significant members of independent directors above the statutory requirement though they have independent chairmanship during most of the years. Here also the number of independent directors changed marginally with decrease or increase of one member per time. But most of the companies maintain the strength for a long time.

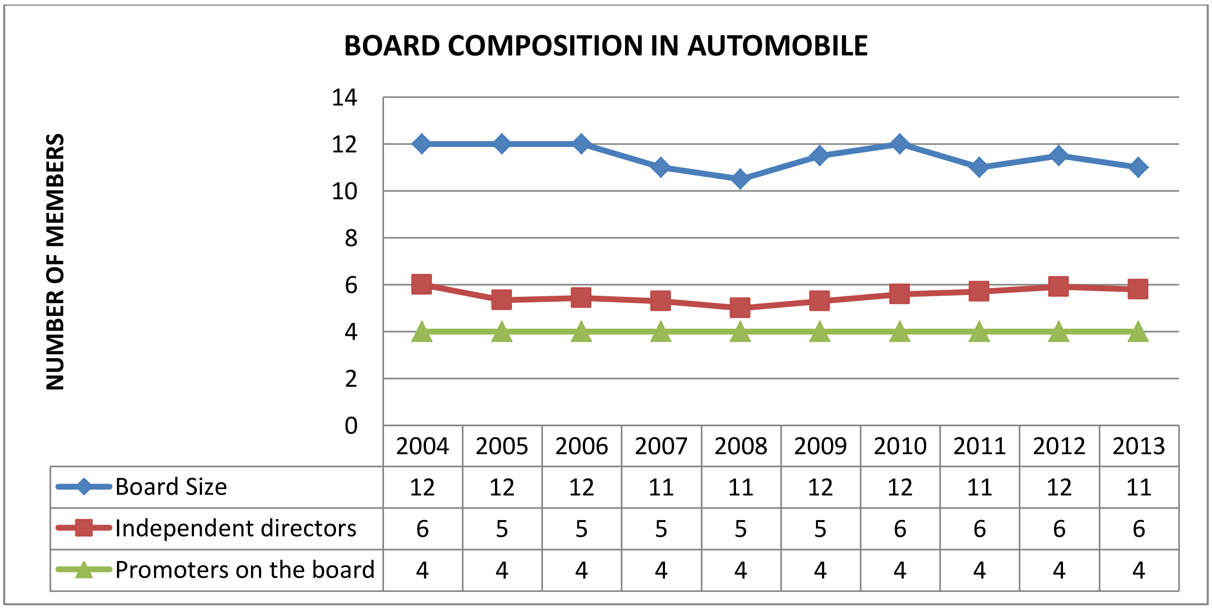
All selected companies have fulfilled the requirements of clause 49 of the listing agreement with minimum number of independent directors. Either one third if chairman is independent or half if chairman is non-independent

Promoter/Promoter Group on the Board

The median which is 4 members represent more than 30% (4/12) of the board size are promoters or promoter group. In most cases these promoter or promoter group members occupies the highest positions of chairman and vice chairman of the board. This situation can be link to the fact that ownership is concentrated among the promoter group with more than 50% ownership. This also means that majority of the board decision will be affected by these promoters influence. Ironically, SML Isuzu which has an independent chairmanship has the highest number of promoter membership of 4-6 over the decade. It has been 6 from 2004 to 2007 and then 4 onwards. Majority of the companies have maintained the same promoter membership number over the decade.

Chairmanship of the Board

With 50% independent directorship, it is obvious that, majority of the companies will have non-independent chairman which is the case for this study. Escorts and TVS had a dual chairmanship over the 10year period. This means that the same person holds the position of chairman and Chief Executive Officer of the company. SML ISUZU on the other hand had an independent chairman for the same period. Almost all companies have maintained the same person as chairman during the period under study. Chairmanship in terms of person and category of director did not change often. All the non-independent chairman of the sample companies are promoters or belong to the promoter's group.



	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Board Size	12	12	12	11	11	12	12	11	12	11
Independent directors	6	5	5	5	5	5	6	6	6	6
Promoters on the board	4	4	4	4	4	4	4	4	4	4

Figure 2 board compositions of Automobile companies

IT Companies

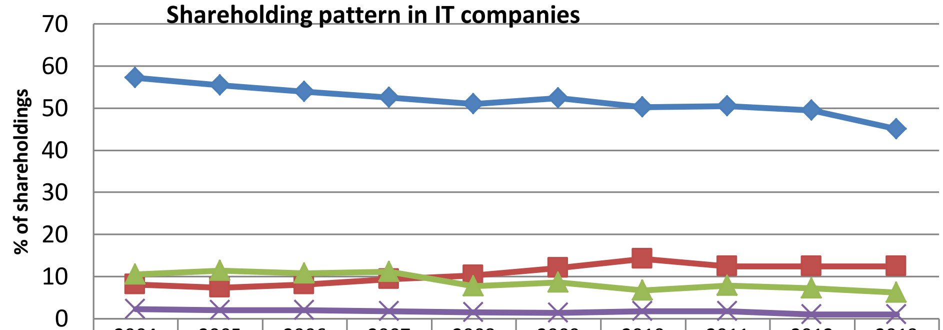
Although the Information Technology (IT) industry is not as old as the Automobile industry, it has gain global recognition, making India IT hub. The industry hosts all kinds of Information Technologies, software engineering, hardware development, training and services and host of others. The rapid growth of the software engineering segment attracts research hence this study takes into account more of software engineering companies.

Ownership Structures

In the above figure ii, although promoter/promoter groups exhibits promoter concentrated ownership of about 50% ownership right, the trend is falling over the period. The graph reveals that the general trend of promoter shareholding decreased from 2004 – 2013.

Unlike the automobile industry where other category holds 15% shares, institutional and individual investors in the IT industry hold just about 10% of ownership rights. While the institutional investors are increasing from 2008 onwards, the individual investors were decreasing.

It was found from the study that, both the promoters/promoters group in the IT and Automobile industry had 52% of the shareholding of their company. At the beginning of the decade while the promoter shareholding of the IT industry was falling from 57.1%, the Automobile industry remain unchanged around 52%. Again in the middle of the decade from 2007-2011, Automobile industry experienced marginal increase from 52% to 54.9% but the IT industry continued to fall from 52.4% to 50.4%. Both industries decrease from 2011 – 2013 but the decrease in the IT sector was more than the automobile industry.



	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
PROMOTERS	57.194	55.477	53.886	52.466	50.997	52.377	50.187	50.428	49.465	45.051
INSTITUTIONAL	8.09	7.325	8.12	9.42	10.24	12.01	14.15	12.405	12.425	12.38
INDIVIDUALS	10.505	11.44	10.78	11.13	7.68	8.555	6.75	7.845	7.21	6.21
GOVERNMENT	2.30	2.02	1.96	1.80	1.55	1.41	1.77	1.75	1.01	1.03

Figure 3 shareholding pattern of IT companies

Composition of Board of Directors

Unlike the automobile industry where the board size was 11-12 members, the IT companies have between 10-11 members over the period understudy.

Though the board strength was stable like in the automobile industry there is slight fluctuation about the membership during the years among the sample companies in the IT industry. The board size has been constant for a period of 3 years among the companies except for NIIT which has maintained 6 member board over the decade. INFOSYS has the biggest board size of 14-15 while NIIT has the smallest of 6 members. No significant trend can be established over the period. Mphasis which is an HP company had a significant change in board size from 12 in 2004 to 9 in 2013. WIPRO also experience an increase from 8 in 2004 to 14 in 2013. TCS had the highest jump in the board strength from 4 in 2004 to 11 in 2013. The fluctuation in the board size of the IT companies can be attributed to the fact that, most of the companies are not as old as the automobile companies and are yet to settle very well. Again they are service oriented and technologically dominated so they are highly affected by economic changes.

Independent Directorship

Similar to the automobile industry, independent directors occupies about 50% seats on the board. This is represented by the median of 5-6 members and mean of 5 members over the decade. All companies have fulfilled the statutory requirements of clause 49. The results point out that majority of the companies does not go beyond the scope of the statutory requirements in terms of independent directorship.

Mapping the changes in the independent directorship to the board size, it was observed that both changes move in the same direction. This means that most increase in the board size is accounted by the increase in the number of independent directors.

The 50% mark of the independent directorship demonstrates that majority of the chairmanship within the IT sector are non- independent been an executive or promoter group.

Promoter Membership on the Board

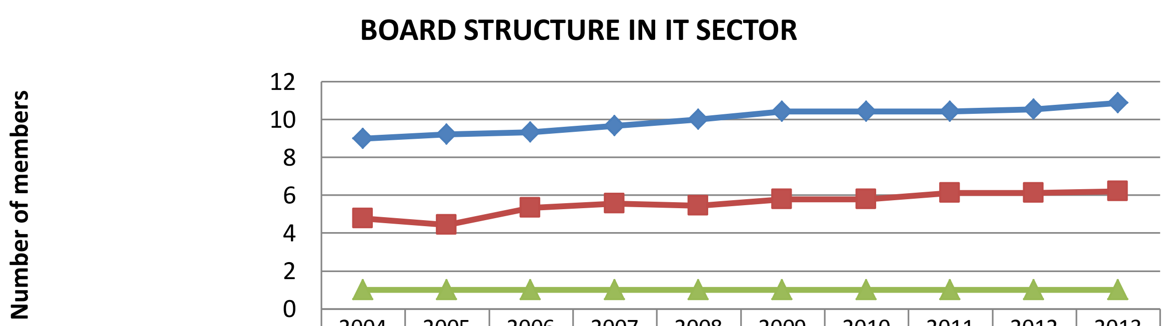
On centrally to the automobile industry where about 33% of the board members are promoters/promoters group, the IT sector has 1 promoters/promoter's group on the board representing about 10% on average. Apart from INFOSY and Mphasis which had more than 3 persons, the other sample companies had one (1) over the decade. Mphasis promoter dominance is from its mother company HP. This means that the board of the IT sector is fewer promoters dominated than the automobile companies. Unlike fluctuations in the number of independent directors on the board, the promoter directors is constant for almost all the companies over the 10years, with the exception of INFOYS and Mphasis which experience marginal changes.

Chairmanship of the Board

With inference from the 50% independent directorship it can be deduced that the sample companies in the IT sector is dominated by non-independent chairmanship. WIPRO and HCL had a dual chairmanship over the period with the same person holding the position throughout the period.

INFOSY had an executive chairman from 2004-2006 but it change to non-executive promoter but the same person from 2007 to 2011. The company had an independent chairman just for 2012 and 2013. Among all the companies selected, Mphasis which is a HP company is the only company which has change its chairmanship in terms of person and category of directors frequently on an average of 2years.

As in the automobile companies, all chairman who are non-independent are promoters or from promoters group. This gives more power to the promoters in decision making of the company at the expenses of the minority interest.



	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Board Size	9	9	9	10	10	10	10	10	11	11
Independent directors	5	4	5	6	5	6	6	6	6	6
Promoters on the board	1	1	1	1	1	1	1	1	1	1

Figure 4 Board structures in IT companies

7. FINDINGS AND IMPLICATIONS

- Institutional investors do not take active participation in the governance of both Automobile and IT companies. With almost zero representation on the board, it shows a major feature of Anglo American model.

- The dominance of promoter/promoter group on the board in the automobile shows that power of the company is still in the few hands which is dangerous for the minority shareholders.
- Although companies are expanding in terms of size and location but the board strength is not changing. This limit decision making and control capacity of the board. The company maybe big for such small board size.
- Experience maybe vital for a success of a company, but keeping same board chairman for a long time may limit innovation and enhance mis-governance.
- Many reports such as Cadbury Sarban Oxly OCED and Kumar Birla suggest that the chairmanship must be separated from the CEO. The dualism of the chairman hinders the control and oversight responsibilities of the board on management.
- It was find out that only few companies have a woman on the board. This implies that woman participation of companies' decisions is insignificant.

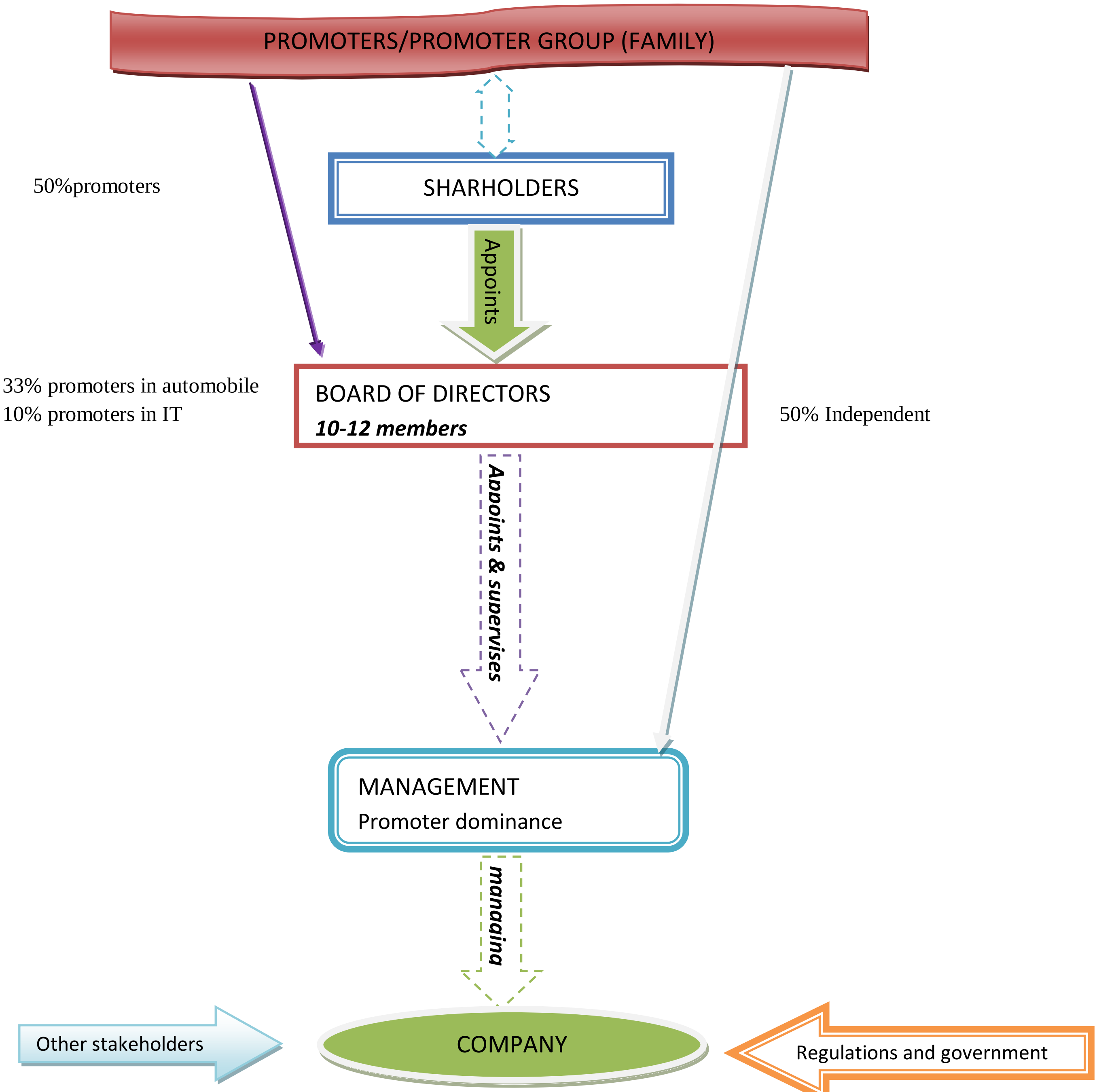


Figure 5: Diagram of the Corporate Structure of selected companies

8. CONCLUSION

All companies are in compliance with clause 49 with regards to board composition. This study has revealed the board size of both the automobile and IT companies from 2004 -2013. It has shown that companies do not change board size significantly. And the margin of change is usually one member increase or decrease.

It also establish the relationship between promoter ownership structure and board composition by demonstrating that high promoter concentration is a contributing factor for more promoters on the board of the companies especially in the Automobile companies.

The IT companies have fluctuation in the board strength over the period than the automobile companies. The changing strength of the independent directors on the board is the contributing factor for the changes in the board size.

All non –independent chairmanship of both industries are from promoter/promoter group. Chairmanship does not change frequently and about 80% of the sample companies maintain their chairman over the decade in terms of person and category of directorship.

Although Company Act 2013 (section 149 (1)) has introduce minimum board size of 2 to 3 and maximum size of 15, most of the company's board strength are small as compare with the company size and locations, hence control and governance is very difficult. It is therefore suggestion of this study that a further empirical study will be conducted to establish a optimum board size in relation to company size, performance and rate of growth.

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