1. Introduction – the role of the board of directors in corporate governance.

In corporate governance literature, the board of directors of a company constitutes the essence of corporate governance with their primary objective being to monitor and control the management. Traditionally, the corporate board is viewed as an internal governance mechanism designed to control self interested management from unscrupulous behaviors with the fundamental task of ensuring that management, in absence of owners, discharges its obligations faithfully and in the best interest of all shareholders, Fama and Jensen (1983), Heracleous (2001).

As final decision making authority in an organization, the role of board is therefore diverse taking into account the fact that it also bridges the gap that exists between shareholders and management. In the face of separation of ownership and control, the board is the only intermediate arm of the firm that interfaces and administers the relationship between the shareholders and the managers. The corporate governance reforms that followed the spate of corporate scandals around the world in the early 2000s, in various countries, focused on the board as the antidote that would help address issues surrounding management and promote best practices Van den Berghe and Levrau,(2004).

An important line of research in the area of corporate governance has been the investigation of various elements of board governance such as board size and composition, CEO duality, board diversity, frequency of board meetings, participation in board meetings, board directors etc. as they relate to and impact firm performance, Fama and Jensen, (1983); Hermalin and Weisbach (1988), Shleifer and Vishny(1997).

The effectiveness of the board of directors as the monitoring mechanism for shareholders can only be efficient if bounded with appropriate size, comprises of independent directors, has the right leadership configuration and caters for gender diversity in the board. To this end, most code for best practices and corporate governance guidelines tend to focus critically on these key parameters as the cornerstone to achieving the much needed board effectiveness and researchers, regulators and nomination committees have tended to view board effectiveness from the vantage

point of these four dimensions and boards are often seen from the perspective of having a separate chairman, a majority of outside(independent) directors, an optimal size (e.g., an 8-11-person board) and diversity in composition as optimal board parameters.

Director independence is a key parameter of Board structure and has been the focus of most corporate governance regulatory reforms across the world. Directors are classified rather homogeneously as being "unrelated" vs. "related", "independent" vs. "non- independent" or "executive" vs. "non executive" , depending on how the degree of "independence" is being conceptualized by the regulator drafting the regulation or the committee selecting the director. In guidelines issued by stock exchanges, such as those of the the Securities & Exchange Board of India (SEBI), and similar guidelines issued elsewhere, the most important question associated with board structure has traditionally been the "independence" of directors.

In corporate governance literature, director independence denotes the fraction of non executive directors on the board as compared to their executive counterparts. This reflects the proportion of outside directors, who participate directly in the day to day management of the firm, to inside directors and provides for the checks and balances in ensuring that the shareholders interests are protected.

From an empirical standpoint, a board is said to be independent if it is made up of more non-executive directors who share no material connection, with the firm, such as family ties, financial relationship, employment, professional services, and who do not share interlocked directorship with each other and with the management. Intuitively, outside non-executive directors are expected to be more reliable and also more effective in representing and protecting shareholders interest and indeed it has been argued that such directors are much more likely to oppose any strategic proposal which they believe is not in the best interest of shareholders. However, while some researchers have found positive relationship between board independence and firm performance, Shleifer and Vishny (1997),Jackling and Johl (2009), others report either negative or no relationship between the two factors, Bhagat and Black (2000), Heracleous (2001), Hsu (2010).

Despite the overwhelmingly strong, intuitive view that greater director independence, in the board structure, would results in better firm performance, very little has actually been learnt about what is actually involved in effective functioning of the board and the absence of a conclusive, demonstrable relationship between board independence and firm performance, in empirical studies, has not been adequately explained. Leblanc and Giles (2003) suggest that the likely reason for the relationship not being demonstrated is the fact that in all the research, there is no analysis of how boards perform as boards - how they make decisions - and of the impact of the behavioral characteristics of various directors on the decision-making process. The current reality of corporate governance research is that the "what" and "how" of a board of directors, its work and its process is, still the "unknown" of corporate governance. No one has demonstrated that there is a relationship between although everyone knows that there is one. So year after year, in the aftermath of the failures and scandals of major companies, the question that is inevitably posed is, "Where was the board?" Leblanc & Giles (2003).

This paper examines the functioning of independent directors on corporate boards in India with reference to the recent changes in the Indian Companies Act, 2013 and the changes proposed by SEBI to clause 49 of the Listing agreement, applicable to listed companies, and is organized as follows; section 2 identifies the special characteristics of Indian organizations that significantly impact the functioning of corporate boards in India, section 3 reviews some empirical evidence on board structures of large Indian organizations comprising the S&P CNX 500 companies, section 4 analyzes the changes in the Companies Act, 2013 and the changes proposed by SEBI, to the Listing agreement (clause 49) that are aimed at creating more effective boards in Indian companies while section 5 summarizes the issues and identifies the shortcomings in the current regulatory framework as regards the selection and appointment process of independent directors which are likely to come in way of having high performing boards in Indian companies.

2. The role of the Board in the Indian business context

Several distinguishing features stand out in India that are in sharp contrast to the rest of the world and point to the inapplicability of the western concepts of corporate governance to Indian organizations and significantly impact the way decisions are taken by board of directors take decisions in India.

Varma(1997) has argued that the issues in corporate governance in India are very different from those found in the Anglo Saxon world and the board of directors may have a rather limited role in managing Indian organizations and instead, a different model for corporate governance , with a significant external focus, may be required for Indian organizations. Unlike the US or the UK, which are characterized by dispersed shareholding, and where the governance issue is essentially that of disciplining the management, that has ceased to be effectively accountable to the owners, the problem in the Indian business organizations is that of disciplining the dominant shareholder and of protecting the minority shareholders.

According to Varma (1997), in the Indian context, the board of directors cannot conceivably resolve the conflict between the dominant shareholder and the minority shareholders since the board derives all its powers from the dominant shareholders who have appointed them to the board; therefore, such disciplining can only be done by forces outside the company itself such as the capital markets regulator and the capital market itself. Recent anecdotal developments in Indian business have clearly bought to the forefront the role of the family as a dominant shareholder and how it has impacted corporate governance in Indian organization; the sordid saga of corporate governance at Reliance which came into limelight in the dispute between the two Ambani brothers (Anil and Mukesh) has been very well documented, Dalal (2005). Not only were grave charges of mis-governance made against one of the largest Indian companies, as Dalal (2005) points out they were ironically levied against a company that had been showered with awards of corporate excellence (by the Institute of Company Secretaries in 2003) and

corporate and social responsibility awards (Golden Peacock, by the Institute of Directors in 2004) which actually coincided with the period when these misdemeanors had actually taken place and which the board of directors of the company was powerless to prevent.

While the role of a family group as a dominant shareholder in India is widely known and accepted, Varma (1997) has pointed out there are two other groups of dominant shareholders in Indian businesses, first are the public sector units (PSUs) where the government is the dominant (in fact, majority) shareholder and the general public holds a minority stake, second are the multinational companies (MNCs) where the foreign parent is the dominant (in most cases, majority) shareholder.

In public sector units (PSUs), members of the board and the Chairman are usually appointed by the concerned ministry and very often PSUs are led by bureaucrats rather than professional managers. Several strategic decisions are taken at a ministerial level which may include political considerations of business decisions as well. Multinational companies (MNCs) in India, on the other hand, are perceived to have a better record of corporate governance compliance, attributed to their applying global standards of transparency and accountability that are supposedly higher than most organizations in emerging markets. The MNC parent usually performs a very active role closely monitoring the Indian affiliate and, with adequate board representation, its influence over executive appointments and the magnitude of its stake, the MNC parent has a strong incentive to closely monitor its Indian affiliate. However, there have been instances of MNCs wishing to acquire additional equity in a company (where they already had majority shareholding) when ownership regulations have changed, but made/wanted to make the acquisition at a valuation that disadvantaged the minority shareholders, Espirito Santo Securities (2012).

While much of global corporate governance norms focus on boards and their committees, appointment of independent directors and managing CEO succession, in the Indian business context, boards are not as empowered as in several western economies since the board is subordinate to the will of the dominant shareholder.

3. Role of the independent directors on the boards of Indian companies.

Worldwide, independent directors on the board of a listed company are seen as an integral element of a company's corporate governance process with board independence taking on a pivotal status in the design of board structure and becoming almost a pre requisite for good governance. Consequently, governance reforms in recent years have increasingly pinned hope, as well as responsibility, on independent directors to enable higher standards of governance in organizations.

In India, for listed companies the definition of an independent director was first made by the Securities and Exchange Board of India (SEBI), who in clause 49 of the listing agreement defined an independent director as a non-executive director 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 that may affect the director's independence, SEBI (2010).Certain specific factors were also listed that helped determine whether or not a director is independent and while these factors dictate as to who cannot become independent directors there is an absence of positive factors that would qualify a person for being an independent director, except perhaps for the age of the person. For example, there is no mention of the types of qualification or experience a person should possess (prior to appointment) to the position so as to be able to discharge board responsibilities effectively. This was a serious deficiency in the definition of independence and it allowed companies to appoint persons who while satisfying the formal requirements of independence, were otherwise not suited for the job, Varrotil (2010).

In any case dominating shareholder(s) in Indian companies, by virtue of being able to muster a majority of shareholders present (and voting) on resolutions to appoint the board of directors in a company, could not only control the appointment of every single director (including independent

directors) and determine the constitution of the entire board, but could also influence the renewal of the term of directorship. Assuming that one of the purposes of the independent directors was to protect the interest of the minority shareholders from the actions of the dominating shareholders, such a purpose could hardly be achieved in the prevailing matrix of director appointment, renewal and removal, Varrotil (2010).

In analyzing the governance role of independent directors on company boards in corporate governance, two key parameters of interest are;

a. Independence of the board i.e. extent to which independent directors are present on the board and,
b. Diligence of the board, extent to which independent directors are diligent in their duties.

While (a) would proxy the independence of the board from the influence of the dominant shareholder(s) (referred to as the index of independence), (b) would be a proxy for the quality of monitoring by independent directors (referred to as the index of diligence).

The conventional approach (followed, in empirical corporate governance studies), to measure the index of independence of the board, would be to use the proportion of independent directors on the board to the total number of directors, Sarkar & Sarkar(2010).Listing regulations in India, formalized in 2000, and instituted by the capital market regulator, the Securities and Exchange Board of India (SEBI) required that boards of listed companies should have no less than half of its board comprised of non-executive directors with the additional provision that one-third of the board must comprise of independent directors if the chairman is non-executive and at least half of the board should comprise of independent directors if the chairman is an executive.

With regard to the measure for the index of diligence of the board, under (b) above, the attendance of the independent directors at board meetings is the key metric and it is conventionally measured as the ratio of board meetings attended by the independent directors on the board to the number of board meetings held by the company, Carcello, Hermanson, Neal, and Riley, (2002), Sarkar and Sarkar (2005).

Given the key role played by dominant shareholders in the Indian context, it becomes appropriate to examine board independence and board diligence across companies with different dominant shareholder characteristics.

An empirical, three year cross sectional study of the companies that constituted the S&P CNX 500 index for 2009-2012, based on 1390 firm years data, reflected the breakup of the companies, based on the nature of dominant shareholding, as presented in Tables 1 and 2, Pande (2013);

Table 1- Classification of sample companies –by numbers

Serial No.	Nature of Dominant Shareholding	2010		2011		2012	
		Nos	%	Nos	%	Nos	%
1	Government	41	9.2%	48	10.1%	42	8.9%
2	Indian Business Groups	337	74.7%	351	74.3%	358	76.2%
3	Foreign Business Groups	58	13%	62	13.1%	58	12.3%
4	No Dominating Group	11	2.5%	12	2.5%	12	2.6%
	TOTAL	447	100%	473	100%	470	100%

Table 2- Classification of sample companies –by market capitalization (Rs million)

Sl No	Nature of Dominant Shareholding	2010		2011		2012	
		Market Cap	%	Market Cap	%	Market Cap	%
1	Government	11,979,618.41	24.45%	15,904,095.79	27.1%	12,601,368.45	25.72%
2	Indian Business Groups	27,932,830.69	57.00%	31,014,346.65	53.00%	27,819,776.42	56.77%
3	Foreign Business Groups	4,833,900.26	9.86%	5,419,524.46	9.3%	5,637,634.04	11.51%
4	No Dominating Group	4,255,161.30	8.68%	6,190,177.65	10.6%	5,261,162.85	10.74%
	TOTAL	44,746,349.36	100%	58,528,144.55	100%	51,319,941.76	100%

While, by numbers, companies with dominating Indian groups constitute more than 74% of the number of companies in the sample under study, they account for only around 53-57% of the total market capitalization of the sample. On the other hand, Government dominated companies (

that comprise of only between 9-10% of the number of companies in the sample) account for as much as 24-27% of the total market capitalization of the sample

As per year 2011-2012 data, presented in Table 3, the quantitative measure of ownership concentration (promoter shareholding), among the S&P CNX 500 companies, was highest in Government dominated companies, followed by foreign group dominated companies and was the least in Indian group dominated companies, Pande (2013).

Table 3-Ownership concentration of sample companies –year 2012.

Serial No.	Nature of Dominant Shareholding	Ownership Concentration (in %)	SD of Ownership Concentration (in %)
1	Government	65.44	16.24
2	Indian Business Groups	51.29	16.41
3	Foreign Business Groups	60.37	16.90
4	No Dominating Group	8.82	24.18
	Average of S&P CNX 500 cos.	52.56	18.67

A composite measure of board performance, the board structure and process ("BSP") index, was constructed by multiplying the independence index of the board with the diligence index of the board members. Table 4 provides the mean value and standard deviation of this index for the period 2009-10 to 2011-12 for the companies in the various groups, based on the nature of dominating shareholder, for the S&P CNX 500 companies, Pande (2013).

Table 4 - Board structure & process (BSP) index of sample companies

Serial No.	Nature of Dominant Shareholding	2010		2011		2012	
		Mean	SD	Mean	SD	Mean	SD
1	Government	.26	.11	.26	.13	.25	.13
2	Indian Business Groups	.35	.10	.36	.10	.37	.10
3	Foreign Business Groups	.29	.09	.31	.09	.32	.09
4	No Dominating Group	.42	.16	.38	.18	.44	.22
	Average- S&P CNX 500 cos.	.33	.11	.35	.11	.35	.11

A higher value of the BSP Index indicates a relatively more independent and more diligent board where the independent directors are more regular in attending the board meetings, with a theoretical maximum figure of 1.0 reflective of a completely independent board where the directors attend all the board meetings. Not surprisingly, companies with no dominating shareholders reflected the best value for this indicator indicating that they had more diligent and independent boards as compared to companies in other categories and companies with government as the dominant shareholder had the lowest level for the BSP Index for all the three years.

A broader investigation (using multivariate regression) into the relationship between firm performance, the dependent variable (measured by Tobin's Q and Return on Assets), and 12 independent variables that included BSP Index as one of the independent variables, arrived at the following conclusions, Pande (2013).

a. There was significant difference in the BSP Index across firm categories that were categorized on the basis of dominant shareholders.
b. Year wise regression models showed the absence of any significant relationship between firm performance and BSP Index in any of three years.
c. Stepwise R^2 changes, in the hierarchical regression method used for regression, provided additional insight by examining the impact of introducing different groups of predictor variables in stages. It was observed that when the BSP Index variable was introduced in the regression model, there was no significant R^2 change reconfirming the statistically non-significant role for the BSP Index in predicting firm value.
d. The year wise analysis of the various OLS regression models showed an absence of any significant interaction effect between ownership concentration (measured on two dimensions- a dummy variable representing the nature of dominant shareholder and the percentage of promoters holding) and BSP Index, leading to the conclusion that ownership concentration had no moderating influence on the relationship between BSP Index and firm performance.

Similar findings were reported by Balasubramanian, Black and Khanna (2008) in their study across 252 Indian companies. While examining which of the sub indices of the overall corporate

governance index (developed by them in their study) were associated with ln q (natural log of Tobin's Q, the dependent variable in their study), Balasubramanin et al (2008) found that the coefficients on board structure were positive but insignificant while the coefficients on board procedure and related party transactions were close to zero. Furthermore, when the board structure index was subdivided into board independence and board committee sub indices, the board independence sub index was not significant while the board committee sub index was only marginally significant.

Furthermore, in their study Balasubramanian et al. (2008) found that in respect of the 92 companies that were part of the BSE 500 companies, none of the five sub indices (board structure, disclosure, related party, shareholder rights and board procedure), that built up their overall corporate governance index, had any significant relationship with firm performance; confirming similar findings from the study by the authors, in respect of the BSP Index, conducted over the S&P CNX 500 companies, Pande (2013).

Balasubramanian et al (2008) contrasted the weak results found in their study on board structure with the significant negative coefficient on a similar index in Black, de Carvalho and Gorga (2010)'s study of Brazil, the positive coefficient in Dahya, Dimitrov and McConnell's (2008) multi-country study and the strong positive coefficient on a similar index in Black and Kim (2010) and reasoned that in India board independence is not strongly associated with firm performance because the minimum requirements for board independence(in India) are strict enough so that over compliance, which is the only variation that can be tested, does not lead to improvement in firm value.

The authors of this paper contest the explanation provided by Balasubramanian et al (2008), on why board independence is not strongly linked to firm performance among Indian companies and suggest that the reason for a lack of any observed, significant association between board independence and firm performance in empirical studies, Balasubramanian et al (2008), Pande (2013), is on account of the fact that the structural factor used to measure board independence (in these studies) do not correctly measure board independence. Since under the current regime of board appointments, in India, the dominant shareholder is in a position to control board

appointments, including the selection of independent directors, any measure of board independence that is based on the number of directors (self) reported as independent would be wrong as those directors, being appointees of the dominant shareholder, would represent their interest in board meetings.

The absence of any significant association between BSP Index and firm performance, observed in our study, leads to the conclusion that the assumption that firm performance can be influenced by structural board related factors is not a valid assumption and points to the fallacy in drawing up and implementing regulatory policy prescriptions for board related structural factors with a view to improving firm performance. Not only is board independence not defined by board structural factors alone, under the current regulations in India the dominant shareholders are in a position to control board appointments as a result of which assessing board independence from the number of independent directors on the board is likely to lead to misleading conclusions.

4. **How independent are independent directors on the boards of Indian companies even after the recent regulatory changes?**

Apart from the basic provisions of the Companies Act, every listed company needs to comply with the provisions of the Listing agreement as per Section 21 of Securities Contract Regulations Act, 1956 and non-compliance with the same could lead to delisting under Section 22A or monetary penalties under Section 23 E of the said Act. Clause 49 of the Listing agreement titled 'Corporate Governance' was introduced by the board of the Securities and Exchange Board of India (SEBI) in 2000 after taking into account the recommendations of the Kumaramangalam Birla committee on corporate governance and has been amended from time to time.

Clause 49 of the Equity Listing Agreement consists of mandatory as well as non mandatory provisions. The mandatory provisions of Clause 49 include provisions dealing with the composition of the board and its procedures viz. frequency of meeting, number of

independent directors, code of conduct for board of directors and senior management, audit committee, its composition, and role, disclosure to audit committee, board and the shareholders while the non mandatory provisions of clause 49 include several board related provisions such as constitution of remuneration committee, training of board members and peer evaluation of board members. While the non-mandatory requirements may be implemented at the discretion of the company, the disclosures of the compliance with mandatory requirements and adoption (and compliance) / non-adoption of the non-mandatory requirements has to be made in the corporate governance section of the company's annual report.

In January 2013 SEBI issued a consultative paper proposing tougher guidelines for listed companies seeking to bring clause 49 of the Listing Agreement into line with the proposals made in the Companies Bill, and to impose a more stringent regime for listed companies, SEBI (2013).

In SEBI's consultative paper, several proposals have been made to address the corporate governance challenges arising from the presence of dominating shareholders in Indian business organizations, for instance, it suggests that independent directors be appointed by minority shareholders, that such directors should be formally trained to be on a company board and regularly evaluated for their performance.

The Companies Act, 2013, which received the assent of the President of India on 29th August 2013, is a reform oriented, governance focused and forward looking legislation that confers greater say in governance to the independent directors while placing greater demand on them in terms of involvement, commitment levels and technical and industry knowledge

For the first time in Company Law, the concept of an independent director has been defined; [Clause 149] and all listed companies are required to appoint independent directors with at least one-third of the Board of such companies comprising of independent directors. The definition of independent directors now includes positive attributes of independence, which was not the case under clause 49 of the Listing agreement and it is prescribed that the candidate must be "a person of integrity and possess the relevant expertise and experience" in the opinion of the board. Independent directors are expected to abide by a code provided in Schedule IV to the Companies

Act, 2013 and hold office up to two consecutive terms with each term being up to five consecutive years; they are eligible for appointment in same company after cooling period of three years. The Central Government is also vested with the power to prescribe qualifications for independent directors and each independent director is also required to declare that he or she meets the criteria of independence. Nominee director appointed by any institution, or in pursuance of any agreement, or appointed by any Government to represent its shareholding shall not be deemed to be an independent director. Only an independent director can be appointed as alternate director to an independent director [first proviso to Clause 161(2)], Companies Act (2013).

In respect of listed companies, the Companies Act, 2013 aligns the concept of board committees, prescribed by SEBI, under the clause 49 of the Listing guidelines, with the Act itself and brings in greater clarity into their roles. Under the new Act, the Audit committee shall consist of a minimum of three directors with independent directors forming a majority and majority of members including its chairperson shall be persons with ability to read and understand the financial statement. [Clause 177(2)]. Additionally, the constitution of Nomination and Remuneration committee, which was non- mandatory under the existing clause 49 and nonexistent under the Companies Act, 1956, has been made mandatory in the case of listed companies and such other class or description of companies as may be prescribed [Clause 178(1)]. The Nomination and Remuneration Committee shall consist of three or more non-executive director(s) out of which not less than one half shall be independent director [Clause 178(1)] and shall formulate the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees [Clause 178(3)]. Also where the combined membership of the shareholders, debenture holders, deposit holders and any other security holders is more than one thousand at any time during the financial year, the company shall constitute a Stakeholders Relationship Committee. [Clause 178(5)], Companies Act (2013).

Prior to the enactment of the new Act, a key criticism of the regime for the appointment of independent directors was that they are appointed like any other director and, given the

significant influence exercised by dominating shareholders on the board of Indian companies, the dominating shareholders were able to pack compliant independent directors on the board of companies who were beholden to them for their position and blindly supported the positions taken by the dominant shareholders- to the detriment of the minority shareholders. While this concern has, to some extent, been addressed in the Companies Act, 2013 by mandating the formation of a nomination and remuneration committee, in the absence of clearly laid down criteria for the selection of independent directors it may be difficult to demonstrate compliance and could result in each company exercising its own judgment which would then become a subject of significant debate.

Any process for appointing independent directors is doomed to failure if it does not remove the influence of the dominating shareholders from the appointment process and while the Companies Act, 2013 provides for the appointment of independent directors by the nominations and remuneration committee - this may not be enough. The nomination committee route, for appointing independent directors, could be effective only in countries characterized by outsider systems such as the U.S. and the U.K. where, since the manager-shareholder agency problem dominates the corporate governance issues, the use of nomination committees moves the independent director nomination process outside the control of management, Varottil (2010). In such a situation when an independent nomination committee picks candidates for independent directorship, it presents the candidate to the shareholders for their vote and since the shareholders are dispersed (as in the outsider system) it is conceivable that they would vote for the candidate presented by the independent nomination committee and are unlikely to come together to vote against a candidate. It has become almost customary for independent directors to be nominated by nomination committees in outsider systems and this practice is widely prevalent in the US and the UK.

On the other hand using the nomination committee route for appointing independent directors in countries, like India, that are characterized by the insider system , is likely to give very different results, Varottil (2010). In the nomination committee route, the appointment of an independent director is a two step process – the first step is the nomination by the nomination committee and

the second step is the election by the shareholders. Even if an independent nomination committee were to nominate candidates, without the influence of the controlling shareholders, those candidates would ultimately have to be voted at a shareholders' meeting, where the controlling shareholders would exercise majority influence. While the nomination committee could manage the first step, it does not have control over the second step and the controlling shareholders would continue to have the ability to influence the shareholder decision on whether the candidate suggested by the nomination committee should be appointed or not. Since it would be an embarrassment if the person nominated by the nomination committee failed to muster enough votes at a shareholders' meeting, due to opposition from the controlling shareholders, the nomination committee was likely to consult controlling shareholders before putting up the names for the appointment of independent directors.

The nomination committee, in the Indian context, would be compelled to function in the shadow of the decision by the controlling shareholder who, because of his numerical superiority, would have the final say on the appointment of independent directors and the independent director appointment process would continue to be within the *de facto* control of the controlling shareholders despite the formation of the nominations and appointments committee controlled by independent directors.

While, the nomination committee process (introduced in the Companies Act, 2013) is superior to the earlier process for appointing directors followed in Indian organizations that functioned without an independent director nomination process, the new provisions do not go to the extent of providing a fool proof mechanism for participation by minority shareholders in the independent director appointment process.

Recognizing the need to adopt a more professional, independent and transparent approach for appointing independent directors, with due representation from the minority shareholders, the consultative paper issued by SEBI in January 2013,also makes reference to the practices followed in other jurisdictions, like Italy, that have provisions for appointment of independent directors by minority shareholders, or the UK, where the regulator has proposed a dual voting

structure whereby independent directors of premium listed companies, with controlling shareholders, need to be approved both by the shareholders as a whole as well as the independent shareholders alone. However, in the Indian context that requires one-third or half of the member of the board to comprise of independent directors, the consultative paper points out that in case, if all the independent directors are to be appointed by "majority of minority", it may result in "abuse by minority", for example, a large corporate firm can easily acquire majority holding among the non-promoter holders (who are normally dispersed) and may appoint "its person" to destabilize its rival board. The consultative paper also points to existing provisions in the Companies Acts, 1956 that protect the interest of small shareholders in electing directors;

- Section 252 of the Companies Act, 1956 enables a public company having paid-up capital of five crore rupees or more or having one thousand or more small shareholders, to elect a director elected by such small shareholders. "Small shareholders" has been defined as a shareholder holding shares of nominal value of not more than Rs. 20,000 or such other sum as may be prescribed.
- Clause 151 of the Companies Bill, 2012 has similar provision enabling a listed company to elect such small shareholders in such manner and with such terms and conditions as may be prescribed.

As per the rules framed under the Companies Act, 2013 a listed company may suo motu or upon receiving notice of not less than five hundred or one-tenth of the total number of small shareholders, whichever is lower, elect a small shareholders' director from amongst the small shareholders. Such director shall be considered as an independent director subject to his giving a declaration of his independence in accordance with sub-section (7) of section 149 of the Act.

While the consultative paper issued by SEBI expresses the view that the provisions of section 151 may be workable in Indian context, it also suggested that it may be explored as to whether listed companies beyond a market cap need to be mandated to have at least one small shareholder director, SEBI (2013).

Further recognizing that cumulative voting by shareholders for appointing the board of directors, as permitted in the Philippines and China, may provide better alternatives to the director selection process and foster stronger minority shareholder protection in India's legal framework for corporate governance, SEBI's consultative paper also reviewed the suggestions for the introduction of cumulative voting or proportionate voting to allow shareholders to cast all of their votes for a single nominee for the board of directors when the company has multiple openings on its board , SEBI (2013). The consultative paper pointed out that there is no empirical evidence to state that cumulative voting has resulted in improving the governance practices and went on to suggest that section 163 of Companies Act, 1956 enabled election of directors through cumulative voting since as per the provisions of this section, the articles of a company could provide for the appointment of not less than two-thirds of the total number of the directors of a public company, according to the principle of proportional representation, whether by the single transferable vote or by a system of cumulative voting or otherwise, the appointments being made once in every three years and interim casual vacancies being filled in accordance with the provisions. Hence, the consultative paper suggested that the option of proportional representation was already provided in the Companies Act and was best left to the choice of the company, SEBI (2013). Since section 163 finds a place in the new Companies Act, 2013 it could be argued that the existing Company Law provisions are adequate to allow proportional representation to the shareholders on the boards of Indian companies.

This argument ignores the fact that the dominating shareholders in Indian organizations have no incentive to incorporate this change, permitting proportionate board representation, in the articles of the company, and the enabling provision will remain as a theoretical provision confined to the statute books only. Real change will happen only when the stipulation for proportional representation, either through cumulative voting or through the voting by only minority shareholders, is made mandatory by statute.

At present, despite the new enactments, given the numerical majority that the dominating shareholders exercise over the company's voting strength, nothing prevents them from appointing their nominee as a shareholder director by following the process prescribed in the

Companies Act and the Rules framed there under and the expectation of genuine small shareholder representation on company boards remains a illusory expectation.

5. Conclusion & the way forward

Greater empowerment coupled with accountability of Independent Director is a step in the right direction to strengthen corporate governance.

The introduction of the new Companies Act, 2013 and the changes that would be introduced, arising from SEBI's consultative paper for listed companies, will undoubtedly usher in much greater transparency in the working of Indian boards especially in respect of the role and responsibility of independent directors who will have a greater voice in ensuring that the interest of all shareholders is taken care of.

Indian corporate governance regulations, in respect of board structure and processes, have been found wanting in addressing issue arising from the presence of dominating shareholders in Indian organizations and the new set of regulations are very welcome in bringing about the much required solution to India's corporate governance woes.

The mandatory requirement for constituting a nominations and appointments committee of the board, with a majority of independent directors, will certainly bring about the much needed transparency and objectivity in the directors selection process. However this may not be enough and there is, probably, a need to look at incorporating stronger mechanism in the statute for the independent director appointment process.

Two alternative approaches have been suggested to facilitate minority shareholder representation on company boards: (i) cumulative voting by shareholders and (ii) election of independent directors by a "majority of the minority, Varottil (2013). The cumulative voting process will ensure that minority shareholders will have the ability to elect such number of independent directors as is proportionate to their shareholding in the company, thereby reducing the

dominance of controlling shareholders in the process. In the alternative approach of voting by "majority of the minority", only the minority shareholders are entitled to vote for the election of independent directors and each independent director will be elected so long as the candidate enjoys majority support within the constituency comprising the minority shareholders. In this approach, neither the controlling shareholder nor the management can influence the appointment as they have no role at all as the dominating shareholders will not even be permitted to vote in independent director elections.

Further concrete action in regulatory reforms is still required in the vital area of independent director appointment before independent directors can become a strong pillar of corporate governance reforms in India as is envisaged in the Companies Act, 2013.

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