Chapter VII

CHANGING ROLE OF BOARD OF DIRECTORS: 
A CASE FOR ITS RESTRUCTURING

The present wave of liberalisation and globalisation has ushered in a shift in the economic scenario from a totally controlled regime to a system of decontrol. The global competition is leading to major industrial growth, diversification, modernisation and expansion of enterprises. This sudden exertion of pressures on public sector enterprises is in a way compelling them to examine their system of governance, adjust their business strategies, improve the quality of decision making, enhance their competitive edge, attempting towards organisational restructuring to cope with the emerging challenges. The changing scenario calls for a new vision, innovativeness, dynamism, proactive role, establishing new linkages, restructured roles of government, enterprise, shareholders, management and customers. The present time is proving to be a test of survival for public sector enterprises to respond quickly to the prevailing global changes.

Changing Role of Public Sector Enterprises

In the Indian context, the present policy of the government pertaining to disinvestment of equity, withdrawal of budgetary support to enterprises, exposure to national and international competition thrusts greater responsibility on the enterprises. The public sector as a whole assumes new responsibilities of:

- Reformulation of objectives in the light of changes in the business environment.
- Adoption of commercial lines of operation.
- Generation of its own internal resources for its continuous growth.
• Development of technology internally or acquiring it from domestic or external markets.
• Enhancement of entrepreneurial skills and competitive abilities.
• Inducing dynamic corporate leadership.
• Ensuring professional management by board of directors.
• Introducing a new work culture in the organisations with the aim of working towards productivity and profitability.

The Confederation of Indian Industry outlines the challenges for the public sector undertakings as:

1. Getting accustomed to withdrawal of budgetary support and special privileges such as purchase preferences and price preferences for purchase by the government or other PSUs.

2. Restructuring and reforming the capital base through financial reengineering that may include upward revaluation of the physical assets.

3. Managing competition from both domestic and foreign producers. This will involve turning out competitive goods and products, customer orientation, after sales service and imaginative marketing.

4. Taking advantage of the ongoing globalisation process in sourcing raw materials from overseas at lower prices, gaining access to cheaper offshore funds, and building up an export base.

5. Cutting down and controlling costs at every level aiming at market price driven costs rather than cost driven price fixation as has been the case so far.

6. Building an overall culture of productivity and productive efficiency at all levels.
7. Identifying redundant man power and appropriately dealing with it through means such as retraining, redeployment, encouraging self employment and providing handsome termination packages through the NRF, etc.

8. Changing over from the regime of distribution of products to vigorous and aggressive selling and marketing involving customer satisfaction and after sales service.

9. Giving due attention to the conditions on the shopfloor and production system, upgrading technology. Wherever necessary ensuring proper working conditions, giving adequate incentives, ensuring adequate quality control and productivity.

10. And above all, managing change as a collective effort involving the management, trade unions, workers and the government.¹

Corporate Governance and Board

Corporate governance in simple terms implies the governing or running of the enterprise by the board of directors. The board is considered the key to good corporate governance. The way the enterprises are governed assumes importance as the effectiveness with which boards discharge their functions determines the credibility and effectiveness of an enterprise. Corporate management assumes importance for both public and private sectors. Hence this concept is neither new nor acquired any sudden ‘novel’ or a special meaning. A closed economy, a sheltered market, limited need and access to global business/trade, lack of competitive spirit, a regulatory framework that enjoined mere observance of rules and regulations rather than realisation of

broader corporate objectives marked the contours of corporate governance for well over 40 years.²

The recent interest about corporate governance is primarily a product of four factors. First, the assertion of rights by the shareholders. Second, the significant presence of foreign institutional investors who are demanding greater professionalism in the management of Indian corporates. Third, there is awareness on the part of lending institutions which are now being subjected to rigorous accounting norms, particularly with regard to income recognition and provisions against non-performing loans. So they are giving much more emphasis to good and efficient corporate governance. Fourth, there is the integration of India into the world economy which demands that Indian industry should play the game by a standard set of international rules, rather than continue their anachronistic practices.³ In general, the principle of governance be it in the public or private sector, makes it obligatory for boards appointed by those who own the corporation to manage it and promote the genuine interests of shareholders whose representatives they are in the company. The recent debate and discussions on corporate governance in India as in other industrial countries is the outcome of the recommendations of the Cadbury Committee constituted in the UK in 1991 to address and report on the financial aspects of corporate governance.⁴ It elucidated on finer aspects of corporate governance and recommended that all major investment/disinvestment proposals, changes in financial and marketing structure, important appointments, and findings of internal auditors to be under the domain of the board. It envisaged that the board would retain full and effective control over the company and monitor the executive management.

² The Hindu. 9 July, 1997.
⁴ It was set up in Britain by the Financial Reporting Council, the London Stock Exchange and the accountancy profession.
The role of the board in corporate governance has been emphasised by the Cadbury Committee as: "Every public company should be headed by an effective board which can both lead and control the business. Within the context of the UK unitary board system, this means a board made up of a combination of executive directors with their intimate knowledge of the business and of outside non-executive directors who can bring a broader view to the company’s activities under a chairman who accepts the duties and responsibilities which the post entails. Test of board effectiveness includes the way in which the members of the board as a whole work together under the chairman whose role in corporate governance is fundamental and their collective ability to provide both the leadership and checks and balances which effective governance demands. Shareholders are responsible for electing board members and it is in their interest to see that the boards of their companies are properly constituted and not dominated by any one individual. All directors are equally responsible in law for the board’s actions and decisions. Certain directors may have particular responsibilities as executive or non-executive directors for which they are accountable to the board. Regardless of specific duties undertaken by the individual directors, however, it is for the board collectively to ensure that it is meeting its obligations."5

The board has a key role to play in the governance of enterprise. The profile of corporate ownership is undergoing change due to influence of factors such as disinvestment by government, participation of foreign institutional investors, entry of multinationals, etc.

**Shareholder and the Board**

The theory behind the constitution and functioning of the board is that because it is elected by the shareholders, it is authorised to govern the company

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on their behalf. In practice, the shareholders owing to their large number have a negligible say in the matters of governance. This is said to be responsible partly for the lack of keen and consistent sense of accountability by the board towards the shareholders. This has been one of the reasons for ineffective corporate governance.

Public sector enterprises being committed to the accomplishment of public policy goals, the commercial viability of its activities had got a back seat all these years. But now its performance measured in financial terms has become vitally important to the nation's economy. The Chairman and Managing Director, SAIL considers that, "In the present competitive scenario, structural changes are required in the public sector. This is so especially with regard to SAIL, where nearly 15 per cent of the equity is held by private shareholders, an element of accountability is to be brought about." The role of the board becomes even more complex as it has to perform a balancing act of reconciling the interests of shareholders and pursuing national objectives.

In Britain the privatisation programme embarked on by the government since 1987 widened the base of share ownership. Along with the shareholders, the institutional investors such as pension funds and insurance companies, have found a prominent place.

The shareholder activism is demanding a different approach in managing the corporations. In Britain the concept of popular capitalism with the people showing enthusiasm in owning shares in state-owned British Tele-Communication, Gas, etc., set a new agenda for its privatization programme. It is based on the premise that people would begin to understand the concept of capitalism and appreciate its benefits only if they are a part of it. In India, this

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6 These views were expressed by the Chairman and Managing Director SAIL (then Vice-Chairman) in an interview given to the researcher on 2 November, 1996, in New Delhi.

concept has not gained much popularity in public sector enterprises. As the Chairman of the Disinvestment Commission points out, "the government has been singularly reluctant to allow representation to non-government shareholders on the boards of public sector undertakings."*

The public sector banks in India have recently taken a lead in expressing their intentions to have shareholder nominees on their boards. Four public sector banks that have diluted the government-stake over the last three years through public issues are set to have shareholders nominees on their board of directors. This includes the Oriental Bank of Commerce, Dena Bank, Bank of Baroda and Bank of India. Among the public sector banks till now, only the State Bank of India that diluted R.B.I.'s stake to 59.73 per cent has shareholders as nominees on the board.9

Transition from Board Management to Board Governance

The board's role is undergoing a transformation. A new wave of thinking that has emerged is the board being assigned the role of governing an enterprise rather than managing it. Governance is different from management. It has two chief elements: overall supervision of management and accountability for the conduct and policies of the organisation to all those who have a stake in it.10 One of the key elements of corporate management is decision making. The model of governance in enterprises has been one in which the senior managers have been responsible for decision making. There was not much involvement of shareholders in this process. Now a change of scenario is visible with boards,

8 Economic Times. 5 June, 1997. The Disinvestment Commission has been stressing the need to give representation to the non-government shareholders on the boards of PSUs. In its third report on disinvestment submitted in May 1997, it recommended that in order to improve the investor perception of PSUs and to enhance share value in subsequent disinvestment, it is necessary for the government to induct immediately representatives of non-government shareholders into the board of directors. (Disinvestment Commission Reports I-IV). New Delhi. 1997:148.

9 Financial Express. 4 September, 1997. The dilution of government stake in these four banks is as follows. Dena Bank (70.99 per cent), Oriental Bank of Commerce (66.48 per cent), Bank of Baroda (66.22 per cent), Bank of India (76.53 per cent).

managers and shareholders having to cooperate in the task of decision making. The emphasis being laid increasingly on corporate democracy seeks involvement of the three critical players; directors need to help managers arrive at best possible decisions, while major shareholders should be able to give feedback to the board on the company's policies and decisions.

John Pound makes a distinction between board management and board governance.11

<table>
<thead>
<tr>
<th>Board Management</th>
<th>Board Governance</th>
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<td>1. The role of board is to hire, monitor and replace management whenever necessary.</td>
<td>1. The role of board is to foster effective decisions and reverse bad policies.</td>
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<td><strong>Characteristics</strong></td>
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<td>Here there is sufficient power to control the Chief Executive Officer and the evaluation process.</td>
<td>Here there is adequate expertise which adds value to the decision making process. It has sufficient incentives to ensure the commitment of board towards creation of corporate value.</td>
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<td><strong>Policies</strong></td>
<td><strong>Policies</strong></td>
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<td>There is separation of the CEO and the chair and a committee of independent directors to evaluate the CEO. Explicit yardsticks are laid down for judging the performance of CEO.</td>
<td>It requires representation in required areas of expertise like core industry and finance. It ensures regular meetings with large shareholders.</td>
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Governing the enterprises through the board also calls for distinct processes as shown below.\textsuperscript{12}

**GOVERNING THROUGH BOARDS**

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<tr>
<th>Identify potential directors to represent all stakeholders</th>
<th>Nominate and elect them to the board for a stipulated term</th>
<th>Organise the board to discharge its assigned duties efficiently</th>
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<td>Establish criteria for measuring the board's procedures</td>
<td>Evaluate efficiency of feedback processes from pay to shareholders</td>
<td>Collect regular feedback on the board's performance</td>
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**CREATE THE BOARD**

**ASSESS THE BOARD’S PERFORMANCE**

**EMPOWER THE BOARD**

**HAVE MANAGEMENT PERFORMANCE MONITORED**

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<th>Review issues of power-sharing between the board and the CEO</th>
<th>Establish areas of separate and common functions and duties</th>
<th>Determine criteria for the board to measure the company's success</th>
<th>Allow board to approve selection of CEO and top managers</th>
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<td>Set up processes for information transfer to the board</td>
<td>Establish control and reporting mechanisms for the board to use</td>
<td>Ensure presentation of relevant information whenever necessary</td>
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In the context of the changing role, the boards are expected to discharge a set of functions which many enterprises till now have chosen not to expect or comprehend.

The board is said to adopt a “detached approach.” Its function is in terms of “overseeing management, reviewing performance and ensuring that the activities of a company are socially responsible and in compliance with the law.”\textsuperscript{13}

Another school of thought emphasises on a proactive view of the board’s role. The function of the board is considered to be establishing strategic direction and overseeing company strategy, assessing and monitoring performance and

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\textsuperscript{12} Business Today. 7 May, 1997:66-67.

especially in the case of executive directors becoming involved in action to ensure implementation.14

According to a report by Oxford Analytica (1992), "internationalisation of business will multiply the demands placed on management. Management will be forced to become flexible and less hierarchical as well as more specialised. This is likely to create pressures and demands on the corporate board of directors. In particular, boards will need to show a high degree of professionalism, greater degree of familiarity with the functions of management, specifically financial, production, marketing and research and development. Boards will also demonstrate adherence to strict ethical standards and codes of conduct and increased familiarity with international markets. Boards will also become more reliant in independent external consulting and support services. This will include independent information on management performance and international business conditions, independent corporate assessment services related to financial as well as more general aspects of corporate performance."15

In a workshop for chief executives when asked what were the biggest business challenges, the top ten were named as:

i) The global market place.
ii) Liberalisation and competition.
iii) Need for differentiation and focus.
iv) Pressures on management.
v) Scarcity of right human resources.
vi) Delivering quality.
vii) Ever more demanding customers.
viii) Managing international team work.
ix) Information technology.

x) Transitional organisation.  

The increasing challenges of business and competition requires the top management to

- comprehend the intricacies of the business the company is operating and likely to enter;
- formulate the long-term vision of the enterprise;
- communicate to all in the organisation the mission of the enterprise and related goals to be achieved;
- exhibit the required tact and sensitivity in dealing with people and teams in the enterprise;
- emphasise self-development to cope with situations of change, diversity and complexity;
- implement policies and strategies through people in the organisation.

The Managing Director of a Steel Plant in SAIL considers that "The institution of Board of Directors requires clear definition of vision and building of strategies to achieve the vision with speed."  

Top management needs to

- understand their business intimately;
- form a vision as to the shape and direction of the function or organisation for which they are accountable;
- communicate clearly the mission of the organisation and objectives to be achieved;
- display tact and sensitivity in managing people and teams;
- work under pressure in situations of diversity, complexity and change;
- implement ideas, policies and activities through individuals and groups;
- concerned about their own development.  

The changing role of the board envisages discharge of functions like

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17 These views were expressed in an interview given to the researcher on 6 September, 1997 in New Delhi.
• Providing direction to the enterprise.
• Designing strategies of innovation.
• Organisation restructuring/redesign.
• Strategic management.
• Stakeholder management.
• Evaluation, monitoring and improvement of performance.

The board is expected to provide direction to the enterprise instead of concentrating on its management. A distinction between the roles of managers and directors is advocated. The directors in the capacity of thinkers are expected to discharge the onerous responsibility of long-term planning, tackle problems of different dimensions, accountable to a variety of stakeholders and need to exercise the task of direction which is crucial to the enterprise. This facilitates providing long-term vision and commitment to the enterprise and deciding on the strategies, plans and policies for implementing these. There is a perceptive change in the role of the board to be direction oriented relegating the task of managing to the management of the enterprise. As aptly observed, “the Chairman needs to observe the distinction between the role of the board and the role of the management as vigorously as he can.”19

The board needs to monitor the implementation of plans, policies and strategies. Only then is it possible for the board to relate the achievements and performance with the mission of the enterprise and initiate the necessary action to maintain performance at a particular level.

**Improving Board Effectiveness: A Global Perspective**

The breadth of challenges before today’s board of directors is extensive. There is a wide ranging debate on the need to have effective boards, which are clear-sighted, proactive, vigilant, accountable, committed to fair play, shareholder concern and long-term goals. There have been serious concerns raised globally about strengthening the boards, enable them attain a stature of proficiency to

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question the decisions taken by it, to enquire into the intentions behind it rather than endorsing it in blind faith. The 'group thinking', a characteristic of the board is being subjected to criticism. This tendency of group thinking that prevails in the boards is considered to be a pathological state which is often responsible for the poor quality of decision making by the board. This frequently leads to negative factors being overlooked and also to a lack of vigilance. It is based on "an illusion that unanimity in the director's decision means truth." The 'dissenting role' of the board is viewed as making a positive contribution to better decision making by forcing a thorough examination of the proposal being advocated.20

An effective board is one that discharges its collective duties, responsibilities and accountabilities, provides direction and purpose, 'develops the business' and 'makes things happen'.21 "Boards of directors, particularly of the private sector are making efforts towards improved governance, and become 'effective' in the true sense. Effective boards are not endorsing CEOs decisions blindly; they are questioning those decisions to find out both the intent behind them and the results that they produce. Effective boards are not eliminating corporate strategy from concerns; they are auditing them for appropriateness. Effective boards are not accepting managerial appointments and remuneration packages blindly; they are probing them for rationale and requirement. And above all, effective boards are not taking a back seat while CEOs run their companies like despots, benevolent or otherwise; they're involving themselves in operations."22

The question arises as to how to make the boards effective. Certain prerequisites are considered necessary for making the boards effective and cope with their new role. These include:

• Able executives and non-executives chosen on merit.
• Well constructed agendas, supported by adequate and timely information.
• Style of conduct of business which encourages all to have their say which is clear.
• Decision making process which is clear, brave and robust.\textsuperscript{23}

The issue of improving the effectiveness of boards thereby affecting the total corporate governance of enterprises has resulted in some countries making efforts to examine certain aspects of board management.

In Britain, the concern about corporate governance in the private sector led to the setting up of a committee examining the financial aspects of corporate governance headed by Adrian Cadbury. Its recommendations included (i) separation of positions of chairman and chief executive (ii) where the positions are combined, there should be independent non-executive directors on the board (iii) there should be an audit committee consisting of at least three non-executive directors (iv) there should be a nomination committee to make board appointments (v) pay of executive directors should be subject to the recommendations of the executive committee (vi) non-executive directors on the board should not be related to those in management (vii) items reserved for board decision must be clearly specified.\textsuperscript{24}

A similar attempt at improving the area of corporate governance in South Africa led to a committee set up by the Institute of Directors headed by Meriyn King. It recommended that “(i) the boards should be balanced between executive and non-executive directors, (ii) roles of chairperson and chief executive officer should be split and in the absence of a split, there should be at


least two non-executive directors, (iii) director's report should incorporate statements on their responsibilities (iv) shareholders should properly use the meetings by asking questions on the accounts for which forms should be provided in the annual reports (v) corporates should have an effective internal audit function and establish an audit committee with written terms of reference from the board."

In Canada, a recently published guide for crown corporations summarised the complex role of the board as to "oversee the corporation on the crown's behalf by holding management accountable for the company’s performance, its long-term viability and the achievement of its objectives." The structures whereby the boards carry out this function are set out in the legislation, the Financial Administration Act which governs all crown corporations and the specific legislation if any under which the individual corporation was established.

In the USA also, the California Public Employees Retirement System (CALPERS) over the past decade has been in the vanguard of a new army of activist investors forcing the boards of under performing companies to act more drastically with their problems. It has recently tried to prescribe a new model of board room behaviour. Its aim is to "proactively identify those characteristics of a corporate board that will best enable the corporation to survive and thrive in today’s increasingly competitive global environment."

The guidelines focused on board independence and leadership, board process and evaluation. These included:

**Board Independence and Leadership**

Fundamental:

* The majority of directors should be independent.

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• Audit, compensation and other key committees to comprise only independent directors.

• Directors should not be given retirement benefits.

• Independent directors to meet stringent independence tests and serve no more than ten years.

Ideal:

• At least 50 per cent of director’s compensation paid in stock.

• Chief executive to be the only executive on the board.

Board Process and Evaluation

Fundamental:

• Government principles should be written down and re-evaluated every two years.

• Establish performance criteria and incentive for the chief executive.

Ideal:

• Set up formal communication with shareholders outside annual meeting.

• Periodically review size of board.

Individual Directors

Fundamental:

• Establish criteria to make sure directors do not serve on too many boards.

• Set age - criteria for directors.

Ideal:

• No directors should sit on more than three boards.

• A retiring chief executive should not stay on the board.
• No more than 10 per cent of directors should be older than 70.27

In India in the light of privatisation and liberalisation of the economy exhaustive discussions and debate are taking place on the need to bring about a clear and better corporate governance. The Disinvestment Commission noted that a majority of investors attach considerable importance to the quality of corporate governance in a company and are even willing to pay a premium for better managed companies. Hence it recommended that the public sector undertakings should be restructured in terms of corporate governance prior to disinvestment.28

The Confederation of Indian Industries (CII) also examined the system of corporate governance and brought out a report titled “Desirable Corporate Governance in India : A Code,” which is considered to be the first of its kind on the issue of corporate governance. It outlined a code the provisions of which include:

• The full board, which should be single-tiered should meet at intervals of two months and at least six times a year.
• The non-executive directors should comprise at least 30 per cent of the board if one of them is the chairman.
• The non-executive directors should comprise at least 50 per cent of the board if the chairman and the managing director is the same person.
• No individual should be a director on the boards of more than 10 companies at any given time.
• Non-executive directors should be active, have defined responsibilities and be conversant with profit and loss accounts.
• Non-executive directors should be paid commissions for their professional inputs besides their sitting fees.
• Directors who have not been present for at least 50 per cent of board meetings should not be reappointed.
• The board should be informed of operating plans and budgets, long-term plans, quarterly divisional results and internal audit reports.

• Details of defaults, payments for intangibles, foreign exchange exposure and managers' remuneration should be reported to the board.
• An audit committee, comprising at least three non-executive directors should be set up and given access to all financial information. Data should be provided in the annual report on monthly average share prices, value added and the financial performance of divisions.  

The Unit Trust of India (UTI), a government owned financial institution, had also drawn up a formula for ushering in good corporate governance where it is a major shareholder. It favoured:

• Induction of more independent directors. The executive directors should not be appointed by the principal promoters alone.
• Revamping of audit committees including only non-executive directors to make them truly independent.
• Making the board more relevant. All important corporate decisions to be discussed by the board to bring greater transparency to corporate governance.
• Scrutinising executive pay packages.
• Better monitoring of investments in subsidiaries.  

The Disinvestment Commission in its report on corporate governance and autonomy made a plea for the board of public sector undertakings to be the final forum for all corporate decisions. It recommended:

• Professionalising the Board

The government is to initiate necessary steps to select experts and professionals from outside the government as non-executive directors on the boards of public sector undertakings.

• Provision for Elected Directors

The government would need to recognise the role of the legitimate institutions of corporate governance such as the boards and the general body

meetings of the shareholders. The commission has been of the opinion that the composition of the public sector undertaking should also reflect the changing pattern of shareholding and in the interest of efficient management of undertaking should enable election of directors who would represent the minority shareholders in the undertakings. The election of employee representatives on the boards should be introduced in proportion to the extent of employee shareholding.

- Selection of Top Management

This, according to the commission, is to be streamlined and time bound.31

Key Issues in Restructuring of Boards of Directors

The efforts launched globally at improving the governance of enterprises brings out the need for effecting restructuring of boards of directors, a critical component of corporate governance. What are the key issues of restructuring?

- Unitary Vs. Two-Tier Board

In any discussion of restructuring of boards of management, a distinction between unitary and two-tier boards assumes importance. The only board that prevails in contrast to the typical unitary board is the two-tier board functioning in countries like Germany, Hungary, Netherlands, Poland and the Ukraine. Countries such as France, United Kingdom, Italy and Romania have a unitary board structure. The two-tier board functions primarily on the basis of the principle of separation of function of supervision from management. There are two types of boards: a supervisory board that oversees the direction in which the company is moving and a management board that is entrusted with the responsibility of running the business. The supervisory board exercises its control over the management board through its power of appointing the

31 Disinvestment Commission. op.cit. : 29.
members of the management board and its right to have the final say on major decisions affecting the company.

The unitary board comprising the executive and non-executive or outside directors has the sole responsibility of initiating policies and their implementation. In a way it is the repository of control of every aspect of the activities of the company. In a two-tier board, while the supervisory board is primarily a monitoring body that supervises the activities of the management board, it is the management board which initiates the company's plans and policies. The supervisory board can comment or provide alternatives to the plans put forward by the management board.

The meetings of the unitary board are held frequently and the collective energies of all the board members can be focused on the company's growth and performance. This is not so in case of two-tier boards, especially the supervisory boards which generally meet at quarterly intervals. This is said to limit their ability to exert a positive influence on the management board and the company's operations.

The relative infrequency of board meetings and separation of responsibilities between the two boards is said to limit the opportunity for constant interaction between the two boards necessary for the development of strategic plans and policies. This is not a limiting factor in case of the unitary board where the policies are developed through constant interaction and dialogue between the board and management.

The only striking/significant feature of the two-tier board is the independence of the supervisory board which facilitates the task of monitoring. The members on the supervisory board have the authority to exercise control over the management proposals as their concurrence is essential for their implementation.
The preference indicated for a supervisory board over a unitary board is attributed to certain reasons.

i) It is easier to set out clear legal obligations and requirements between the executives and non-executives when there are two separate board organisations.

ii) The argument against a two-tier system is that it is unnecessarily bureaucratic. There is virtually a de facto two-tier board system anyway already in many companies in the UK and the board committee structure that has come into vogue has already introduced an element of bureaucracy. Two focused boards with their separate roles spelt out are more manageable.

iii) Supervision can best be carried out by interested parties such as the shareholders, rather than by disinterested outsiders.

iv) The separation of the roles of chairman and CEO is smoothly handled.

v) It affords stability in the face of takeover bids.

vi) Separating the shareholders from the managers makes the role of management easier and more clear cut.\textsuperscript{32}

Irrespective of the structure of the board, what really counts is the way boards work. Unitary boards have shown themselves capable of directing businesses competently, of setting high standards of conduct, of being responsive to shareholders and of taking account of society's needs. To do all this, they have to be properly led and have committed directors on them who can give enough time to meet the demands imposed by the task of directing a

\textsuperscript{32} Thomas Sheridan and Nigel Kendall, op.cit. : 161.
business effectively. The choice between a unitary or two-tiered board structure depends on the characteristics of the country and governance preferences.

The structure of the board assumes importance in assessing the effectiveness of boards. What really matters is the competence the board possesses in pushing the business forward and its capacity to assert itself in times of need. But if they fail the acid test the saying 'no test' - they are not really boards at all but advisory committees. The acid test sounds negative, but it is based on an important principle that of reciprocal respect - the only people in a position to judge whether the board passes the acid test or not are its members.

- **Outside/Non-Executive Directors**

A legacy of license raj in India that still has not enabled public and private sector enterprises to get away is the predilection for appointing government officials and former bureaucrats on the board. It is increasingly being realised that the interests of boards will be served better by having along with full-time directors, external professionals whose expertise would match the requirements of the company. The practice of having outside/non-executive directors prevails in many developed countries like the UK, USA, Germany and Japan.

Hugh Parker, who examined the board room effectiveness over many years in the US, UK and Europe questions the efficacy of the board which is wholly constituted of executive directors (insiders of the company). He observes, "a board consisting wholly of executive managers will understandably be preoccupied with the day-to-day problems of running the business." Parker recommends the inclusion of non-executive directors to make the board

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33 Adrian Cadbury. op.cit. : 69.
34 Dominique Pannier. op.cit. : 16.
35 Jonathan Charkham. op.cit. : 268.
36 In the UK, directors who are on the board as experts from outside the enterprise are called non-executive directors. In the USA they are termed outside directors.
balanced and effective. He has specified three roles for non-executive directors. The first and foremost is to bring to the deliberations of the board a measure of independence and objectivity. Another is to provide special skill or expertise that may be lacking on a particular board. A third role that has taken on growing importance in the US and is likely to do so in others, is to serve on special committees to which executive directors cannot be appointed on grounds of perceived self-interest.37

As discussed earlier, a view prevails, that it is in the interests of the enterprise for the board to imbibe a detached approach in its discharge of overview and monitoring functions. It emphasises that the members of the board should be detached from operations. The board is considered to be stronger and effective if it is genuinely an "outsider" board, the bulk of whose members have never served as full-time officers of the company. The general tendency prevalent amongst the full-time members is "to think too much in terms of immediate or technical problems."38 This to a certain extent can be warded off by the induction of outside directors. It is said that, "What is needed on a board is not people who agree with management anyhow, but people who are likely to see things differently, to disagree and to question the assumptions on which the Chief Executive’s team acts without usually knowing that it is making them."39

The independence and objectivity of the board is said to be best ensured when the majority or at least a reasonably large component of directors are those who are independent of control by the government of managerial interests in the company.

38 Peter Drucker. The Practice of Management: 180.
39 ibid. 181.
The movement towards a greater proportion of “outside” directors on the board got a fillip in the late 1970s, especially in the USA, as a result of some cases of executive malfeasance by the executive directors.

An outside director is generally considered as one who has no business connections with the company. The need for having a proportion of outside directors on the board is to enable the company to use their expertise in directing the company rather than its day-to-day management. The advantages of having outside directors are to enable them to discharge the function of assessing the company’s performance and actions of board in achieving the aims of enterprise. The objectivity of outside directors is said to facilitate the appraisal process. This process of appraisal and monitoring ensures better accountability of the board. How effective these directors are can be assessed from what happened at Compaq, the American Computer manufacturer a few years ago. When the company’s profits began to dwindle, the chief executive gave an assessment that the setback was purely temporary and no drastic change in strategy was called for. The non-executive chairman of the company board, however, disagreed. He successfully persuaded the board to replace the chief executive with someone who thought that a major restructuring was essential. Compaq went on to become the largest personal computer manufacturer in the world. This shows what the non-executive directors are capable of if they have the company’s business interests in mind.

At the other end, we have a typical example of the public sector enterprise Air India, where the experiment of part-time chairman and a full-time Managing Director was tried out. The part-time chairman was inducted from the private sector, the expertise of whom was expected to facilitate the effective management of the airline. This experiment did not yield fruitful results due to the government’s frequent interference and lack of sufficient autonomy that hindered the exercise of the necessary initiative by the part-time chairman. Non-

40 *Business India*. 18 November - 1 December, 1996 : 59.
executive directors’ expertise can be of real value to the enterprise, provided there are no deterrent factors affecting it.

In the UK, way back in 1973, the conservative government convinced of the desirability of appointing non-executive directors, made a plea for their appointment to company boards. The Confederation of British Industry (CBI) in 1973 agreed that the appointment of non-executive directors would be ‘highly desirable’. They would exercise an independent and objective approach to corporate policies and bring to the company the benefit of their wider knowledge and experience.41

PRONED42 even formulated a Code of Recommended Practice on Non-Executive Directors. It defines an independent ‘non executive director’ as one who has integrity, independence, personality and experience to fulfil the role of a non-executive director effectively. As a guideline, the code suggests the duties and responsibilities of a non-executive director should include the contribution to an independent view of the board’s deliberations; to help the board provide the company with effective leadership; to ensure the continuing effectiveness of the executive directors and management and to ensure high standards of financial probity on the part of the company. They were to be appointed for a specific term and subject to a reflection by rotation.43

One of its recommendations has been for companies to appoint non-executive directors to their boards. It believed that their ‘independent judgement’ and monitoring of corporate performance strategy will raise standards of good corporate governance. It recommended that the calibre and number of non-

42 PRONED (Promotion of Non-Executive Directors) is an association that was established in Britain under the sponsorship of a group of institutions representatives of industry and finance led by the Bank of England. It exists to promote recognition of the crucial contribution which outside directors of the right kind can make to company boards, to help companies and fund appropriate candidates for such appointments.
executive directors on the board should be such that their views should carry sufficient weight in the board’s decisions.

A question that arises which is equally important is whether the role of non-executive directors is restricted to providing expert advice to the board or are they a party to the decisions taken by the board? In the UK and USA the executive directors are liable for any negligent act and can be sued by individual shareholders. In India also this has been a subject of debate.

In 1949, the Calcutta High Court ruled that, “If directors who are responsible for the management of a company and who presumably know the duties imposed upon them by law, make no attempt to see that those duties are carried out, there is justification for holding in my opinion, that they have wilfully and knowingly permitted the company to fail to carry out those duties. The suggestion that these various directors were mere figureheads not taking any active part in the control of the company, is in my opinion, not worthy of serious consideration. They were directors, they attended meetings throughout the period with which we are concerned and they were responsible for the company. There was nothing, so far as we know, to prevent them seeing that the duties imposed by the company were properly carried out.”

By a ruling in a similar case in March 1977, Justice Anand virtually overturned this precedent and in doing so, gave a new meaning to the position of nominee and non-executive director. “It cannot be denied that independent directors from the professions or from the financial consultants or those that represent different interests such as the financial institutions, have a salutary effect on the management of a company in spite of the various legal constraints and limitations and if such a distinction is not made, it is likely to scare such persons away from any possible association with the company as directors. It is unreasonable ‘to fasten liability’ on directors for the defaults and trenches of

44 Business India, op.cit. 59.
a company where such directors are either the nominee directors or are appointed by virtue of their skill or expertise."45

- Code of Conduct

There is an increasing trend of formulating a code of conduct for boards to ensure better governance. The board is said to exhibit the moral responsibility of ensuring proper use of funds at its disposal as well as justify its actions and methods for achieving the results. This calls for quality in corporate behaviour.

In the UK, for effective corporate governance, the Cadbury Committee has evolved a code of ethics known as the 'Code of Best Practice'. The code is designed to achieve the necessary high standards of corporate behaviour. The principles on which the code is based are those of openness, integrity and accountability.

Openness: An openness is required to ensure that all interested parties are confident in the organisation. Being open in the disclosure of information leads to effective and timely action and lends itself to necessary scrutiny.

Integrity: It includes straightforwardness and completeness. It needs to be reflected in the honesty of an organisation's annual report and its portrayal of a balanced view. The integrity of reports is said to depend on the integrity of those who prepare and present them, which is a reflection of the professional standards within the organisation.

Accountability: This is the process whereby individuals are responsible for their actions. It is achieved by all parties having a clear understanding of those responsibilities and having clearly defined roles through a robust structure.46

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45 Business India. op.cit. 59.
This code in Britain is directed to the Boards of Directors of all listed companies which are expected to state whether they are complying with the code and give reasons for non-compliance. This requirement is aimed to enable shareholders to know where the companies in which they have invested stand in relation to the code.

In Malaysia, the Registry of Companies, Ministry of Domestic Trade has evolved ‘Company Director’s Code of Ethics’ to enhance the standards of corporate governance and corporate behaviour with a view:

1. To establish standards of an ethical code for directors based on acceptable beliefs and values one upholds.

2. To uphold the spirit of social responsibility and accountability in line with the legislation, regulations and guidelines governing the company.

The principles on which this code relies are those that concern transparency, integrity, accountability and corporate social responsibilities. In the performance of his duties, a director is expected to observe the standards laid down in the code.47

In the Indian public sector also, the need for having a code of ethics covering both the enterprise and the concerned administrative ministry is being felt. The chairman PESB comments that, “There are two key factors for the professionalisation of board of directors: (i) intellectual integrity and (ii) financial integrity. The directors advancing their own interests being on the board would jeopardise the objectives of public enterprises. Evolving a code of ethics begins the process of cleansing the public sector.”48

47 K.R. Chandratre. op.cit. : 507.
48 These views were expressed in an interview given to the researcher by the Chairman PESB on 25 March, 1997, in New Delhi. Incidentally, these views found effect in the report of the Committee for the Review of Guidelines for Public Sector Enterprises headed by the Chairman PESB in August, 1997.
The Committee for the review of guidelines for public sector enterprises in its report submitted to the government on 29 August, 1997, has incorporated the Code of Ethics for public sector undertakings and administrative ministries. This is designed to supplement and complement rules and regulations regarding conduct, discipline and appeals and ensure good corporate governance. The code suggests that the enterprises, as well as officers in the administrative ministries dealing with them, distance themselves from the interests of the political establishment of the day. The section of the code "conflict of interest and peer pressure" calls upon the PSE employees to refrain from decisions which could result in benefits to a particular person or party at the expense of public interest. In the event of a conflict, the code specifies that the officials concerned should disclose it to the superiors.49

- Training/Developing Directors

There is an increasing need to have not just a board of directors but an acceptable best board which is a source of leadership and strength to the company.

The complexities of the job of a director of the board, especially in the present times, leads to the question of the 'development of board members' for better board membership. In general, directorship on a board is considered as one that is just picked up as one moves along the ladder. The job of a director is not merely confined to the discharge of minimum legal and financial accountabilities. These are generally defined by the legislative and regulatory framework within which the company has been incorporated. A board that concentrates solely on a narrow legal interpretation of its responsibilities is likely to fail in the marketplace, as it has to meet the expectations and requirements of numerous stakeholders who have an interest in the company.

In addition to legal duties and responsibilities bestowed upon them, directors have a plethora of other functions to perform. They need to develop the vision and mission of the enterprise, strategic decision making, business/commercial awareness, customer orientation and so on. There is need to prepare them appropriately on assuming the position of board member and make them up to date with the best practices of governance.

In India, although the Companies Act, relevant Memorandum and Articles of Association of companies prescribe the powers and responsibilities of directors, no mention is made about the functions of directors in governing the enterprise. It is generally assumed that the skills of a director are a natural development as those of a manager. This is not true as there is a tremendous difference in the tasks of managing and directing. A good manager need not necessarily prove worthy on the board.

Britain has taken a lead in this aspect in their professional associations laying down guidelines for directors for the proper discharge of their responsibilities. The Institute of Directors published a document entitled “Guidelines for Directors”, which is essentially a set of recommendations on good board room practice. It considered that a board of director’s responsibility was for determining the company’s strategic objectives, ensuring that the company operated to satisfy the customers and all the providers of the resources necessary to achieve those objectives. The main functions of the board in carrying out its responsibilities to the company were to ensure a necessary balance between the interests of shareholders, employees, customers, suppliers and community. The board must ensure that the company reviewed its business plans in the wider context embracing the interests of all concerned.50

The Business Round Table (USA) in 1978 summarised the basic responsibilities of the board of directors, as to select the CEO and his/her

principal management associates. A corollary function is to replace the managers who do not perform the expectations of the board.

Second, the board is accountable for the financial performance of the enterprise. It is not in a position of course to conduct the day-to-day operations of the company, but it is responsible for continuously checking on corporate financial results and prospects. The board should consider and act on many major commitments of corporate resources. It should consider corporate strategic plans and major strategies to be pursued by the company.

Third, it is the board’s duty to consider the overall impact of the activities of the corporation on the society of which it is a part and the interest and views of groups other than those immediately identified with the corporation. This obligation arises out of the responsibility to act primarily in the interests of share owners, particularly their long range interests.

Finally, the board should see that policies and procedures in the corporation to promote compliance with laws on a sustained and systematic basis at all levels of operating management.51

The growing technical and managerial complexities of running an enterprise and expansion of markets, calls for intense specialisation not only in processes of production and distribution but also in areas like human resources, marketing, finance, etc.

- **Boardroom Appraisal**

This is another issue that is being debated as one of the key elements of corporate governance. Board room review or appraisal relates to assessing how far and how effectively the board has carried out its functions. This facilitates better learning from the past to be able to do better in the future. It is the board in

determining how well it has fulfilled its responsibilities, will need to assess how far it has maintained the momentum of the business and how well it has balanced the needs of the future against the needs of the present.52

The board room review has the following goals:53

i) To measure the company’s structure of governance against its business objectives and to ensure that it has the right structure for its current situation and circumstance; there is no one structure; it depends on the time and situation.

ii) To ensure that the board(s) has (have) the right balance.

iii) To ensure that the structure of governance conforms not only with legal and regulatory requirements, but it is also in accordance with best practice.

iv) To plan board room development in accordance with the foreseen development of laws and regulations.

v) Above all, to make sure that the whole structure of governance, present and planned is in the best interest of the company and its stakeholders.

Board room appraisal enables the board as a whole and the directors individually to reflect upon their actions. Peter Drucker once wrote that priorities were easy, but it was posteriorities -what jobs not to tackle - which were tough.54 The board needs to appraise its choice of priorities and posteriorities. This appraisal brings to light the constraints the board faces, changes sought in board procedures, vision of the enterprise, strategies being adopted, especially in relation to its competitors, etc. The chief executive of the enterprise can play a

52 Adrian Cadbury, op.cit.: 39.
53 Thomas Sheridan and Nigel Kendall, op.cit.: 219.
54 Adrian Cadbury, op.cit.: 38.
vital role in assessing the review of individual board members. But a better way would be to carry out this task through consultants.

Any evaluation would be useful if done for the board as a whole and for individual directors. But it needs to be based on consistent and objective standards.

- **Autonomy**

Another key prerequisite needed for an effective board is autonomy for day-to-day operational management and also in decision making. While it is needed in case of private sector boards to function freely from the fetters of management, with regard to public sector enterprises it is essential to emerge from the clutches of the government. These enterprises are treated as the hand maidens of vested interests such as politicians and bureaucrats.

The Indian public sector is being pulled apart by the government exercising its control through various agencies like Comptroller and Auditor General, Central Vigilance Commission, Parliament and so on. This control which hangs over the public sector enterprises as Damocles’ sword does not ensure effective decision making, as every decision taken by the board has to weighted against innumerable consequences.

This aspect of managerial autonomy is peculiar to the public sector. The present liberalised environment calls for developing required freedom in various areas like financial, personnel, construction management, etc.

Autonomy with an inbuilt accountability mechanism can prove an aid to effective corporate governance.

**Restructuring Public Sector Board: The Case of Navaratna Boards**

The continuing debate about the privatisation of the public sector taking place and the various methods that have been made accessible in the recent
past led to the Government of India making efforts towards restructuring the public sector boards of directors. The Government in June 1997, had decided to grant financial and functional autonomy to nine select public sector undertakings. This has been in tune with a commitment made by the government in the common minimum programme of identifying public sector undertakings with growth potential and turning them into global giants.

The government has defined a global company as one:

- with huge size (in terms of turnover, assets, profits and capacity);
- which have made their presence abroad in terms of exports or a share of overseas markets; and
- possess the ability to compete with other multinational corporations either in India or in neighbouring countries.

This has been considered by the government as one of the steps towards public sector reform that will act as the basis for further restructuring. The nine enterprises are those select companies whose performance over the past five years has been high in terms of sales, profits and turnover. These include (1) Indian Oil Corporation (IOC) (2) Hindustan Petroleum Corporation Limited (HPCL), (3) Bharat Petroleum Corporation Limited (BPCL), (4) Oil and Natural Gas Corporation Limited (ONGC), (5) Indian Petrochemicals Limited (IPCL), (6) Steel Authority of India Limited (SAIL), (7) Bharat Heavy Electricals Limited (BHEL), (8) National Thermal Power Corporation Limited (NTPC), (9) Videsh Sanchar Nigam Limited (VSNL).

The Salient Features of Navaratna Package

- **Financial Powers**

  During the budget presentation, the government allowed public sector undertakings with a gross block of Rs. 500 crore to incur capital expenditure upto...
Rs. 100 crore without the approval of the government. This ceiling of Rs. 100 crore does not apply to Navaratna enterprises. They have been granted the freedom to incur all capital expenditure without any monetary ceiling.

The raising of debt from the domestic capital markets and for borrowings from the international market is subject to the approval of the Reserve Bank of India/Department of Economic Affairs as may be required and should be obtained through the administrative ministry.

The Navaratna public sector enterprises are exempted from seeking clearances from the Public Investment Board, the cabinet or the cabinet committees for capital expenditure incurred on new projects.

- **Operational Freedom**

The Navaratnas are to enter into technology joint ventures and to obtain by purchase or other arrangements technology and know-how. The freedom to establish financial joint ventures and wholly owned subsidiaries in India or abroad has been granted to these public sector undertakings with certain stipulations. They are, the equity investment of the public sector undertaking is to be limited to:

1. Rs. 200 crore in any one project.
2. Five per cent of net worth of the PSU in any one project.
3. 15 per cent of the net worth of the PSU in all joint ventures/subsidiaries put together.

- **Human Resource Development**

These enterprises have been given the autonomy to structure and implement schemes relating to personnel and human resource management,
voluntary or compulsory retirement schemes. Also, they can effect the organisational restructuring including establishment of profit centres, opening of offices in India and abroad, creating new activity centres, etc.

• Corporate Boards

The Navaratna boards are to undergo restructuring with induction of eminent non-official part-time directors. At least one third of the board of directors are to be non-executive directors. Each of the Navaratna boards is to induct initially at least four non-official directors who have an "impeccable stature and background." Those undertakings with a very large number of functional directors can have more non-official directors. Within six months of their induction, the number of non-official directors is to be increased to constitute at least one-third of the board’s total strength.

The restructuring of the boards of the Navratna enterprises through the induction of outside professionals as part-time directors has been stipulated by the government as a prerequisite for enjoying the managerial and financial autonomy. A beginning has been made by providing for appointment of non official directors in BHEL and SAIL.

The government through this experiment is intending to make at least nine blue chip public sector enterprises board managed. But the question that remains unanswered whether this autonomy will mean anything to them, as these are in the true sense, government-owned enterprises. They continue to function within the writ jurisdiction of high courts, the ambit of parliamentary questions.

55 The Steel Authority of India Ltd. has formulated plans to lay off a third of its workforce through a Voluntary Retirement Scheme (VRS) to be introduced in 1998. It intends to reduce its staff strength by almost 60,000 employees in the next five to six years by retrenching about 10,000 people by annum. At the same time, the company intends to exercise its discretionary powers by disallowing good employees from leaving the organisation by offering them additional incentives.
The initiatives being taken the world over towards improving corporate governance is aimed at improving the effectiveness and accountability of the board of directors. The effectiveness of the board gets reflected in its performance, while accountability can be gauged by how transparent the company is in disclosing to its members and other stakeholders. Till recently in the public sector, the shareholder equity involved a minor proportion of the total financial involvement of a company, the major proportion being formed out of borrowings from banks and other financial institutions. But this scenario is changing. The board as the repository of necessary freedom and authority is expected to be fully accountable for its actions and decisions.

The role of the board is transforming, with the functions it is expected to discharge undergoing a changed complexion. It is to transcend the exercise of routine function of approval of annual accounts, to include review of corporate strategy, selection of key managers, managerial compensation, monitoring and self-appraisal.

Any attempt at improving the corporate governance in the public sector calls for clarifying as such the role of the board. There is still some ambiguity in the role of the board. The Administrative Reforms Commission way back in 1967 stated: "In the present scheme of things where policy is laid down by the government and important powers of financial controls are exercised by the controlling ministry, the role of the policy making board becomes somewhat ambiguous and atrophied. It cannot deal with high policy since it is a prerogative of the government. It cannot deal with day-to-day administration which is within the domain of the chief executive. Thus it is reduced to a quasi-administrative level and compelled to look for and function in an area which is neither reserved to the government nor delegated to the chief executive. It is in this context that some of the policy making boards as constituted today, attract the criticism of being ineffective and even redundant." Similar such sentiments were echoed later on also by innumerable committees such as the Economic Administration.
Reforms Commission, Arjun Sengupta Committee and so on. But the problem continued to persist.

Now prompted by developments introduced in by liberalisation, the government has taken a limited initiative to relook at governance of the public sector towards restructuring boards. This experiment will meet with success only when apart from structural changes, there is change in the attitude on the part of government towards the public sector, in conferring autonomy and freedom in the true sense, maintaining an arms length relationship with them. In the Indian situation, mere structural solutions do not yield results. What is needed is a change in the attitude on the part of all concerned, commitment to professional ethics and integrity, ensuring transparency in decision making.