INDEPENDENT DIRECTORS- ASSETS OR PUPPETS

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Abstract

In the wake of the corporate governance scandals, concept of Independent directors has grappled academicians and policy makers worldwide as to whether these independent directors are working effectively or not. The main objective of the paper is to enunciate the factors influencing the effectiveness of independent directors in listed Indian companies. The study uses Principal Component factor analysis to identify the factors that impact the effectiveness of independent directors.

Research findings: The results of the analysis suggest that presence of independent directors has an impact on the accounting returns of the company as well as market returns by increasing investor confidence. Further it is observed that most of the Independent Directors are selected through personal channels and thus lack the ability to take proper decisions due to biasness towards those who have appointed them. Proper system of appointment and selection of Independent Directors is required for making them more effective.

Implications: Independent directors are required for not only running the organisation in an efficient manner but also for improving its performance and enhancing investor confidence. In fact it is an interrelated concept. If the independent directors efficiently discharge their duties it will lead to improved financial results in the long run which in turn will boost investor confidence thereby leading to increased market value of the firm. Policy makers need to formalise the institution of independent directors and regulate their appointment and selection. Further it is suggested that efforts need to be made to increase the autonomy of independent directors so that they can more actively participate in the corporate system.

Keywords: Independent Directors, Corporate Governance, Firm Performance, Factor Analysis

JEL classification: G30 ,G34, L25, C3

Introduction

Corporate governance scandals worldwide have caused a crisis of confidence in the corporate sector. Loopholes in corporate governance system has endangered the global financial stability and shifted the focus of the regulators on the boards of the company. Board of directors in a company play the crucial role of not only protecting the interests of the shareholders but also ensuring that the decisions taken by the board leads to maximisation of shareholders wealth. The composition of the board of directors is crucial to the independent functioning of the board. There are primarily three types of directors in the company-executive directors, non-executive

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directors, and independent directors. There is a significant body of literature on corporate governance, which has guided the composition, structure and responsibilities of the board and studied their impact on the performance of the company.

Jensen and Meckling (1976) argue that a bigger board size improves the effectiveness of the board and helps in bringing down the agency cost thereby leading to better financial results.Adam and Mehran (2005), Dalton (2005) and Kiel and Nicholson (2006) also argued that larger board increased the diversity in terms of skills, experience, gender, knowledge and nationality. Fama and Jensen (1983) and Raheja (2005) suggest that although inside directors have an informational advantage, but outside directors bring in neutrality and help solve the principal-agency problem. On the other end, Hermalin and Weisbach (1991) and Lipton and Lorsch (1992) argued that firm performance is insignificantly related to higher proportion of outsiders on the board. Bhagat and Black (1998) also found no consistent evidence that the proportion of independent directors affected future firm performance. They found that high proportion of independent directors rather correlated with slower growth. Thus it is observed that the though companies are realising the importance of having an independent board still its impact on returns is debatable

The concept of Independent directors (ID) is new to India. The concept originally was introduced in U.S. during 1950’s and later moved to U.K. in 1990’s. In India, the concept of Independent directors gained momentum with the introduction of corporate governance in late 90’s. The Companies Act, 1956 did not directly mention about Independent Director's and no provision existed regarding the compulsory appointment of Independent Director's on the board. However, Clause 49 of the listing agreement which is applicable to all listed companies mandated the appointment of Independent Directors on the board. In spite of the fact that most of the companies were adhering to the provisions of the Clause 49, scams and frauds were on a rise. With the growing corporate scams and the alleged involvement of Independent Directors in them, a need was felt to update the Act and make it globally compliant.

The Companies Act 2013 that replaces the old Companies Act 1956 is regarded as a landmark change in the corporate world after almost six decades. The new act contains comprehensive provisions related to corporate governance and independent directors. The Companies Act 2013 was passed by the parliament on 29th August, 2013 and was made partially effective by implementing 98 Sections w.e.f. 12thSeptember 2013. The Ministry of Corporate Affairs, on 26th March 2014 notified a majority of the remaining sections of the Companies Act, 2013, including sections 139 to 148, relating to audits and auditors. The Act was stated to be effective from 1st April, 2014.

As per sec 149(6) of Companies Act 2013, an Independent director in relation to a company, means a director other than a Managing director or a whole-time director or a nominee director,—

(a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

(b) a person

(*i*) who is or was not a promoter of the company or its holding, subsidiary or holding company

(*ii*) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

(*c*) who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the twoimmediately preceding financial years or during the current financial year;

(*d*) none of whose relatives has or had pecuniary relationship or transactionwith the company, its holding, subsidiary or associate company, or their promoters or directors, amounting to two per cent. or more of its gross turnover or total income orfifty lakh rupees or such higher amount as maybe prescribed, whichever is lower, during the two immediately preceding financial years or during the current financialyear;

(*e*) who, neither himself nor any of his relatives—

(*i*) holds or has held the position of a key managerial personnel or is orhas been employee of the company or its holding, subsidiary or associatecompany in any of the three financial years immediately preceding the financialyear in which he is proposed to be appointed;

(*ii*) is or has been an employee or proprietor or a partner, in any of thethree financial years immediately preceding the financial year in which he isproposed to be appointed, of—

(A) a firm of auditors or company secretaries in practice or cost auditorsof the company or its holding, subsidiary or associate company; or

(B) any legal or a consulting firm that has or had any transactionwith the company, its holding, subsidiary or associate company amountingto ten per cent or more of the gross turnover of such firm;

(*iii*) holds together with his relatives two per cent. or more of the totalvoting power of the company; or

(*iv*) is a Chief Executive or director, by whatever name called, of any non profit organisation that receives twenty-five per cent. or more of its receipts fromthe company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or

(*f*) who possesses such other qualifications as may be prescribed.

Every listed public company was required to have at least one-third of the total number of directors as independent directors. However, the Central Government could prescribe the minimum number of independent directors in case of any class or classes of public companies.

Given the recent trend of globalization, the importance of board of directors who are viewed as vehicles of growth of a company has sharply increased. The present paper focuses on independent directors and their role in enhancing corporate performance. The paper is divided into six parts. The first part studies the concept of independent directors. The second part talks about the literature review. Third and fourth part lay down the objectives and research methodology of the paper. Fifth part of the chapter analyses the information collected with the help of a structured questionnaire using factor analysis to find out factors that lead to effectiveness of independent directors. Last part of the paper lays down the conclusion and limitations of the study.

Literature review

Over the last thirty years various studies have been conducted on Independent Directors and their impact on the firm performance and other variables that determine their efficacy. As per the agency theory the board of directors are agents of the shareholders and their primary objective is to protect the interests of the shareholders. Shareholders are normally suspicious of boards that are mostly composed of insiders. It has often been argued by many that independent board members are more effective monitors than senior corporate managers. Hence, companies with more independent board members are more likely to be managed in the interest of the shareholders. Various studies have been conducted to study the association between board structure and overall firm performance and found a positive association between them. **Liang and Li (1999)**studied the association between board characteristics and firm performance measured in terms of Tobin’s q and Return on Assets of 228 small private firms in China. Multiple regression analysis was used to study the relation between dependent and independent variables. They concluded that presence of outside directors on boards positively impacted returns on investment. **Kajola(2008)**reviewed the relationship between corporate governance variables like board size and its composition and audit committee compositionwith performance measures like return on equity and profit margin. Analysis was conducted on a sample of 20 Nigerian firms between 2000 to 2006 using panel methodology and OLS estimation. The results suggested a significant positive correlation between board size and return on equity. **Chakrabarti et al. (2010)** conducted an event study to analyse the value added by Independent Directors in the emerging markets. Their study was based post the Satyam fiasco which lead to ceasation of many Independent Directors from the Indian boards. They found that in January 2009, the four-day cumulative abnormal return surrounding director resignations was -1.3%. The effect was found to be strong even after controlling for unobserved firm and director parameters using fixed-effects and ex-post firm performance measured in terms of Tobin’s q. They found a positive impact of Independent Directors on the boards of the company. In fact they found the effect to be disproportionately greater for those Independent Directors who were members of audit committees or had business expertise. **Kumar and Singh (2012)** examined the efficacy of outside directors on the corporate boards of 157 non-financial Indian companies listed on BSE 200 for the year 2008. They studied the impact of presence of non-executive directors on the market performance of the company measured in terms of Tobin's q. OLS Regression was used to find the association between the two. The research revealed thatwhile the proportion of grey directors on board had a significant negative impact on the market value of the firm, the Independent Director's proportion had an insignificant positive effect on the same.

Contrary to this, there are several studies that indicated negative or no association between board characteristics and firm performance. Many studies suggested that limiting board size to a certain level improves the firm's performance because the benefits of larger boards are outweighed by the increased monitoring costs and poorer communication and decision making of larger groups. **Bhagat and Black (1998)** found no consistent evidence that the proportion of Independent Directors affected future firm performance. They found that high proportion of Independent Directors correlated with slower growth and, less strongly, with lower stock price returns in the recent past, however this correlation disappeared for future performance. They found evidence that proportion of inside directors correlates with higher past stock price returns but had no impact on future prices. This could be due to the reason that companies that faced slow growth increased the proportion of Outside Directors on their boards, assuming that it would lead to better corporate performance. **Erickson et al. (2005)**asserted that in a dominant shareholder regime returns were negatively affected by presence of Independent Directors. The study examined Canadian public companies between 1993 and 1997 and found a negative relationship between the fraction of outside directors and firm value. However, the authors suggested that Independent Directors on the board were able to mitigate agency problem arising out of dual class common stock. **Caselli et al.(2007)** concluded that Independent Directors impacted the rate of return only on thoseprojects that required special skills. They analysed Italian closed-end funds from 1999 to 2003, and found that busy Independent Directors did not significantly affect the internal rate of return. The study suggested that when performance is unsatisfactory the Independent Directors usually resign and shave off losses. **Garg (2007)** conducted a study on companies listed on BSE 200 to find the association between board composition and firm performance. Multiple regression and panel data using random effect model was used to conduct the analysis. The results of the study suggested an inverse association between board size and firm performance. The impact of board independence on firm performance was found to be highest when the board independence was between 50 and 60 per cent. The study found that Independent Directors did not effectively perform the monitoring role due to lack of training, improper definition of roles tasks, and responsibilities. **Balasubramanian et al. (2008)** conducted an extensive survey in early 2006 of listed Indian public companies. They builtan Indian Corporate Governance Index (ICGI) consisting of five sub indices Board Structure index, Disclosure index, Related Party Transactions index, Shareholder Rights index and Board

Procedure index. OLS regression was used to find out association between firm performance and ICGI. The study concluded a positive association between Shareholder Rights index and firm market value. They further asserted that the association between remaining indices of ICGI with firm market value was insignificant. The study proposed that India's legal requirements were already quite strict and over compliance does not produce valuation gains to the company. **Black (2010)** reasoned that board independence in India was not strongly associated with firm performance because the minimum requirements for board independence were already stricter and over compliance did not lead to improvement in firm value.

Chibuike and IwnEgwivonwu(2010) suggested that influence of Independent Directors onthe firms performance was rather culture bound. While studies in U.S found no positive relation, those conducted in the Asian markets revealed results contrary to those that were done in the European and American markets. Several studies suggested that firms with more Independent Directors performed rather worse. **Varma (1997)** argued that in India, the board of directors were not able to resolve the conflict between the dominant shareholder and the minority shareholders because the board derived its powers majorly from the dominant shareholders. The dominant shareholders appointed and remunerated the directors. The study suggested that in Indian scenario an outside regulator should be outsourced the function of nominating and remunerating the boards for them to perform efficiently.**Garg (2007)** conducted a study on companies listed on BSE 200 to find the association between board composition and firm performance. Multiple regression and panel data using random effect model was used to conduct the analysis. The results of the study suggested an inverse association between board size and firm performance. The impact of board independence on firm performance was found to be highest when the board independence was between 50 and 60 per cent. The study found that Independent Directors did not effectively perform the monitoring role due to lack of training, improper definition of roles tasks, and responsibilities etc.

Jackling and Johl (2009) investigated the relationship between internal governancestructures and financial performance of Indian companies. The effectiveness of boards of directors, in terms of board composition, size, and board busyness was addressed in the Indian context. They used a sample of top Indian companies. The study supported the agency theory by showing a positive association between outside directors and firm performance. The findings also suggested that larger board size had a positive impact on performance as it gave greater exposure to the external environment. They found a close association between board size and Tobin's q. The study however failed to support the resource dependency theory in terms of the relationship between frequency of board meetings and performance. The study also confirmed that outside directors with multiple appointments had a negative impact on performance and hence directorships needs to be further curbed. **Khanna andMathew (2010)** in their study concluded that all Independent Directors viewed their role ofa strategic advisor to the promoters. The directors did not view themselves as watchdogs and felt that any legal requirement imposing such a role would be inappropriate. They also felt that remuneration of directors was not sufficient and did not correspond with the risk associated with their job. The directors also felt that selection through nomination committee would help in overcoming the problem of promoters influence on directors. They were of the view that their interaction with the minority shareholders was negligible as they were hardly present at general meetings. The directors were also of the view that they did not have easy access to internal information of the company. Although Post Satyam many directors felt that boardroom had become more receptive to their suggestions but still efforts should be made to have clear guidelines on their duties and responsibilities. Directors were also of the view that constraints should be imposed on liability specially the power to arrest and criminal liability.

Thus with the present review of published literature it is identified that board independence and its impact on corporate performance is culture bound. In the western context there have been many research studies that were based on methodology that linked elements of board structure to financial measures of corporate performance. These studies focussed on whether the percentage of non-management directors on a board correlate with frequency of CEO replacement, response to takeover bids, or variations in stock prices etc.. Their results disagreed in their statistical significance and, in some cases, even on the positive or negative character of the relationship. On the other hand studies conducted in emerging economies proposed a positive impact of board composition on both corporate performance and investment opportunities. It is also observed that very few studies have been conducted to study the effectiveness of independent directors. The present study aims to study the efficacy of independent directors post the satyam debacle.

Research objectives and Hypothesis

Various studies have proposed that the board composition influences organization in either positive or negative manner. Although the issue is debatable, various conceptual analyses have suggested that a firm’s board of directors contribute to the process of corporate governance by selecting and evaluating the firm’s chief executive officer (CEO) and other top managers, shaping the firm’s strategic direction, setting corporate productivity objectives, and assessing business success. As discussed earlier, a number of studies have been conducted worldwide to examine the relationship between the composition and effectiveness of boards of directors of the firms. In view of the major research findings and the plight of independence directors in India with respect to their fiduciary duties and powers along with the increasing rate of high profile scams and scandals, the present paper proposes the following objectives:

1. To enunciate the factors influencing the effectiveness of independent directors in India.
2. To evaluate how independent actually are independent directors in Indian firms.

On the basis of the above objectives, following hypothesis have been formulated to get empirical results from the proposed study.

H_{01}: Presence of independent directors has no significant impact on the corporate governancepractices of the company.
H_{02}: Training of directors has no significant impact on their effectiveness.
$H_{03:}$ Clear emancipation of roles and responsibilities of independent directors has no significant impact on their effectiveness.
$H_{04:}$ Process of appointment and selection of independent directors has no significant impact on their effectiveness.
H_{05}: Remuneration of independent directors has no significant impact on their effectiveness.
$H_{06:}$ Performance evaluation of independent directors has no significant impact on their effectiveness.
$H_{07:}$ Personal referral of independent directors has no significant impact on their effectiveness.
H_{08}: Boards with a higher percentage of independent directors are not effective monitors of minority interests.

Research Methodology

The present paper employs primary data analysis to identify the factors that impact the efficiency of independent directors on firm performance. The primary information has been collected with the help of a structured questionnaire to ascertain the perception of directors towards their role and responsibility in adhering corporate governance in organizations. The questionnaire was drawn up on a 5 point Likert's scale ranging from "strongly agree" to "strongly disagree". Securities and Exchange Board of India (SEBI) had made it mandatory for the entire group 'A' companies of Bombay Stock Exchange (BSE) and all companies included in S&P Nifty of the National Stock Exchange (NSE) to comply with Corporate Governance requirements and to publish a separate corporate governance report as part of their Annual report from the year 2001.Thus the sample for the study consisted of directors from companies listed on BSE and NSE. The sampling method used for collection of primary data was a combination of convenient sampling and snowball non probability sampling. The questionnaire was mailed to the directors and personal visits were also made to collect information relevant to the study. Responses were also collected in person by attending three conferencesorganized by Associated Chambers of Commerce of India (ASSOCHAM). After the Satyam scam, the market for independent directors had become highly volatile. Lots of changes were taking place in the roles and responsibilities of independent directors and hence people were reluctant to fill the questionnaire. A total of one hundred and eighty questionnaires were distributed during the conferences but only forty one responded to them. Online questionnaires were send through LinkedIn to almost six thousand directors and company secretaries but even after repeated reminders only eighty responses were received. Thus a total of one hundred and twenty one responses were received.

The study has been conducted using a structured questionnaire prepared on a five point Likert scale to collect information regarding the effectiveness of directors. The questionnaire has been divided into eight parts that deal with various aspects of director's effectiveness. Twosets of questionnaires had been designed, one for directors of the company and other forcompany secretaries. The sampling method used for collection of data through questionnaires was a combination of convenient sampling and snowball non probability sampling. Information was collected through internet and conferences that were held by the Associated Chambers of Commerce of India (ASSOCHAM).Three conferenceswere attended in which around three hundred and twenty questionnaires were distributed but response was very low and only Forty one persons filled the questionnaire. Many attendees to the conference took the questionnaire and promised to fill it up and send it later but not a single response was received. As the topic of Independent Directors is very sensitive, most of the people were reluctant to share information on Independent Directors and their workings.

Rigorous efforts were further made to collect information online by sending mails and approaching people through professional networks like LinkedIn, which was of great help in this regard. Around six thousand mails were sent to people working in the capacity of directors, Independent Directors, managing directors and company secretaries. The response rate was extremely low as even after repeated reminders through mails and phone calls only eighty responses were received online. Another important reason for low response rate was introduction of the Companies Act 2013 as most of the company secretaries were busy with implementing new provisions, and Independent Directors were unclear about their changing role. In total one hundred and twenty one respondents replied out of six thousand respondents that were contacted either online or face-to-face during conferences. As the number met the minimum criteria for conducting factor analysis, same was conducted on the information gathered through primary sources.

Factor analysis

Multivariate statistical technique called factor analysis has been used for the purpose of data reduction and summarisation. Factor analysis has been undertaken to reduce the originally identified variables into minimum number of factors influencing effectiveness of Independent Directors. Principal Component Analysis (PCA) has been used as a dimension reduction technique to summarize the information available in the data. The main benefit of using factor analysis is that it considers all the variables simultaneously. The chapter tested the following hypothesis through factor analysis

Factor analysis I

Factor analysis has been run in two parts. In the first part 9 variables are taken and analysis is conducted. Before doing factor analysis Cronbach's alpha measure is calculated to test the reliability of the variables to conduct factor analysis. Cronbach's alpha is used to assess whether the variables to be added are measuring the same concept or not. It measures the internal reliability of the items. The lower the alpha score the more likely that the variables are not measuring the same concept and so should not be analysed together. An alpha score above 0.5 is considered reliable to conduct factor analysis.

Table 5.2 Reliability Statistics(a)

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	Number of Items
.618	.609	9

Source: Researchers projection in SPSS

The Cronbach's alpha score of the variables considered for conducting factor analysis was found to be 0.618 as shown in table 5.2 and hence indicative that factor analysis can be done.

KMO and Bartlett's Test

Bartlett's Sphericity test and the KMO index are used for checking the implementation of the Principal Component Analysis on a dataset. Bartlett's test of Sphericity is used to test the null hypothesis stating that "the variables measured in the factor analysis are uncorrelated". The test statistics for sphericity is base in a Chi square transformation of the determinant of the correlation matrix.

Table 5.3 KMO and Bartlett's Test (a)

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.699
Bartlett's Test of Sphericity	Approx. Chi-Square	210.289
	Df	36
	Sig.	.000

Source: Researchers projection in SPSS

A large value of test statistic favours the rejection of the null hypothesis and hence favours factor analysis. Its significance value should be less than 0.005 for conducting factor analysis. Further KMO statistic measures sampling adequacy. This index compares the magnitudes of the observed correlation coefficients to the magnitudes of partial correlation coefficients. Small values of the KMO statistic indicate that the correlations between the pair of variables cannot be explained by other variables and that factor analysis may not be appropriate. It is suggested that KMO value greater than 0.5 is considered desirable for running factor analysis. As shown in table 5.3, value of KMO statistics was found to be 0.699 which was above 0.5 and hence considered good enough to perform factor analysis. Also, the significance value in Bartlett's test of sphericity was 0.000 which indicated that the correlation matrix was significantly different from identity matrix. Thus it was felt that the strength of the relationship among variables was strong and factor analysis could be conducted. As per the analysis the approximate chi square value was 210.289 which further indicated that the data was fit for factor analysis.

Communalities

Communalities measures the amount of variance in a given variable explained by all the factors jointly and may be interpreted as the reliability of the indicator. It is measured in percentage.

Table 5.4 Communalities (a)

Variables	Initial	Extraction
Personal relations an important factor while choosing	1.000	.691
Personal referral of shareholders important while appointment	1.000	.783
Personal referral of CEO important while appointment	1.000	.669
Remuneration an important factor at the time of appointment	1.000	.470
Political links important while appointment	1.000	.601
Present system of selection of Independent Directors is a major reason for their ineffectiveness in the board room	1.000	.515
Biasness towards those who have appointed you	1.000	.462
Company provides sufficient training to Independent Director's	1.000	.582
Customised training will lead to increase in efficiency of Independent Director's	1.000	.651

Source: Researchers projection in SPSS

Communality for a variable is calculated as the sum of the squared factor loadings for that variable. Since factors are uncorrelated, the squared loadings may be added to get the total percentage of the variance explained. The extracted communality is that percent of variance in a given variable that may be explained by the factors which are extracted, which will normally be fewer than all the possible factors, resulting in coefficients which is less than 1.0.When an indicator variable has a low communality (<= .25) it indicates that the factor model does not work well for that indicator and hence it should be removed from the model. Low communalities across the set of variables indicate the variables are little related to each other. However, if the communality exceeds 1.0, there is a spurious solution, which may reflect too small a sample or the researcher has too many or too few factors. The below table 5.4 shows that the extracted communalities of each variable was greater than 0.462 and hence it was a good fit model for carrying out factor analysis.

Total variance explained

The Eigen values for a factor indicate the total variance attributed to that factor. The percentage of variance shows the percent of variance for each component before and after rotation. Cumulative variance shows the percentage of variance shown by the variables whose Eigen value is greater than 1 as specified while performing the test.

Table 5.5 Total Variance Explained (a)

Component	Initial Eigen values			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	**2.750**	30.557	30.557	2.750	30.557	30.557	2.226	24.729	24.729
2	**1.415**	15.718	46.275	1.415	15.718	46.275	1.897	21.072	45.801
3	**1.259**	13.989	60.264	1.259	13.989	60.264	1.302	14.463	60.264
4	.866	9.623	69.888						
5	.759	8.429	78.317						
6	.679	7.545	85.861						
7	.505	5.610	91.472						
8	.444	4.934	96.405						
9	.324	3.595	100.000						

Source: Researchers projection in SPSS

Table 5.5 shows how the variance is divided among the possible factors. It was found that four factors have Eigen values greater than 1.0 which is a common criterion for a factor to be useful. When the Eigen value is less than 1.0, it indicates that the factor explains less information than a single item would have explained. The first factor showed the highest variance as it explained

30.557% of the total variation. The second factor explained 15.718% of variance while the third factor explained 13.989% of the variance. Variance of all the three factors was summed up, and it was observed that they cumulatively explained 60.264% of the total variance. The study has used Varimax rotation which is an orthogonal method of rotation of the factors. It suggests that the information explained by one factor is independent of the information of the other factors.

Rotated component matrix

Table 5.6 Rotated Component Matrix (a)

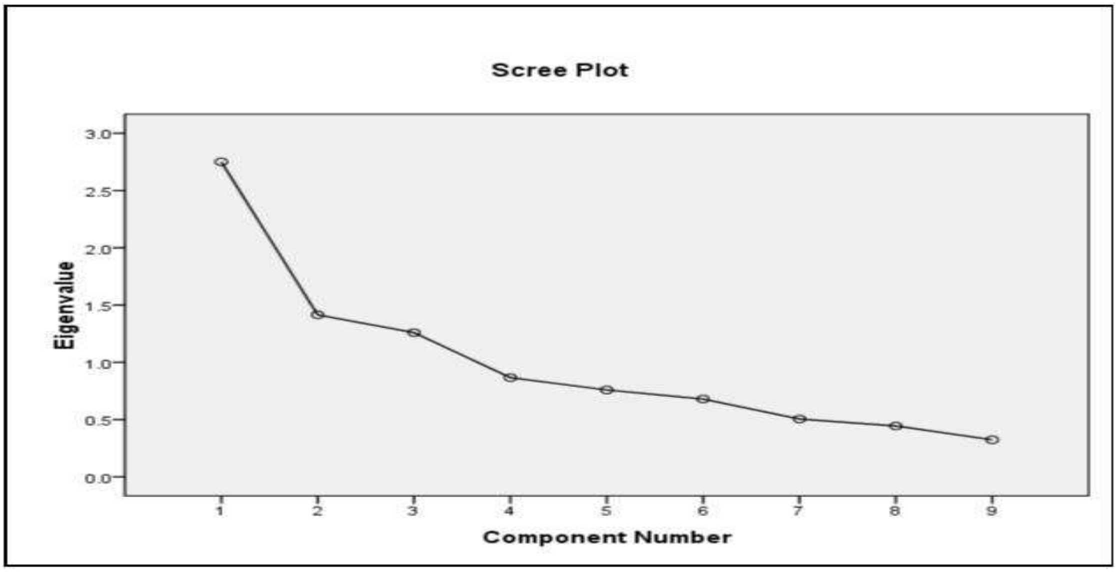
Variables	Component		
	1	2	3
Personal relations an important factor while choosing Company	**.814**		
Personal referral of shareholders important while appointment	**.870**		
Personal referral of CEO important while appointment	**.786**		
Remuneration an important factor at the time of appointment		**.680**	
Political links important while appointment		**.758**	
Present system of selection of Independent Director is a major reason for their ineffectiveness in the board room		**.712**	
Feeling of biasness towards those who have appointed you		**.522**	
Company provides sufficient training to Independent Director			**.740**
Customised training will lead to increase in efficiency of Ids			**.802**

Source: Researchers projection in SPSS

The factors were further rotated so that they are easier to interpret. Table 5.6 shows the rotated component matrix that contains the factor loadings, which helps in identifying the most important factors that emerge from the analysis. Each factor consisted of those variables that had a loading of 0.50 or more. Also it was found that all variables had positive sign which indicated that all variables had a positive impact on effectiveness of Independent Directors. It was further observed that no variable had a loading on more than one factor. The rotated component matrix resulted into three factors. Factor 1 was loaded with three variables; factor 2 was loaded with four variables while the third factor was loaded with two variables. The first factor related with personal relations of Independent Directors and explained almost half of the total explained variance. Thus we may reject the null hypothesis H_{012} and conclude that personal referral of Independent Directors has a significant impact on their effectiveness. The second factor related with the appointment and remuneration of Independent Directors and explained 15.718% of the variance. On the basis of this factor we may reject the null hypothesis H_{09} and H_{10} and conclude that process of appointment and selection of Independent Directors and remuneration has a significant impact on their effectiveness. The third factor that explained almost 13.989% of the total variance indicated that training of Independent Directors had a positive impact on their effectiveness. Thus we may reject the null hypothesis H_{07} that suggested that training of directors has no significant impact on their effectiveness. We conclude that training has a positive and significant impact on the performance and effectiveness of Independent Directors.

Scree Plot

Figure 5.22 Scree plot of factor analysis I



Source: Researchers projection in SPSS

Further Scree plot is also undertaken to identify the number of factors that should be extracted, which is represented by Figure 5.22. Point of inflexion can be seen occurring at component number 2, 4 and 7 after which a stable decline was observed. Hence it further supported the results of rotated component matrix that three factors can be extracted from factor analysis.

Factor analysis II

Factor analysis was done on 14 variables to extract important factors using principal component analysis. The results have been discussed below.

Table 5.7 Reliability Statistics(b)		
Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	Number of Items
.728	.738	14

Source: Researchers projection in SPSS

Cronbach's alpha has been used to assess whether the variables to be added are measuring the same concept. An alpha score above 0.5 is considered to be reliable to conduct factor analysis. The Cronbach's alpha score of the variables considered for conducting factor analysis was 0.728 as shown in table 5.7 indicating that factor analysis could be done.

KMO and Bartlett's Test

Table 5.8 shows the values of Kaiser-Meyer-Olkin Measure of Sampling Adequacy and Bartlett's Test of Sphericity obtained on running factor analysis on the fourteen variables.The test suggested the value of KMO statistics as 0.729 which was considered good enough to perform Factor analysis. Also, the significance value in Bartlett's test of Sphericity was 0.000 which indicated that correlation matrix was significantly different from identity matrix.

Table 5.8 KMO and Bartlett's Test (b)		
Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.729
Bartlett's Test of Sphericity	Approx. Chi-Square	292.640
	Df	91
	Sig.	.000

Source: Researchers projection in SPSS

Thus it may be concluded that the strength of the relationship among variables was strong and factor analysis can be conducted. As per the analysis the approximate chi square value was 292.640. This indicated that the data is fit for factor analysis

Communalities

Communalities measures the percent of variance in a given variable explained by all the factors jointly and may be interpreted as the reliability of the indicator. A variable having communality less than 0.25 indicates that the factor model does not work well for that indicator and hence it should be removed from the model.

Table 5.9 Communalities(b)

Variables	Initial	Extraction
Role of Independent Director's as watchdog	1.000	.308
Role of Independent Director's as strategic advisors	1.000	.643
Proper defining of roles and responsibilities will improve Independent Director's effectiveness	1.000	.485
Presence of Independent Director's help in protection of minority Interest	1.000	.474
Presence of Independent Director's protects the stakeholders interest	1.000	.584
Presence of Independent Director's helps in reducing frauds	1.000	.409
Performance needs to be evaluated for reappointment	1.000	.615
Company clearly spells indicators for evaluation	1.000	.411
Evaluation will lead to better performance	1.000	.663
Independent Director's should be held liable for acts of the company	1.000	.547
Satisfied with recent changes regarding liability of directors	1.000	.682
Recent changes will attract honest directors to the company	1.000	.541
Independent Director's have positive impact on performance and market value	1.000	.701
Presence of Independent Director's puts pressure on the company to adhere to corporate governance norms	1.000	.560

Source : Researchers projection in SPSS

In the analysis, none of the extracted communalities had communality less than 0.25 as shown in Table 5.9 and hence it was considered a good fit model for carrying out factor analysis.

Total Variance Explained

The Eigen values for a factor indicate the total variance attributed to that factor. The percentage of variance shows the percent of variance for each component before and after rotation. Table 5.10 shows how the variance is divided among the possible factors. The analysis suggested that four factors had Eigen values greater than 1.0.The first factor showed the highest variance and explained 23.530% of the total variance explained. The second factor explained 12.824% of variance while the third factor explained 10.027% of the variance. The fourth and the last factor explained 8.071% of the variance. The sum of the four factors together explained 54.452% of the total variance. The study used Varimax rotation to rotate the factors and interpret the results.

Table 5.10 Total Variance Explained (b)

Co M p On En t	Initial Eigen values			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	**3.294**	23.530	23.530	3.294	23.530	23.530	2.378	16.987	16.987
2	**1.795**	12.824	36.354	1.795	12.824	36.354	1.790	12.789	29.776
3	**1.404**	10.027	46.381	1.404	10.027	46.381	1.754	12.529	42.304
4	**1.130**	8.071	54.452	1.130	8.071	54.452	1.701	12.148	54.452
5	.936	6.684	61.137						
6	.880	6.285	67.422						
7	.796	5.688	73.109						
8	.723	5.163	78.272						
9	.644	4.601	82.873						
10	.594	4.239	87.113						
11	.504	3.601	90.714						

12	.483	3.447	94.161						
13	.415	2.961	97.122						
14	.403	2.878	100.000						

Source: Researchers projection in SPSS

Rotated Component Matrix

Rotated component matrix contained the factor loadings, which helped in identifying the most important factors that emerged from the analysis. The rotated component matrix resulted into four factors as shown in table 5.11. Factor 1 was loaded with six variables but the fourth variable had a loading on the fourth factor also. The coefficient of the variable was relatively high for the fourth factor and hence it was assumed to be a part of fourth factor. Thus the first factor had five variables while the rest three factors were loaded with three variables each.

Table 5.11 Rotated Component Matrix (b)

Variables	Component			
	1	2	3	4
Role of Independent Director's as watchdog	**.398**			
Role of Independent Director's as strategic advisors	**.790**			
Proper defining of roles and responsibilities of the ID's will have a positive impact on performance	**.516**			
Presence of Independent Director's help in protection of minority interest	.437			.455
Presence of Independent Director's protects stakeholders	**.736**			
Presence of Independent Director's helps in reducing frauds	**.559**			
Performance should be evaluated for reappointment			**.779**	
Company clearly spells out indicators for evaluation			**.489**	
Evaluation will lead to better performance			**.794**	
Independent Director's should be held liable for acts of the Company		**.708**		
Satisfied with recent changes regarding liability of Independent Director's		**.799**		
Recent changes will attract honest directors to the company		**.656**		
Independent Director's will have a positive impact on performance and market value				**.831**
Presence of Independent Director's puts pressure on the company to adhere to CG norms				**.632**

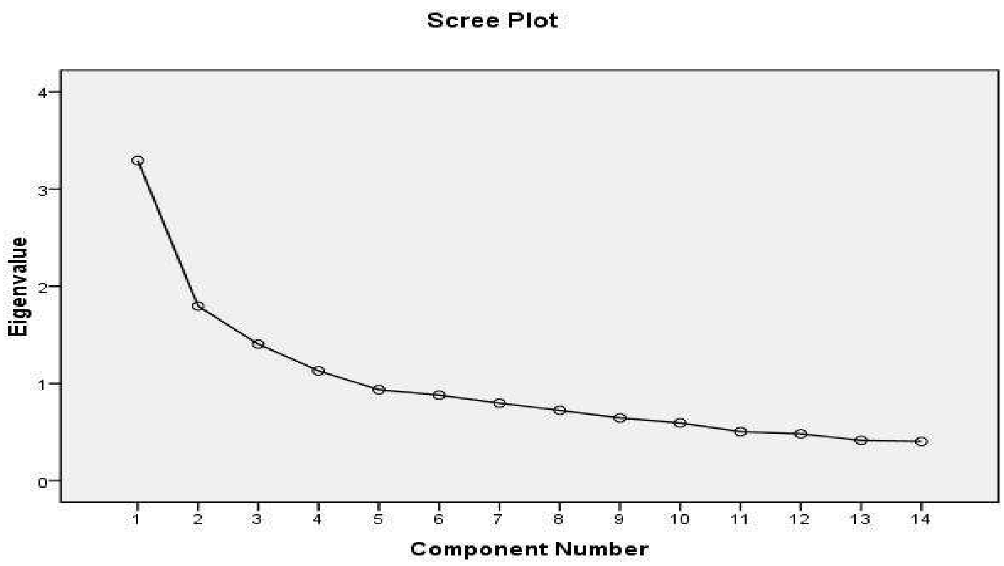
Source: Researchers projection in SPSS

The first factor related with roles and responsibilities of Independent Directors and explained 23.530% of the total explained variance. Thus on the basis of this we may reject the null hypothesis H_{08} and suggest that proper defining of roles and responsibilities of Independent Directors has a positive and significant impact on their performance. The third factor that attributed for almost 10% of variance explained the impact of recent changes in liability of Independent Directors on their performance. The fourth factor that explained almost 8.071% of the total variance indicated that presence of Independent Directors on the board not only ensured better corporate performance but also improved the corporate governance practices of the firm. Thus with the results of the analysis we may reject the null hypothesis H_{06} and conclude that presence of Independent Directors had a significant impact on the corporate governance practices of the company and also on the financial performance of the company.

Scree Plot

Further Scree plot shown in Figure 5.23 depicts that point of inflexion occurs at four points

Figure 5.23 Scree plot of factor analysis II



Source: Researchers projection in SPSS

Thus it is observed that primary data analysis identified certain common factors that were important for improving the effectiveness of Independent Directors. These factors related with appointment, training and evaluation of directors. The analysis proposed that appointment of directors should be done through a proper data bank and not at the will of certain affluent shareholders. Training of Independent Directors has also emerged as a crucial factor expected to

improve the effectiveness of Independent Directors as it would lead to better performance of directors as it not only increases
their ability to understand the business environment of the company but also gives better understanding of its functioning. Evaluation of directors is yet another variable that has emerged as an important factor determining the effectiveness of directors. Evaluation of board performance by the board of directors instils fear in the minds of passive Independent Directors of not being reappointed on the board thereby improving their performance.

Findings of the study

Thus on analysing the results of the survey it is observed that independent directors are an integral part of the organisation and are required for the efficient functioning of the company. Factor analysis suggested seven factors that would help in enhancing the effectiveness of independent directors in India. These factors are summarised below:

Personal referrals

Personal referrals relates with the personal relations of the independent director with the promoter or CEO of the company and how it impacts his effectiveness. Factor analysis suggested that personal relations were an important factor for both independent director as well as the promoter. Independent director gave importance to personal relations while choosing a company whereas promoter preferred appointing those on the board with whom they had personal relations. When independent directors are appointed through personal referrals they are not able to do justice to their position and merely act on the directions of the promoters.

Appointment and Remuneration of Independent director

Apart from personal relations, remuneration and political links emerged as an important factor during analysis. Independent directors prefer to be appointed in those companies where remuneration is high. This could also be because there is lot of risk associated with the profile of independent director. Political links also play an important role in the appointment of director as nowadays there is close nexus between politicians and corporate. It is a win-win position for both the parties as both tend to gain in the bargain. This tends to reduce the efficiency of independent directors. In fact most of the respondents said that they had a feeling of biasness towards those who had appointed them. Thus in order to increase the efficiency of independent director it is important to bring about a major change in the process of appointment of ID’s.

Training

Third important factor was training. Training helps in better understanding of the internal and external functioning of the business and positively impacts performance. Factor analysis suggests that company should provide training to the directors and training should be customised keeping in mind both the business requirement and the requirement of independent director.

Roles and responsibilities

Proper and clearly laid down roles and responsibilities of directors help in enhancing their productivity. Primary analysis revealed that there is lack of clarity in the minds of independent director with regard to their role in the company. While some perceived themselves to be the monitors others felt they were strategic advisors. Hence there is a needto clearly define the roles and responsibilities of the ID's with regard to minority shareholders and other stakeholders.

Performance evaluation

Performance evaluation emerged as an important factor as both corporate as well as independent directors have started realising the importance of evaluation in subsequent appointment of directors. Performance evaluation improves performance of the director as he fears being shown the exit door in case he doesn't perform properly and at the same time it helps company figure out those independent directors who have been contributing towards the company and thus should be reappointed. In fact provisions could be made in the company to pay commission on the basis of performance of the directors.

Liability of independent directors

Primary analysis suggested that post Satyam independent directors had become very cautious in selecting directorships in companies. The respondents felt that independent directors suffer from informational disadvantage and thus should not be blindly held liable for the decisions which are beyond their control. Most of the respondents were satisfied with the recent changes introduced by the Companies Act 2013 with respect to the liability of independent directors but they were unsure whether such change would attract honest directors to accept directorships in companies.

Corporate governance and financial performance

Presence of independent directors on the board enhances firm performance by improving investor confidence. Further it was also observed that apart from financial performance, presence of independent directors on the board puts pressure on the company to adhere to the corporate governance norms both in letter as well as spirit. This further improves the market position of the company thereby impacting its returns.Thus if the regulators as well as the companies give importance to these factors they will be able to not only attract efficient independent directors on their board but also benefit from their increased effectiveness in the form of better returns and enhance investor confidence.

Conclusion

Thus the factor analysis as well as the suggestions provided by the respondents leads us to the conclusion that the personal relations play a very crucial role in the appointment and selection of Independent Directors. Most of the Independent Directors are selected through personal channels and thus might lack the ability to take proper decisions due to biasness towards those who have appointed them. Proper system of appointment and selection of Independent Directors is required for making them more effective. Secondly, the company needs to provide training to the directors and evaluate their performance to improve their effectiveness. The company should also properly define the roles and responsibilities and liabilities of the Independent Directors with more clarity to improve their performance. The presence of Independent Directors not only improved the corporate governance practices of the company but also had positive impacts on the returns of the company by increasing investor confidence. Thus if the company wants profitability and sustainability it is required to have a judicious mix of properly selected and well trained Independent Directors on its board.

Given the increasing trend of independence in Indian boards it can be said that if due care is taken in appointing competent and unbiased people on the board as Independent Director, these directors can help in adding value to the firm by increasing investor confidence. Companies Act 2013 has raised the standards further by laying strict provisions on appointment, selection, tenure etc. of the Independent Directors but it is a known fact that unless the attitude changes, Independent Directors will not be taken seriously for what they are really worth and will continue to be independent only by definition and not in practice. Apart from appointment of right number of Independent Directors on the board steps need to be taken to improve their effectiveness so that the impact of these directors on the firm and its value can be further increased. Act 2013 had bought about a paradigm shift in the area of Independent Directors. The act has elaborately laid down the provisions for selection, training and remuneration of Independent Directors. The demand for effective vigil mechanism has increased tremendously after the emergence of various corporate scandals in India. However, it is yet unknown, empirically, whether this will actually have an impact on the financial performance of the company or not.

To sum up, this paper has important implications for both corporate and policy makers. The companies need to realise the importance of independent directors on the boards of the company and take steps for their proper selection, training and evaluation. Directors shouldbe reappointed strictly on the basis of their competence and performance evaluation report. Companies should realise that having mere puppets on the boards would not take them far. The policy makers and regulators also need to strengthen the provisions related with the appointment, selection and remuneration of independent directors and put in efforts to further professionalize the institute of independent directors.

Limitations of the study

Although due care was taken while conducting the study but it has been rightly said that no study is perfect. There are few limitations that are inherent with the study and cannot be overcome due to technical and feasibility issues. The drawbacks related with the study are mentioned below and can be taken care in future researches.

1. The primary limitation of the study can be associated with the time period presumed for the purpose of this study. The study only considers the period before the implementation of the new Companies Act 2013. The act has brought radical changes in the area of independent directors but its effect is beyond the scope of this study.
2. The scope of the study has been limited to the role of independent directors in corporate governance in India and not much focus has been paid to other countries where this concept originated like UK and US.
3. The study only focuses on non-financial and non-government listed companies. It is not sure whether the study would give similar results for financial and unlisted companies also.
4. The study takes into account primary data and hence bears with it the biasness element attached with primary data.

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NOTE: Some of the legal definition specially that of “Independent Director” has been quoted from the Companies Act 2013 available at the Governments legal site www.mca.com. The definition has been widely used in many other papers related to the topic and being a legal definition cannot be altered.