Strategic Management for Competitive Advantage
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Lecture 42
Composition, structure and other requirements of Board

Welcome to the course Strategic Management for Competitive Advantage. As we continue with corporate governance, today, we will be discussing a very important aspect: the composition, structure and various other requirements of boards.

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So, to start with, in this lecture, we will be talking about the Board's composition, structure and size. So, we will be going through the keys to improving the Board's effectiveness Board and the Directors' performance evolution in the subsequent lecture we will discuss.

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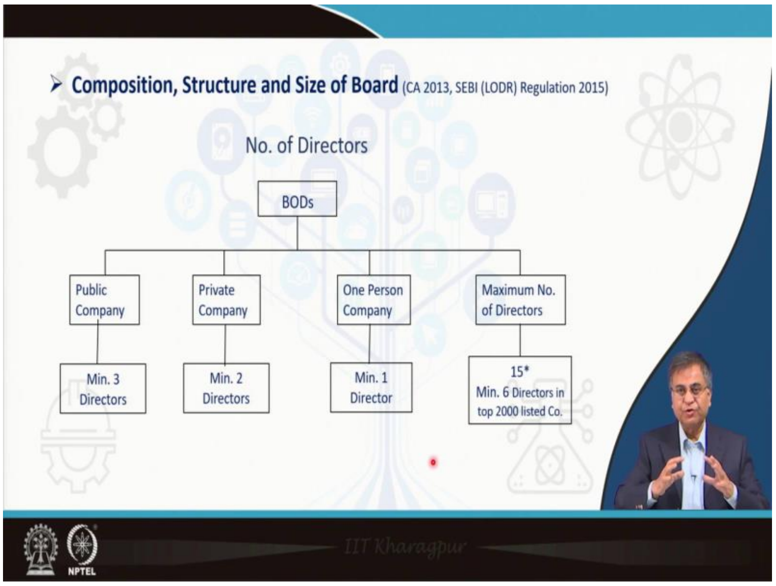

So, look at this diagram, and I will explain it. This diagram represents the composition, structure and size of the Board. This is enshrined in the companies act 2013 and SEBI, the Security Exchange Board of India's listing obligations and disclosure requirement regulation, which was approved in 2015.

So, what does it show? The number of directors, how many each listed companies, what are the minimum, maximum number of directors specified in these companies act and SEBI LODR. So, for a public company minimum, there should be three directors; three directors are the minimum requirement.

For a private company, a minimum of two directors are obligatory; for one personal company, a minimum of one director and the maximum number of directors a company can have is 15. 15 is the maximum. If a company wants to go beyond 15, that has to be approved through a resolution in the Board of directors and shareholders' meetings. Then only they can go beyond 15.

And minimum, there should be 6 directors in the top 2000 listed companies in the stock exchange; they should have a minimum that also has been specified in 2020 April 2020, minimum 6 directors in leading 2000 listed companies. So, these are the statutory requirements for a listed company or otherwise to have a minimum and maximum number of board directors in the respective company.

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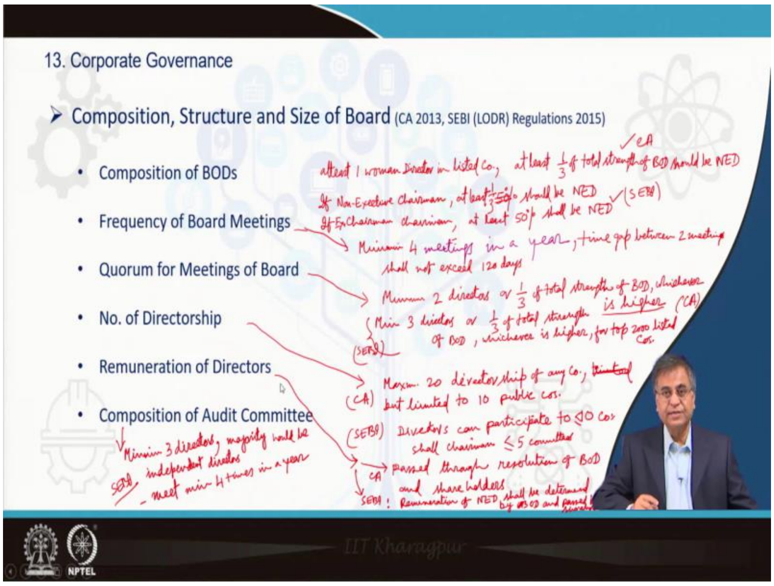

Next, we will discuss the composition of the Board of Directors. How are this Board of Directors? We have seen the number of Board of Directors. Now, its composition. What are the executive directors, and what are the Non-Executive directors? What should be the composition? Those independent directors and all, those we will be discussing. So, let us discuss it. Compositions of BODs say these both CA the Companies Act and SEBI, that regulation says, at least, Board of directors should have at least one woman director, at least one woman director got to be there.

So, in all listed companies, there is at least one woman director. And now, what should be the CA Companies Act says that the Board of Directors at least one-third should be non-executive or independent directors, and at least one-third of BOD's total strength should be non-executive directors or independent directors. SEBI also says that if the Chairman is executive, at least 50 percent of the Directors should be non-executive. If non-executive Chairman, at least 50 per cent should be NEDs-non-executive directors.

If Chairman, if Executive Chairman, no, it is just the opposite; if non-executive Chairman, then at least 30 per cent, at least one third should be NED. If the executive Chairman, then at least 50 per cent shall be NED. So, if the executive Chairman, then at least 50 per cent should be NED; if the non-executive Chairman, one-third, at least one-third should be NED. So, these are some of the compositions of BOD. This is for companies' act, for SEBI, SEBI listing obligations and disclosure requirements. These are the say compositions of BODs.

Now, the frequency of board meetings. It is also specified in both, you know, the Companies Act and SEBI regulations. Both say what the frequency should be. There should be at least four board meetings annually, and the time gap between two sessions shall not exceed 120 days. These are the frequency of meetings. So, that means usually once in a quarter, BODs should be there. Then it says about quorum for meetings of the Board. What should be the quorum for the conference? The quorum should be a minimum of one-third the total strength of the BOD or two directors, whichever is higher.

So quorum is a minimum of 2 directors or one-third of the total strength of BOD, whichever is higher. So, this is as per the Companies Act. But as per SEBI, they say one-third of the total strength of BODs, minimum 3 directors or one-third of the total strength of BOD, whichever is higher. This is for the top 2000 listed companies. This is SEBI, this is SEBI. Then there is the number of directorships, and there is a limitation for the number of directorships. What is this number of directorships? As per the companies act, any individual can have a maximum of 20 directorships in any company.

But it should be limited to 10 public companies. This is the Companies Act. This is as per the Companies Act. But now, directorships for SEBI talks about participation. It says that the Board of Directors can participate in only 10 committees. The Board of Directors can participate in less than or equal to 10 companies. And shall be Chairman of less than 5 committees. This is the number of directorships. Then comes the remuneration.

Remuneration, both companies act, and SEBI says, like the remuneration of the Board of Directors shall be passed through resolutions of Board and shareholders through the resolution that remuneration of directors should be through passed through the resolution of BOD and shareholders, this is Companies Act. But SEBI says here the remunerations of NED, the non-executive director, shall be determined through, determined by BODS and passed through shareholders. SEBI says remuneration of NED shall be determined by BOD and passed by shareholders.

Now, last is the composition of the audit team. So, here the composition of the audit team says that minimum 3 directors will contain minimum 3 directors, most of whom should be independent directors. The majority should be an independent directors. So, at least 1 means at least 2; if it is 3, at least 2 should be independent directors, and this audit team must meet how many times? Minimum 4 times. They should meet a minimum of 4 times a year. This is as per the SEBI rule.

But companies act do not specify this minute here? And what are the tasks of the audit teams and all? That is as specified by the BODs. All these things will be there. So, this gives you a broad view of the composition, structure, size of the Board and all those quorums, frequency of board meetings, quorum and the number of directorships, remunerations, and all these we have discussed.

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Now, let us move to the next. So, what is the difference between executive and independent or non-executive directors? We have talked for so long about independent directors and non-executive directors. So, what are the differences? Executive directors are the whole time on the company's payroll. They are the executive director, the company's employees or the company or the decision makers of the company, and they are doing the normal regular work of the company. They are the executive directors.

And non-executive directors are independent directors. They are nominated or selected by the shareholders. And, for both Executive Director and non-executive directors, the shareholders approve appointments. Now, who are these NEDs, non-executive directors? They are generally outstanding people in their domain.

Suppose, it may be a strong administrative person, it may be a strong marketing specialist, it may be a consultant who has a lot of experience, it may be an academician who can give fresh thought to it, which can, and it may be a financial expert who can provide financial insight to the Board to the organization, it can be a marketing specialist who can give marketing, how the, how to achieve more market shares and all or it may be legal luminaries, or it may be a technologist who can help the organization in technological front, or it may be a banker.

So, it may be a person of wide, but those people should be experts in their domain and can add value to the organization. They bring up what? They bring up the environmental, outside environmental reality. And the company's people, when you work in an organization for your life and all, your thinking becomes constricted, your review becomes like structured thinking, you cannot go for a say a broader, wider cross-functional thinking, those things will suffer.

So, these people are coming from the outside and are more concerned and in touch with the outside environment market. So, they can bring in fresh ideas, and they can bring in new expertise, that will be that cross-fertilization of both these will be very helpful for the organization. That is why the importance of NEDs and IEDs is there. So, it should be a mixture of both, which has been now incorporated in the Companies Act and SEBI regulations. So you put it that way. So, the differences between these two are apparent now.

Now, what are the roles of constituency-based directors? You know, what is a constituency-based director? Say you must have heard that this is a particular domain; they represent a particular group or set of people. It may be workers' directors, and it may be a government director, nominee director, or the suppliers' directors, you know, nominated by the supplier or the customers.

Depending on that, that may be any constituency, but mostly we have seen the worker's director. That is the worker's representative, but this was introduced. Their effectiveness and all was not found to be very high because these worker directors, whoever comes, comes with the agenda of the worker even in the company is running in bad weather or the running in the loss and all, even then the demand, workers' market is giving bonuses and all-undue high bonuses, and they pursue that.

But these worker directors will come to the meeting, and they frankly say that he has to give their opinion for the worker's interest. So he insists on putting a dissent note. But you know, in most of the boards in India, dissent decisions are taken on consensus. So dissents notes are not taken.

Anyway, this is another government director; if you see the PSUs, public sector units, the government say if it is a central PSU, the concerned ministry, the concerned administrative ministry put they are joint directors and all as a government director. They influence the government and carry out the government's policies and all.

And at times, they may be very influential, and CEO may take a backseat. But we have also seen cases where the CEO takes the thing. If it is a pushy CEO, he takes on and can subdue the government directors; also, the cases are there. So, another is the state PSUs you will find, also state government nominates and all but their functionings and all are not up to that expectation. These are the government directors.

Similarly, in private companies, you will find another constituency by the nominee director. Who are these nominee directors? The Financial Institute nominates nominee directors. If the financial institutes have a large stake in that organization, their finances are tied there. They have lent the money, so to protect their investment, they nominate their nominee. So, these nominee directors say to safeguard the financial Institute's interest or investment.

And not only that, but they also try to safeguard the shareholders' interests. These are, you have seen it, that Vijay Mallya case and all, who led it? It is the nominee directors because it was the banks, those who have landed hugely on Kingfishers and other allied companies. So, the banks led by the SBI, then PNB and all, took the forefront to take it, to recover their money. So, these are the nominee directors.

So, these are some of the roles of a constituency-based director. But you know, too much of constituency-based director, like it may be the supplier, customers, if you go that way, there will become a, that Board will become a narrow approach and on their own. There may be more conflict, and these nominee directors do not have if they are more and all, do not have the expertise to run an organization; the working of an organization, that is a different thing.

So, the regular director and executive directors are adept in that. So, the mixture should be some optimum combinations. The next is the, is a thing called the Board of Committees. What are these board committees? As per the Companies Act and SEBI regulations, every Board should constitute some committees. Some committees are mandatory. That is, they have to do that. Now, all listed companies must do the audit and remuneration committees. There may be a committee for, say, a CSR committee, Corporate Governance Committee, Ethics Committee, and then a risk management committee.

So, it may be any number of committees. These committees play a vital role. So, an audit committee, which is now a risk management and remuneration committee, is necessary. You have to do a stakeholder communication committee and a relation-Stakeholder Relations Committee. So these are the board committees, and through these committees, the directors monitor one of the means is monitor the functioning of the organization. This can also give them the board members to interact with the top personnel of the organization.

Say an audit committee that independent directors should head, and this audit committee's members may be the director of finance of the organization, the director of internal or manager internal audit of the organization or any other persons. So they can interact with them and get the organization's pulse and functioning. And there are many statutory requirements for these board committees. What should be there? These are also guided by the Companies Act and the SEBI regulations; these are the board committees.

Then lastly, if we discuss boards in public and private sector enterprises, what is your impression if you have seen it? Which one is more efficient? Public sector enterprises board or private sector enterprises board? Can you think of and give your images on these? People usually answer that private-sector enterprise boards are far more efficient than public-sector enterprises board. These are the general feelings and general impression that is observed.

But, in reality, there are no facts, and all are there because, what you see the private sector boards and all, maybe few companies, a few multinational or few good companies, but if you see there are hundreds of 1000s of private sector enterprises whose Board is also like a phantom or rubber stamp. If you see the many of the family managed and those boards, those are also not that professional. But whereas, in public sector boards, there are many promising public sectors and all boards in India.

You can see those Maharatna, then your Mini Ratna, all those companies. There are many companies, dozens and dozens of companies, and those boards are very efficient. So, you cannot just say or give sweeping statements that the private sector is better than public sector enterprises. Generally, it has been seen as conflicting things and all. No established findings you will find and generalize it. These are some boards.

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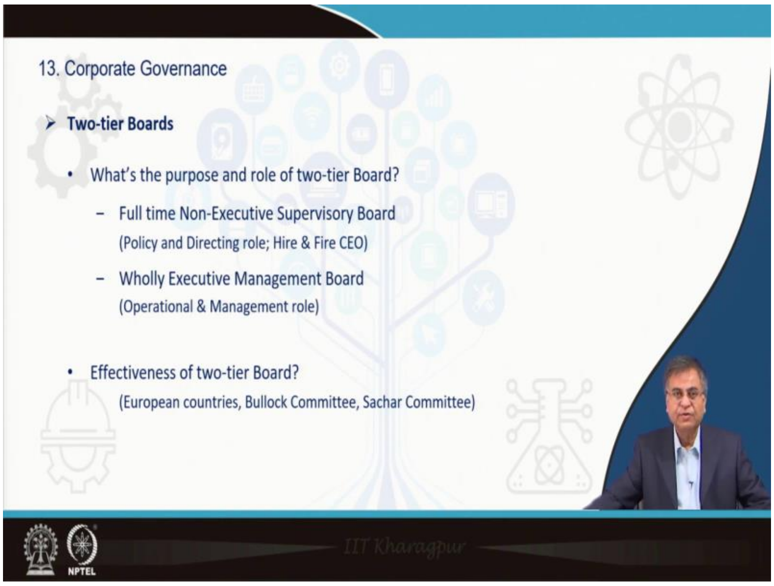

Now, we will talk about two-tier boards. You might have heard what two-tier boards are. What is the purpose and role of a two-tier board? A two-tier board is like, say, one tier is the total-time non-executive supervisory Board; these are the non-executive boards, and their role in policymaking and directing role only that. And they have the enormous power to hire and fire CEO and top management. This is one-tier. And also it has a wholly executive management board, and these executive management boards are concerned with operational and leadership roles.

That means the non-executive supervisory Board is for governance, policymaking and directing, and the executive management board is for the operational and managing things within the organization these two roles. And it says no member should be common to both the tiers and levels. They should be distinctly different. And these two-tier boards were found to be some degree of success in Germany and a few European countries. But it was not that successful in France.

And also, there is called a bullock committee in the UK. What is that? This, I was talking about the effectiveness of the two-tier Board. Then in the UK, these were examined by the Bullock committee. The bullock committee found many overlapping activities between these two levels, and there may be more confusion and conflict among them. The CEO's role is to present the management function report card to the non-executive supervisory Board there.

So, the Bullock committee did not favour this idea; as a result, they rejected it and it was not introduced in Britain or the UK. So, in India, this was examined by the Sachar committee, and they also went deep into it and weighed the pros and cons of this two-tier committee and ultimately negated the idea. So, that is why a two-tier Board is not there in India. So, we have only a single-tier board because of this confusion and ambiguity, and this may be the overlappings of jobs and activities between these two tiers. There are two-tier boards.

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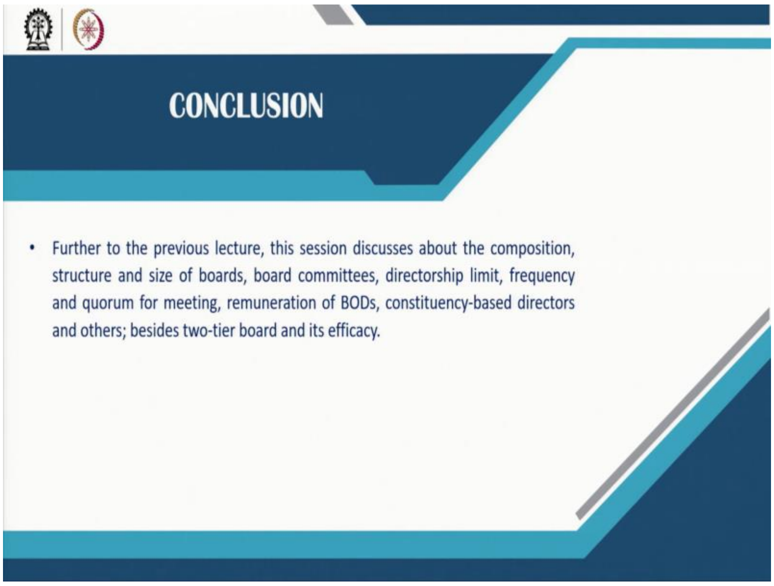

Now, to summarize this, we can tell in this session that we have discussed the composition, structure and size of the boards. The Board committees, directorships limit, then frequency and quorum for the meeting, remunerations of the Board of Directors, constituency-based directors and others; we have also discussed a two-tier board and its efficacy.

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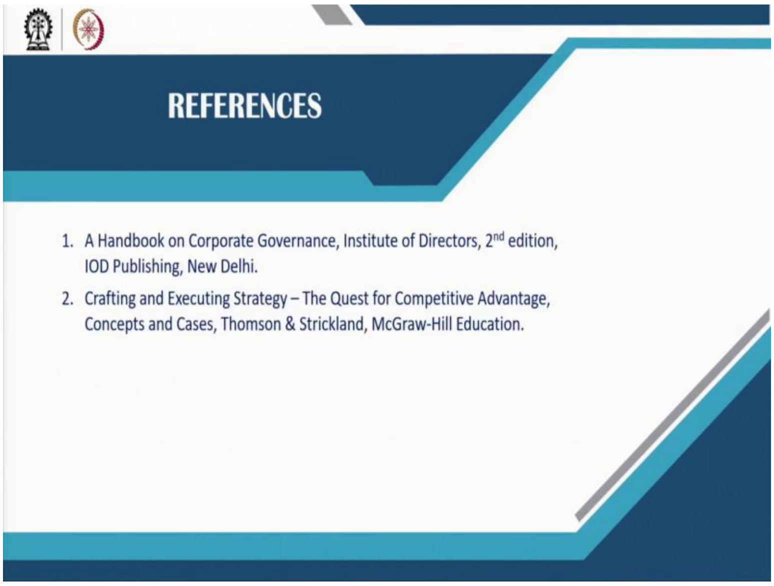

Then there are some reference books. The first book, the handbook on corporate governance by the Institute of Directors, is very good. If you can get it, go through it, it will give you enhance your knowledge of corporate governments in the Indian context hugely.

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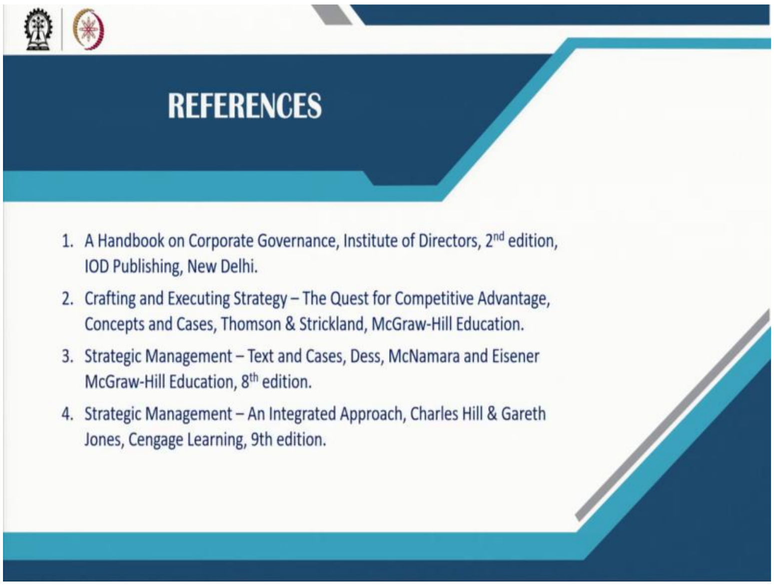

So, these are the other books you can refer to and improve your knowledge further. So, thank you very much for attending.