How independent (Outside) directors’ compensation structure, their frequency of meetings and concentrated ownership effects shareholder’s wealth? Evidence from Indian traded companies

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How independent (Outside) directors’ compensation structure, their frequency of meetings and concentrated ownership effects shareholder’s wealth? Evidence from Indian traded companies.*

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ABSTRACT

Corporate Governance advocates have strongly encouraged firms to include proper structure in independent directors’ compensation to help align directors’ interested with that of corporate stockholders. While the argument in favor of structure based director compensation is intuitively appealing, there is very little evidence of the efficacy of structure based director compensation. Regulators in India through Clause - 49(equivalent to Sarbanes –Oxley act of U.S.A) of stock exchange listing agreement on other side wish to increase market stability and efficiency through new reforms in compensation without examining the impact of ownership structure on the shareholder’s wealth. In an effort to determine the effectiveness of this policy, the study used multivariate regression to examine the relation between director compensation and firm performance. Data used are for two period 2005 and 2010, a sample of 260 firms from BSE-500 companies listed in India because this period includes two relevant time in the history of corporate governance regulation which represents important event and crisis so, it makes a nice variation to the analysis.

The findings provide some interesting insights into the relation between Independent director compensation and shareholders wealth. First, an empirical study of Independent director’s compensation from Indian firms adds significantly to existing literature because most of the insights generated so far rely on US data. Second, the research generate insights relevant for the regulation design of control structures that allow limiting the impact of large inside ownership shareholder(promoter) on minority shareholder wealth. Third, the indicators to measure shareholder wealth are refined. In other words, it throws light on who are the main enemies for shareholders wealth? It answers how one of corporate governance variable that is ownership structure can influence performance and efficiency of the shareholders wealth.

The paper has high relevance for practitioner/regulator audiences. Alternatively, what issue regulators should address to impact financial market activity more effectively through this ownership structure? It reflects on how a decade old corporate governance regulation can be detrimental for shareholders wealth! Lastly the issue of independent director’s compensation fits well into current academic discussions that academics have shown less interest in understanding how non-executive board members are compensated and how non-executive director’s compensation affects firm performance?

Key words: Executive Compensation, Corporate governance, Director, Independent, India, Outside, companies, Shareholders’ value maximization.

JEL classification: C 23, C 33, G14,G 34, G 38, L 51

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Science was the process of first making a guess, then computing the consequences of that guess (building a model), and finally confirming or rejecting the guess with experiment.

- Richard Feynman, noble laureate physicist

1. Introduction: This study examines the effect of Independent (Outside) directors’ compensation on firm performance (shareholders wealth) in greater detail by identifying the form of director compensation (i.e., board sitting fees, commission and salary) as well as the value of each type of compensation. The clause -49 of Listing agreement at Indian stock exchange defines an “Independent Director” as a non-executive Director of the company who:

   a. apart from receiving director’s remuneration, does not have material pecuniary relationships or transactions with the company, its promoters, its Directors, its senior management, or its holding company, its subsidiaries, and associates which may affect independence of the director;
   b. is not related to promoters or persons occupying management positions at the board level or at one level below the board;
   c. has not been an executive of the company in the immediately preceding three financial years;
   d. is not a partner or an executive or was not a partner or an executive during the preceding three (3) years, of any of the following:
      i. the statutory audit firm or the internal audit firm that is associated with the company, and
      ii. the legal firms and consulting firms that have a material association with the company;
   e. is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect the independence of the Director;
   f. he is not a substantial shareholder of the company, i.e., owning two percent (2%) or more of the block of voting shares; and
   g. he is not less than twenty-one (21) years of age. Nominee directors appointed by an institution that has invested in, or lent money to, the company are also treated as independent Directors.

1.1 Theoretical framework: According to agency theory, a potential problem exists when the ownership of a firm is separated from its management – as is typical of the modern corporation (Berle and Means, 1932; Jensen and Meckling, 1976). Because the owners (shareholders) are rarely involved in the day-to-day operations of a firm, it is difficult, and costly, for them to monitor a professional manager (agent) to ensure that the manager does not put his own interests ahead of those of the firm’s shareholders. Additionally, there is little incentive for any one shareholder to engage in monitoring because he or she
would bear the entire cost and time whereas the benefits would accrue to all of the firm’s shareholders (Porter, 1992). The regulatory pillars underlying executive compensation in India are clause 49 of Listing agreement at Indian stock exchanges, which arguably sets the key normative parameters in this area. Black and Khanna (2007) noted that the announcement had far-reaching corporate governance reform in 1999, introduction of clause 49, increased the stock price of large firms in India around 4-5% over a three-day window of time. SEBI formalized the recommendations of the BIRLA committee in 2000 by including these as part of the Listing agreement’s clause 49. Recommendation of the Murthy committee was later incorporated in 2006 into clause 49, ostensibly to apply lessons from the Enron scandal into the Indian corporate governance framework. Section IV (E) of clause 49 mandates that “all elements” of a director’s compensation package be disclosed in the Annual report, to include salary, bonus payments, stock option grants, pension contributions as well as any other benefits (perquisites such as houses, cars etc). This disclosure requires to be accompanied by information regarding the fixed portion of the compensation package as well as details of performance linked pay and performance criteria.

So, in conclusion, the separation of ownership and management has been recognized by scholars and practitioners as a concept and has stuck through the years. Karl Marx in Volume III of *Capital* (1867) discussed the separation of ownership and control in a review of class structure and Berle & Means published a three-book series on corporate governance in 1932 that coincided with the formation of the Securities and Exchange Commission in 1933. *The Modern Corporation and Private Property* (Berle & Means, 1932) documented the separation of ownership & control. Berle and Means, 1932, argued that owner or shareholders of the firm exercised virtually no control over either day-to-day operation or long-term strategy and policy. Instead, control of the firm was given to professional managers who held very little of the ownership.

Jensen & Meckling (1976) defined the agency relationship as a contract in which one or more persons (principals) engaged another person (agent) to perform some services on their behalf, which involved delegating decision-making authority to the agent. The theory of the firm (Jensen & Meckling, 1976) suggested that it is necessary to encourage & protect specific investment, both tangible & intangible. The ability to protect these investments has been diminished by not having the motivation of management (the agent) and motivation of owners (principals) in alignment.
Fama and Jensen (1983) thought that the problem was that managers and owners did not have alignment of interest between the agent and the principal, and that contracts were not written to the extent that can be enforced for transactions. The agency relationship can be reduced to a Series of contracts that provide safeguards for both parties to ensure that both sides fulfill their contractual responsibilities (Fame & Jensen, 1983). These contracts specify the rights of each agent in the organization.

Fama and Jensen (1993) suggested that contracts for corporate governance lacked enough substance to be enforceable. They thought that the process of contracting included a four-step decision process: (1) initiation of proposals for resource allocation, (2) choosing of initiatives to be implemented, (3) implementation of initiatives, and (4) Monitoring of agents’ performance. Even though a contract may be written to outline the Usage of funds, contracts are generally flawed and incomplete and cannot cover the wide Array of issues that may arise. Managers, therefore, end up with control rights or discretion over how to an investor’s funds. Professional managers are thought to have less incentive to maximize performance, and as a result, workers’ performance in the firm is more likely to decline as compared to a presumed increase of performance in Owner-managed firms (Fama & Jensen, 1993).

2. Motivation of study: Research on corporate governance mechanism dates way back to 1776, in the cornerstone writings of Adam smith, in the “The Wealth of nation”: “The directors of such companies (joint-stock companies), however, being the managers of other people money than of their own, it cannot well be expected they should watch over it, with same anxious vigilance with which the partner in the private coparcenary, frequently watches over his own like the stewards of the rich man, they are apt to consider the attention to the small matters, as not for the masters honors, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less in the management of such affairs of such company”.

Adam smith’s thinking predates numerous later scholars thinking on the incentives in the inter-personal and inter-organizational relations.

Various groups, such as the National Association of Corporate Directors (NACD), have strongly promoted various structure of director compensation, but the scarcity of research on director compensation suggests that further investigation is needed.

Daily et al. (1999) point out,........
there is virtually no evidence of a relationship between director compensation and firm’s performance. In fact, there is no consensus that we should even expect to see one. Ironically, while greater levels of stock ownership may cause directors’ interests to more closely align with those of shareholders, significant ownership may also cause directors to lose some of their objectivity and independence. (p. 48).

Secondly, this study is relevant, with the view…

that academics have shown less interest in understanding how non-executive board members are compensated and what effect their compensation has on firm performance (Sarkar and Sarkar, 2012).

Hempel and Fay (1994) examine the relationship between board compensation and firm performance using 1986 and 1990 proxy statement. They find little evidence of a relationship between director compensation and firm performance. However, the majority of the firms including in their sample compensated directors by paying them a cash retainer plus meeting fees. Additionally, due to data restrictions, the existence of a stock-based compensation plan was examined rather than the actual value of the stock plan.


3. Model Specification: Accounting and stock market returns are widely reported measures of firm performance and have been frequently used in research [kren and kerr, 1997]. This study employs a multivariate regression model to test the hypothesis regarding the effects of the composition of independent director compensation, concentrated ownership pattern on shareholders wealth.

Hypothesis 1: There is a relationship between structure of independent director compensation and shareholder’s wealth.

The accounting–based measure used for shareholder wealth in this study is – Earning per share (EPS) is defined as Profit After Tax divided by Total number of equity shares issued for the year 2005, year 2010, pooling data of year 2005 and 2010 years of compensations are awarded.
Hypothesis 2: There is a relationship between corporate ownership structure and shareholders wealth.

Accounting measures of shareholder wealth that is earning per share (EPS) was employed by Kesner [1987], Kim et al. [1988] in there study because each measure has strengths and weaknesses in evaluation as performance measure for shareholders wealth. The author assumes that market based measures; it is possible that, even if director compensation can influence performance, there may be no correlation between pay and returns if the market fully impounds the director compensation information at the beginning of the period. Accounting –based measures offer a less noisy measure of firm performance.

Hypothesis 3: There is a relationship between frequency of independent director’s meetings and shareholders wealth.

The specific regression takes the form:

\[
\text{Shareholders wealth} = f (\text{Structure of Director Compensation} + \text{Control variable} (\text{Frequency of meeting, Industry, Promoters holding, institutional holding, Board size}) + \text{error}
\]

Where,
Shareholders wealth= EPS= for the year 2005, year 2010, and panel of year 2005 and 2010, year in which the compensation is awarded, calculated as income before tax, extraordinary item and discontinued operations divided by average total assets;
Structure of Directors Compensation Includes= (Salary, Board Sitting fees and commission)

4. Sample: The sample includes 520 firms observations-260 firms (see ANNEXURE-I) from Bombay stock exchange-BSE-500 for the year 2005 and same 260 firms for the year 2010. The firms were selected at random. If the firm had observations in both sample years, and if both sample –year observations met the data requirements, then both years are included in the sample. This process was continued until 260 observations from each
year selected. The summary statistics of Independent director compensation observed by Sarkar and Sarkar (2012), for the year 2006, 2007 and 2008 were Rs. 2,72,000, Rs 3,26,000 and Rs. 3, 93,000 respectively. The compensation Variable matched with slight variation this may be due to the fact that this data is of 260 companies for two periods for year 2005 and 2010 from BSE-500 companies and that from the top 500 companies and there is period component to it.

As shown in table 1, total independent director compensation averages Rs. 386 444 (Median=Rs. 120000). In examining the sample by year (Table 2), it is apparent that Independent director Compensation policies have undergone major changes from year 2005 to year 2010.

Total Independent director compensation averaged Rs. 386 444 (Median= Rs 120000) in 2005, but increased to Rs. 5,46,973 (median= Rs. 200000) by 2010.

5. UNIVARIATE STATISTICS:

Table 1. Sample summary statistics

The sample consist of 520 firms observation taken from BSE-500 firms. 260 observation are from the year 2005 and same 260 companies for the year 2010. Independent director compensation variables are for most of Independent director for the firm. Board sitting fees represent the value in Indian rupees. Commission represents values in rupees. Board sitting fees represents in rupees. Salary in rupees. Total compensation as sum of board sitting fees, commission and salary in rupees. The remaining variables are described as below.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>Median</th>
<th>Standard deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Variables</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board sitting fees</td>
<td>97256</td>
<td>60000</td>
<td>114139</td>
</tr>
<tr>
<td>(Rs.)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commission (Rs.)</td>
<td>317318</td>
<td>0.000</td>
<td>804401</td>
</tr>
<tr>
<td>Salary (Rs.)</td>
<td>10340</td>
<td>0.000</td>
<td>220636.7</td>
</tr>
</tbody>
</table>
Data Source: Authors compilation from the annual/balance sheet of 260 companies from BSE-500(see ANNEXURE-I). Note- 1million=Indian Rs.10 lakhs; 1 US $=63 Indian rupees (Rs.) as on 12th December'2013: Indian Rs.10 Lakhs =Rs.

1million.:Indian Rs.1 crore=Rs.10 millions

### Table 2. Sub Sample summary statistics and tests of difference of means

The last column provides absolute value of difference of means for the two sub samples 2005 vs. 2010, using test of difference of mean based on Wilcoxon signed rank test, for definition of variables refer the above table 2 on summary statistics
<table>
<thead>
<tr>
<th>Variables</th>
<th>87438</th>
<th>51000</th>
<th>108578.9</th>
<th>116535</th>
<th>84000</th>
<th>122098.7</th>
<th>16.87***</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board sitting fees (Rs.)</td>
<td>272436.9</td>
<td>0000</td>
<td>735978.2</td>
<td>405446</td>
<td>0000</td>
<td>918046.4</td>
<td>5.47***</td>
</tr>
<tr>
<td>Commission (Rs.)</td>
<td>10549.30</td>
<td>0000</td>
<td>220636.7</td>
<td>9931.324</td>
<td>0000</td>
<td>248979</td>
<td>2.90***</td>
</tr>
<tr>
<td>Salary (Rs.)</td>
<td>386444.3</td>
<td>120000</td>
<td>840430.0</td>
<td>546973</td>
<td>200000</td>
<td>977836</td>
<td>17.91***</td>
</tr>
<tr>
<td>Total compensation(Rs.)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Control Variables</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Sales.Rs.(In crores)</td>
<td>4814.416</td>
<td>1201.865</td>
<td>21134.45</td>
<td>4716.599</td>
<td>1339.280</td>
<td>19670.26</td>
<td>10.31***</td>
</tr>
<tr>
<td>Total Asset.Rs. (In crores)</td>
<td>11381.95</td>
<td>2093.730</td>
<td>39769.28</td>
<td>10656.28</td>
<td>2018.076</td>
<td>37372.01</td>
<td>7.01***</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Corporate Governance Variable</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Board size</td>
<td>11.49</td>
<td>11</td>
<td>3.669</td>
<td>11.51</td>
<td>11</td>
<td>3.621</td>
<td>2.95***</td>
</tr>
<tr>
<td>Institution Holding (%)</td>
<td>27.09</td>
<td>27.06</td>
<td>15.62</td>
<td>27.06</td>
<td>27.30</td>
<td>15.33</td>
<td>0.88</td>
</tr>
<tr>
<td>Promoters Holdings(%)</td>
<td>39.72</td>
<td>39.63</td>
<td>21.96</td>
<td>40.38</td>
<td>39.87</td>
<td>22.18</td>
<td>1.14</td>
</tr>
<tr>
<td>No. Of Meetings attended</td>
<td>4.69</td>
<td>4</td>
<td>2.91</td>
<td>4.775</td>
<td>5</td>
<td>2.84</td>
<td>8.87***</td>
</tr>
</tbody>
</table>

*** Indicates statistical significance at the .01 level, two-tailed
** Indicates statistical significance at the .05 level, two-tailed
* Indicates statistical significance at the .10 level, two-tailed

Data Source: Authors compilation from the annual/balance sheet of 260 companies from BSE-500(see ANNEXURE-I).
Turning to the corporate governance variables despite the fact that compensation has dramatically increased since 2005. While the board size remained the same 11.49 members in 2005, to 11.51 members in 2010, institutional holding remained same from 27 percent to 27.06 percent by 2010.

In 2005, promoters holding make up to a 39.72%, while in 2010 it is 40.38%. By 2005, the no. of meetings attended by the Independent Director was 4.69, whereas in 2010 it is 4.7. There was no other significant differences in the corporate governance variables in 2005 and 2010.

6. Empirical strategy/Analysis:

1) Relevance of the Year- Two factors has played a major role in India, in the last 10 years or so, corporate governance and the institution of independent directors have evolved. First, introduction of Clause 49 (considered equivalent to Sarbanes –Oxley act of USA) by security exchange board of India (SEBI) in year 2004 and the Satyam fraud in year 2009 are considered as important in improvements in corporate governance and the role of independent directors.

a) Justification for the Year 2005 data: Introduction of Clause 49 by security exchange board of India (SEBI) in year 2004 tempted the authors to go for the data of year 2005 to see the impact of clause 49 (of Indian stock exchange listing agreement for Indian companies) on Independent director’s compensations and shareholders wealth.

b) Justification for the Year 2010 data: The Satyam Company scam in the year 2009 had a major impact. Dozens of independent directors resigned from a number of companies as responsibilities and risks of being a board member became clear. So, the author considered /assumed that in the year 2010, only those who are sure of their effectiveness continued as independent director, other important thing that happened in the year 2010 was their compensation went up after this event.

So, in conclusion, after the Satyam scam of the year 2009, Clause 49 resulted in the induction of more independent directors and improvements in board processes. Boards meet more often as required by the regulations; it is assumed directors are speaking up in board meetings to ask substantive questions, voice concerns and offer advice rather than
just to pop in a cashew as in the past that is before the Satyam scam of 2009.

2) Regression Result:

A) Independent Director compensation:

From Table 3 presents the results for the regressions of Earning Per share (EPS), for the year 2005, 2010 and full sample (year 2005 + 2010) on Independent Director compensation. The models are not significant with p < .01 and the adjusted R-squares are fairly low (Jensen and Murphy, 1990a, 1990b also report low R-squares) explaining little variation in EPS model. No independent director Compensation variables are significant in any of the EPS models.

B) Frequency of meeting:

Vafeas (1999b) finds that firms increasing meeting frequency experience improved performance. Specifically, he finds that boards meet more often following poor firm performance and that firm performance improves for these firms in the year after they increase the frequency of board meetings. This improvement in performance continues over the two and three years after the year of abnormal meeting frequency. However, Vafeas (1999b) examines firms that increase their board meeting frequency - presumably as a response to this poor performance. Alternatively, Hempel and Fay (1994) find no relation between frequency of board meetings and firm performance.

Board meeting frequency was first defined as the log of the number of meetings (LMTG) and then as a dummy variable (DMTG) with the value of one for firms meeting seven or more times. In the EPS model, LMTG and DMTG are insignificant and negative.

From Table-3, Contrary to Vafeas’ (1999b) findings, this suggests that firms with a high frequency of board meetings have lower performance in the year following the observation year. Additionally, in the EPS model (Table -1) both LMTG and DMTG are insignificant.

Table-3 Compensation of Director, Frequency of meeting and Corporate governance variables (EPS MODEL)

Regressions of Earning per share (EPS) on Independent Director Compensation, Industry control, t-statistics tests indicated in parentheses beneath the coefficients,
## EPS for period

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>YEAR 2005 EPS1</th>
<th>YEAR 2010 EPS 2</th>
<th>FULL SAMPLE EPS 3</th>
<th>FULL SAMPLE EPS 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>OLS</td>
<td>OLS</td>
<td>Fixed effect</td>
<td>Random effect</td>
</tr>
<tr>
<td>Intercept</td>
<td>11.2464***</td>
<td>20.8954***</td>
<td>13.286***</td>
<td>13.1062***</td>
</tr>
<tr>
<td></td>
<td>(3.5815)</td>
<td>(4.1364)</td>
<td>(5.0771)</td>
<td>(4.2733)</td>
</tr>
<tr>
<td>Compensation Variables</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board sitting fees</td>
<td>-7.11E-07 (-0.1184)</td>
<td>-5.10E-06 (-0.5898)</td>
<td>-1.10E-06 (-0.2428)</td>
<td>-1.19E-06 (-0.2670)</td>
</tr>
<tr>
<td>Commission</td>
<td>8.28E-07 (1.3317)</td>
<td>4.09E-07 (0.4494)</td>
<td>7.37E-07 (1.4738)</td>
<td>7.19E-07 (1.4587)</td>
</tr>
<tr>
<td>Salary</td>
<td>1.76E-06 (0.7639)</td>
<td>8.83E-07 (0.2788)</td>
<td>1.59E-06 (0.9723)</td>
<td>1.55E-06 (0.9565)</td>
</tr>
<tr>
<td>Control Variables</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Sales</td>
<td>0.000123***</td>
<td>0.000167***</td>
<td>0.000178***</td>
<td>0.000174***</td>
</tr>
<tr>
<td></td>
<td>(4.4843)</td>
<td>(3.6188)</td>
<td>(8.4198)</td>
<td>(8.4033)</td>
</tr>
<tr>
<td>Total Asset</td>
<td>2.68E-05 (1.58188)</td>
<td>2.27E-05 (0.7900)</td>
<td>-3.21E-06 (-0.1869)</td>
<td>3.69E-07 (0.0218)</td>
</tr>
<tr>
<td>Corporate Governance Variable</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Variable</td>
<td>1376</td>
<td>2860</td>
<td>4230</td>
<td>4230</td>
</tr>
<tr>
<td>-------------------------------------------</td>
<td>-------</td>
<td>-------</td>
<td>-------</td>
<td>-------</td>
</tr>
<tr>
<td>Board size</td>
<td>0.5123*** (3.0971)</td>
<td>0.2913 (1.0975)</td>
<td>0.5109*** (3.5069)</td>
<td>0.4779*** (3.2984)</td>
</tr>
<tr>
<td>Institution Holding</td>
<td>0.04000 (0.9040)</td>
<td>-0.0370 (-0.5221)</td>
<td>0.0145 (0.3572)</td>
<td>0.00840 (0.2154)</td>
</tr>
<tr>
<td>Promoters Holdings</td>
<td>-0.0592* (-1.9201)</td>
<td>-0.11017** (-2.2424)</td>
<td>-0.0735*** (-2.7600)</td>
<td>-0.0780*** (-2.9850)</td>
</tr>
<tr>
<td>(Founding and controlling /Dominant shareholders)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Log No. Of meeting attended##</td>
<td>0.1346 (0.049)</td>
<td>-3.2529 (-0.7237)</td>
<td>-1.5177 (-0.6947)</td>
<td>-1.4122 (-0.6474)</td>
</tr>
<tr>
<td>Dummy for more than six Meeting</td>
<td>-1.6103 (-0.8768)</td>
<td>0.2774 (0.0948)</td>
<td>1.3016 (0.9326)</td>
<td>0.9374 (0.6777)</td>
</tr>
<tr>
<td>AdjR²</td>
<td>0.026</td>
<td>0.0177</td>
<td>0.1048</td>
<td>0.0279</td>
</tr>
<tr>
<td>F</td>
<td>6.6054***</td>
<td>2.866**</td>
<td>6.8998***</td>
<td>9.3815***</td>
</tr>
<tr>
<td>N(Companies)</td>
<td>260</td>
<td>260</td>
<td>520</td>
<td>520</td>
</tr>
<tr>
<td>No. Of Observation</td>
<td>1376</td>
<td>2860</td>
<td>4230</td>
<td>4230</td>
</tr>
</tbody>
</table>

*** Indicates statistical significance at the .01 level, two-tailed **Indicates statistical significance at the .05 level, two-tailed * Indicates statistical significance at the .10 level, two-tailed.

##The average firm in the sample met 4.06 times and the median firm met four times.

**Variable definitions**
- a) Net sales is the accounting figure from the profit and loss statement in rupees of the company for the year in which compensation is awarded.
- b) Total asset is the accounting figure from the balance sheet (in rupees) of the particular company for the year in which compensation is awarded.
- c) Board size is the no. of the directors in the companies reported in the balance sheet of the particular companies for the year in which the compensation was awarded.
- d) Institution holding measured as percentage of shares held by the institution as reported in the balance sheet for the year in which compensation was awarded.
- e) Promoters Holdings measures as percentage of shares held by the
promoters group as reported in the balance sheet for the year in which compensation was awarded. f) No. of meetings measures the attendance of Independent directors as reported in the annual statement for the year in which compensation was awarded.

7. Discussion: Sarkar and Sarkar (2000), showed in late 1990’s the average board size was smaller in India compared to U.S., with 9.46 members on Indian board compared to 11.45 members on the U.S. Board. While the percentage of inside directors was almost identical (25.38% compared to 26% in U.S.) Indian board had relatively fewer Independent director (54%) compared to U.S. (60%) and relatively more affiliated outside directors (20% compared to 14% in U.S.). Over 40% of Indian companies had promoter on the board and in over 30% of the companies the promoter served as chair. Sonja Fagernis (2007), reports that average total compensation (salary plus commission of Indian CEOs increased almost threefold between 1998 and 2004 from Rs. 21 lakhs (2.1 millions) to Rs. 61 lakhs (6.1 Millions) in real terms. During this period the proportion of profit based commission to total pay also increased from 13.4% to 25.4%, and the percentage of CEOs as percentage as part of their compensation increased from 34% to 51%. Meanwhile executives compensation as fraction of profit has increased from 0.55% to 1.06%. Ghosh, A (2006), in his studies during the period 1997-2002 (a sample of 462 manufacturing companies), the average board compensation in India was around Rs.53 lakhs (5.3 millions) with wide variation across the firm size. The average board compensation was Rs.76 lakhs (7.6 millions) for large firms and Rs.25 lakhs (2.5 millions) for small firms. Board compensation was also higher on an average Rs.69 lakhs (6.9 millions) when the CEO was related to the founding family.

7.1 Reflection on the role of Independent (Outside) directors: On personal note, the new Companies Act, passed by government of India in the year 2013 has several additional provisions regarding independent directors, but the important point is to reflect on whether the term “independent director” itself an oxymoron? How the Independent directors would justify their appointment to minority shareholders? What will be the qualifications criteria for independent directors to sit in board of the companies? It will be interesting to see how this act passed in 2013 will stand the test of time, also, how independent director, play their role as watchdog on the promoters (Founding and controlling/dominant shareholders) and the top management of the company and protect
minority shareholders' interests.

The functions of these independent directors (as per clause-49, introduced by SEBI in the year 2004) are expected to perform is to question various decisions made by the board, keeping in mind the interests of the society at large and also balancing it with the need for the company to survive and thrive. Primarily, they are expected to be unbiased, neutral, professional, honest, straightforward and frank candidates and most importantly, have a mind of their own. But, in a realistic world, it’s a tall order.

**7.2 How the independent (outside) directors are appointed:** Given the fact that the promoters((Founding and controlling/dominant shareholders ) of the company have the prerogative to appoint independent directors on the board of a company, the entire selection process reflects the purpose for which the appointment has been made: either it could only be made to fulfill the legal requirement, or it could be done to move towards ideals and really give the power to independent directors to be the conscience keepers of the company so that the company gradually, but surely, moves towards higher business ethical values, legal compliance, and enhancement of social good. But, that is what ought to be. In practice, unfortunately, the story is different. In the private sector companies, one has to be well known and trusted by the promoters to be invited to join the apex body of company that is board of directors as an independent director. In public sector companies, where government is the promoter, these appointments are made not by the chairman of the firm but by the minister in charge of the Public Sector Unit (PSU). A lot of influence is required to become an independent director in a PSU.

**7.3 Conflicting of interest, asymmetric information between Independent (outside) director and Promoter:** Under this condition, then, how independent director be expected to be really independent? Another point worth considering will be promoters and managements have far more information and knowledge regarding the affairs of a company/firm and have more resources at their disposal compared to independent directors. The promoters and managements also have more financial stake in decisions and, therefore, protect their interests vigorously. These make the job of an independent director very difficult, but not impossible. It will be interesting to see how ‘independently’ independent directors execute their ‘fiduciary’ duty imposed under clause 49 towards minority shareholders! Under conflicting interest, of promoters / top management at one hand and independent director on other hand, role of independent directors in Indian companies will be variable of interest for years to come after 2013 not
only to various stakeholders like shareholder’s, foreign investors etc., as well to researcher’s, practitioner’s, regulator’s, academician’s more importantly to the law makers of India.

8. Conclusion: From the findings of this study, one can infer several things—with the introduction of Clause -49 in year 2004, by SEBI, capital market regulator in India, in theory, the role of independent directors was to bring objectivity to the board, protect the interests of minority shareholders, and improve risk management. So, from the results (table-3) of this study suggest that there no relation between Independent director compensation structure and shareholders wealth. First, compensation structure of Independent director is not effective if seen from the stockholders perspective that is the EPS Model mentioned at table -3. Second, from the results (table-3), there is no relation between the frequency of the Independent director’s meetings and shareholders wealth (EPS), contradicting the finding of Vafeas (1999a:1999b). Which raises question are independent directors speaking up in board meetings to ask substantive questions, voice concerns about minority shareholders and offer advice or just they pop in a cashew provided by the firm in the form of compensation? Thirdly, from table-2 and table -3, there is a high agency cost in terms of monitoring by independent directors in safeguarding minority shareholder rights. Although as can be seen from table-2, the total compensation of independent director has increased to Rs.546000 (0.546 million) in the year 2010 from Rs.3,46,000(0.346 million) in the year 2005 which is about 57% increase in total compensation from the year 2005, which has created no effect on the shareholders wealth that is earning per share(EPS). Sarkar and Sarkar (2009),reveals in India marked level of concentration is in the hand of the “Promoters”(i.e. Founding and controlling/Dominant shareholders),they reported promoters own 50% of a sample of almost 2500 listed manufacturing companies. Sarkar and Sarkar(2000),as for effect of concentrated shareholding on the company’s performance ,noted during 1995-96 holding above 25% by directors and their relatives were associated with higher valuation of the companies.(while there was no clear effect below that threshold effect).Therefore, in such a high informatory asymmetry environment with presence of greater ownership of promoters outside (independent) directors, both monitoring and advisory role is less efficacious (Duchin et al., 2010). The ownership concentration among a dominants shareholder (promoters-i.e. Founding and controlling shareholders) minimizes the risk of takeover, and therefore acts substitute mechanism for monitoring by independent
directors (in the sample, see table-2, the promoters group/ Founding/dominant and controlling shareholders hold 40% of shareholding). A higher proportion of independent with high insider ownership further attenuates conflict of interest between them and the management / owner that may hinder the decisions making process (Singh and Gaur, 2009). Another perspective for explanation is ownership and control by promoters/ Founding/dominant and controlling shareholders, on firm allows them to have their own people on the board as an independent director. Sonja Fagernis (2007), also reports that CEOs related to founding members or directors are paid more than other CEOs. She also presents evidence that presence of Directors from lending institution lowers the pay whereas presence of more Independent directors on board is associated with greater pay for performance to the insiders, which affects the other minority shareholders. In such cases, the independent director role is more or less ceremonial and only for legal compliance requirement purpose. This is supported by EPS model, of table 3, where compensation structure of Independent director is not effective and promoters holding are negatively correlated with EPS and significant for all the four panels. Finally, from the economist perspective, their exist no linear pay-performance relationship , which prefer incentives throughout the entire range of performance levels and advocate fixed performance standard which discourages earning manipulations, (Jensen and Murphy,2004).however, the absence of linear pay-performance relationship of Independent director-compensation and shareholders wealth’s is to be seen with the high ownership of promoters which makes the role of independent directors un-effective when it comes to monitor the promoter ,as seen in table -3, promoter’s holding is negatively related to shareholders wealth in all the models! So, one can conclude very high promoter’s (Founding/dominant and controlling shareholder) holdings at the about 40 % level is negatively effecting shareholders wealth in all the models (table-3) of this study. In final analysis, what are visible the elements of corporate governance that are laid out in conventions, codes and laws that have been strengthened over the years. As Adam Smith (1776) puts it that “the invisible hand” – guides the market, it is “the invisible spirit” that guides independent directors. So, let this invisible spirit guide the independent directors, who are “agents” - custodians of ‘promoter’s as well as minority shareholder’s money. Under the model corporation law companies are artificial juristic persons and need natural persons to make decisions. The conscience keepers of a company are, therefore, the individuals managing the show. But it has not strengthened
the spirit of corporate governance. The moral fabric of the company as well variation in shareholder’s wealth are spun and woven by the major inside block holders (promoters), who are in control of the affairs of the company. Unfortunately, statistics cannot measure and monitor this invisible spirit. The spirit lies in the hearts of the independent director’s. It is rooted in the foundation of moral sentiments and values.
ANNEXURE-I

Sample list of 260 companies selected from Bombay stock exchange (BSE)-500 companies
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