THE INTERNATIONAL JOURNAL OF BUSINESS & MANAGEMENT

Role of Independent Directors in Corporate Governance: A Study on Indian Defence Public Sector Undertakings

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Abstract:
Business activities spreading across the continents, shareholders scattered across the world and investments by institutional investors created necessity to have an independent member on the Board who takes impartial and disinterested decisions. Corporate governance disclosures would depend upon expectations of regulators and stakeholders. SEBI's listing Agreement DPE guidelines focused on the induction of independent directors on the Boards as well as on various Board committees, along with other countries all over the globe. Independent Directors would bring an element of objectivity to Board processes in the general interests of the company and thereby to benefit both majority as well as minority shareholders and other stakeholders. They would help the company Boards by providing fresh and independent judgment to the strategic thinking and independent decision making. They would contribute to the development of sound business strategies and performance monitoring. The independent directors would ensure and assure that the Board decisions would not be based on narrow vision. They would constitute necessary component of a balanced Board structure where in-depth knowledge of executive directors was blended with wider experience and knowledge of independent out-side directors. The role of independent directors is effective in DPSEs.

Keywords: *Independent directors, corporate governance, stakeholders, DPSUs*

1. Independent Directors

Some of the recent developments in the capital markets, major diversification of the equity capital leading to ever larger distance between the owners of capital and the managers; the decline of banking and the rise of the institutional investors; working of the economic system where enterprises spreading offices and employees in dozens of countries; business activities spreading across the continents; shareholders scattered across the world; and investments by institutional investors created necessity to have an independent member on the Board who takes impartial and disinterested decisions.

This is focused on the role of independent directors in corporate governance in general but specific in Indian Defence public sector enterprises.

Corporate governance disclosures would depend upon expectations of regulators and stakeholders. There was no point in making statutory provisions for enforcing the number of independent directors but, it would be imperative that there should be a convergence between corporate governance and effective functioning of independent directors. Satwalekar (2009) opined that while the above was important and might be necessary to fulfill their role and responsibilities as an independent director to enable true governance, independent directors' hands must be strengthened. Several studies found that a Board with higher proportion of outside directors did better job of monitoring and management.

Independent Directors would bring an element of objectivity to Board processes in the general interests of the company and thereby to benefit both majority as well as minority shareholders and other stakeholders. They would help the company Boards by providing fresh and independent judgment to the strategic thinking and independent decision making. They would contribute to the development of sound business strategies and performance monitoring. The independent directors would ensure and assure that the Board decisions would not be based on narrow vision. They would constitute necessary component of a balanced Board structure where in-depth knowledge of executive directors was blended with wider experience and knowledge of independent out-side directors.

SEBI's listing Agreement focused on the induction of independent directors on the Boards as well as on various Board committees, along with other countries all over the globe. Many empirical studies agreed on the importance of independent directors to the success of a firm. (Elloumi and Gueyié, (2001) concluded that firms with high ratio of independent directors on the Board, had faced less frequent financial pressures. In addition to this, Daily et al., (2003) it was also stated that when a business environment worsens, firms with many independent directors have had lower probability of filing for bankruptcy.

2. Recommendations of the Irani Committee on Independent Directors

According to the committee**,** there cannot be a single prescription of independent directors for all companies but number may be prescribed by rules. A minimum one third of the Board was recommended for a company having public interest. Nominees of institutions should not be considered “independent” as they represent sectional interests. Independent directors should make self-declaration of eligibility if so appointed.

3. Companies Act, 2013 and Independent Directors

The Companies Act, 2013 looked at all directors alike. They were not exempted from any of the duties, liabilities, and responsibilities of the Board. These directors were as much as part of the corporate governance teams as any other director. There was no parity in power between independent directors and other directors of the Board. Woman Director: Every Listed Company /Public Company with paid up capital of Rs 100 Crores or more / Public Company with turnover of Rs 300 Crores or more shall have at least one Woman Director.

4. Independent Directors – Selection and Appointment

The selection and appointment of independent directors should be transparent and on certain value basis. Therefore, the companies should have an entirely independent nomination committee which should determine the norms and qualifications for Board membership. According to DPE guidelines, the following professionals were eligible for appointment as independent directors: advocates, doctors, charted accounts, company secretaries, cost accounts, architects, professors in the field of management, finance and human resources, who may be providing professional services on work to work basis or retainer-ship basis. They should be treated as independent since payments to them were made purely on their professional expertise and such relationship would not in any way affect independence in their judgment.

In considering the independence of directors, it was necessary to focus not only on whether a director’s background and qualities of head and heart qualify him as independent but also whether he/she had proven track record of personal integrity to act honestly, and independently. Such qualitative independence would ensure that directors think and act independently without succumbing to promoters’ or other controlling directors’ pressures and like influences.

Krishnamurthy (2009),stated that in Russia an independent director was defined as a person who is not financially or otherwise depending on the company/s management, controlling shareholders, large counterparts and competitors; who was not the representative of the state; who was not at the same time a member of executive body; who was not depending on the companies affiliated to owner of holding20 percent of voting rights or members of Board of directors or auditors; who were not consultants contracted by the company; who had publicly declared his independent director’s status; who received the remuneration for his work only in the capacity of professional expert having necessary qualifications; who would work faithfully in the Board of directors; who possessed good reputation; who would disseminate accurate information about the company and would maximally facilitate to disseminate access to information by all shareholders of the company about personal transactions as director and his relatives.

Non-executive / independent directors on public sector enterprises Board should take cognizance of composition, domain/ industry knowledge, roles, responsibilities, training and compensation. It would be vital to widen the pool of non-executive directors available to serve on PSE Boards. They included candidates from private sector as well. At present, there was a tendency to look for the candidates only from public sector. Public Enterprises Selection Board (PESB) would play a critical role in short listing candidates and maintaining database of eligible candidates. There was a big gap between the governance standards prevalent in the larger and more profitable disinvested PSEs verses the smaller and not so profitable ones. Functional directors, on the larger profitable and better performing PSEs, would have to assume non-executive director roles, in the ‘smaller and not so profitable’ companies, to promote better sharing of good practices. It would lead to reduce the gap between prevailing standards in CPSEs.

5. Significance of Independent Director

The non-executive director in general and independent director in particular should contribute to and constructively promote the development of the company strategy, scrutinize management performance, satisfy them that financial information was accurate and should ensure that robust risk management was put in place. They would have a greater exposure to the major shareholders and thus would contribute to more effectiveness of the Board.

It would be seen that under listing agreement, not less than 50 percent of the Board of a company should comprise of independent directors, if the company had an executive chairman. If the company did not have an executive chairman, then the number of independent directors could be reduced to not less than one third of the total membership of the Board.

According to Joshi, (2009),a director could be considered as independent if he/she had never been the employee of the corporation or any of its subsidiaries, was not the relative of the company; provided no major services to the company; and received no compensation from the company other than the sitting fees for attending the Board or committee meetings.

6. Role of Independent Directors in Board Effectiveness

The independent directors were the critical elements in ensuring good corporate governance. Their role was that of conscious keepers. They would bring an independent thinking and rich experience in their respective fields. They were capable of resisting the influence of promoters and taking independent decisions keeping in view of overall interests of all stake holders. Moreover, they would take actions which could be justified and take responsibility for their decisions.

The role and responsibilities of an independent director under Companies Act, (2013), would depend upon the nature of the directorship. Independent directors were of course neither full time nor part time functional directors. They were neither executive directors nor were nominees. Therefore, the position of independent director should be weighed very carefully as the implications of clause 49 for the Board of directors was diverse and explicit. They had personal accountability for violations of law. An independent director was expected to be no more up-to-date on the subject matters than the other directors; their unique contributions would lie in their considered, unbiased opinion on the subjects placed before the Board and decisions expressed keeping in mind, the highest regard for the company's long-term interests. The qualities of an independent director would include:

- Possessing knowledge to meet the expectations of the company and its regulators without assuming disproportionate risks,
- demonstrating independency of mind, resisting pressures and maintaining objectivity,
- obtaining the code of conduct and ensure to abide by it,
- seeking external professional help from experts in cases there was any scope for doubt,
- demanding all requisite notes to agenda well in advance and attend meetings well prepared for meaningful discussions at the meeting,
- bringing an element of objectivity in decision making pro

Seeking a more effective role by independent directors, in days to come, the ICSI (2009) had recommended to the Ministry of Corporate Affairs (MCA) and market regulator SEBI, to fix the appointment term of independent directors as six years. The fixed term of independent directors would ensure Boards with new blood and would avoid any intimacy between them and the executive management. In reality, the Board members were picked up on their equation with the CEO and the rest of the Board, rather than based on their wisdom. Hence the post of independent directors in most of the companies turned out to be a status symbol. While some independent directors feel obligated to CEO and they were utilizing the Board status as networking opportunity for self-interest at the expense of the company.

The U.S. federal securities laws reflected the importance of independent audits by requiring or permitting the Commission to require that financial statements filed with the commission by public companies, investment companies, broker/dealers, public utilities, investment advisers, and others be certified (or audited) by independent public accountants, and by granting the Commission the authority to define the term "independent." The Commission stated that an auditor would be deemed to be independent if he or she was independent in fact but not to appear to be independent. He or she should act in an unbiased and objective manner and he or she should be free of any financial interest, which would create the perception that he or she may not be independent.

Further, the Congress, the Commission, the U.S. Supreme Court, and the accounting profession historically stressed the need for auditors not only to be independent but also to avoid circumstances that may impair reasonable investors' perceptions of auditors as independent from their audit clients.

In fact, independent directors were considered as both a 'safeguard' and a significant source of competitive advantage'. The inclusion of independent directors would bring a different view, a more knowledgeable view, a more professional view, of the world in which the company operates. The capabilities required in an independent director - inter alia – would include, the financial and marketing literacy, mentoring capabilities, independence of mind. The Blue ribbon committee in USA focused on the role of independent directors. These directors were expected to perform an effective role, such as balancing the conflicting interests of stakeholders; succession planning; facilitate withstanding and countering pressures from owners; filling gaps in experience and skills of senior management; acting as a coach, mentor, and sounding Board for management of the company; provide wider judgment and wider perspectives. The independent directors could help in improving transparency and accountability in the company management.Several studies stated that many CEOs and CFOs of listed companies in India, were accustomed to appoint their long-time friends and associates as independent directors, who often turned out to be well-meaning individuals who were too admiring of management to consider its actions with a critical eye. As a consequence, listed companies might need to place stricter limits on independent director's compensation.

Independency of directors was not merely the question of law or regulation. It was not mere the compliance position. It should become a culture in true corporate governance in letter and also in spirit. Independent directors should serve as watch dogs over management. There should be conscious efforts to promote transparent, objective, and independent discussions and decision making by Board of Directors. The culture of independence should flow through meetings of the committees of the Board. The Board and committee chair persons should schedule meetings, determine the agenda, duration of meetings such that there would be an effective participation by all directors. In addition, prior to the meeting of the Board or committee, a meeting of independent directors of the Board or committee should be encouraged, so as to enable a discussion among them on the matters concerning the business of such Board or committee, whether or not a part of the agenda. Independent directors should at individual level, consciously protect their independent status vis-a-vis the company. They should attend all the meetings of the Board and the committees with enormous preparation. They should seek sufficient time and take opportunity to participate in the discussion in the meeting. They should disclose even doubtful situation of any conflict of interest. Independent directors must not only be independent according to the legislative and SEBI and stock exchange listing standards but also be independent in thought and action.

The Board should meet on calendar basis to review the CEOs' presented position and accepts his agenda. It should also carry out risk reviews and take strategic decisions. No assessment should be made on the quality of CEO's decisions, but the company's direction or other independent reviews required to truly representing shareholders view should be taken up.

7. Lead Independent Director

Several research studies indicated that it was considered, globally, as a good practice, that an independent director as a lead director would coordinate the activities of other non-employee directors and advice chairman on issues ranging from the schedule of Board meetings to recommending retention of advisors and consultants to management. Where the chairman of the Board is not independent director, and the role of chairman and CEO is not separate, the Board should name the director as 'Lead Director' who would approve the information flow to the Board, meeting agendas, and meeting schedules to ensure a structure that provides an appropriate balance between the powers of CEO and those of independent directors. In recent years, Carol B. (2009) the tide appears to be turning away from the "lead director" approach in favor of separation of the chair and CEO positions.

8. Separate Meeting of the Independent Directors

Studies revealed that a separate meeting of independent directors would facilitate for more open discussions by them and any concerns and issues can be shared or aired freely. Therefore, independent directors meet at least once in a year 'alone' in executive session, without CEO. The lead independent director should preside over the meeting.

9. Independent Directors and Enterprise Performance

The research on relationship between independent directors on the Board of companies and firm performance revealed mixed results. The studies included were: Bhagat and Black (2002), Klein, Shaipro and Young (2005). In their research studies it was concluded that independent directors did not improve firm's profitability. Studies conducted by Rosenstein Wyatt (1990) and Pearce and Zahra (1992) showed that out - side directors had a positive impact on firm's performance. It was found that that the Board with higher proportion of outside directors did better job of monitoring and management. Therefore, there was a significant relationship between proportion of independent directors on the Board and firm's performance.

10. Role of Independent directors in Defence Public Sector Undertaking (DPSUs)

The section contained eleven questions relating to mode of appointment, age, term of appointment, renewal of term of appointment, attendance to the meetings, remuneration, independence in decision making, contributions to the functioning of the enterprise, record of dissent views, preference of women independent directors on the Board or committees, the responses were analyzed by applying Chi-square test.

11. Independent Directors – Appointing Authority

In CPSEs the independent directors are appointed by the President of India (administrative ministry), on the recommendation of search committee constituted for the purpose, by assuming the powers vested in him under the provisions of Articles of Association of the company. The responses as to who were the appointing authorities for independent directors was received and presented in table 5.50.

Criteria	Percent
Owners / Government	100
MCA	0
Financial Institutions	0
Court orders	0
Total	100

Table 1: Independent Directors - Appointment

All the independent directors in DPSEs were appointed by President of India by assuming powers vested under Articles of Association of the concerned DPSE.

12. Independent Directors - Minimum age for Appointment

Under DPE guidelines the minimum age for appointment as independent directors is 45 years. The respondents were asked their opinion on what the minimum age limit for appointment of independent directors should be? The research hypothesis (Ho) was that the minimum age limit of 45 years is appropriate for appointment as independent directors. The responses obtained were analyzed and presented in Table 2

Chi-Square Tests		
Pearson Chi-Square value	**Degrees of Freedom**	**Asymp. Sig. (2-sided)**
11.559	14	0.642

Table 2

Table 2 indicates that the probability value of 0.642 at 5 percent significance level was higher than the critical value 0.05. Therefore, null hypothesis could not be rejected. It revealed that the minimum age limit of 45 years would be appropriate for the appointment of independent directors.

13. Upper age limit for Independent / Non- official Directors

Under DPE guidelines the upper age for the retirement of independent directors should be 65 years which is relaxable up to 70 years in case of eminent professionals. The respondents were asked their opinion on what the upper age limit for retirement of independent directors should be? The research hypothesis was that the justifiable upper age for independent directors is 65 years. Test results were analyzed and presented in table -3.

Chi-Square Test		
Pearson Chi-Square value	**Degrees of freedom**	**Asymp. Sig. (2-sided)**
21.281	21	0.442

Table 3: Independent Directors- Maximum age

Table 3 revealed that the probability value of 0.442 at 5 percent significance level was greater than the critical value of 0.05, the null hypothesis could not be rejected. The results obtained were also in line with the DPE guidelines, restricting the upper age limit to 65 years for independent directors.

14. The Term of Appointment for Independent Directors

As per DPE guidelines, initial term of appointment of independent directors is a period of 3 years. The respondents were asked their opinion on what the initial term should be? The research hypothesis (Ho) was that the initial term or tenure of appointment of 3 years for independent directors was appropriate. The responses were analyzed and given in table 4.

Chi-Square Tests		
Pearson Chi-Square Value	**Degrees of freedom**	**Asymp. Sig. (2-sided)**
1.819	7	0.969

Table 4: Independent Directors - Term of initial appointment

Survey revealed that 74.8 percent of respondents opined that the initial term / tenure of appointment of independent directors should be 3 years. None of the respondents chose a term less than 3 years. Table 4 shows that the probability value of 0.969 at 95 percent confidence level was higher than the critical value of 0.05, the null hypothesis could not be rejected.

15. Renewal of Appointment of Independent Directors in the Same Company

The Institute of Company Secretaries of India (ICSI) recommended to the Ministry of Corporate Affairs (MCA) and market regulator SEBI, to fix a total term of 9 years for independent directors (two extensions of 3 years each after initial appointment term of 3 years). However, DPE guidelines suggest an initial period of appointment of three years and renewal for a further period of two years thus making the total term of appointment 5 years. Respondents were asked whether they preferred renewal. The research hypothesis (Ho) was that the number of renewals to be granted after the period of initial appointment was for one time for a further period of 2 years. The test results were analyzed and shown in table 5.

Chi-Square Tests		
Pearson Chi-Square value	**Degrees of freedom**	**Asymp. Sig. (2-sided)**
13.476	7	0.061

Table 5: Independent Directors - Renewal of appointment

Survey revealed that respondents comprising of 52.4 percent supported one-time renewal for a further period of two years after the initial appointment. Thus the DPE stipulation found favour among slightly more than half of the respondents. It may be mentioned here that 47.6 percent of respondents were of the opinion that maximum number of renewals should be two, each renewal being for a period not exceeding three years. All the respondents agreed that there should be renewal. Table 5 indicates that the probability value 0.061 at 5 percent significance level was greater than the critical value of 0.05, the null hypothesis cannot be rejected.

16. Attendance to the Meetings

Independent directors are required to attend the Board/ committee meetings regularly. The details of attendance of all directors are being published by DPSEs as a part corporate governance report in their annual reports. Respondents were asked whether independent directors attend the meetings regularly. The research hypothesis (Ho) was that the independent directors attend meetings of Board or committees thereof regularly. The test results and the analysis were given in table 6.

Chi-Square Tests		
Pearson Chi-Square Value	**Degree of freedom**	**Asymp. Sig. (2-sided)**
9.886	14	0.770

Table 6: Independent Directors- Attendance at meetings

Survey that 83 percent of respondents stated that the independent directors attended the meetings of the Board or its committees thereof regularly. Table 6 revealed the probability value of 0.770 at 95 percent confidence level was greater than the critical value of 0.05, the null hypothesis cannot be rejected. Therefore, it is stated that the independent directors attended the meetings regularly.

17. Remuneration of Independent Directors (IDs)

The remuneration of independent directors is fixed by the Board of directors of the company subject to the provisions of Companies Act, 1956 and the provisions of Articles of Association of the concerned DPSE. At present independent directors in DPSEs are not being paid any remuneration except in the form of sitting fees for attending Board committee meetings. The Companies Act, 1956 and the rules made there under laid down a monetary ceiling of Rs. 20,000/- per meeting.

The responses on the appropriate basis for calculation of remuneration payable to independent directors were obtained and presented in figure1.

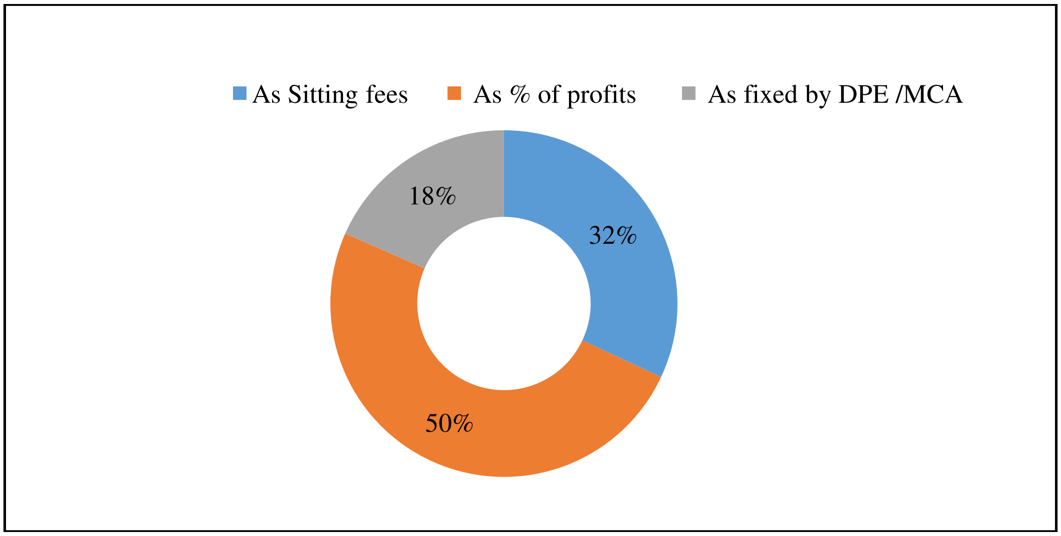

Figure 1: Independent Directors – Remuneration - Basis of payment

Figure 1 showed that 50 percent the sample preferred that remuneration of independent directors be fixed as a percentage of profits. The finding, if agreed by the regulators, would act as a great motivator to independent directors. However, 32 percent of respondents felt that it is appropriate if the payment of sitting fees is based on the number of meetings attended.

18. Independence of Independent Directors in Decision Making Process

Independent directors bring an independent thinking and rich experience in their respective fields to the decision making process of the Board. They are capable of resisting the influence of official and functional directors who might use their formal authority. The primary aim of appointing independent directors is to ensure independent decision making, keeping in view the overall interests of all stake holders. Respondents were asked whether independent directors were in fact, independent in terms of decision making. The research hypothesis (Ho) was that the independent directors are really independent in decision making. The test results were analyzed and presented in the table7 given below.

Chi-Square Tests		
Pearson Chi-Square value	**Degrees of freedom**	**Asymp. Sig. (2-sided)**
1.882	7	0.966

Table 7: Independent Directors - Independence in decision making

The survey revealed that 100 percent respondents opined that the independent directors were in fact independent in decision making, in spite of some difference in degree of opinion. Table 7 revealed that The null hypothesis could not be rejected as the probability value 0.966 at 95 percent confidence level was greater than the critical value 0.05.

19. Independent Directors' Contribution to the Working of the System / Enterprise

The primary objective of having independent directors on the Board is to bring in, improvements in the working of the company. Their un-biased outlook on various aspects can enrich the decision making. Respondents were asked whether independent directors contribute effectively to the DPSE. The research hypothesis (Ho) selected was that the independent directors' contribution was effective in decision making process of DPSEs and also to the working of the system / enterprise. The test results were analyzed and presented in the table 5.58 given below.

Chi-Square Tests		
Pearson Chi-Square value	**Degree of freedom**	**Asymp. Sig. (2-sided)**
5.819	7	0.561

Table 8: Independent Directors - Contributions to the Enterprise

The survey showed that 84.4 percent of respondents strongly agreed that the independent directors' contribution was effective in decision making process of DPSEs and also to the working of the system / enterprise. Table 8 indicates that the probability value 0.561 at 95 percent confidence level was greater than the critical value 0.05. Accordingly, the null hypothesis could not be rejected.

20. Occasions of Recording Dissent by Independent Directors

The general opinion was that the views of independent directors would be un-biased. In case the Board takes a different view than that expressed by independent directors, the option available to them would be to record their dissent in the board proceedings. The respondents were asked to express their views as to on how many occasions such a situation has emerged. The hypothesis selected was that there was no occasion to record dissent by the independent directors. The test results were shown in table 9.

Chi-Square Tests		
Pearson Chi-Square Value	**Degrees of freedom**	**Asymp. Sig. (2-sided)**
3.311	7	0.855

Table 9: Independent Directors - Occasions to record dissent

Survey revealed that 89.10 percent of respondents opined that there were no occasions wherein dissent was recorded by the independent directors. Table 9 shows that the probability value of 0.855 at 5 percent significance level is greater than the critical value 0.05, hence, null hypothesis could not be rejected.

21. Preference of Women Independent Directors on Board / Committees

Gender diversity on the Board is expected to bring fresh perspective and ensure more effective decision making. Several research studies revealed that gender diversification of the Board mitigates the dangers of having uniform vision within uniform Boards. Women's participation on Boards is linked to good corporate citizenship. The research hypothesis (Ho) was that women were preferred as independent directors on the Boards or its committees. The responses were analyzed and shown in the table 10.

Chi-Square Tests		
Pearson Chi-Square Value	**Degrees of freedom**	**Asymp. Sig. (2-sided)**
1.564	7	0.980

Table 10: Independent directors– Preference of women

Survey revealed that 77.6 percent of respondents preferred women independent directors on the Boards of DPSEs or their committees to mitigate the dangers of uniform vision. Table 10 indicates that the probability value of 0.980 at 95 percent confidence level was greater than the critical value 0.05, null hypothesis could not be rejected. Therefore, women were preferred as independent directors on the Boards or its committees. The same is corroborated with provision relating to the appointment of women directors on the boards of every Listed Company /Public Company with paid up capital of Rs 100Crores or more / Public Company with turnover of Rs 300Crores or more shall have at least one Woman Director.

22. Board Members' Level of Satisfaction while Discharging Role / Responsibilities

Board members are expected to discharge their role and responsibilities with utmost care and caution. The respondents were asked to express the level of satisfaction derived by them while discharging their role and responsibilities. The research hypothesis (Ho) was that the Board members did receive satisfaction in discharging their role and responsibilities and their effectiveness in corporate governance. The results obtained were analyzed and shown in table 11.

Chi-Square Tests		
Pearson Chi-Square Value	**Degrees of freedom**	**Asymp. Sig. (2-sided)**
24.56	21	0.267

Table 11: Independent Directors - Role and responsibilities -Effectiveness

Survey revealed that more than 90 percent of respondents expressed satisfaction in discharging of their role and responsibilities and their effectiveness in corporate governance. Table 11 shows that the probability value of 0.267 at 5 percent significance level was more than the critical value of 0.05, the null hypothesis could not be rejected. It can be concluded that Independent director's role is effective in corporate governance.

23. Conclusion

Independent Directors would bring an element of objectivity to Board processes in the general interests of the company and thereby to benefit both majority as well as minority shareholders and other stakeholders. Independency of directors was not merely the question of law or regulation. It was not mere the compliance position. It should become a culture in true corporate governance in letter and also in spirit. Independent directors should serve as watch dogs over management. There should be conscious efforts to promote transparent, objective, and independent discussions and decision making by Board of Directors Independent directors have a positive impact on firm's performance. The role of independent directors is effective in DPSEs

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