

INDEPENDENT DIRECTORS, CORPORATE GOVERNANCE AND COMPANY PERFORMANCE IN INDIA

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ABSTRACT

This paper is being submitted to a University for Ph D in Commerce- in the Subject of Independent Directors Corporate Governance and Company Performance in India. The paper covers three areas. They are: Independent Directors, Corporate Governance and The Company performance in India. Where there are independent directors this paper tries to analyze the present scenario in Indian Corporate Sector and examines the role of Independent Director in Corporate Governance, in particular and the Company Performance thereon and what the impact on Company performance is. We are examining whether Independent Directors (IDs) play a critical role in implementing sound corporate governance practices in companies.

KEYWORDS: *Independent Directors, Corporate Governance, Government Economic Policies.*

Introduction

Company performance and Government economic policies are linked. Hence there is a need of Good Governance that will result in better company performance and achievement of Government Economic goals. We are trying to prove in this paper the importance of every transaction in a company should be fair and transparent to its stakeholders. In my view, this is the essence of Good Corporate Governance. With more emphasis on performance, a closely related issue that has emerged now is the balance in governance roles and responsibilities between shareholders and boards

Majority Family Owned Listed companies In India

We are studying the India Scene, we find that there are a large number of Listed companies which are family owned, meaning that majority shares are held by Family. So, we can say ,in India, we can say that there two types of listed companies. They are:

- Professionally Managed companies, where the shareholding is widely disbursed
- Family Owned , where the shareholding is concentrated with a family

Example of Professional Board Listed Companies are:

- L& T
- HDFC Limited
- Tata
- Infosys

While it may be premature to state that there are very few Professional Board Listed companies in India, we find from this paper, that there is indeed lesser number of professional Board Listed entities. However, they appear to be growing in number, albeit, very slowly. There are certainly a large number of Family Owned Listed companies.

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Some examples are:

- Reliance Group
- Aditya Birla Group
- Bharti Group

If we analyze the number of listed companies, we will find that over 75 percent of listed companies in India are Family owned.

Independent Directors

Independent Directors, as the name suggests, are expected to be independent from the Company management and act as the trustees of shareholders. Conversely, it can be stated that , independent directors are those who are not subordinate to any other promoter director or activity related to the company.

Position under the Statute

Companies Act, 1956 (which has been replaced by the Companies Act, 2013) does not contain any definition of Independent director. So we had to rely on definitions given in Clause 49 of the listing agreement. Clause 49 states that ID's are those who apart from receiving director's remuneration do not have any material pecuniary relationships or transactions with the company, promoters, senior management, holding company or subsidiary or associates which affect their independence .Clause 49 has been amended to define independent directors as follows As per revised **Clause 49**, a person shall not serve as an **independent director** in more than seven listed companies. Further, any person who is serving as a whole time **director** in any listed company shall serve as an **independent director** in not more than three listed company

Independent Directors: Evolution in India

The Kumar Manglam Birla Committee, formulated by Securities Exchange Board of India (SEBI) brought in the concept of "Independent Director" in the Indian corporate arena. This was followed by introduction of Clause 49 in Listing Agreement between companies and stock exchanges by SEBI in 2001. Globally, things were changing at a very fast pace. Events which influenced more effective measures for Good Corporate Governance in companies were

- The collapse of Enron company in USA,
- World com failure in USA
- Introduction Sarbanes Oxley Act (SOX) in United States.

With these events in hind sight, the Ministry of Company Affairs (MCA, then known as Department of Company Affairs -DCA) constituted, the Naresh Chandra Committee, to study and report on the measures for Corporate Governance in India. Subsequently, in 2003 Narayan Murthy Committee was constituted by Securities and Exchange Board of India (SEBI). The terms similar to that of Chandra Committee, whose recommendations were incorporated in the Clause 49 by amending it in 2004. Definition of Independent Directors as formulated by the Chandra Committee was accepted however, without the condition of nine-year term.

Minority Shareholders and Independent Directors

Independent directors are the first line of defense for minority shareholders. We need to be sure of the following:

- Do we know that independent directors are, really, acting independently of management and controlling shareholders to protect the interest of minority shareholders
- Do we know that independent directors are, in fact, monitoring controlling shareholders and management, or providing consultative input and guidance on key managerial issues

The regulatory environment in India provides a window to observe the inner workings of independent directors. For publicly-traded companies listed on National Stock Exchange (NSE) and Bombay Stock Exchange (BSE), the Securities Exchange Board of India (SEBI) encourages that listed entities disclose independent directors' dissent during board meetings. It may be better approach if the Regulatory Authorities make it mandatory for listed entities to disclose in the Board Minutes any Dissent by Independent Directors.

Role of Independent Directors & Corporate Governance

It has been provide globally through various researches, that Independent Directors (IDs) play a critical role in implementing sound corporate governance practices in companies. Stakeholders are nowadays increasingly relying on Independent Directors to deliver on their responsibilities to enhance corporate governance standards and thereby increase stakeholder's wealth.

Independent directors - an overview of their powers or deficiencies in law

Section 118. Minutes of proceedings of general meeting, meeting of Board of Directors and other meeting and resolutions passed by postal ballot:

- Every company shall cause minutes of the proceedings of every general meeting of any class of shareholders or creditors, and every resolution passed by postal ballot and every meeting of its Board of Directors or of every committee of the Board, to be prepared and signed in such manner as may be prescribed and kept within thirty days of the conclusion of every such meeting concerned, or passing of resolution by postal ballot in books kept for that purpose with their pages consecutively numbered.
- The minutes of each meeting shall contain a fair and correct summary of the proceedings thereat.
- All appointments made at any of the meetings aforesaid shall be included in the minutes of the meeting.
- In the case of a meeting of the Board of Directors or of a committee of the Board, the minutes shall also contain— (a) the names of the directors present at the meeting; and (b) in the case of each resolution passed at the meeting, the names of the directors, if any, dissenting from, or not concurring with the resolution.
- There shall not be included in the minutes, any matter which, in the opinion of the Chairman of the meeting,— (a) is or could reasonably be regarded as defamatory of any person; or (b) is irrelevant or immaterial to the proceedings; or (c) is detrimental to the interests of the company.
- The Chairman shall exercise absolute discretion in regard to the inclusion or non-inclusion of any matter in the minutes on the grounds specified in sub-section (5).
- The minutes kept in accordance with the provisions of this section shall be evidence of the proceedings recorded therein.
- Where the minutes have been kept in accordance with sub-section (1) then, until the contrary is proved, the meeting shall be deemed to have been duly called and held, and all proceedings thereat to have duly taken place, and the resolutions passed by postal ballot to have been duly passed and in particular, all appointments of directors, key managerial personnel, auditors or company secretary in practice, shall be deemed to be valid.
- No document purporting to be a report of the proceedings of any general meeting of a company shall be circulated or advertised at the expense of the company, unless it includes the matters required by this section to be contained in the minutes of the proceedings of such meeting.
- Every company shall observe secretarial standards with respect to general and Board meetings specified by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980 (56 of 1980), and approved as such by the Central Government.
- If any default is made in complying with the provisions of this section in respect of any meeting, the company shall be liable to a penalty of twenty-five thousand rupees and every officer of the company who is in default shall be liable to a penalty of five thousand rupees.
- If a person is found guilty of tampering with the minutes of the proceedings of meeting, he shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

Manner of Selection and Appointment of Independent Director

To find out the impact of Independent Director on corporate Board and their independence in discharge of duties, the following parameters have been examined:

- Qualification of Independent Director;
- Experience of Independent Director;

- Types of remuneration received by the Independent Director;
- Number of Other Companies in which Independent Director holds position;
- Past Relationship with the Company;
- Board Meeting attended by Independent Director during the year.

Independent Directors and Board Independence

The ultimate aim of Independent Directors is to ensure Board Independence. The two terms Independent Directors and Board Independence are different terms. So there may no independent Directors but there could be Board Independence. And Vice Versa too, What would the implications be, if greater board independence does not improve, and may reduce, firm performance? Steps like insisting that independent directors own more shares, or that they be more completely independent, could be worth trying.

Current India Scenario

India a large percentage (approximately 75%) of companies that are traded in the Stock Exchanges are family owned, promoted and managed. (Source: Stock exchange data & Annual Reports of Companies, available in public domain) This high percentage makes it that nearly two third of the Sensex/ Nifty fifth companies are family promoted, controlled and managed. These companies are very large, and have grown to this through family control. Some of the these family companies have recently listed and opened up Eg Godrej group. So from our perspective, this large percentage of listed entities in India being family owned is a major point of difference with the western world.

What is the Role and Duties of Independent Directors

The role of an ID is considered to be of a great significance. The guidelines, role and functions and duties and etc are broadly set out in a code described in Schedule IV of the Act, 2013. The code lays down certain critical functions like safeguarding the interest of all stakeholders, particularly the minority holders, harmonizing the conflicting interest of the stakeholders, analyzing the performance of management, mediating in situations like conflict between management and the shareholder's interest and etc.

Role of Independent Directors in Company Meetings & Committee Meetings

- The Act, 2013, requires the entire ID's to meet at-least once in a year. The meeting must be convened without the presence of the non-independent directors and members of the management.
- An ID would also evaluate the performance of the chairperson of the company. Also, the Act, 2013 requires an ID to review the performance of the non-independent directors and the Board as a whole of the company. These measures would immensely aid in ensuring the smooth and proper functioning of the Board of Directors of a company.
- The Act, 2013 has also emphasized on the appointment of an ID as a member or as a chairperson in various committees. Committee consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the board.

Liability of an Independent Director

Under the Act of 2013, the liabilities of the independent directors have been reduced, and are limited: "only in respect of acts of omission or commission by a company which had occurred with his knowledge, attributable through board processes, and with his consent or where he had not acted diligently". Important Statutes and Legal and regulatory framework that Independent Directors must look into to ensure better corporate governance

Implementation Mechanism of the Corporate Governance in India

In India, the Corporate Governance Code is implemented by seeking adherence to the various laws, procedures, practices, rules, etc. relating to corporate functioning in our country. The main elements which are used for implementation are as given below:

- The Companies Act, 2013: board of directors, meetings, management, conduct of meetings, appointment or removal of auditors or directors, corporate restructuring, mergers, interoperate activities,
- The Insolvency and Bankruptcy Code, 2016

- The Foreign Exchange Management Act, 1999: Implemented to regulate , control and monitor foreign investments, investors and flow of foreign funds
- Securities & Exchange Board of India Act, 1992 and Rules and Regulations made there in
- Listing Agreements with Stock Exchanges
- Securities Contract Regulation Act, 1956
- Competition Law , 2002

Corporate Governance a Simple Definition

It was often understood corporate governance to mean “protection for minority shareholders”, which is another subject. Even people who understand what corporate governance means tend to mix up American theory with our reality.

Some Simple Definitions of Corporate Governance

“Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment”¹

Why is Corporate Governance Required?

Throughout the world the joint stock, Limited-liability Company has become the preferred vehicle for running business. It has proved its worth in providing employment, generating wealth, and contributing to economic and social development. The original concept of the company, which stems from the mid-nineteenth century, has proved immensely innovative, elegantly simple and superbly successful.

Evolution of Corporate Governance

As with countries, companies need to be governed as well as managed. Corporate governance is concerned with this process. The Board of directors is central and its structure and processes are fundamental; so are the board's relationships with the company's shareholders, regulators, auditors, top management and other legitimate stakeholders

Corporate Governance Today

Originally, the basis of corporate governance was shareholder power of management. Shareholders were relatively few and close enough to the board of directors to exercise a degree of control. Indeed in several of smaller, tightly-owned companies around the world that is still the situation today. But there are several large companies which have huge shareholder base (eg Reliance Industries Ltd). The corporate governance model here is different from that of the smaller companies.

Corporate Governance – Position in India

The Indian corporate sector is evolving as far as legal structure and internal management, control and administration of corporations is concerned. It is faced with numerous issues demonstrating the ineffective implementation of laws and code of business ethics. In India, the importance of Corporate Governance and its relation with Independent Directors (referred as “ID's”) is now well recognized with the introduction of corporate governance clauses in Listing Agreements, and SEBI guidelines and regulations. The Companies Act, 1956 (referred as “the Act, 1956”) do not directly talks about ID's, as no such provision exists regarding the compulsory appointment of ID's on the Board. However, Clause 49 of the listing agreement which is applicable on all listed companies mandates the appointment of ID's on the Board. A need has been felt to update the Act and make it globally compliant and more meaningful in the context of investor protection and customer interest.

The Companies Act, 2013 (referred as “the Act, 2013”) came into force as Act no. 18 of 2013 after obtaining the assent of the President on August 29, 2013. The Ministry of Company Affairs (referred as “MCA”) enforced the 98 sections of the Act through the notification dated September 12, 2013. Section 149 of the Companies Act, 2013 deals with the appointment and qualification of ID's on the board of the Company and their importance in good corporate governance in the Company.

¹ Source: The Journal of Finance, Shleifer and Vishny [1997, page 737].

Some Recent Codes and Regulations which have an Impact on Independent Directors and Corporate Governance in India

In India the concept of Independent directors came into being with the introduction of Clause 49 to the Listing Agreement. This came into being in 2006. The importance of the role of an Independent Director is of great significance. The guidelines, role and functions and duties and etc. are broadly set out in a code described in Schedule IV of the Companies Act, 2013. The code lays down certain significant functions like safeguarding the interest of all stakeholders, particularly the minority holders, harmonizing the conflicting interest of the stakeholders, analyzing the performance of management, mediating in situations like the conflict between management and the shareholder's interest, etc. The independent directors are also expected to attend the general meetings of the company and to keep themselves aware of the matters which are going on in the company.

Responsibilities of Independent Directors for a Good Corporate Governance

Being a member of the Board, their role and responsibilities are very much similar to any other director of the Board. The fiduciary duties of care, diligence and acting in good faith apply equally to independent directors as to other directors.

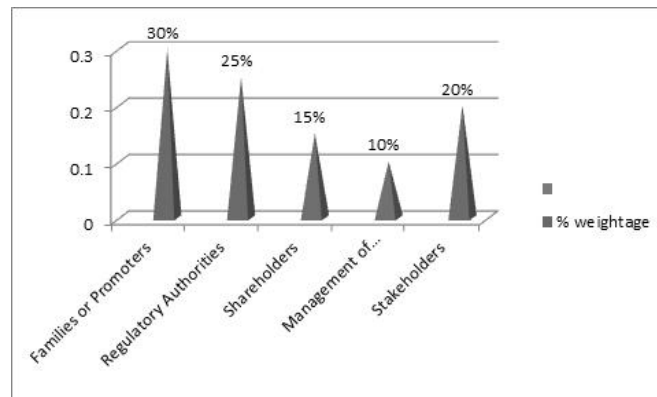
Role towards the Board

It is the duty of the independent director to ensure that all those concerns that are important for the company are properly addressed by the board of directors. The objectives and duties of the independent directors are same as that of the executive directors. However, as compared to the executive directors the time that is needed to be devoted by the independent director and the degree of skill and care required for the company, both are less

How many independent directors

Where there is executive chairman, 50% of the Board has to be independent directors

Otherwise it is 1/3 of the total board should be independent directors



Source: Filings of Companies in Stock Exchanges through their annual reports, public notices and shareholding pattern

Findings

Based on some important responsibilities to be performed by Independent Directors, the following findings emerge. Prior research on board composition It is important to note here that prior research does not establish a clear correlation between board independence and firm performance.

Does board composition affect firm performance?

Prior studies of the effect of board composition on firm performance generally do not affect firm performance after at certain threshold.

Conclusion

The corporate governance regulations in India are supposedly stringent. However, since majority of listed companies in India are family owned, the impact of the Corporate Governance Regulation, Independent Directors and Company Performance is not clearly visible. Have Independent directors enabled corporate governance in India?

Given this argument, we look at whether Independent Directors have enabled better Corporate Governance in India. The need for the independent directors can be established by the fact that they are expected to be independent from the management and act as the trustees of shareholders. This implies that they are obligated to be fully aware of the conduct which is going on in the organizations and also to take a stand as and when necessary on relevant issues. In India the concept of Independent directors came into being with the introduction of Clause 49 to the Listing Agreement. This came into being in 2006. The importance of the role of an Independent Director is of great significance. The guidelines, role and functions and duties and etc. are broadly set out in a code described in Schedule IV of the Companies Act, 2013.

The code lays down certain significant functions like safeguarding the interest of all stakeholders, particularly the minority holders, harmonizing the conflicting interest of the stakeholders, analyzing the performance of management, mediating in situations like the conflict between management and the shareholder's interest, etc. The independent directors are also expected to attend the general meetings of the company and to keep themselves aware of the matters which are going on in the company. What does the study reveal? Recourse to independent directors by private equity investors per se is not tied to performance increases.

Our study also shows that independent directors impact the rate of return only on deals which require very specific skills, i.e. turnaround and buyout investments. Besides, busy independent directors do not seem to affect negatively the internal rate of return. Finally, independent directors tend to resign when performance is unsatisfactory and consent to shave losses when performances are negative.

The key responsibilities of IDs relate to broadly 4 categories:

<p>Strategy, risk management internal financial controls</p>	<p>Strategy: Information about other companies, their strategies and industry trends. Risk (a) compiling a risk inventory, (b) formulating assessment techniques and risk response strategies, (c) creating a risk appetite and improving tolerance levels, (d) ensuring effective communication and monitoring and (e) integrating ERM with operational systems.</p> <p>Internal Controls:</p> <ul style="list-style-type: none"> • risk of material misstatement, entity level controls, • significant accounts and disclosures, relevant financial assertions, significant processes, deficiencies and remedial measures and • c. communication of the same to the Audit Committee and the board. 	<p>Results vary. Large entities follow these, but medium and smaller units do not follow this process. In FMC, the role of Independent directors in this area is restricted and hence , to that extent it impacts Corporate Governance and ethics</p>
<p>Related party transactions</p>	<p>The Companies Act, 2013 requires all related party transactions to be approved by the Audit Committee.</p>	<p>By and large, most professional companies follow this process (For eg L&T limited, HDFC Limited). On the other hand, there is no guarantee that FMC follow this process and the Independent Director has no say in this matter. Briefly, the ID has to fall in line. ID can only ensure that there is no breach of the Act on this matter.</p>
<p>Prior research on board composition 19 Ethical and compliance oversight</p>	<p>In the report, they have to state that they have complied with all applicable rules and regulations. IDs are also required to review the vigil mechanism established by the company and ensure that whistleblowers are not victimized. IDs, as part of their responsibility, need to periodically evaluate the extent and effectiveness of the code of conduct trainings, whistle blowing incidents, reporting systems and disciplinary actions. In certain cases, they may even request for audits by the internal or external auditors to satisfy themselves that the programs are running effectively</p>	<p>Statutory compliance reports are placed at each meeting of the Board. However, it is found that where there are critical issues, these are not reported to Stakeholders (such as notice from ED for FEMA, etc) ID in FMC plays a key role in this Ethical and compliance oversight.</p>

Succession planning and executive remuneration	Remuneration committee Nomination committee	Most companies have independent directors on these two committees, but there appears to be no movement forward on leadership issue, unless it is a purely professional company as compared to family listed entity. ImFMC , ID has a relatively minor role in this part as the Promoter decides .
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Hence, we can confidently say that full compliance with clause 49 yet to be achieved. Almost a decade after Clause 49 of the SEBI Listing Agreement was implemented; compliance has not yet been fully achieved. Clause 49 of listing agreement states that the board of directors of the company shall have an optimal combination of executive and non-executive directors, with no less than 50% of the board comprising non-executive directors. It also states that where the chairman of the board is a non-executive, at least one-third of the directors should be independent and in cases where the chairman is an executive, at least half of the board should be independent director. Non-executive directors remuneration- The average total remuneration received by non-executive directors was INR 2.9 mn in 2015, compared to INR 2.5 mn in 2014. The minimum sitting fees per meeting paid to non-executive directors in 2015 was INR 20,000. In the companies surveyed, non-executive directors received an average commission of INR 4.2 mn in 2015, compared with INR 4 mn in 2014.

Roles and Responsibilities	Howe effective Independent Directors are in	
	Professional Companies	Family owned Companies
Compliance of laws	Yes	Yes
Accountability	Yes	No
Business dealings	Yes	No
Risk management	Yes	No
Fiduciary duty of trust	Yes	Yes
Duty of care	Yes	Yes
Strategic review	Yes	Yes
Policy Formulation	Yes	No
Management supervision	Yes	No
Protecting minority ownership	Yes	No

In India context, we could study Corporate Governance, Firm performance from two angles. They are: Professionally Managed Listed Companies & Family owned Listed Companies.

From the table provided below (Source Business India), of the top 20 companies in Assets value, only a handful few (3) are Professional Managed Listed Companies and ther Remaining are Family Owned Listed Companies. According to a Report published in Press Trust of India, November 3, 2011 Family controlled listed companies - India leads in Asia.

Measures that may Help

- Dissent of Independent Directors should be recorded in the Minutes.
- In the absence of recording the dissent expressed by Independent Director, it will not be appropriate to look at the Corporate Governance Philosophy in the company
- Independent director should be made to head Sub committees of Directors relating to remuneration, accounts and audit and any special projects.

independent directors	
Meetings attendance	Yes
Presence in Committees	Yes
Better Corporate Governance	Yes
Increased Profitability	Yes
Increased shareholder returns	Yes

Conclusion

It can be concluded as follows in India, (based on above said measures)

A good number of Family owned companies have broad based their Boards and have given a positive listening ear to advice and role of Independent Directors the Professional Managed companies have benefited by Independent Directors, eg recent Corporate Governance issues in a well-known IT company. Corporate Governance has improved vastly across all forms of listed companies. There is room for further improvement in the areas of Corporate Governance, Minority Interest Protection, and Statutory Compliance. However, as over the next couple of years, there will be more benefits that accrue to Companies.

Chart on Measure for implementation of Good Corporate Governance in Companies in India to ensure stakeholders wealth

Mandatory tenure for Independent Directors.	Under the Act, an independent director can have a maximum of two tenures of five consecutive years (a total of ten years), with a cooling off period of three years
Listing agreement.	
Clear demarcation of the roles and responsibilities of the Chairman of the Board and that of the Managing Director/ CEO. The Roles of Chairman and CEO should be separated to promote balance of power.	There is no clear Demarcation on the roles and responsibilities of Chairman and CEO.
Mandatory Induction training for Independent Directors	No mandatory training for Independent Directors
The board should undertake a formal and rigorous annual evaluation of its performance and that of its committees and individual directors.. Disclosure	Annual evaluation is not mandatory
Remuneration policy for the members of the Board and Key Executives should be clearly laid down and disclosed.	Remuneration policy as per KMP
Directors' Responsibility Statement should include a statement that the directors had devised proper systems to ensure compliance of all laws applicable to the company and that such systems were adequate and operating effectively.	
Secretarial Audit should be made mandatory in respect of listed companies and certain other companies. The Secretarial Audit be conducted by a Company Secretary in Practice. The report on the audit of secretarial records shall be submitted by the secretarial auditor to the Corporate Compliance Committee of the Board of Directors of the company. The Secretarial Audit Report should form part of the Board's Report.	
Adoption of Whistle Blower Policy should be made mandatory, to begin with, for listed companies. A model policy in this regard may be specified covering important clauses that protect employees' interests.	
The Audit partner/Firm should be rotated on the grounds such as : 1. to maintain independence of Auditors. 2. to look at an issue (which may be financial or non-financial) from different perspective. 3. to carry out an Audit exercise with different mind set i.e. when the same person does an Audit continuously, he is bound to have a fixed mind set towards the company. Periodicity of Rotation : Audit Partner - Once every three years Audit Firm – Once every six years	

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