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Board of Directors: An Empirical Study of Indian Navratna Companies

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Abstract

We highlight how directors and senior managers perceive the roles of a board to involve overseeing risk and compliance, strategy, governance, developing the CEO and senior management and managing stakeholders. We find that managers and directors perceive board effectiveness as linked to different combinations of these roles. This paper aims to undertake a study of national configurational demographics in order to determine the spread of understanding of the Board of Directors' role, performance and contribution. Qualitative methodology, exploratory in nature through in-depth interviews and workshop discussion involving Nine Navratna Indian Companies (i.e. ONGC, NTPC, SAIL IOC, HPCL, BPCL, GAIL, MTNL, BHEL), was undertaken. The role of the Directors' is considered as having a distinct effect on board dynamics, role and contribution and the monitoring and support of management. The findings of this qualitative exploratory study need to be integrated into a quantitative empirical survey in order to ascertain the validity of the results to date. The two key conclusions highlight the requirement for governance due diligence, examining the financial and competitive strength of the organisation as well as uncovering contextual sensitivities. The study offers additional insight on how demographic factors influence the shaping and determination of the role of Directors. The aim of this paper is to distinguish between different roles of boards of directors in companies and to fit the theoretical debate into a framework for better understanding. The paper includes a preliminary qualitative study of Indian companies with the aim of testing the framework and exploring the roles of boards in India. The study shows that boards have various roles or patterns of roles and that the roles can change with change of circumstances.

Keywords: Corporate Governance, Public Enterprises Section Board, Official Director, Non-Executive Director, CEO, Navratna Companies, Selection of Director, Corporate Vision & Mission, Monitoring, Controlling Management.

Introduction

No business can be better than its top management, have broader vision than its top people, or perform better

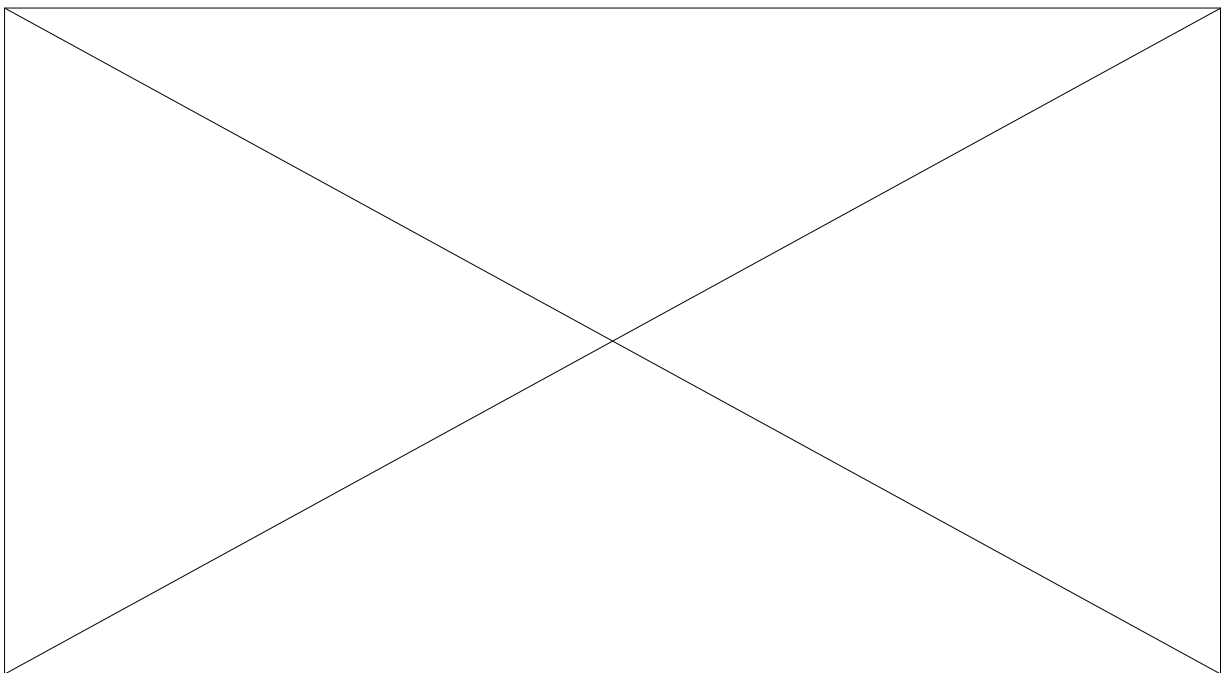
than they do. A business needs a central governing organ and an organ of review and appraisal. On the quality of these two organs, which together comprise

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Board of Directors (BODs), its performance, results and spirit largely depend. Therefore the selection process followed for identifying directors is an important aspect to be focused on while studying BODs. In terms of the recent developments in the area of corporate governance world over and especially after the Cadbury Code in the UK and the Blue Ribbon Committee of USA the role of the non-executive especially that of the Independent directors has come into prominence. The Confederation of Indian Industries code on Corporate Governance and the more recent SEBI recommendations based on the Kumar Mangalam Birla Committee report on Corporate Governance are important landmarks in this field in our country. In terms of the SEBI committee recommendations it is mandatory for all listed companies in India to have an optimum combination executive and non-executive director with not less than fifty percent of the board comprising the non-executive directors. The number

of independent directors would depend on the nature of the chairman of the board. In case a company has a non-executive chairman, at least one third of the board should comprise of independent directors and in case a company has an executive chairman, at least half of the board should be independent. This is a mandatory recommendation for all the listed companies and these companies are to include compliance to these recommendations on corporate governance in their annual report. The BODs consists of three kinds of directors - the executive directors or the functional directors responsible for the actual functioning of an organization, the non-executive directors representing majority shareholders (like the financial institutions' nominees in case of the private sector companies and the government nominees in case of the public sector companies) and the non-executive directors who are independent. Chairman of the BODs may be executive or non-executive. In our survey all the public sector companies have executive chairmen.



(Role of Board of Directors)

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In the BODs surveyed by us there are Director Finance and Director Personnel, along with a CMD, there are some Technical Directors as well depending on the business in which the company is for example ONGC has Director Exploration, director Production. HPCL have Director operations, Director Refinery and director Marketing and SAIL has Managing Directors for its four different plants and functional directors are in finance, projects, commercial, Research and development and operations. Displays the disciplines of the executive directors in these units. It is observed that while PSEs have directors of the executive directors in these units, it is observed that while PSEs have directors specializing in particular functional areas, the private companies have general directors as inside directors as well. Their specialized requirements are met by the senior managers who may also be designated as vice president or president in particular area of operation.

Functions of Directors	PSE's in which such functional directors exist amongst Nine PSE's surveyed*
CMD	All companies other than SAIL
Chairman	SAIL
MD SAIL	
Director (Finance)	All companies
Director (HR)	All companies
Director (Operations)	ONGC, SAIL, NTPC
Director (Projects)	GAIL, SAIL, NTPC
Director (Drilling)	ONGC
Director (Commercial)	SAIL, NTPC
Director (Marketing)	HPCL, BPCL
Director (Exploration)	ONGC
Director (Refiners)	HPCL, BPCL
Director (Ind. Sys. Products)	BHEL
Director (Planning)	GAIL, SAIL
Director (Power)	BHEL
Director (Eng. Res. Dev.)	BHEL
Director (Technical)	ONGC, NTPC
Director (R & D)	SAIL

Government directors, referred to as part time official directors, are appointed by the administrative ministries and are officers dealing with the concerned enterprise,

usually there are two part-time official directors - a representative of the administrative ministry and financial adviser of the ministry. These directors provide a link or liaison between the enterprise and the ministry.

Selection Process of BOD in India: The process of short listing and screening is done by the Public Enterprises Section Board (PESB) in coordination with the administrative ministry and then the final list of potential candidates to be considered for selection is ready. The PESB takes into account the performance in the interview and the track record as brought out in the confidential reports in respect of candidates from the PSEs or from organized services are concerned. For candidate from the private sector, such confidential respects are not available; if such candidates are selected, a confidential investigation is done by the Government before their appointment. This is due to the time taken by the administrative ministry in taking clearance from the Central Vigilance Commission (CVC). Now PESB directly informs the CVC of the empanelled names at the same time as forwarding names to the administrative ministry. Meanwhile the CVC can takes its time in conveying vigilance clearance. While in the administrative ministry, the process for obtaining approval of the Appointments Committee of Cabinet and the President is commence. Once all the approvals are obtained, subject to CVC clearance, the appointment is done.

Selections Process in Public Sector Enterprises:

The public sector companies are set up under the companies Act with the president of India as major shareholder. Subsequently in some cases the PSEs shares have been partially divested. However the Government of India still continue to remain the majority shareholder and continues its hold on major issues relating to formation of PSE BODs are finally approved by the President only, based on the recommendations of the public PESB which functions in cohesion with the relevant ministry for screening of probable candidates; selecting and finally forwarding these

nominations for approval of Appointments Committee of the Cabinet (ACC).

Selection Process for Non-Executive Directors

(NEDs): There is a consensus regarding having non-executive directors on BODs of public sector undertakings. The importance of having some independent members on the public sector BODs has been acknowledged for ensuring objective, professional and balance BODs deliberations. However functional directors of the BODs felt that having 50% non-executive directors could lead to confusion in BODs meetings as these out side directors would not have much idea about the technical aspects of organization functioning and the specific factors or two such directors could be alright but more than his may go against efficient BODs functioning. The NEDs included in our study agreed with the view provisions of CII code and SEBI guidelines relating to appointment of NEDs.

Selection Process of Government Nominees or Part-time Official Directors:

The selections of the official part time directors are done by the concerned ministry only based on their official involvement in that company affairs. These directors are normally joint secretary in the concerned ministry handling that company business and the financial adviser to that ministry. These Directors represent the Government on the Board and hence it is essential that they have some knowledge of the company functioning and affairs and the knowledge of government stand on various issues so that they may act as an effective link between the Government and the company. Opinion is expressed here that to maintain the Board prestige and taking into consideration the level of maturity required in these official part time directors, they should be at least of the level of joint secretary and not less, as happens in some cases where government officers of deputy secretary level or director level are placed on BODs of major PSEs. Effectively also this is incorrect as a PSE board director is treated as equivalent to joint secretary of the government of India and a CMD is

equal to Additional secretary.

Selections Process in Private Sector Companies:

In the private sector in India it is the responsibility or privilege of the promoters to nominate the board members, may be through a formal process on the basis of recommendations of nominations committee or informally depending on owner's choice and preference. The entire board is selected in this manner. The board guidelines in GM in the USA stress on the BODs involvement in Board Selections and the commonwealth principles on corporation governance stress on ensuring that board appointments are made through a managed and effective process that provide a mix of proficient directors, each of whom is able to add value and to bring independent judgment to bear on the decision making process. In India also the corporate governance conscious private sector companies surveyed by us have nomination committee for BODs level selections. They give their recommendations for selections to these positions which are placed before the BODs or shareholders who finally decide. But this is happening in the professionally managed private companies only other companies these selections are done in an arbitrary manner which they prefer not to disclose. Here the majority shareholders or promoters play a deciding role.

Weakness in the Selection Process: The process of selection of the functional directors of the PSEs has been streamlined and improved. Still the board members of the NAVRATNA public sector enterprises surveyed don't find the process very satisfactory. It needs a rational and logical process and solutions to all such situations should also be built in the system. The need for a fair and timely carried out selection exercise may be emphasized by everyone. Here the point is make that time lag is very long between the issue of circular indicating a vacancy six months in advance and issue of actual appointment letter. There are cases where selection process began six months in advance and appointment letter is issued after the retirement.

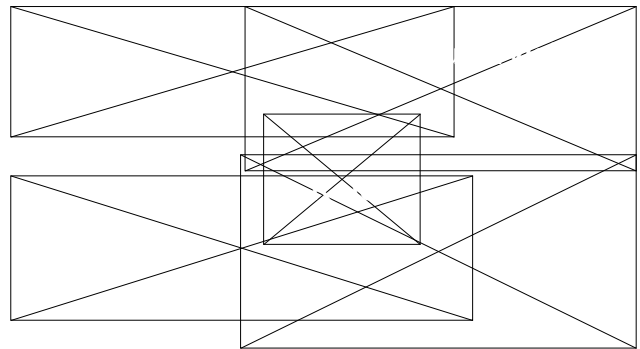
Relevance of Qualifications: The qualifications matter in board level selections, as a qualified person will not only be able to take sound decisions but also command respect of subordinate. It is normal human reaction that we give more regard to a person who is more qualified as we see him / her as an expert in his area and we presume that he is more rational and analytical in his approach and capable of taking better decisions. Thus qualifications are given their importance for appointment to PSE BODs. But it is also emphasized that need is more of generalists with proven leadership skills and business acumen. In selecting the functional directors, the norms specified by the PESB are followed and therefore qualifications are given the importance. It is observed in our survey that technical and related qualifications are there in the present in position directors previous experiences may however have been different as some of the BODs members that they had under-qualified colleagues in some disciplines and faced problems of difference in approach to some issues of organizational relevance.

Tenure and Age for BODs positions : The term of the BODs director should be at least five years. This is essential to provide long term stability and continuity in board functioning and strategy formulation and its implementation and monitoring. In the private sector the board term is for a fixed period but normally the BODs continue to get re-elected till any real problem occurs. In fact there is a general agreement that the BODs should be allowed to continue subject to achieving acceptable level of performance. But in the public sector the decision for continuance of a BODs member at a particular level is taken based on a prescribed procedure. Here the maximum term is five years for functional directors or up to the time of superannuation whichever is earlier.

Role of Directors

BODs is to supervise the management actions and functioning and any lapse in compliance with legal or constitutional responsibilities should be checked by the

BODs if they fail to do so they also become accountable for the lapse; the BODs role consists of two levels one relates to setting mission objectives and policy formulation and the second level functions include monitoring management, and reviewing and controlling their activities from time to time. The role of the board of a company can thus be explained by the Diagram. It includes accountability, direction, executive management & supervision as the main functions of the BODs.



These functions are mixed in different proportions depending on the priorities of the BODs, nature of organization and other external environmental factors. Corporate governance involves dual responsibility fulfilling internal organizational and meeting societal needs. Organizational needs refer to the requirements for company's growth and development whereas the societal needs and to be fulfilled not for business reasons but to achieve social objectives and fulfill responsibilities of the organization towards the society in general without expecting any physical returns to these efforts in terms of the business gains.

A. The primary role of Board of Directors

The role of Board of directors in corporate governance has long been a popular subject of business and academic discussions. Literature on boards of directors suggests that the BODs has three primary roles: (1) Building corporate strategy,

(2) Monitoring and controlling top management (3) Advising and counseling senior management.

- 1) **Building corporate Strategy:** Through the Companies Act 1956 does not specify the role of Board nor do any other codes outline the same still it is universally accepted that the BODs is responsible for macro governance of the organization.
 - It decides what the company vision and mission will be and stipulates in the companies surveyed by us the BODs has clearly outlined the vision and mission i.e. what business the company will be in and what direction it will take in that particular sphere. This is a long term job and once these are formed the BODs tries to formulate;
 - Corporate objectives, targets and long term strategies to achieve these. However in this effort it must;
 - Ensure cost efficient operations. Idea is to ensure that the resources are utilized to the maximum so that investors get full return for their investment. In this process the BODs is to ensure,
 - Balancing interests of shareholders with those of the creditors, employees, customers, suppliers, government and community in general. These are the different stakeholders whose interest is aligned with company growth and success. However.

The primary responsibility of the board is often perceived to be that of trustees to the shareholders. The shareholders have invested their hard earned money in the company and made the BODs responsible for ensuring that the resources are utilized in a manner to yield maximum return to shareholders investment so this is the primary objectives their loyalty must lie with the investors.

2) **Monitoring and Controlling Senior Management**

Overseeing and evaluating executive management is one activity, which the BODs are responsible for. The BODs is the supervisory body, which sets the direction for functioning of the organization. The routing and internal operational affairs of the company are normally handled by the unit heads and their team of senior managers. In the discipline this team of top managers maneuvers the organization through different activities and phases. Therefore these managers are implementing what the BODs visualize. Therefore it is important for the BODs to ensure that the senior managers understand what the BODs expect of them.

Removing Non-Performing Senior Management, it is very important for the BODs to ensure that this team at the top has the desired combinations of qualities required at that level to shoulder the responsibilities placed on them. For this constant assessment of the top managers functioning and performance is essential. The private sector directors stated that they have these practices of quietly doing away with non performers so that the right kind of people come forward and work for improving the organization functioning. But in the PSEs all the functional directors stated that removal of non-performing employees is not simple and only way out is to sideline them or transfer them against request and thus they may at times opt for Voluntary Retirement Schemes offered by these organizations but this normally does not work as the employees do not want to leave the security and privileges enjoyed in their job or they do not have any alternate openings so decide to stay on.

3) Advising and Counseling Senior Management

They are also responsible for over viewing on a periodic basis only, the current operations principally to assess performance against promise. One thing that they certainly must not do is to involve themselves in the day-to-day operations and jobs. 'Drucker' emphasized that the board will be stronger and more effective if it is detached form operations. The BODs is to monitor the managers who take care of the operation affairs and it monitors them at regular intervals but not too often so that unnecessary reporting does not become an unproductive and time vesting exercise.

B. Additional Responsibilities of BODs

Succession Planning: The BODs must periodically review succession and management development plans for its human resource. After all human resource is the biggest asset of an organization and a dedicated human resource ensures that the company has a competitive edge over its rivals. Therefore it is essential that this resource is put to best possible use. The right people should get the relevant job exposure and training and opportunities for growth and development so that they form a dedicated workforces and work towards achieving company goals.

Information Flow: The BODs thinking, processes and plans are communicated down the line. Information flow is as relevant here as it is in any other area of business and thus it is very important that the BODs decisions and the procedure for implementing these should be conveyed down the line to the grassroots levels to ensure clarity in their minds regarding company functioning and future plans. Not only is downward flow of information

essential for achieving organizational objectives but upward flow of information is also desirable so that BODs keeps itself aware of what is happening at different levels in the organization.

C. Fulfillment of Societal Needs

Corporate compliance with all relevant laws: The BODs must ensure that company's business is carried on in a manner, which is in keeping with the relevant legal and constitutional provisions. The company interest cannot be placed above these legal and other mandatory requirements as in the long run this will benefit the company image.

Ethical behavior on part of the management: The Company BODs must abide by ethical standards of conducting business. For this at times short-term gains may have to be sacrificed but again we may stress that long term stability can be achieved by running a business in a ethical way. Infosys or Larsen and Toubro or Wipro or TISCO are known Indian companies run in keeping with ethical norms.

Ensuring physical as well as environmental, social and cultural protection: corporate sector is responsible for environmental care, social welfare and protection of our culture and heritage. That is why the BODs of these companies are coming up with proposals of increasing plant cover, proving educational opportunities to the backward classless and also providing for spreading literacy and taking care of community health and hygiene by participating in various plans for the same. The Tatas and IOC are getting together to protect the TAJ MAHAL which is one of the seven wonders. Thus the BODs are responsible for initiating and implementing various schemes and plans as responsible corporate citizens. ONGC one of the companies

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surveyed has successfully implemented a project of electrification of an island village, called Amala off the Mumbai coast, for its socio-economic revival.

What the BODs must not do?

The BODs must not involve itself in day to day functioning of the organization and also that governance does not involve ensuring returns in the short run. Actually the functional directors almost always are from within i.e. they have worked at management levels in the organization and therefore find it difficult to remain aloof from routine matters and day to day activities.

The Role of Non-Executive Directors

The most usual view is that the non-executive director, since he is respected for his wisdom and independence, will be more influential and listened to, although it may not be his function to actually institute policy. These non-executive directors provide a wider and mature perspective to the board deliberations.

The role of non-executive director involves:

- Seeing issues in totality;
- Giving the external view;
- Providing an independent view where potential conflict of interest arises.
- Providing special skills;
- Advising on the public presentation of the company's activities and performance

The Role of the Part-Time Official Directors or Government Nominees

The part time official directors are representatives of the ministry and also referred to as Government directors they act as a link between the company and the ministry under which it comes. The part time directors represent the government interest on the

BODs. Infact they play a dual role and are supposed to present the organizations decisions or views to the Government. But the role of part time directors often becomes one sided and they seem to be acting most of the time more like a representative of higher agency and consider their role to be that of ensuring that the Board as a whole and the chief executive do conform to the policies, principles and procedures in respect of which he is so to speak a watch dog. But quite a few BODs members also held the view that the role of the Government director is more positive than negative, and that the real difficulties of the public enterprise are with the bureaucratic machinery in the Ministries; and that in dealing with that machinery the Government directors in fact played a useful mediating role.

Desirable Role of Board

An ideal role for the modern company Board is to create a self driven, self assessed and self regulated organization. For this all the BODs members need to contribute:

- To set and monitor though but achievable financial targets, including for example profitability, cash flow, return on capital, dividend policy, gearing retention, etc.
- To outline the preferred corporate a decade ahead and to ensure that it takes account of both strengths and weaknesses as well as the needs of the environment.
- To make the most senior appointments and plan carefully succession and career progress.
- To act as the custodian of the corporate image and to nurture key relationships with the media, the institutions, employees, unions, government and shareholders i.e. Take care of the external environment as well.

Actually all this talk of ideal BODs role and improving

corporate governance and efforts are already on to implement it not only in the developed economies but in other progressive countries like India as well where even in the public sector this changes is seen. The BODs members also strongly agree that the BODs should be detached from day to day operations.

Desirable Role of NEDs

The purpose of appointing non-executive directors is to provide the board with knowledge, expertise, judgment and balance, which may not be available, if the board consists only of executive directors. Coming to the ideal role of non-executive directors we may specify that:

- They can increase the element of independence and objectivity in board decision making.
- They take a detached look at companies functioning and its medium-run and long-term policies.
- They should provide independent supervision of the companion's management.

Desirable Role of Part Time Official or Government

The Government directors must identify themselves with the objectives and goals of the enterprise and engage in joint thinking on equal terms with their fellow-directors. They will definitely be able to contribute to the decision making process by virtue of knowledge and experience they possess, their awareness of trends and developments in the economy outside the parameters of the operation of the enterprise itself, and in other similar ways. While doing this the Government director should be careful not to try to himself on a higher pedestal than his colleagues on the BODs or to appear to speak from a position of authority. The government Director on his part should identify himself with the objectives and goals of the enterprise engage

in joint thinking on equal terms with his fellow directors and not assume a superior status. While playing partly a representative role on behalf of the Government on the Board, he should not reserve his position on matters before the Board but, should try to join the Board consensus; Also in subsequent examination of Board approved proposals in the Government his role should be that of an elucidator, and he should try not to sit in judgment on the decisions of the Board.

Evaluation of BODs' performance of NAVRATNA Companies

Evaluation of performance is a process, which is concerned with measuring. What should be measured should be decided on the basis of the use to which the results will be put. The evaluation of NAVRATNA BODs can enable us to know as to how the BODs as a collective entity is performing, and what contribution it is making towards fulfillment of the objectives of the organization. Only when performance is evaluated properly can action be taken for its improvement. The objective of evaluation is to identify component strategies and policies that cause strategies, methods adopted for implementation of policy, the role of various individuals involved and other related incidental aspects. Thus, the evaluation is not an audit procedure which is primarily concerned with financial accounting and control. A board is team of knowledge workers, and to do its job, the board needs the same resources and capabilities that any other successful team of knowledge workers needs to do their jobs effectively. Such groups need

- Knowledge
- Information
- Power
- Motivation
- Time

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Knowledge: The combined knowledge and experience of the board members absolutely must match the strategic demands facing the company. A performance evaluation that systematically assesses boardroom expertise and identifies current and future gaps is therefore critical to assuring that the board maintains the right mix of knowledge. That's why a right mix of technical & non-technical, executive, non-executive directors is required in a well performing BODs. It is also essential that other than the functional director finance some other directors also have some idea of accounting and financial principles so that a useful discussion on the financial aspects of different proposals may be undertaken. Similarly, familiarity with the company law is also helpful.

Information: To be effective, a board needs a broad range of information about the condition of its corporation. It needs, for example, up to date information on the competition, on key strategic issues and on possible acquisition targets. And it needs that information presented clearly and concisely because its time is limited. The BOD has to satisfy various stakeholders and demands from different quarters. Furthermore, the board needs to get its information from a board range of sources such as outside stakeholders, customers, employees and the directors themselves. An evaluation of board resources therefore must ensure not only the kind of data a board gets but also their origins. The data made available should have authentic origin. The BOD has to ensure this as it should not be forged to just satisfy BOD queries. If the BOD takes decisions based on incorrect data will not be effective achieving its objectives. Outside data is particularly when assessing a board's performance relative to that of its competitors. Institutional investors, market analysts, regulatory bodies, the press, and

academic journals government agencies are all potential sources of outside information. Evidence suggests that institutional investors, in particular, want to be asked for their view of board performance.

Power: An effective board needs authority - the authority to act as a governing body, surely, and to make key decisions, - but also the power to see that senior management is accepting and implementing its decisions. The BOD independence also adds to its power. A board's power is a function of the backgrounds of its members and the way they are chosen. It is crucial, then, that a committee of independent directors and not the CEO-oversees the process of selecting new directors,

Motivation: The BODs will be motivated to function in the interest of the organization objectives if it feels that its actions and decisions will be suitably rewarded. These days the private sector enterprises all over the world are giving stock options or performance related incentives to encourage greater BODs involvement in its functions.

Time: To make effective decisions, directors need sufficient well-organized periods of time together as a group. Evaluations should note whether the frequency of meetings is adequate, whether there is sufficient time available to prepare for meetings and to deliberate on important decisions, and whether time spent in meetings is used efficiently. For instance, board members should not devote time in meetings to getting information from management that could have been communicated earlier. The management should anticipate the information required to taking certain decisions and make it available to the BOD. Rather, they should spend meeting time engaged in substantive discussion and decision making. Here it is also important that

attendance is good and as recommended by CII, directors' attendance record should be considered while deciding upon re-appointment.

Evaluation : Evaluation is particularly difficult for boards of directors because it requires members to make decisions about themselves. The parameters for evaluation must be established by a BODs committee and a Corporate Governance committee should be there to look into the evaluation of the Corporate Governance practices based on prescribed parameters. The effectiveness of the evaluation every much depends on how the board structures the evaluation process. It should consist of three phases: The first -setting annual board objectives at the beginning of the fiscal year. The process picks up again at the end of the year, when, in the second phase, the board secretary collects and disseminates about the board's activities. With that information in hand, in the third phase, board members can judge how close they came to meeting their objectives while also examining the adequacy of the resources available to the them over the year.

Conclusion

Evaluation of Navratna BODs operations are at times confidential and very complex, studying, analyzing and evaluating them becomes a very difficult task. The perform efficiently a BOD needs knowledge, time, information, motivation and power. Public Enterprises Section Board (PESB) has to play a strong role and endure that concerned Ministry is not allowed to get away with any arbitrary decision and whatever it decides should be done on time to ensure a smooth transition in the company with a proper handing over and taking over. The concept of orientation of non-executive official and non-official directors has not received much focus till now, not only in India but all

over the world. As against management Corporate Governance involves dual responsibility fulfilling internal organizational and societal needs. All the PSE representatives confirmed that they have formulated the corporate vision, mission and objectives in compliance with the above referred circular. It is very important for the BODs to ensure that the team of senior mangers has the desired combinations of qualities required at that level to shoulder the responsibilities placed on them. The BODs role consists of two levels one relates to setting mission objectives and policy formulation and the second level functions include monitoring management, and reviewing and controlling their activities form time to time. In our survey, we found that the BODs must not involve itself in day to day functioning of the organization and also that governance does not involve ensuring returns in the short run. This research based on nine NAVRATNA companies (like ONGC, NTPC, SAIL IOC, HPCL, BPCL, GAIL, MTNL, BHEL)

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