JYU DISSERTATIONS 108

Shabnamjit Hundal

Corporate boards and audit committees in India

The impact of independence and busyness of corporate boards and audit committees on firm performance and financial reporting quality

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SCHOOL OF BUSINESS AND ECONOMICS

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ABSTRACT

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The study aims to analyze the effects of multiple directorship assignments (busyness) taken up by corporate directors and audit committee members on firm performance and financial reporting quality. The key arguments of the current study are that the busyness of corporate directors can affect their independence, among other factors, and second, the phenomenon of busyness can also be used as a non-conventional measure of independence of directors. It is further argued that the effects of firm-level busyness on firm performance and financial reporting quality can be better explained when firm characteristics and other institutional settings, such as ownership structure of firms, are incorporated in comparison to the situation when the same phenomenon is explained by following limits of busyness as prescribed by the regulators. Similarly, the relation between firm performance, financial reporting quality, board member busyness and board independence have been studied in the context of India as most of the previous studies examining the similar relationship have been conducted in the context of developed markets. In addition to the above, the effects of the intensity (quality) of busyness, underlying the level of rigor and responsibilities on firm performance and financial reporting quality have also been studied in the dissertation.

The empirical findings of the current dissertation provide more realistic and meaningful information novel pertaining to the effects of busyness on firm performance and financial reporting quality by applying endogenously determined levels of busyness as against exogenously prescribed busyness limits by regulators. The inclusion of the intensity of busyness provide even more relevance to the above findings.

Keywords: Audit committee, board of directors, financial reporting quality, firm performance, multiple directorships, reputational capital, discretionary accruals, agency theory, resource dependence theory, spline regression.

TIIVISTELMÄ (ABSTRACT IN FINNISH)

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Tässä väitöskirjassa tarkastellaan, miten Intiassa toimivien yritysten hallitusten ja tarkastusvaliokuntien jäsenten samanaikaiset tehtävät useiden yritysten hallituksissa ja valiokunnissa vaikuttavat riippumattomuuteen ja edelleen yritysten taloudelliseen toimintaan ja talousraportoinnin laatuun. Väitöskirjaan sisältyy johdanto ja kolme julkaistua artikkelia. Aineisto koostuu 3 733 listatusta yrityksestä. Tulosten mukaan johtajien kuormittavuus vaikuttaa riippumattomuuteen, ja kuormittavuus riippumattomuuden mittarina selittää yritysten toimintaa ja talousraportoinnin laatua. Yritysten taloudellisen toimintakyvyn, raportoinnin laadun, hallituksen jäsenten kuormittavuuden ja riippumattomuuden välisiä suhteita tarkastellaan kehittyvän markkinan, Intian, kontekstissa. Aihetta käsitellään kahden keskenään osittain ristiriitaisen teoreettisen viitekehyksen, agenttiteorian ja resurssiriippuvuusteorian, valossa.

Avainsanat: Hyvä hallintotapa, tarkastusvaliokunnat, Intia, riippumattomuus, kuormittavuus

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Jyväskylä 19 June 2019
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LIST OF ORIGINAL ARTICLES

This dissertation is comprised of an introductory chapter and the following articles, which are referred to throughout the text by the Roman numerals indicated below:

I. Hundal, S. 2013. Independence, Expertise and Experience of Audit Committees: Some Aspects of Indian Corporate Sector. American International Journal of Social Science 2 (5), 58–75.
II. Hundal, S. 2016. Busyness of audit committee directors and quality of financial information in India. International Journal of Business Governance and Ethics 11 (4), 335–363.
III. Hundal, S. 2017. Multiple directorships of corporate boards and firm performance in India. Corporate Ownership & Control 14 (4), 150-164.

ALKUPERÄISET ARTIKKELIT

Tämä väitöskirja koostuu johdantokappaleesta sekä alla luetelluista artikkeleista, joihin viitataan tekstissä seuraavilla roomalaisilla numeroilla:

I. Hundal, S. 2013. Independence, Expertise and Experience of Audit Committees: Some Aspects of Indian Corporate Sector. American International Journal of Social Science 2 (5), 58–75.
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III. Hundal, S. 2017. Multiple directorships of corporate boards and firm performance in India. Corporate Ownership & Control 14 (4), 150-164.

1 INTRODUCTION

1.1 Background

This doctoral dissertation examines the effect of independence of corporate directors and audit committee members, as reflected by their multiple directorship positions held (busyness), on firm performance and financial reporting quality. The motivation of this dissertation has been drawn from the phenomenon of busyness of corporate directors. In the modern day corporates, directors of a firm, both, executive and non-executive, can hold directorships in other firms too, however, subject to the regulatory requirements prevailing in a given corporate setting. The researcher has the motivation to study different viewpoints that position the phenomenon of multiple directorships of corporate directors with respect to their independence and the resultant effects on firm performance. In order to capture the effects of institutional settings of firms belonging to different ownership structures, such as local private firms, foreign firms and government firms, the spline regression technique has been applied. The spline regression technique facilitates to determine endogenous cut-off points of busyness of corporate directors.

The effects of the independence of corporate boards and affiliated committees on firm performance and financial reporting quality has been a widely researched discipline, however, the previous studies have not been free from certain limitations. First, a major limitation of majority of the previous studies is the way independence of boards of directors is measured. Several researchers have applied conventional measures of independence of corporate boards of directors, for example, a frequently used conventional measure of board independence is the proportion of independent directors on the firm board (Costello & Wittenberg-Moerman, 2011; Holthausen, 2009, Jackling & Johl 2009, Bushman et al., 2004). However, in this dissertation an alternative argument is

developed, and according to this argument the conventional measures of board independence can be symbolic and exogenous. However, in this dissertation an attempt has been made to *dig deeper* and explore factors that may determine the very independence of boards of directors. The concept of 'independence' of corporate boards of directors has its own dynamics and it can be erroneous to assume it to be given (Ferris & Jagannathan, 2001). In this dissertation, the phenomena of busyness of corporate directors has been studied as a determinant of board independence, *ceteris paribus*. In particular, the phenomenon of busyness of directors, as a determinant of independence of corporate boards, has also been empirically analyzed in order to measure its impact on firm performance and quality of financial information. Second, the phenomenon of independence of the board of directors has been studied in relatively large number of previous studies, whereas the independence of various committees constituted under the umbrella of a firm board of directors has not fully explored (Sarkar & Sarkar, 2009; Zahra & Pearce, 1989). Although in this dissertation the phenomenon of independence has been studied and analyzed with respect to corporate boards of directors, nonetheless, it is pertinent to understand that the concept of 'independence' is not merely restricted to corporate boards of directors as it also includes corporate committees in its ambit. In this dissertation, the phenomenon of independence of audit committee members on the financial reporting quality has also been studied and analyzed. The most common firm-level corporate committees are audit committee, remuneration committee and nominating committee. However, some specific committees can also be formed based on firm characteristics and regulatory requirements; for example, 'health and safety committee' assumes a strategic significance in an oil company, both from the standpoints of the nature of the firms as well as the statutory requirements, but this committee may not even exist in an information technology (IT) company. The audit committee of a firm can be considered as arguably the most important among all committees formed by its board of directors. It is a part of the internal controls system of firms, which plays an important role in ensuring the truthfulness and timeliness of financial reports (DeZoort et al., 2002). Audit committees take various monitoring and control initiatives, which aim to produce high quality financial reports and to enhance accountability of managerial actions. Several empirical studies have found that an audit committee can achieve its objectives, when working independently of the managerial influences and interventions (Kapoor & Goel, 2017; Sharma & Iselin, 2012; Marciukaityte & Szewczyk, 2011; Hunton & Rose, 2008; DeZoort et al., 2002). Similarly, several regulators have also highlighted the importance of independent functioning of boards of directors and audit committees of firms (Sarbanes-Oxley Act, 2002).

Jackling and Johl (2009), Ferris and Jagannathan (2001), Ferris et al. (2003) and Liu and Paul (2015) have found busyness as an important determinant of the independence of the board of directors. In the similar vein, it has been argued in this dissertation that multiple directorship assignments taken by the audit committee members, and corporate directors affect their independence, and

consequently the quality of financial reporting and firm performance. Nonetheless, majority of researchers have applied conventional measures of independence of corporate boards of directors, for example, the proportion of independent directors on the firm board has been frequently used as a measure of board independence (Costello & Wittenberg-Moerman, 2011; Holthausen, 2009). An attempt has been made in this dissertation to address this limitation by applying busyness of corporate directors, as the non-conventional measure of board independence. Furthermore, an attempt has been made in this dissertation to explore the association between the independence of, both, board of directors and audit committees on the one hand, and firm performance and financial reporting quality on the other, from two alternative and conflicting perspectives- the agency theory and the resource dependence theory. Busyness affects the independence of corporate boards and audit committees both favorably and unfavorably (Liu & Paul, 2015). Furthermore, the independence of corporate boards and audit committees affects their effectiveness. The effectiveness of corporate boards is measured on the basis of several parameters including strategy, performance management, corporate governance, and compliance, investment efficiencies, risk management, organizational health, and talent management and shareholder, and stakeholder management (McKinsey Quarterly, 2016; Cossin & Caballero, 2014; Machold et al. 2011). Similarly, the effectiveness of audit committees can be measured on the basis of several parameters including availability of a sound system of internal controls, and oversight of management, fairness and truthfulness of financial reporting, and disclosures, risk management system, culture of accountability, and quality of compliance and relationship with external auditors (Blue Ribbon Committee (BRC), 1999; PricewaterhouseCoopers, 2011).

The argument that the busyness of board of directors and audit committee members can negatively affect firm performance and financial reporting quality rests on the agency theory. The argument follows that busy directors may not be able to monitor and control managerial actions, and therefore firm performance and financial reporting quality may deteriorate (Field et al., 2013; Andres & Lehmann, 2013). The argument that the busyness of board of directors and audit committee members positively affects firm performance and financial reporting quality rests on the resource dependence theory. The argument follows that corporate directors earn multiple directorships owing to their high quality of *reputational capital*, defined in this dissertation as the combination of human capital (for example, education, expertise, experience) and relational capital (for example, business networks); and owing to the higher (lower) level of reputational capital of corporate boards, among other determinants, firm performance and financial reporting quality may improve (deteriorate) (Felicio et al, 2014).

Another limitation of the extant literature is that most of the empirical studies examining boards' independence and their impact on firm performance and financial reporting quality have been carried out in the Anglo-Saxon institutional settings, and relatively less is known about the same phenomenon

in the context of an emerging economy like India. The Indian corporate sector has several unique characteristics. First, India has the largest number of listed companies in the world albeit a lower fraction of widely held companies (Desjardins, 2017). Economic reforms initiated in the early 1990s in India have expanded the size and composition of Indian corporate sector. For example, the total market capitalization of listed companies in India was almost $2 trillion in 2017, therefore, placing India as the ninth largest stock market in the world (Burugula, 2017). Second, the ownership and control structure of firms are highly skewed in favor of promoter-owners in India (MCA, 2013). Third, promoter-owners of firms, including individuals, families, groups of firms, and government bodies, have disproportionately higher control over firms than their ownership in the same, therefore, promoters may have the opportunity to handpick directors of their choice in order to strengthen their control for a given level of ownership across firm boards within the business group (Kaczmarek et al., 2014; Chakrabarti et al., 2008; Sarkar & Sarkar, 2000). Due to high level of ownership concentration and family business groups dominance, the phenomena of pyramiding and tunneling, and earnings management are widespread among Indian business groups (Mathew, 2007; Chakrabarti et al. 2008). Fourth, the Indian corporate sector is not only big in size but complex too. The composition of Indian corporate sector has also experienced a major shift from the public sector dominance to the private sector, including local Indian and foreign firms (Committee on Corporate Governance, 2003). Currently, based on ownership structure, there are three major categories of Indian firms-local private sector, public sector and private sector, and each category bears significant impact on the corporate system of India. Above mentioned developments with respect to the size of corporate sector and its composition have necessitated major changes in the corporate governance system of India. Furthermore, Indian corporate system is characterized by significant participation of small investors, active takeover market and pivotal role of financial institutions in the corporate financing (Sarkar & Sarkar, 2012; Shroff, 2008; Shaun, 2007; Chibber & Majumdar, 1998). Despite the fact that the country's legal system is very comprehensive and has several provisions with respect to providing protection to investors, nonetheless, the cumbersome legal procedures and unusual delay in legal enforcement along with over-burdened courts and high levels of corruption, are the major problems (Sarkar & Sarkar, 2012).

In this dissertation, an attempt has been made to highlight unique characteristics of institutional settings of firms in India and incorporate such characteristics in the empirical analysis.

1.2 Theoretical underpinnings

In this dissertation key theoretical arguments have been following two theories-the agency theory and the resource dependence theory. The association between the independence of board of directors and audit committee members on the one

hand, as measured by their busyness, and firm performance and financial reporting quality on the other have been studied through the perspectives of the above mentioned theories. The key theoretical underpinning of this dissertation is that board of directors' independence *per se*, as reflected through the conventional measures of independence, may not be enough to assess its effects on firm performance and financial reporting quality. The independence of board of directors of a firm, among other things, can depend on multiple directorship assignments taken-up by them in boards of directors and committees of other firms. Busyness can affect the independence of corporate boards and committees both favorably and unfavorably. The agency theory and the resource dependence theory explain the above phenomenon from two alternative and at the same time conflicting theoretical viewpoints. The argument that the busyness of board of directors and audit committee members can affect firm performance and financial reporting quality unfavorably rests on the agency theory. The crux of the agency theory argument is that due to their extensive busyness, directors serving on multiple boards may not be able to perform their key responsibilities related to monitoring and controlling managerial actions, and resultantly all components of the agency cost, monitoring, bonding and residual loss, can increase (Hill & Jones, 1992; Machold & Farquhar, 2013). The increased agency cost of the firms can diminish firm performance and financial reporting quality. The argument that the busyness of board of directors and audit committee members favorably affect firm performance and financial reporting quality rests on the resource dependence theory. According to the resource dependence theory the presence of corporate directors on multiple boards symbolizes their high reputational capital, which includes human capital (for example, education, expertise, experience) and relational capital (for example, business networks), and as a result firm performance and financial reporting quality can improve.

1.3 Multiple directorships in India

The phenomenon of multiple directorships in India has evolved out of supply constraints in the managerial labor market soon after the nation got independence in 1947. Due to the paucity of experienced, qualified and reputed corporate leadership in a newly independent nation, relatively successful and experienced directors filled the supply gap. Consequently, it was not uncommon to find some directors on more than fifty corporate boards. Several private entrepreneurs in India, during those early years of industrialization, started offering directorships to already established directors. The genesis of such move was to recruit directors enjoying high reputational capital in the market of corporate directors in order to solve the problem of shortage of managerial talent (Mehta, 1955). It can be postulated that the advantages related to multiple directorships during the early phase of industrialization and corporatization were based on the resource dependence theory.

On the contrary, Bhabha Committee (1952) pointed out the possible challenges arising out of the unabated busyness of directors; therefore, it recommended limiting the number of multiple directorships of corporate directors. The idea of limiting the busyness in India can be seen through the agency theory perspectives. In India, the ownership and control structures of firms have always been skewed in favor of promoters. Promoters include individuals, families, firms, and government bodies. A significant feature of the Indian corporate system is that promoters strive to maximize their control over a firm for a given level of ownership in it (Field et al., 2013; Chakrabarti et al., 2008; Sarkar & Sarkar, 2000). Promoters often appoint directors in a firm, who are either serving on boards of other firms within the business group that the particular firm is also affiliated to or those *external* directors, who have strong linkages with them (Kaczmarek et al., 2014). Promoters can handpick such directors in order to strengthen their control for a given level of ownership across corporate boards within the business group (Chakrabarti et al., 2008). The argument following the agency theory suggests that regulatory development related to placing limits on multiple directorships can enhance efficacy of monitoring and control of directors.

The section 275 of the Companies Act of India was the first step to specify maximum number of directorships to fifteen, later on increased to twenty, that directors of publicly traded firms could hold. However, the Securities and Exchange Board of India (SEBI), (an equivalent to the Securities and Exchange Commission (SEC) in the USA) in its guidelines published by the Ministry of Corporate Affairs of India, known as the Clause 49, subsequently recommended that no director can become a member of ten boards or serve as the chairperson of more than five committees (MCA, 1956). Nevertheless, because the above mentioned limit did not include private firms, unlimited companies and non-profit organizations (except subsidiaries or holding companies of a publicly traded firm), the Companies Act of India paved the way for the actual number of multiple directorships to easily exceed the regulatory limit. In addition, the imposed limit was purely exogenous, as it was *formed* in relation to the average level of multiple directorships in the USA and the UK, therefore, ignoring the institutional settings of firms in India (Bhabha Committee, 1952).

Regarding multiple directorships, section 165(1) of the Companies Act of India (MCA, 2013, p. 97) states that "No person, after the commencement of this Act, shall hold office as a director, including any alternate directorship, in more than twenty companies at the same time**:** Provided that the maximum number of public companies in which a person can be appointed as a director shall not exceed ten". However, inconsistencies and conflicts can be observed with respect to the number of multiple directorships specified by various regulators, for example the Companies Act 2013 specifies maximum limit of busyness to ten (MCA, 2013), whereas the revised clause 49 restrict the same to seven with effect from 2014 (Ernst & Young, 2014).

According to an argument, the government owned (public sector) firms in India, due to several reasons, for example their historic legacy, larger size, role as

a major employment provider and functioning in highly strategic sectors (e.g. infrastructure and utility), maintain high corporate governance standards. Owing to the above mentioned characteristics highlighting their pivotal place in the corporate spectrum, the public sector firms in India invite those directors to their boards, who can ensure the high level of control, monitoring and disclosure (Ahuja & Majumdar, 1998). However, according to an opposite argument, the selection, appointment and promotion procedure of directors in the public sector firms in India is fundamentally based on the seniority and may ignore merit, and as a consequence the government bureaucrats may be sitting in multiple corporate boards without making any significant contribution to the firms (Kang & Zhang, 2015).

Regarding the foreign directors in India, there is a perception that since most of the foreign firms in India belong to the countries having higher corporate governance standards, therefore, such firms when operating in India continue to maintain their standards and resultantly favorably affect the performance of their subsidiaries, joint ventures and affiliates in India. Based on the above perception, one can argue that the phenomenon of busyness of directors in the context of foreign firms is value additive to the corporates in India. Some empirical studies, notably by Patibandla (2006) and Chibber and Majumdar (1999), provide evidence in support of the above argument.

In the context of local private sector firms in India the promoter directors play a highly significant role in the corporate governance system (Sarkar & Sarkar, 2000). This is so because ownership and control structure of firms, in particular in the local private sector firms, in India is tilted towards promoters, who in turn *cherry-pick* directors who, first, are loyal to them and second, help them to consolidate their position in various echelons of the corporate group. Consequently, directors holding multiple directorships in India often cater to the utility function of the promoters instead of that of firms (Chakrabarti et al., 2008; Khanna & Rivkin, 2001; Mathew, 2007). However, according to a counter argument, higher ownership and control of promoters help to enhance discipline, and accountabilities of mangers, which in turn can positively affect firm performance (Jensen & Meckling, 1976; Oded & Wang, 2010).

1.4 Research objectives and structure of the dissertation

The following are the principal objectives of this dissertation. First, to explore the impact of busyness of boards of directors and audit committee members, applied as a measure of board independence instead of conventional measures of independence, on firm performance and financial reporting quality in India in the light of the two alternative theoretical perspectives, that is agency theory and resource dependence theory. Second, to investigate the above phenomenon when the endogenously determined levels of busyness are applied in comparison to the busyness limits prescribed exogenously by regulators. This *endogenous versus exogenous* debate is highly relevant in a country like India, because many

researchers argue that exogenously imposed busyness limits do not necessarily reflect the important institutional settings of firms, for example, promoters' ownership and control underline important characteristics of firms in India (Jackling & Johl, 2009; Bushman et al., 2004; Donnelly & Mulcahy, 2008). The third objective of the dissertation is to study how the nature of busyness is associated with firm performance. The principal argument underscoring the third objective is that it is not just *quantity* of busyness that matters, *quality* of busyness matters too. Arguably, when a director of a firm accepts a certain number of directorships in other firms as a member of specialized committees, for example, audit, compensation, and nominating committees, then the nature of work he/she is expected to do is likely to be more demanding in comparison to another situation when the same director joins general boards of directors only of the same number of firms, other things being equal. The phenomenon of the nature of busyness is denoted by the intensity (or quality) of busyness in this dissertation.

The current dissertation is an attempt to bridge the gap in the extant literature in several ways. In this dissertation it is highlighted that independence of corporate boards depends on several factors; and it is further argued that the phenomenon of multiple directorships of a board of directors is a determinant of independence of corporate boards. An independent board of directors can influence managerial behavior, accountability and corporate decision making, which in turn is capable of influencing firm performance. A shortcoming of the existing literature is that the phenomenon of directors' independence is often associated with the board of directors alone and there are not many studies that include the perspective of committees working under the ambit of corporate boards. In this dissertation, the phenomenon of directors' independence is also studied from the standpoint of busyness of audit committee members and its effects on the financial reporting quality. The audit committees belong to the internal corporate governance system of a firm, and its principal objective is to ensure that the financial information pertaining to the firm is true, relevant and objective (DeZoort et al., 2002). However, according to BRC (1999) and Sarbanes-Oxley Act (2002) an audit committee, which lacks independence, may not achieve its objectives. Similarly, majority of the literature pertaining to corporate governance related aspects has been written in the context of Anglo-Saxon institutional settings, however, in the current dissertation an attempt has been made to study and investigate new insights pertaining to the corporate settings of an emerging country like India. The Indian corporate system has many distinct features, for example, India has the highest number of publicly listed companies in the world, and at the same time the ownership and control structure of firms is substantially inclined towards promoter-owners. Notably, promoter-owners in India have disproportionately higher control over firms than their ownership in the same (Desjardins, 2017; MCA, 2013; Donnelly & Mulcahy, 2008). As a result of the above feature, there is always a chance that promoters can *pick and choose* those directors, who can help promoters to strengthen their control for a given level of ownership in various firms of the same business group (Chakrabarti et al., 2008; Sarkar & Sarkar, 2000). Due to variation in the institutional settings of

firms, there is a strong case for the endogenously determined busyness levels in a country like India. With respect to types of ownership, the Indian corporate sector can be divided into three categories- local private sector firms, government-owned firms (public sector) and foreign origin firms. Although, the disparity between the above mentioned categories of firms with respect to their number and size in Indian corporate spectrum is marked, however, due to the enormous size of the corporate sector of India, each category stands significantly impactful and visible in the corporate echelons (Committee on Corporate Governance, 2003). The current dissertation acknowledges and incorporate above mentioned unique characteristics of institutional settings of firms in India by analyzing three sub-samples of firms categorized based on their ownership structure.

The dissertation comprises of three articles. The first article is a review of literature and it studies how independence, expertise and experience of audit committees generally as well as particularly in the context of Indian corporate sector can have impact on the quality of financial reporting. The article underpins several determinants that may affect the independence of audit committees, for example, informativeness, CEO's power, frequency of committee meetings, substitutability and complementarity between various corporate governance mechanisms, relative share of directors in the firm ownership and earning management. This inference related to the first objective of the dissertation is that independence of boards of directors of firms *per se* may not explain its impact on firm performance. However, it is important to explore factors that influence independence of boards of directors as such busyness of directors; and the second and third articles have empirically explored this phenomenon through the agency, and resource dependence perspectives. Similarly, the literature pertaining to financial and accounting skills, and knowledge of the audit committee members, as well as their experience in the relevant field, has also been reviewed. The article further discusses issues such as the litigation risks that firms may confront in the event of false information disclosed in the financial reports and stock market reactions, when firms appoint audit committee members having the background in accounting and finance. Similarly, the first article throws light on the various features of audit committees in India, such as regulatory developments and corporate governance reforms. The study also highlights that lack of independence, expertise, and experience of audit committee members are the major limitations of the audit committees in India. There are also elements of contradictions and vagueness in the corporate governance reforms, in general, and those pertaining to audit committees, in particular.

The second article is an empirical study and it investigates the impact of the busyness of audit committee members of a firm on boards and committees of other firms on the financial reporting quality. The core idea of the article is that the increased independence of the audit committee members can facilitate them to perform their functions effectively and as a result the financial reporting quality of firms is expected to improve. The article examines, first, the association

between multiple directorships of audit committee members and quality of financial reporting in India, second, whether endogenously determined busyness levels of the audit committee members provide better insights than those exogenously mandated by regulators, and third, whether the intensity or quality of busyness of audit committee members also affects the financial reporting quality. The study endeavors to develop measures of busyness and hypotheses in the light of the agency and resource dependence theories, and applies the spline regression technique that captures institutional settings of firms in order to analyze the data pertaining to the three sub-samples comprising of local private, foreign, and government firms and the full sample firms in India. The study finds that endogenously determined busyness levels of sub-samples and the full sample are capable of explaining the relationship between multiple directorships of audit committee members and financial reporting quality in a better way than the multiple directorships limits mandated by regulators. The above finding also meets one of the principal objectives of the dissertation. Further, the study finds that a lower (higher) level of busyness of audit committee members enhances (deteriorates) financial reporting quality of firms. This finding is in conformity with the first objective of the dissertation that the non-conventional measure of audit committee independence, that is the busyness of the audit committee members, explains the phenomenon better than that explained by the conventional measures of independence of directors *per se*. The empirical finding shows that the busyness of audit committee members causes adverse effects on the financial reporting quality of firms, and this finding can be explained through the agency theory perspective. The quality or intensity of busyness has mixed effects on the financial reporting quality of firms. The findings show that for the sub-samples of government, and local private firms and for the full sample, the intensity of busyness starts impacting the financial reporting quality adversely at a relatively high level of busyness of audit committee members, and for the sub-samples of foreign firms, the same variable starts showing favorable effects at a lower level of busyness of audit committee members.

The third article is also an empirical study and its objectives are to investigate, first, the association between multiple directorship assignments undertaken by corporate directors and firm performance, second, whether endogenously determined levels of multiple directorships, highlighting the ownership structure and other institutional settings, explain the above association better than those by exogenously imposed limits determined by regulators and third, the association between the quality or intensity of busyness and firm performance. Once again the study strives to develop measures of busyness and hypotheses in the light of the agency and resource dependence theories. The spline regression technique is applied in order to reflect institutional settings of a large sample and sub-samples of firms classified as local private, foreign, and government firms in India. For local private firms, the association between the number of directorships and firm performance becomes negative before reaching the maximum number of directorships set by

legislation, whereas, for foreign firms and government firms, the same continues to remain positive throughout. This finding can be explained as per both key theoretical perspectives of the dissertation that is the agency theory and the resource dependence theory. Endogenously determined cut-off points of busyness reflect institutional settings of firms, which may remain masked otherwise. Similarly, the intensity of busyness is also an important determinant of firm performance. The intensity of busyness starts negatively affecting firm performance even before reaching the maximum limit of multiple directorship assignments that corporate directors can hold. This finding is supported by the agency theory argument.

The findings of the second and third articles are useful to study the same phenomenon in other emerging markets having corporate governance, and ownership structures similar to those observed in India. The effects of busyness can be different on different firms; however, exogenously imposed regulatory limits do not reflect institutional settings of firms, and both, second and third articles attempt to fill in this research gap.

2 FINANCIAL REPORTING QUALITY AND AUDIT COMMITTEES

Accounting rules and corporate governance systems ensure that firms provide truthful and fair financial information (Davies & Aston, 2011). Corporate managers use different reports and disclosures containing financial information pertaining to firms in order to communicate firms' financial performance to outside investors and other stakeholders. In the words of Ball (2008, p. 2), "the financial reporting is as an important economic activity", as these reports provide information which can be useful in various aspects related to firm operations, investment, and financing decisions; assessing future cash flow prospects of the current and future projects; and estimating firms' existing, and potential resources as well as claims to these resources. Generally, firms provide information about their financial health through various mandatory[1] reports, such as financial statements (balance sheet, income statement, comprehensive income statement, cash flow statement and statement of change in equity), notes to financial statements, management discussion and analysis, corporate governance reports, directors' remuneration reports and other means of financial reporting (such as regulatory news, statements, letters, and filings). In addition, firms can provide financial information voluntarily through management forecasts, analysts' presentations, conference calls, investor presentations, press releases, relevant web links and management reports. The above examples underline firms' direct communication with the external users of financial information (Machold & Price, 2013). However, financial information pertaining to firms is also disclosed by several external information intermediaries, such as, financial analysts, industry experts and financial media (Healy & Palepu, 2001). It is noteworthy that types, contents, structure and categories of financial reporting can vary from one regulatory system to another.

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1 For example, details about the financial statements requirements in the USA is available at http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.pdf (accessed on 6 March 2016).

The series of corporate failures, for example, Enron, WorldCom and Adelphia, witnessed in the beginning of the 21st century, highlighted the pervasiveness of financial reporting manipulation practices; and at the same time inability of accounting rules, and corporate governance requirements and best practices to check discretionary managerial actions (Culpan & Trussel, 2005; Warfield et al., 1995). The fragile nature of internal corporate governance mechanisms has been a 'common denominator' of almost all the major corporate failures witnessed in the beginning of the 21st century. In the aftermath of aforesaid corporate failures researchers, law-makers, professional bodies, and regulators (notably Sarbanes-Oxley (SOX, 2002), and Securities and Exchange Commission (SEC, 2002)) have emphasized that in order to enhance the quality[2] of financial reporting and accountability of decision makers, a revamping of the internal corporate governance system, which includes boards of directors, audit committees, internal auditors and executives, is of utmost importance.

The audit committee is an important constituent of the internal corporate governance system, and its principal objective is to review financial statements, before they are submitted to the board of directors, in order to ensure that such statements provide the complete picture of the financial health of firms, provide details of accounting policies and procedures, and contain relevant disclosures. The audit committee ensures fairness of financial information and promotes a culture of accountability within the organizational structure of firms (BRC, 1999). An 'ideal' audit committee is the one which, "…helps to ensure that management properly develops and adheres to a sound system of internal controls, that procedures are in place to objectively assess management's practices and internal controls, and that the outside auditors, through their own review, objectively assess the company's financial reporting practices."[3]

The audit committee can perform its core responsibilities of review and oversight of a firm's financial reporting processes and internal controls, when it is able to function independently of managerial influences (DeZoort et al., 2002). An independent audit committee plays a key role in creating a forum, separate from management, in which auditors and other interested parties can candidly discuss their concerns (Abbott et al., 2000a; Niemi et al., 2012).

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2 International Accounting Standards Board (IASB, 2008) outlines the following components of quality of financial reporting: *conservatism, predictive value, feedback value, timeliness, verifiability, neutrality, and representational faithfulness*. http://www.fasb.org/resources/ccurl/515/412/Concepts%20Statement%20No%208.pdf (accessed on 27 December 2016).

3 Standards Relating to Listed Company Audit Committees, Securities Act Release No. 33-8220 (2003), pp. 69-70, *available at* 2003 SEC LEXIS 846 ("SEC Audit Committee Release"). http://www.sec.gov/rules/final/33-8220.htm (accessed on 12 March 2013).

2.1 Corporate governance mechanisms, quality of financial reporting and audit committees

The size and complexity of corporate entities have grown over time, leading to increased separation of ownership and control of firms. Managers of modern day public corporations, due to their superior knowledge and better access to the firms' data, know more than shareholders (owners) about the financial health of firms; and as a result, information asymmetries between managers and shareholders have become more pronounced over time (Berle & Means, 1932). Information asymmetries may enable managers to follow their personal utility functions, which may not essentially be in line with the objectives, vision and mission of firms. Managers, in order to optimize their personal utility function, can manipulate accounting information, therefore, reducing truthfulness, and reliability of financial reporting (Healy & Palepu, 2001). A firm can use *internal and external* corporate governance mechanisms to enhance financial reporting quality. Internal corporate governance mechanisms, as the name suggests, are internal to a firm. The essence of internal corporate governance mechanisms is *the contracting arrangement*, under which, managers are given incentives for providing objective financial reporting and full disclosures of private information to owners (Kreps, 1990; Roe, 2004).

Figure 1 elucidates a process highlighting a stark reality of modern day corporate settings in which ownership and control are decoupled from each other, therefore, causing information asymmetries between owners and controllers that subsequently require to be addressed through the interplay of different corporate governance mechanisms. The quality of interplays among different corporate governance mechanisms determines quality of financial reporting. The above mentioned process has three distinct stages. The first one is '*the problem stage*', which highlights information asymmetries arising due to the separation of ownership and control of firms. Arguably, the ownership of modern day corporates is *diffused* and *dispersed*, resultantly, controllers have information advantage over owners. The second stage highlights *'interactions'* between different elements, within each of the two broad categories of corporate governance mechanisms, that is internal and external; and between elements belonging to both categories. For example, the audit committee of a firm (internal) interacts with the board of directors (internal) by directly reporting to the latter, and at the same time coordinates with the statutory auditor (external) during the financial statement preparation process (Niemi et al., 2012). Similarly, the decision regarding the number (or proportion) of independent directors in an audit committee (internal) is not only influenced by the board of directors (internal), but also by regulatory requirements, and listing requirements of stock exchanges (both external). One of the key objectives of such interactions is to mitigate the information asymmetries in order to reach '*the outcome stage*', that is to improve the financial reporting quality of firms. The high (low) quality of interactions between various elements of corporate governance mechanisms can

decrease (increase) information asymmetries and thus enhance (deteriorate) the quality of financial reporting.

The audit committee is one of the various internal corporate governance measures, and its primary responsibility, on behalf of the firm board of directors, is to oversee the integrity of the financial reporting controls and procedures implemented by the management, to protect the interests of shareholders and other stakeholders. Furthermore, audit committees review the financial statements in order to create a system of discipline and control, which aims to reduce the opportunity for fraud. Audit committees can also increase public confidence in the credibility and objectivity of financial statements. The corporate audit committees are instituted in order to enhance the quality of financial reporting, by reviewing the financial statements on behalf of the board and to create a climate of discipline and control which aims to reduce the opportunity for fraud. Above mentioned system of discipline, control and accountability, in which the audit committees play an important role, helps to increase public confidence with respect to the credibility and objectivity of financial statements. Similarly, an audit committee also assesses the nature and type of services provided by external auditors to the firm, and in return the fees paid to external auditors by the firm (Niemi et al., 2012). Furthermore, an audit committee reviews the independence and experience of external auditors and sends proposals to the board for the reappointment of external auditors (PricewaterhouseCoopers, 2011; Gorman, 2009; Cadbury Report, 1992).

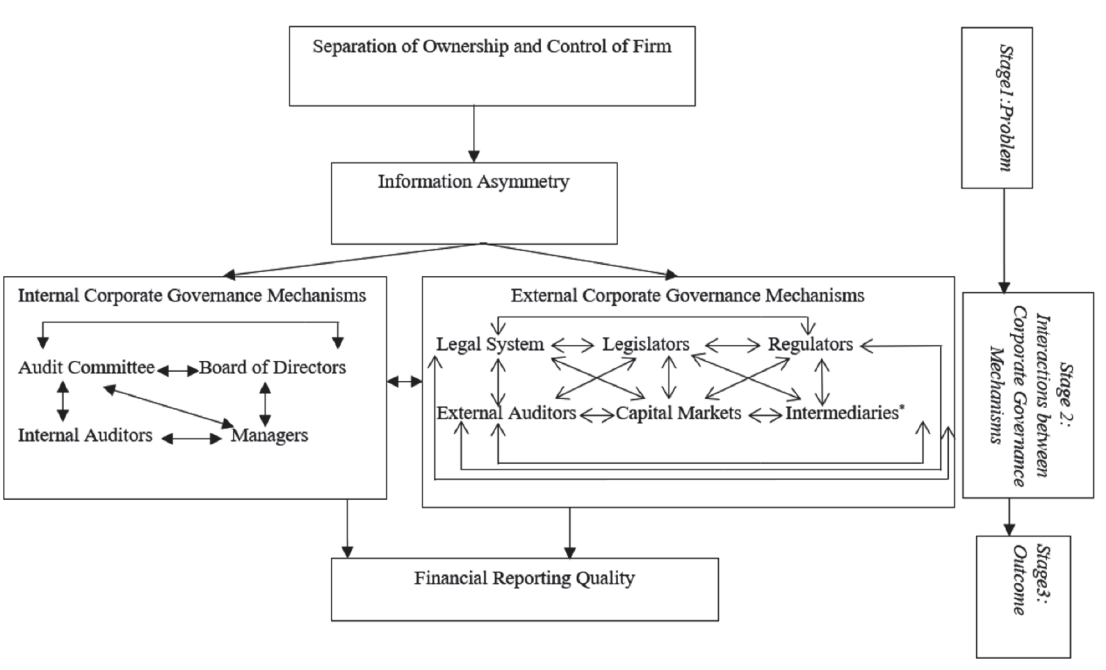

FIGURE 1 Ownership, Control and Financial Reporting Quality[4]

[4] Adapted from corporate governance mosaic and financial reporting quality (Cohen et al. 2004)

* Intermediaries include, among others, financial analysts, rating agencies and financial media

An audit committee stands on two pillars of accountability: first, management's accountability to firm board, and second, board's accountability to firm's investors. In broader terms, audit committees perform board's oversight, and control functions, however, in specific terms, functions of audit committees are directly linked to *internal*[5] as well as *external*[6] audit processes of the firm (Cohen et al., 2004). However, there has been a steady addition over time to the list of functions of audit committees, for example, maintaining regulatory compliance in the financial reporting, and ethical matters, risk management and internal controls (Collier & Gregory, 1999; Bédard et al., 2004; Lee et al., 2004).

2.2 Agency theory and audit committee

In figure 2, economic contracts highlight rights and responsibilities of the principal and the agent. The formal legal contractual relationships between the principal and the agent may have *constraints* caused by divergences of incentives and risk preferences, and information asymmetries that exist between them as economic contracts can be anything but perfect.

The information asymmetries between the principal and the agent arise because managers, generally, have better firm-specific information than outside directors and shareholders. On the one hand, agents have incentives to conceal certain types of information, for example, falling profitability and rising operating costs and on the other hand have strong motivations to exaggerate their firms' projected profitability in order to win boards' confidence, select their favorite projects and emit positive signals to shareholders in order to follow their personal utility functions (Verrecchia, 2001). In corporate boards having Anglo-Saxon type *diffused and dispersed* ownership structure, information asymmetries are biased against shareholders and outside directors, and as a consequence monitoring of agents gets difficult (Beyer et al., 2010; Ang et al., 2000). On the other hand, in the continent Europe and Asia, particularly, ownership structure is such that usually a *small number of large shareholders* owns substantial shares of firms and as a result, they dominate corporate boards. Therefore, information asymmetry is often in favor of the big blockholders and managers, and against minority shareholders. Such phenomenon can reduce liquidity of the capital market, and increase the risk of expropriation of minority shareholders (Goergen

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5 According to the Institute of Internal Auditors (IIA, 2009), *"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."* The IIA lays down four key principles that an audit committee should adhere to: *integrity, objectivity, confidentiality and competency*.

6 External audit aims to ensure whether, the financial statements are true and fair, company has kept proper accounting records, the records agree with the financial statements, the statements comply with the statutory and stock market requirements and appropriate accounting policies have been applied consistently. See Davies and Aston (2011).

et al., 2008). Therefore, information asymmetry exists between the principal and the agent, regardless of the type of ownership structure. This phenomenon of information asymmetry signifies the market imperfection, and a direct outcome of such anomaly is that external investors find it difficult to estimate the expected rate of returns on their capital invested in a particular firm. As a result, a mismatch between the market value and the real value of a firm can arise, as high profitability firms may be underpriced and low profitability firms may be overpriced. Akerlof (1970) calls such situation of market failure as *lemons problem*.

A possible solution to above mentioned divergences is to create *ex-ante* economic contracts, which include pre-determined performance benchmarks against which *ex-post* outcomes are compared. Such performance based economic contracts are created based on the assumption that by linking the agent's reward to some pre-determined performance benchmarks, the agent will also have the incentive to enhance firm value, and, thus, resulting in the alignment of interests of the principal and the agent. Generally, economic contracts use accounting and stock price based benchmarks in order to measure the agent's performance. However, both measures of firm performance have inherent flaws. Empirical evidence shows that managers can affect the quality of financial reporting by several ways in order to influence accounting as well as market-based performance measures.

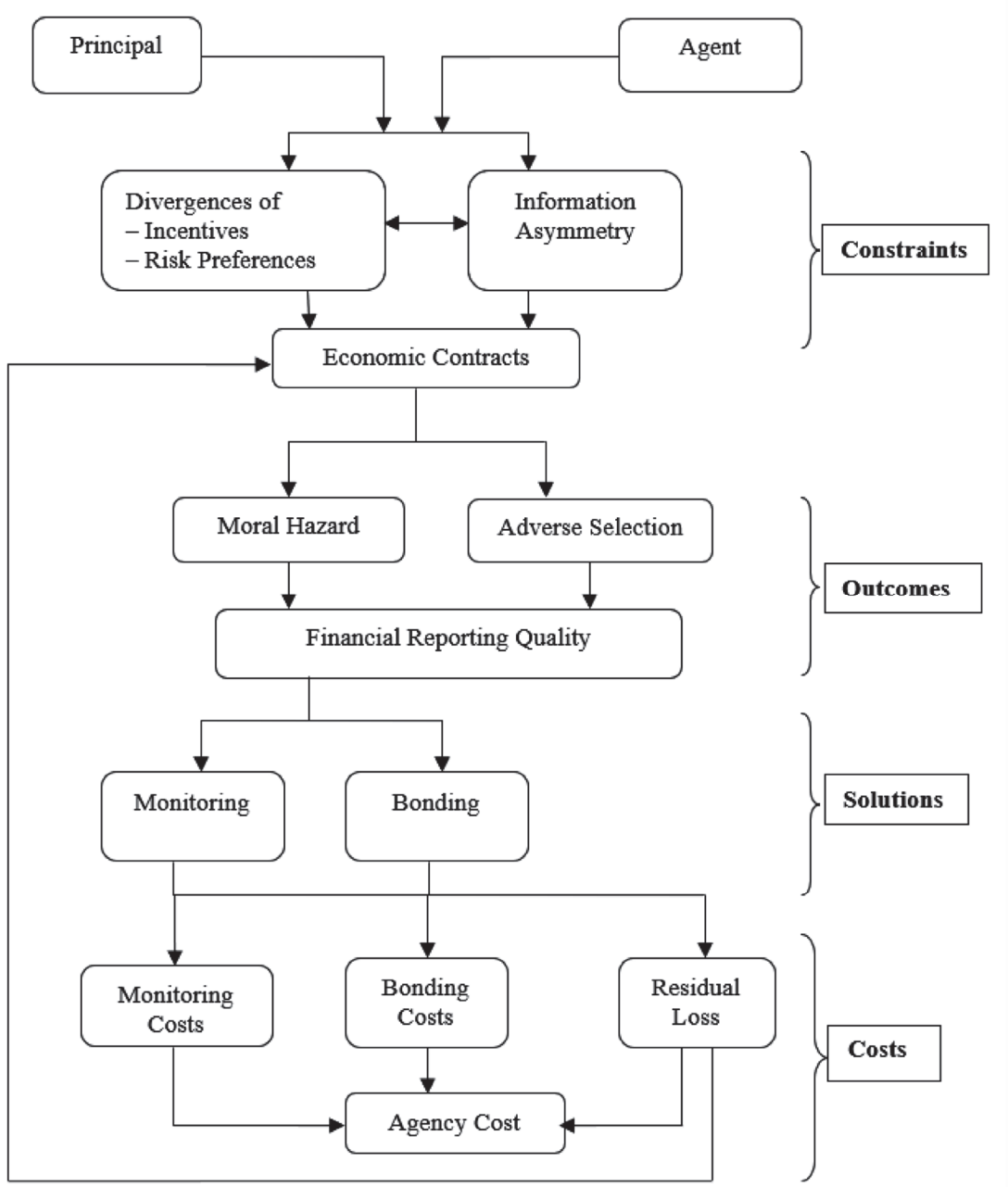

FIGURE 2 Agency Theory Framework and Quality of Financial Reporting (compiled by the author)

The major limitation of the accounting performance based contracting arrangement is that the agent, in order to claim the performance based component of reward, can manipulate the accounting numbers (Core et al., 2003; Shleifer & Vishny, 1989, 1997). For example, accrual accounting leaves discretion with the agent in choosing the rate of depreciation, speed at which the firm's customers pay for credit sales and proportion of customers likely to default. Similarly, accrual accounting can be used to capitalize operating expenses instead of expensing, therefore, inflating reported income, something that WorldCom did. Accrual accounting is not the only method that firms can use to

manipulate earnings, for example, Enron could push its reported profits by a little over 9 percent in the year 2000, by not expensing stock options worth $155 million granted to the senior executives (Culpan & Trussel, 2005). Therefore, managerial discretion of the choice of accounting methods, with the motivation to obtain performance-based reward, can be deleterious to the quality of financial reporting (Agrawal & Chadha, 2005; Warfield et al., 1995; Hermalin & Weisbach, 1998). Managers can do earnings management for a variety of reasons, for example, to influence stock market perceptions, to increase executive compensation, to reduce the likelihood of violation of debt covenants and to avoid regulatory intervention (Healey & Wahlen, 1999; Bradbury, 1990).

The stock based compensation is expected to align the interests of the principal and the agent, nevertheless, empirical evidence shows that the agent may still have the motivation to show opportunistic behavior. For example, the agent may follow several earnings management practices, which can push stock prices upwards *plus* lower the exercise prices subsequently, and resultantly enhance *exercisability* of stock options and thus the agent can earn higher capital gains than he/she earns otherwise. Several studies show that managers can affect the quality of financial reporting by several ways in order to influence stock prices; first, by disclosing exaggerated income forecasts (Seyhun, 1998; Lakonishok & Lee, 2001); second, by concealing good news until they decide to offload their stakes in the firm (Sivakumar & Waymire, 1994); and third, by selling their stakes in the firm, which is accused of accounting fraud, before it is formally subjected to regulatory actions (Summers & Sweeney, 1998; Beneish, 1999).

As depicted in figure 2, divergence of risk preferences and incentives, and information asymmetry, have an endogenous relationship. When the agent has more information than the principal, both parties are likely to have different risk preferences, and incentives. For example, when the agent has the private information that the firm is likely to face difficulty in meeting its payment obligations in the near future, other things being equal, he/she is likely to maintain a higher level of cash reserves in order to avoid any kind of liquidity crisis. Since the principal may not know the above-mentioned *likely scenario*, the principal expects the agent to invest in positive net present value projects, assuming that such projects are available to the firm. Similarly, there are likely to be more information asymmetries when the principal and the agent are pursuing different risk preferences and incentives. For example, an agent may be risk averse, and wants to undertake an investment projects in such a way that the firm should grow at a steady growth rate; on the other hand, the principal may be risk lover, and believes that the firm should invest in high growth projects with high risk involved, other things being equal. Such divergences can widen the difference of perceptions of both parties about the intrinsic value and the market value of the firm, which signifies information asymmetries.

Due to information asymmetries and difference in risk preferences and incentives, perfect economic contracting between the principal and the agent is

not possible, and as a result two types of outcomes may follow i.e. *moral hazard* and *adverse selection* (see figure 2). Moral hazard implies that 'the agent is shirking' and demonstrates lack of efforts in performing core responsibilities, in deviation of the terms and conditions agreed-upon in the economic contract. The outcome of the moral hazard is that it leaves room for the agent to take sub-optimal decisions and behave in an opportunistic manner (Adams, 1994). Similarly, adverse selection refers to a situation when 'the agent is misrepresenting his/her abilities', and the principal cannot determine if the agent is performing the work for which he/she is paid. The agent may claim to have certain skills or abilities at the time of hiring, and the principal cannot completely verify such claims made by the agent, neither at the time of his/her selection nor when he/she is working (Adams, 1994; Gomez-Mejia & Wiseman, 2007). Similarly, the agent may possess some valuable information, and decisions based on such information may affect shareholders' value markedly, however, the principal may not able to understand whether the agent has made the most appropriate decision based on the information possessed by the latter. Theoretically, the utility that the principal can get by appointing the agent depends on the belief the agent has superior knowledge and skills to understand the technical and managerial complexities, which are necessary to run the business. While moral hazard tends to happen after the economic contract, adverse selection may occur both before and after the contract between the principal and the agent.

Many scholars argue that monitoring of the agent's actions is one of the key responsibilities that corporate boards and constituted committees are expected to perform on behalf of shareholders and other stakeholders (Dalton et al., 2003; Dalton et al., 1998; Boyd, 1995; Daily, 1996), in order to minimize moral hazard. Since moral hazard implies that *the agent does something that the principal does not,* therefore, through effective monitoring (for example, external audit) the principal can check the agent's action. On the other hand, the fundamental premise of adverse selection is that *the agent knows something that the principal does not*; therefore, monitoring measures may not be effective to address the problem of adverse selection as the principal may not know *what to monitor*.

An audit committee can play a vital role in addressing both problems, that is moral hazard and adverse selection. An audit committee can provide a solution to the problem of moral hazard by facilitating the timely release of unbiased accounting information, after subjecting financial statements to scrutiny of external auditors (PricewaterhouseCoopers, 2011; New York Stock Exchange (NYSE), 2013). This helps the principal to monitor the actions taken by the agent, and reduces the risk of shirking by the agent. The essence of monitoring lies on *scrutiny, evaluation, and regulation* of the actions of corporate executives by board of directors of the firm. An audit committee can enhance quality of financial reporting by playing an important role in the appointment of specialist external auditors (Abbott & Parker, 2000b), removal of questionable external auditors (Abbott & Parker, 2001; Carcello & Neal, 2003), and monitoring the independence

of external auditors (Abbott et al., 2000a). The principal pays for the monitoring costs.

Similarly, the agent incurs *ex-ante* bonding costs, for example, cost of internal audit, in order to *emit signals* to the principal that the former is acting responsibly, and in a manner consistent with terms and conditions of the employment contract (Institute of Internal Auditors, 2009; Watts, 1988). Bonding costs demonstrate the agent's commitment to the principal, and provide a solution to the adverse selection problem. There are various measures of bonding cost such as expenditure incurred on internal audit, audit committees and independent directors (Watts, 1988). An audit committee can also play an important role along with internal auditors and board of directors in providing solution to the adverse selection problem faced by a firm (Carcello et al., 2005, Raghunandan et al., 2001).

Besides monitoring and bonding costs, there is another component of agency cost called *residual loss*. Even though a firm can incur monitoring and bonding costs to solve the problems of moral hazard and adverse selection, nonetheless, some divergence between the agent's actions and the principal's interests continue to remain (Eisenhardt, 1989; Fama, 1980; Hill & Jones, 1992). This phenomenon is perpetual because divergence between the agent's *actual decisions*, and the *ideal-world decisions* always remains and which further reflects in the form of sub-optimal outcomes (Jensen & Meckling, 1976). Such type of divergence that reduces the principal's welfare is known as *residual loss*. In the words of Hill and Jones (1992, p. 132) agency cost is "the sum of the principal's monitoring expenditures, the agent's bonding expenditures, and any remaining residual loss". Residual loss is a measure of imperfect monitoring and contracting.

2.3 Independence of audit Committees and quality of financial reporting

An audit committee, which is independent of the interventions of management and blockholders (Denis, 2001), can do better monitoring of managerial actions, and bring more transparency to the information environment. Several empirical findings show that investors view independent audit committees enhancing objectivity, reliability and transparency of financial reporting and disclosures, which in turn strengthen investors' confidence, (Duchin et al., 2010; Pitman & Fortin, 2004). Klein (1998b) argues that investors react positively to the monitoring actions taken by independently functioning audit committees. For example, one of the monitoring measures that an independent audit committee can apply is to increase frequency of its meetings with the external and internal auditors of the firm. Generally, such meetings are held for several reasons, for example, to review financial statements, audit process, and internal accounting controls of the firm. Investors' perception that increased frequency of such

meetings is an effective tool to monitor managerial actions and demonstrate the true financial position of the firm becomes stronger with the increase in the independence of the audit committees. As a result, for such firms, investors place lower risk premium on their expected returns (Ashbaugh & Warfield, 2003). Similarly, DeAngelo (1981) finds that increased independence of audit committees reduces the incidence of rent extraction activities of the managers and as a result the burden on the external audit process declines and so does cost of external audit. There are several empirical studies confirming above finding (for example Brandon et al., 2004; Khurana & Raman, 2006; Dhaliwal et al., 2008; Dye, 2001; Verrecchia, 2001; Easley & O'Hara, 2004; Gietzmann & Ireland, 2005; Nikolaev & Van Lent, 2005).

Several documents of *best corporate governance practices*, for example OECD (2004), SOX (2002), BRC (1999) and Financial Reporting Council (2010), unequivocally emphasize that independence of the audit committees is of paramount importance to provide true and unbiased financial position of the firms. For example, BRC (1999) gives recommendations to the major U.S. stock exchanges to take measures that encourage listed companies to constitute fully independent audit committees. However, BRC has been criticized, first, for leaving discretionary powers to appoint inside directors whenever such decision can be *justified* by the firm management and, second for exempting small listed firms (market capitalization less than $200 million) from having exclusively independent audit committees. Therefore, BRC left room for the inside directors, who are considered to side with the management's interests, to become members of the audit committees (Fairfax, 2010).

On the other hand, the SOX (2002) is very categorical in mandating that any listed company having an audit committee with less than *hundred percent* independent directors should be de-listed (Romano, 2005). This strictness displayed in the SOX can be attributed to the series of corporate scandals witnessed in the USA, notably Enron in 2001 and WorldCom, and Adelphia in 2002. A common feature of the above mentioned scandals has been the failure of audit committees of these firms in ensuring the truthfulness of the financial statements owing to the influence of firm managements. Therefore, it is not difficult to understand why the SOX (2002) prescribes only a hundred percent independent audit committee as a solution to reduce unwanted managerial interventions and pressures. The SOX (2002) further highlights that a fully independent audit committee consisting entirely of *financial experts*[7] enhances the

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[7] Sarbanes-Oxley Act (2002) defines the term *financial expert* as follows, *" for purposes of subsection (a) (of section 407), the Commission shall consider whether a person has, through education and experience as a public accountant or auditor or a principal financial officer, comptroller, or principal accounting officer of an issuer, or from a position involving the performance of similar functions—*
(1) an understanding of generally accepted accounting principles and financial statements;
(2) experience in—
(footnote 4 continued)(A) the preparation or auditing of financial statements of generally comparable issuers; and

quality of oversight and monitoring tasks performed by it, which in turn can improve the quality of financial reporting. A similar definition, in the context of Indian corporate sector, is given by the Birla Committee (2000, p. 19), "a qualified and independent audit committee should be set up by the board of a company. This would go a long way in enhancing the credibility of the financial disclosures of a company and promoting transparency". As Klein, (1998b, p. 16) argues, "intuition behind the hypothesis that independent directors make better monitors comes from a sentiment endorsed by the legal, regulatory, and academic professions."

It can be argued the independent director who has no pecuniary interest in the firm, other than the honorarium (fee) he/she receives for attending the meetings, is less likely to be influenced by management, (SOX, 2002). The executive directors *(insiders)*, who are the employees of the firm, and dependent-outsider directors *(grey*[8]*)*, are considered to be relatively less assertive in providing their professional judgments and views independently (Pearce & Zahra, 1992); therefore, there are reasons to doubt whether the audit committees, dominated by non-independent directors work objectively (Baysinger & Butler, 1985; Byrd & Hickman, 1992).

The following measures of audit committee independence are generally applied in the empirical literature: first, *a binary* measure reflecting whether an audit committee is 100 percent independent *(value '1')* or not *(value '0')*. This measure underlines the definition of independence of the audit committees, as per guidelines of NASDAQ and NYSE. The second measure highlights the proportion of independent directors comprising in audit committees. The third measure of independence of audit committees is another binary measure. According to this measure, an independent committee is considered independent *(value '1')* if at-least more than 50 percent of its members are independent, and zero otherwise. According to still another measure, an audit committee that meets more frequently is considered to be not only independent but active as well (Abbott et al., 2004; McMullen & Raghunandan, 1996; Klein, 1998b).

Generally, non-independent audit committees are less likely to implement required accounting controls and procedures, due to influence of managers over their functioning (AICPA, 2005; Lama, 2011), and as a result such firm may face high risk of litigation and resulting loss of reputation (Krishnan, 2005; Carcello & Neal, 2000). The BRC (1999) underscores two main advantages that the independent audit committee brings to a firm; first, improvement in the

(B) the application of such principles in connection with the accounting for estimates, accruals, and reserves;
(3) experience with internal accounting controls; and
(4) an understanding of audit committee functions."

[8] Grey directors are those who are not employees or managers, but who may not be independent of current management because of *business dealings* with the company or family relationships with management (Baysinger & Butler, 1985). Grey directors are similar to the *affiliated director*s who have some affiliation with the corporation, officers of firms that do business with the corporations, relatives of an officer, former executives, employees or consultants.

monitoring and oversight of managerial actions; second, decline in the incidence of frauds committed through manipulation of financial data by corporate managers.

Independent audit committees can develop the following initiatives to enhance their monitoring and oversight quality.

2.3.1 Attitude of skepticism

The attitude of skepticism is based on the premise that it is wrong to presume managements implementing high standards of internal controls (AICPA, 2005). Modern day audit committees work in a challenging economic environment and under a complex financial reporting regime, therefore, a healthy skepticism is a fundamental part of the audit process, and the audit committees may use it in order to develop an inquisitive approach of working, which leaves no room for *presumed* good behavior of firm management. Such approach can increase audit committees' level of *alertness* and *inquisitiveness,* which can be helpful in detecting potential financial frauds. In this context, AICPA (2005, p. 3) further states, "…the audit committee should set aside any beliefs about the integrity of management because override is most often committed by "*good executives gone bad*" rather than consistently dishonest people." Similarly, *in-depth* knowledge related to matters specific to a firm's nature of business can also help an audit committee to *zero-in* potential areas where management can bypass internal accounting controls. For example, by altering the nature or timings of certain transactions; such as those related to reserves and unusual transactions; the management can disregard internal accounting controls. A *skeptic* independent audit committee can be better prepared to notice previously mentioned earnings management practices.

Skepticism denotes a challenge to the management's assumptions of potential risks, expected accounting profits and growth prospects of the firm (ICAEW, 2012). For example, the audit committee can check whether, for example, the evidence given by the management about the firm's growth is enough, the basis of forecasted income and state of economy is appropriate, and estimated time required to carry out audit process is adequate. The attitude of skepticism is more effective when it is adopted by all the entities relevant to the audit process including audit committees, external auditors and internal auditors. The SOX (2002) implicitly encourages the independent audit committees to adopt the attitude of skepticism by requiring that in the event of financial misstatements, enforcement actions can be instituted not only against the audit committees *per se*, but also against its members in the individual capacity. Although the independent directors are less likely to be influenced by the firm managements, however, with this new provision of their enhanced liability, the independent directors are likely to show even more vigilance and inquisitiveness regarding the quality of financial reporting (SOX, 2002).

2.3.2 Transparency

The independent audit committees can reduce the information asymmetry between the principal and the agent through various actions that help to increase transparency of financial reporting and disclosure, and reduce the agency costs of the firms (Ang et al., 2000; Karamanou & Vafeas, 2005). An independent audit committee in co-operation with its internal auditors, external auditors, board and management, can develop various initiatives, for example, disclosure of related-party transactions, auditor rotation policy, non-audit fees paid to the auditors and details of remunerations of board members and management, in order to enhance transparency of financial reporting of the firm (Patel et al., 2002).

An independent audit committee serves as a signal to the firm management that the latter's actions are monitored by it and any wrongdoing and/or failure to disclose material information can be punished by regulators and market for corporate controls (Lama, 2011). Transparency of the financial information and disclosures can be beneficial to the firm at-least in two ways: first, the firm management behave in a more responsible manner and is deterred from taking selfish actions due to the fear of inviting ire of regulators and market for corporate controls. Second, investors perceive firms having high standards of transparency with respect to financial reporting as a better governed firm, therefore, investors, especially institutional investors, consider investing in such firms potentially less risky, which can reduce firms' cost of capital due to lower risk premium (Healy et al., 1999). Similarly, several studies find that with larger proportion of independent directors in the audit committees, incidence of discretionary current accruals[9], a measure of earnings management, significantly declines (DeFond & Jiambalvo, 1991; Xie et al., 2003; Carcello et al., 2006).

Klein (2002a) and Krishnan (2005) provide empirical evidence to support their argument that audit committees are relatively less successful in raising the level of transparency of the accounting information and other disclosures in the context of firms having high growth potentials and operating in relatively uncertain business environment. High level of technical and organizational complexities of such firms make it difficult for investors and other stakeholders to decipher the true corporate financial health as reflected by the accounting information and other disclosures. Klein (2002a) finds that in such firms the independence of the audit committee is usually lower. A possible reason of this phenomenon is that the *outsiders* do not possess required skills to understand the complex nature of the business and organizational structure of such firms.

It is pertinent to understand that potential endogeneity may be observed in the studies showing the association between transparency of financial reporting and proportion of independent directors in audit committees. Generally, a firm having lower level of transparency is likely to have a lesser independent audit committee; whereas, a firm with lower proportion of independent directors in its

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[9] Warfield et al. (1995) have measured discretionary accruals as the difference between current all non-cash working capital and the previous five-year average of all non-cash working capital of a firm.

audit committee is also likely have an incentive to hide important information, and resultantly compromising the transparency of financial information.

2.3.3 Informativeness

Informativeness is the *perceived reliability* of the accounting information, for example, higher (lower) *responsiveness* of cumulative abnormal stock returns to changes in the firm's accounting performance can be considered as a measure of higher (lower) level of earnings informativeness (Boubaker & Sami, 2011; Fan & Wong, 2002). Several studies have established a positive association between independence of the audit committee and *the informativeness* attribute of accounting information. Klein (2000) finds that firms having more independent audit committees are more successful in enhancing informativeness of accounting information in comparison to those firms having lesser independent audit committees. Klein further highlights that increased informativeness, among other things, enhances shareholders' value, as investors are willing to pay more for the stocks of the firms that publish credible financial reports and other disclosures, *ceteris paribus*.

Several studies show that higher ownership concentration of the firms, inclined in favor of the controlling shareholders, can lead to poor earnings informativeness (Kinney et al., 2004; Gietzmann & Ireland, 2005; Gopinath & Allen, 2010). Investors perceive that controlling shareholders can show opportunistic behavior by taking advantages of weak domestic legal system, and corporate governance mechanisms, in order to increase their own wealth at the expense of minority shareholders (Shleifer & Vishny, 1997). For example, by using ownership pyramids and cross-holding ownership structures, controlling shareholders can claim disproportionately higher cash flow rights than what permitted as per their voting rights, therefore, deviating firm wealth to enhance their personal riches (Donnelly & Mulcahy, 2008; Fan & Wong, 2002). Overall, the investors, for the previously mentioned reasons, consider lower level of informativeness contained in the financial reports of firms having higher degree of ownership concentration.

Independent audit committees objectively review the firms' financial statements and oversee audit process and internal accounting controls, by having regular interactions with the external and the internal auditors, the managers and the members of corporate boards. Investors can directly observe in the annual reports and other publications of the firm whether the members of an audit committee are independent and professionally competent, and how frequently they meet. In many countries, regulators require best corporate governance practices related to the composition and activities of the independent committees, nevertheless, in those countries where no such provisions exist, the firms with high ownership concentration can voluntarily follow required best practices followed elsewhere, in order to increase informativeness of their financial reporting.

Dechow et al. (1996) and Beasley (1996) find that the incidence of SEC accounting enforcement actions (proxy for lower informativeness) is lower for

firms with formal audit committees comprised of independent directors only. Klein (2002a) finds a negative relation between discretionary accruals and the proportion of independent directors on audit committee. The gist of the findings of the above studies is that independent directors are motivated to constrain earnings manipulation activities of corporate managements. The litigation risk and possible loss of reputation of audit committee members motivate them to ensure high quality of financial reporting. To support this argument, Klein (2002a) further shows that discretionary accruals are negatively related to the proportion of independent directors on overall board as well, and this implies that even those independent directors, who are not entrusted with the tasks related to financial reporting specifically, have the motivation to enhance informativeness of financial reporting.

According to an alternative argument, in the firms where certain specific information is important, it may not be in the interests of the firm if there is leakage of such proprietary information to its competitors (Armstrong et al., 2010; Fan & Wong, 2002). In many technology firms, investors react positively when inside directors replace outside directors on boards and committees (Donaldson, 1990; Donaldson & Davis, 1991; Kiel & Nicholson, 2003). Klein (1998a) finds that informativeness, both accounting and market based financial information, of firms improves as the proportion of insider directors in the boards and audit committees increases. Klein argues that such positive reaction of investors on the appointment of insiders is because many investors perceive that inside directors, due to their closer affiliation to the firm, possess valuable firm-specific information and skills relevant to firms' activities, for example, those related to technology, innovation, product/process development, industry/sector analysis, takeover, financing and long-term investments. Therefore, investors may consider contribution of inside directors to the firm higher than that of outside directors. Similarly, the extent to which the independence of the audit committees can affect the informativeness of financial reporting also depends on the future growth prospects of the firms. Amir and Lev (1996) demonstrate that accounting earnings of firms are relatively less useful benchmarks, when the investor assess value of high growth opportunities firms (also characterized by highly volatile cash flows), for example, firms in the IT, telecom and biotech industries. In these firms, accounting and market based conventional performance measures can be useful only when adjusted to the additional relevant economic information, for example, type and extent of competition, proportion of expenditure incurred on intangible assets (for example, R&D, brand, and human resources) and regulatory developments. Amir and Lev (1996) also find that the analysts' forecasts play a major role in the equity-valuation of these firms.

Many researchers, (for example, Forker, 1992; Davidson et al., 2005; He et al., 2007; Kalbers & Fogarty, 1993; Menon & Williams, 1994; Bradbury, 1990) attribute deep rooted *managerial entrenchment* for the lack of effectiveness of independent audit committees. Firm managements may use independent audit committees only *as a façade* in order to give signals to the outside world of the

high quality financial reporting. Empirical literature also shows that independence of audit committees does not prevent financial frauds as independent directors simply may find themselves unable to do anything effective to stop managerial expropriation (Beasley, 1996; Spira, 1999; Dechow et al., 1996).

2.3.4 Limiting non-audit services (NAS) revenue

It is argued that the phenomenon of disproportionately higher level of NAS fees earned by the statutory auditor of a firm mirrors, first, the auditor's financial dependence on the board, and second, lack of independence of the audit committee in performing its core job of monitoring and oversight of the managerial actions. NAS can be described as those professional services that a client firm hires from a registered public accounting firm, however, such services are not related to the audit or a review of the financial statements of the client firm (SOX, 2002).

The ratio of NAS fees to the total fees earned by a statutory auditor from a client firm can be used as a measure of audit quality, that is as this ratio increases, perceived audit quality diminishes. Simunic (1984) argues that supplying audit services as well as NAS can create a conflict of interests among the different businesses provided by the audit firms to their client firms. This phenomenon can be explained with an example of an audit firm, providing both audit services and NAS (for example, tax consultancy service and recruiting executives dealing with the tax related matters) to its client firm. Assuming that the audit firm is equally interested in the success of NAS and audit business, there is a likelihood that business objectives that motivate the supply of both types of services to the same client firm, may come in conflict with each other. To continue above example, an audit firm may get a motivation to hide, for example, tax related anomalies observed in the audit process, as tax consultancy is also provided by itself, to the same client firm. Therefore, fulfillment of the objective of one business arm may lead to forsaking the objective of other. The rationale of such *action or inaction* of the audit firm is, first, to continue getting both types of businesses from client firm, and second, to save the reputation of its NAS business affiliates (Amir et al., 2010; Zang & Emanuel, 2008; Turley & Zaman, 2004). Similarly, some researchers provide evidence that with the increased proportion of NAS in the total fees, auditors provide their client firms with more discretions with respect to accounting policies, and as a result, the audit quality can be compromised (Simunic, 1984; Beck et al., 1988).

There is an argument that when the auditor is providing only audit services to the client firm then the auditor's position vis-à-vis the client is stronger, as withholding of auditor's opinion can adversely affect the reputation of the client firm. Furthermore, it is also difficult for the client firm to replace the auditor, when there is an ongoing dispute related to earnings quality of the client firm. It is possible that the audit firm loses audit revenue by not getting audit business next time from the concerned client firm. However, when the auditor is providing NAS as well to the client firm then the auditor's position vis-à-vis the

client gets weaker, because withholding of auditor's opinion may indicate not only the loss of audit revenue but NAS revenue too. Therefore, for the audit firm the economic stakes are high when it provides, both, audit and NAS services. Due to their strong business interests, auditors may compromise their independent professional judgments and as result, quality of financial reporting may decline. This phenomenon is supported by many empirical studies that when the audit firms have high financial and business stakes, owing to NAS, they become susceptible to clients' pressure to condone the earnings management practices for the fear of potential loss of NAS revenue or audit revenue or even both (Simunic, 1984; Beck et al., 1988; Beeler & Hunton, 2001). Frankel et al. (2002) find that firms paying larger amount of NAS fees for the given amount of audit fees experience higher level of discretionary accruals. Similarly, investors place high risk premium on firms having a high ratio of NAS fees to audit fees. Investors' perception of the financial reporting quality of such firms is low. As a result, the cost of capital of such firms may increase (Teoh & Wong, 1993).

However, according to an alternative argument the nature and level of NAS, provided by an auditor to its client firm, is based on *economic efficiency* that the auditor attains by acquiring firm specific knowledge over a period of time. Firm-specific knowledge and experience, acquired by serving one type of businesses activity, can also be useful to the auditor in providing other services to the client firm. Simunic (1984) empirically finds that with the increase in supply of NAS, efficiency of audit services also increases, as the source of firm and industry specific information is common and, therefore, joint supply of both categories of services creates *knowledge spillovers*. Such types of transfer of knowledge can also yield higher economic efficiencies to the client firm as its search costs and transaction costs to find a credible consultant may decline, *thanks to one stop shopping* (Porter et al., 2003). Simunic (1984) further finds that due to increased competition among audit firms, total fees (audit plus NAS) paid by the client firm to a single service provider diminishes than when the same client firm buys both types of services separately from two different service providers. Therefore, the firm can benefit from economies of scale arising out of joint supply of audit services and NAS.

Many researchers argue that investors place higher value to *economic bonds* created between the client firm and the auditor, when the audit firm provides NAS to its clients. The investors may perceive that when an auditor provides NAS to the firm, both financial *(total revenue)* as well as non-financial *(reputation)* stakes of the auditor increase (Arrunada, 1999). An audit firm may lose its reputation if it does not uphold quality of financial reporting of the client firm and as a result there may be adverse effects on its non-audit business too (Dopuch et al., 2003). Therefore, one may argue that in a situation when an audit firm provides audit services and NAS, then due to its increased financial and non-financial stakes, it is less likely that the audit firm compromises its core professional responsibilities and thus jeopardize its reputation (Arrunada, 1999; Dopuch et al., 2003). Arrunada (1999) provides empirical evidence that the client firms that buy audit services and NAS from the same audit firm receive positive

stock reaction due to the enhanced economic bonding. This finding is supported by Ashbaugh et al. (2003), Larcker and Richardson (2004), Shockley (1981), Craswell et al. (2002), and Beattie and Fearnley (2002), who find no evidence whether high level of NAS fees earned by the auditors diminishes their independence.

Larcker and Richardson (2004) find that the relationship between discretionary accruals and abnormal total fees (due to the NAS fees) is negative in those firms where the external corporate governance mechanisms, in general, and external auditors, in particular, have more significance in the overall corporate governance system. The above relationship may be relatively pronounced in the firms characterized by small size, higher ownership concentration, low institutional ownerships, less independent boards and audit committees. In these firms, because other mechanisms of internal corporate governance are not very strong and the auditor's opinions may be the most valuable governance signal, therefore, in the event of financial misstatements the litigation risk and the reputational loss risk faced by the auditor is high.

There are several researchers, who are either proponents or opponents of the practice of a firm buying both, audit services and NAS, from its audit firm. Nevertheless, it is important to discuss, first, what type of NAS can be provided, and second, how much NAS revenue can be earned as a fraction of total revenue, when an auditor is providing, both audit services and NAS to the same client firm so that no agency costs are inflicted on the firm. In this context, an independent audit committee of a firm, through its monitoring and control mechanisms, can ensure that the statutory auditor of the firm does not: first, engage herself in the prohibited NAS[10], and second, earn total revenue by providing NAS beyond certain threshold fixed by the regulator (SOX, 2002). For example, section 13(a) of the SOX (2002) requires that NAS must be pre-approved by the audit committees and its details must be disclosed in the financial

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[10] The SOX (2002) has prohibited following nine categories of non-audit services by amending section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1) including:

"1. Bookkeeping or other services relating to the accounting records or financial statements of the audit client;
2. Financial information systems design and implementation;
3. Appraisal or evaluation services, fairness opinions or contribution-in-kind reports;
4. Actuarial services;
5. Internal audit outsourcing services;
6. Management functions or human resources;
7. Broker or dealer, investment advisor, or investment banking services;
8. Legal services and expert services unrelated to the audit;
9. Any other service that the accounting board determines, by regulation, is impermissible.

Public Company Accounting Oversight Board established under section 101 of the Sarbanes-Oxley Act of 2002 may, on a case by case basis, exempt any person, issuer, public accounting firm, or transaction from the prohibition on the provision of services under section 10A(g) of the Securities Exchange Act of 1934, to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors, and subject to review by the Commission in the same manner as for rules of the Board under section 107."

statements of the firms. Many regulators prescribe that the details of NAS should be shown in the firms' websites and cross reference should be provided in the audit committees' report as provided in the annual reports. Many regulators recommend that even though the details of NAS to be provided in the firms' reports should be left upon the professional judgments of the respective audit committees, nonetheless, disclosures of such transactions should be explicitly given so that investors and other stakeholders can clearly understand the essence of the firm's policy pertaining to NAS in relation to relevant regulations. Abbott et al. (2003, p. 215) argue, "….audit committees that are independent and active financial monitors have incentives to limit non-audit service [NAS] fees, relative to audit fees, paid to incumbent auditors, in an effort to enhance auditor independence in either appearance or fact". Section 202 of the SOX (2002) further mandates that the value of NAS must be less than 5 percent of the total amount paid by a client firm to its auditor during the same fiscal year in which NAS are provided.

Several empirical studies (for example, Abbott & Parker, 2000a, 2001; Carcello & Neal, 2000 2003; Abbott et al., 2003) find that fully independent audit committees are more successful in monitoring the proportion of NAS fees to audit fees earned by statutory auditors from their client firms, therefore, limiting the excessive financial dependence of the audit firms on their clients (SOX, 2002). Above finding is in line with recommendations given by the SEC, which advocate to give more power to the audit committee in order to improve monitoring and control mechanisms of the firms. Therefore, an independent audit committee can play an important role to ensure that economic bonds between the audit firm and the client firm do not reach a point where economic dependence of the audit firm on its clients is likely to jeopardize the quality of financial reporting.

2.4 Factors affecting independence of audit committees

In the previous section, there has been detailed discussion of various monitoring and control mechanisms that an independent audit committee can develop, in order to enhance quality of financial reporting. The independence of the audit committee is not an exogenous phenomenon. Several factors may affect the independence of the audit committees and some of them are discussed below.

2.4.1 CEOs' control and independence of audit committees

The nature and extent of managerial influence and control over the entire board of directors is also an important factor that may affect the independence of the audit committee of the firm. Before we discuss how the CEO's control over the entire board of directors affects independence of the audit committee of that firm, it may be interesting to know how such control is measured. Majority of empirical studies have used three measures of the CEO's control over board of directors. First, a dummy variable, called the *CEO Influence* (Klein, 1998b), which

is equal to one if the CEO sits on the board's nominating committee or compensation committee, and zero otherwise. Second measure is the time period the CEO has been on the board. A longer tenure indicates higher level of the CEO's dominance (Hermalin & Weisbach, 1998). Third, whether the titles of the CEO and chairman of corporate board vest in the same person. The CEOs of firms with *split titles* are assumed to have lower control over corporate boards and committees.

Higher *bargaining power* of the CEO can provide him/her capacity as well as motivation to reduce independence of the audit committee (Klein, 2000). According to an argument, a stronger CEO may indulge in accounting data manipulation in order to do income smoothing and undertake wealth expropriation actions, whereas, an independent audit committee, owing to its principal responsibilities of monitoring and control, is expected to thwart such actions of the CEO (BRC, 1999). Therefore, the CEO may consider an independent audit committee as a threat and use his/her powers to marginalize the audit committee. Generally, the CEOs have two reasons to strengthen their control over corporate boards and committees. First, as Klein (2000) argues, to justify their high levels of compensation, especially that part of total compensation which is based on accounting and market performance measures *(see moral hazard in sub-section 2.2)*. Second, as argued by Shleifer and Vishny (1989), to justify their actions of investing the firms' resources, even in firm value eroding projects, as long as such investments are in line with expertise and experience of the CEOs *(see adverse selection in sub-section 2.2)*. Such investments are generally made by a CEO in order to consolidate his/her position in the firm's ranks and make his/her sacking difficult (entrenchment effect). In order to justify their actions and in turn win the confidence of investors, stronger CEOs may be inclined to produce pre-determined accounting results. Therefore, such CEOs, having higher bargaining strength, see the independent audit committee as an impediment (Weisbach, 1988; Murphy & Zimmerman, 1993; Houlthausen et al., 1995). Several other studies also confirm that accounting data based performance measures used by the CEO and other top level firm executives strengthen their bargaining power in the overall board. For example, Hermalin and Weisbach (1998) find that the *highflyer* CEOs use inflated accounting performance of their firms by weakening monitoring and control powers of the audit committees, to justify increments in their remuneration. Hermalin and Weisbach (1998) further find that there is less *investors' outrage* to the weakening of independence of audit committees as long as the firms *meet or beat* their performance targets.

The phenomenon of the CEO's control over corporate boards and committees depends on various determinants, for example, higher the level of the CEO's stock ownership or CEO's association with promoters or founding family, higher is the likelihood of his/her control over board (Shleifer & Vishny, 1997). Similarly, Shivdasani and Yermack (1999) find that the CEOs' control is more in firm boards having following characteristics: *smaller board size, less than majority of independent outside directors in the board, and no independent director as a major blockholder.*

It is important to understand the issue of independence of an audit committee in the overall corporate governance spectrum of the firm's board because, first, the audit committee directly reports to the board of directors, and second, the audit committee inherits characteristics of overall board i.e. *like board, like committees* (Shivdasani & Yermack 1999, Klein 2002a). Several empirical studies find that the level of independence of audit committees is negatively associated with incidence of the CEOs' control over boards and other important committees, notably the compensation committees and the nominating committees. Klein (2002a) finds significant positive association between earnings management, measured by value of discretionary accruals, and incidence of the CEOs sitting on boards' compensation committee. In the words of Klein (2002a, p. 377), "a CEO sitting on its board compensation committee has both the motivation and the access to manipulate earnings to maximize his/her overall compensation package." Klein (2002b) provides empirical support to above argument, as a sub-sample of the CEOs sitting on the compensation committees of their firms are able to get higher compensation packages, both salary and bonuses, in comparison to another sub-sample of the CEOs who are not sitting on the compensation committees in their respective firms. Similarly, Klein (1998b) finds that the CEO's presence in the nominating committee of the firm also increases her control and may lead to earnings management practices. Shivdasani and Yermack (1999) find that when the CEOs are sitting on the nominating committee, the firm appoints fewer independent outside directors and instead inducts more *affiliate (gray)* outsiders, on corporate board and other constituted committees.

Many researchers argue that the CEOs can camouflage their control over the corporate boards in order to avoid regulatory actions and adverse stock market reaction. Klein (2000) finds only two percent of firms in her sample have their CEOs as sitting members of the audit committees. One of the major reasons of this apparently high level of *'independence'* is that the CEO's presence on the audit committees *per se* is perceived as a visible sign of his/her control over the corporate board and audit committee, and this action can be responded by the investors' outrage, adverse media coverage and regulatory actions. However, the CEOs can follow a lesser noticed route and choose to sit on the nominating committees of their firms. In the words of Klein (2000, p. 12), "The nominating committee serves the duo function of recommending possible candidates for election to the board and nominating existing board members to serve on board committees."

However, according to section 303-A of Listed Company Manual of NYSE (2013), the nominating and the compensation committee must be comprised of independent directors only. Nevertheless, the CEOs continue to retain their control by handpicking independent directors of their choice, therefore, do not let their bargaining power diminish, although regulators aim to make board and committees free from managerial interventions. This phenomenon leads to an important research question to be addressed- how can *quality of independence* be separated from *quantity of independence*?

Klein (1998b) argues that firms having stronger CEOs have lower frequency of meetings of their audit committees, a measure of independence of the latter. Many researchers argue that the likelihood of accounting manipulations that the CEO of a firm may commit declines with the increased frequency of meetings of its audit committee (Abbott et al., 2004; Garcia et al., 2012). McMullen and Raghunandan (1996) highlight that before facing the SEC enforcement actions or earnings restatements, the sample firms were having consistently lower frequency of meetings.

The incidence of twin titles, the CEO and the chairperson of corporate board, vesting in the same person, is one of the various measures of the CEOs' control over their firms. Brickley et al. (1997) discuss that above incidence depends on several factors. First, prospects of becoming chairman of the firm acts as an incentive mechanism to the CEOs. A CEO may get an offer to the chair of the same firm in recognition to his/her efforts and performance. Second, higher the degree of firm-specific knowledge and experience requirements to run a firm, higher is the likelihood that twin roles of the CEO and chairperson vest in the same person as there may be more information asymmetry in such firms if the CEO and chairperson are two different persons. However, as per an alternative argument, emanating from the agency theory, if both titles are vesting in the same person, then managerial discretion, for example entrenchment effect, may be very strong (Claessens et al., 2002; Hermalin & Weisbach, 2003).

2.4.2 Alternative corporate governance mechanisms and independence of audit committees

According to the BRC (1999, p. 38), "In its oversight capacity, the audit committee is neither intended nor equipped to guarantee with certainty to the full board and shareholders the accuracy and quality of a company's financial statements and accounting practices. Proper financial reporting, accounting, and audit functions are collaborative efforts conducted by full-time professionals dedicated to these purposes." The audit committee is one amongst various internal corporate governance mechanisms that are supposed to improve the quality of financial reporting of firms through effective monitoring and oversight *(see figure 1)*. Many empirical studies have explored whether the association between independence of audit committees and *alternative* corporate governance mechanisms applied by the firm is of the nature of *complement* or *substitute* to each other (DeFond et al., 2005).

Two distinct corporate governance mechanisms are *substitutes* to each other, when increasing the role of one automatically diminishes that of the other, *ceteris paribus*. Several empirical studies find that the percentage of independent directors in audit committees, which is a measure of independence of the latter, is negatively associated to some of the alternative corporate governance mechanisms, such as the percentage of directors' shareholdings, incidence of the CEOs not sitting on nominating and compensation committees, incidence of outside blockholders and institutional investors sitting on the firm's board and effectiveness of regulation (Beasley & Salterio, 2001; Demsetz & Lehn, 1985; Gagnon & St-Pierre, 1995).

Vafeas (2001), and Agrawal and Knoeber (1996) find that there is a positive association between directors' ownership stakes in the firm and their enthusiasm to safeguard shareholders' interests, and deter managerial expropriation (Hermalin & Weisbach, 1991; Shivdasani, 1993). Klein (1998b, 2000) shows that the audit committee independence and two alternative corporate governance mechanisms, that is the percentage of shareholdings of directors and incidence of outside blockholders and institutional investors sitting on the firm's board, are substitute to each other. Agrawal and Knoeber (1996) further find that increased shareholdings of directors make insiders more disciplined and accountable, and as a result, firm's stock market performance improves, resultantly one may ask whether such firm really need to have an audit committee fully comprised of independent directors.

Independent audit committees and alternative corporate governance mechanisms can be termed as *complements* when the effectiveness of the former increases when functioning of one or more of the latter also increases. Klein (1998b) finds that fraction of independent directors of an audit committee is more pronounced when some other alternative corporate governance mechanisms, such as percentage of share ownerships of outside blockholders and institutional investors, are already existing (Klein, 1998b). Klein (2000, 2002a) gives empirical support to such complementarity relationship in her subsequent studies also. Similarly, one may argue that independence of an audit committee is positively associated with the level of relevant experience and expertise of its members. For example, DeZoort et al. (2002) gives empirical evidence that those firms whose audit committee members are not only independent but also have relevant experience and expertise in auditing and internal control related matters, and also prepare firms' internal control evaluations experience improvement in their quality of financial reporting. Above finding shows that independence of audit committees, when complemented by experience and expertise of their members, enhances the quality of financial reporting. Beasley and Salterio (2001) argue that an independent board is more likely to have independent, experienced and qualified audit committee members.

DeFond et al. (2005) caution that there is a risk of generalizing above relationships as various alternative corporate governance mechanisms get affected differently by different business, financial, legal and political factors, therefore, their *degree and direction* of complementarity and substitutability vis-à-vis independence of the audit committees cannot be the same. Besides, some alternative corporate governance mechanisms can be both complements and substitutes. For example, the percentage of share ownerships of outside blockholders and institutional investors can be both complements and substitutes to the independent audit committee. Klein (1998b, 2000b) argues that a potential outside blockholders or institutional investors prefer to invest in a company having an independent audit committee *(complements)*. However, in post-investment scenario, it is very common that outside blockholders/institutional investors have incentives to monitor management by themselves and serve as an additional control mechanism (Macintosh &

Schwartz, 1995; Shleifer & Vishny, 1986; Jensen, 1993), therefore, reducing the need for monitoring by an independent audit committee *(substitutes)*.

Similarly, care should be used in interpreting the direction of complementarity and substitutability relationships between alternative corporate governance mechanisms and independence of audit committees. For example, Vafeas (2001) argues that a *non-monotonic* relationship between independence of the audit committees and the directors' equity ownership may be observed in a firm; with the *incentive effect*[11] prevailing for low ownership levels, and the *entrenchment effect*[12] dominating thereafter. When the directors' equity stakes are at *not so high* levels there can be alignment of their interests with those of other non-blockholders. In such situation, directors welcome an independent audit committee, in the same way as other minority shareholders do. However, as directors' equity ownerships grow to substantial levels in the firm, they may start expropriating shareholders' wealth, for example, by undermining minority shareholders' rights, and in this scenario, directors may have the motivation to jeopardize independent working of the audit committees (Aboody & Kasznik, 2000; Yermack, 1997).

2.4.3 Cost considerations and independence of audit committees

The empirical literature has also examined the cost considerations related to the independence of audit committees. There can be various types of costs incurred by the firms when employing independent directors on the board and the committees, for example, search costs, liability insurance premium of directors and officers, committees' meeting fees, directors' training, and board's expansion related expenses (Lamb, 2005). When the level of independence of the audit committee changes, the cost of independence may also change.

In her empirical findings, Klein (2002a) shows that there exists a *non-linear negative* relation between the audit committee independence and earnings management, the latter measured by value of discretionary accruals. The *negative relation* implies that with the increased independence of the audit committee, the monitoring and control mechanisms become relatively objective, and stronger, and as a result the value of discretionary accruals declines. The *non-linear* relationship, in reference to the empirical findings of the above study, signifies that the negative relationship between the independence of the audit committee and earnings management is relatively pronounced, when the audit committee has the *minimum majority* of independent directors (51 percent of independent directors), and the magnitude of the negative relationship becomes weaker as the proportion of independent directors of audit committee increases from minimum

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[11] Claessens et al. (2002) provide empirical support to the phenomenon of incentive effect in their study by showing that with the increasing managerial ownership, there can be more convergence of interests of principal and agent, therefore, reducing agency costs.

[12] Morck et al. (1988:25) define entrenchment effect as an action that can be undertaken as, "….with effective control, the manager may indulge his preference for non-value-maximizing behavior, although perhaps to a more limited extent than if he had effective control but no claim on the firm's cash flows."

majority independence to *exclusive independence* (100 percent). Above finding implies that *just majority* of independent directors in the audit committees is enough to discourage earnings management practices followed by the firms, and any further induction of independent directors can be followed by falling *marginal* improvements in containing earnings management practices, other things being equal. Interestingly, the above implication is in conflict with the recommendations of almost all of the *'most-followed'* corporate governance regulations (for example, NYSE, NASDAQ, BRC), which explicitly recommend the audit committees to be exclusively comprised of independent directors.

Many researchers, who advocate *majority independent* audit committees over *exclusive independent*, argue that the former is a more cost effective monitoring mechanism than the latter. For example, many critics of Section 301 (SOX, 2002) argue that the mandatory requirement that a listed firm must have an audit committee comprised of independent directors only is too harsh on small and foreign origin firms. Lamb (2005) and Linck et al. (2008) find that costs of having an exclusively independent audit committee can outweigh potential benefits arising out of it, as the post-SOX period has witnessed on average 51 percent hike in director compensation and 150 percent increase in liability insurance premiums of corporate directors and other senior executives. Similarly, due to increased regulatory compliance costs related to the independent audit committees, the financial burden has fallen more severely on smaller companies, (Wintoki, 2007; Linck et al., 2008). On the other hand, Bronson et al. (2009) find that the benefits of the audit committee independence are consistently achieved only if it is completely independent. This result reiterates prior research findings that independence of the audit committee can be sacrificed if there is any room for managerial influence. Such influence can jeopardize objectivity and unbiasedness of financial reporting.

2.4.4 Directors' expertise and independence of audit committees

Many researchers argue that the outside directors having financial expertise function more independently and are less likely to endorse earnings management actions of the management due to enhanced liabilities and higher risk of reputational capital loss associated with independent directors (Beasley & Salterio, 2001; Dhaliwal et al., 2008). DeFond et al. (2005) and Klein (2002b) find that stock markets welcome the appointment of the independent directors having financial expertise as they are expected to increase informativeness of financial reporting due to their independent and professional judgments and additional monitoring of the managerial actions.

The SEC (2003) distinguishes between 'accounting' and 'non-accounting' financial experts. An accounting-financial expert is the one who possesses the specific accounting expertise, whereas, the non-accounting-financial expert usually has only general experience in understanding and analyzing financial statements and does not necessarily possess *in-depth* knowledge and skills of accounting practices. The SEC (2002) has initially proposed that the audit committee should be comprised of accounting-financial experts only, however,

this proposal was criticized on the following grounds, first, smaller firms may find it difficult to attract accounting-financial experts to join their audit committees, second, the audit committee members do not require to have highly sophisticated accounting background in order to perform oversight functions, third, the fear of directors' liabilities may even dissuade accounting-financial experts to join the audit committees. The current definition of financial experts given by the SEC is in accordance with the non-accounting-financial experts (SEC, 2003). Furthermore, Armstrong et al. (2010) highlights that independent directors having financial expertise can act as 'troubleshooters' to firms facing pressure to enhance quality of their financial reporting, and such pressure may be exerted by institutional investors, adverse media coverage, regulatory actions and falling stock prices.

When a firm invites independent directors, who are also financial experts, to join its board, it sends a positive signal to investors, regulators and other stakeholders. The strength of such positive signals increases even more when firms also volunteer to share details pertaining to their financial health, and financial reporting system with 'likely to be' directors. Such signals reflect the confidence of a firm with respect to quality, truthfulness and unbiasedness of its financial reporting. For instance, any decline to accept the invitation to join the board position by the financial expert outsider invitee may cause reputational loss to the firm. According to another argument, when a firm invites a financial expert outsider to sit on the board and/or the audit committee, it emits the signal of its seriousness about, first, strengthening of its financial reporting practices if high standards of financial reporting quality already exist and, second, endeavoring to improve the same if the firm is struggling with poor standards of financial reporting quality (DeFond et al., 2005).

Empirical evidence provides a mixed picture, for example, Xie et al. (2003) find that firms having independent directors with accounting or financial expertise on their boards and audit committees experience lower earnings management practices, as measured by discretionary current accruals. Several studies demonstrate that the frequency of an earnings restatement is lower in firms with an independent financial expert director, who is on the audit committee (Agrawal & Chadha, 2005; Bédard et al., 2004; Krishnan, 2005). Similarly, Krishnan (2005) further shows that firms having high proportion of independent directors having financial expertise on the audit committee, experience lower incidence of internal control problems. DeZoort et al. (2002) give empirical evidence that those independent audit committee members having experience and expertise in auditing and internal control related matters, prepare firms' internal control evaluations that are comparable to those prepared by the statutory auditors. However, on the other hand there are also studies that show that increased proportions of independent directors having financial expertise, on the audit committee, cannot control the managerial actions of making upward bias in the earnings forecasts of firms due to the excessive dominance of the CEOs (Karamanou & Vafeas, 2005; Carcello & Neal 2003; Lee et al. 2004).

3 BUSYNESS OF DIRECTORS AND CORPORATE PERFORMANCE

A large body of research has examined the association between the independence of corporate boards of directors and the financial performance of firms and found mixed results. First, an important argument following from several studies is that independent boards of directors positively affect firm performance (Costello & Wittenberg-Moerman, 2011; Holthausen, 2009; Bushman et al., 2004). The key premise of the above argument is that independent directors can effectively monitor and enhance accountability of corporate managers, which can result in improvement in the firms' performance. Second, there are also studies, which find the above mentioned association negative (Kiel & Nicholson, 2003; Klein, 1998a). Investors may place high value on firm-specific knowledge in some industries/sectors (for example, telecommunication/technology), and since firm executives have such strategic firm-specific knowledge, therefore, when an independent director, who may not be privy to such strategic knowledge, replaces an executive director, as a consequence investors can react unfavorably and stock price of the firm can start falling. In the case of knowledge based industries/sectors, the above mentioned phenomena is highly significant. Third, some studies even find no clear and substantive relationship between the board independence and firm value. For example, Dalton et al. (1998) apply meta-analyses in their study and find no clear evidence of any systematic relationship between the board independence and financial performance of sample firms. In a similar vein, regulators, such as the SEC in the USA, have often emphasized to increase independence of corporate boards and committees, especially in the aftermath of corporate governance scandals witnessed in the beginning of the 21st century, as a mean to enhance managerial accountability (SOX, 2002). In the best corporate governance practices, various regulators have specified the minimum independence levels for boards and committees.

Most of the empirical studies exploring the phenomenon of the independence of corporate boards have used conventional measures of it, for example, the proportion of independent directors on the board. However, in this dissertation the number of directorships held by corporate directors are used as

the non-conventional measure the independence of corporate directors. In this dissertation, the phenomenon of multiple directorships or busyness of corporate directors emerges as a determinant of independence of corporate boards, *ceteris paribus*. Corporate directors, both, executive and non-executive, can hold multiple directorships in various firms at the same time, subject to regulatory requirements prevailing in a given corporate setting. Therefore, it is important to obtain empirical evidence to several questions. First, whether the phenomenon of busyness affects firm performance. Second, whether there is a limit to busyness that affects firm performance favorably or unfavorably. It has been found in several studies that firms having *too busy* directors on board experience adverse financial performance (Beasley, 1996; Shivdasani & Yermack, 1999; Core et al., 1999, Fich & Shivdasani, 2006; Jackling & Johl 2009). In several countries, such as India, Malaysia and South Korea, corporate governance regulations have already placed limits on the number of directorships corporate directors can accept. In contrast, several developed countries like the USA and the UK are still debating the pros and cons of imposing mandatory limits on multiple corporate directorships (Sarkar & Sarkar, 2009). From time to time, regulators (for example, the National Association of Corporate Directors, 1996; Competition Commission of the UK, 2013; Financial Reporting Council, 2003) and researchers (for example, Au et al., 2000; Booth and Deli, 1996; Brickley et al., 1999) have debated whether multiple directorships affect firm value, and whether there is a need to limit the maximum number of directorships that corporate directors of a firm may accept in other firms.

3.1 Agency theory, multiple directorships and firm performance

Both, the agency theory and the resource dependence theory provide the key theoretical foundation to the current dissertation. According to agency theory, the separation of ownership and control in modern public corporations can cause conflict of objectives and information asymmetries between the owners (principal), and the managers (agent) of a firm (Berle & Means, 1932; Fama & Jensen, 1983a). Since managers of a firm have an information advantage over its shareholders, they can adopt certain discretionary actions that maximize their personal utility function at the expense of shareholder wealth erosion (Roe, 2004; Watts & Zimmerman, 1986). An important function of boards of directors is to identify managerial discretionary actions and establish a system of monitoring and control, in order to deter such discretionary managerial actions. However, a corporate board also consists of firm executives, therefore, the effectiveness of the monitoring, and control mechanisms adopted by it gets questionable unless independent members are inducted too. According to agency theory, independent directors are required to apply monitoring and control mechanisms over executives, on behalf of investors and other stakeholders of firms, with an objective to minimize the agency conflicts arising due to the separation of ownership and control (Eisenhardt, 1989; Jensen & Meckling, 1976; Ferris et al.,

2003; Petra, 2007). However, the phenomenon of multiple directorships undertaken by corporate directors can negatively affect the performance of firms that such directors are affiliated to. One can argue that applying the conventional measures of the independent board, such as a higher proportion of independent directors to total board size, can enhance the monitoring of the managers and safeguard the interests of shareholders (Costello & Wittenberg-Moerman, 2011; Holthausen, 2009; Jackling & Johl, 2009; Bushman et al., 2004). A key argument made in this dissertation is that it is important to explore factors that can affect the efficacy of the conventional measures of independence. Among other things, the independence of corporate directors is influenced by the busyness of boards (Jackling & Johl, 2009). Ferris et al. (2003) have developed the busyness hypothesis that postulates that as their number of directorships increases, corporate directors become over-committed. However, it is important to understand that despite being independent, busy directors may lose their effectiveness to perform their above mentioned core responsibilities.

Beasley (1996) finds that the probability that a firm can experience accounting fraud increases as the average number of outside directorships held by its directors increases. The underlying assumption of imposing regulatory limits on multiple directorships is that *serial/over-boarded* directors do not have sufficient time and other resources to perform their operational, monitoring, and control functions in the manner they are contractually obliged to do, resulting in deterioration of financial reporting quality and firm value. Unfavorable effects of multiple directorships lower the reputational capital of busy directors in the labor market of corporate directors (Andres & Lehmann, 2013).

Shivdasani and Yermack (1999) argue that powerful CEOs create a network of directors, who can be categorized as dependent outside directors (gray/affiliate directors). These directors in order to maximize their personal utility function, such as seeking another term of directorship in the same company or other companies in the same group, show their loyalty to the CEOs appointing them. Similarly, such directors are chosen from organizations with strong business ties with firms having powerful CEOs. Such directors serve on multiple boards within a network of firms created by the CEOs. The strong affiliation of such affiliated directors with the CEOs makes them dependent directors, which may hinder their independent monitoring of managerial actions, and power to give free and fair opinions, for example, such directors may choose not to challenge the discretionary actions of managers (Fich & Shivdasani, 2006). Core et al. (1999) provide evidence that affiliated directors on boards of firms, which are part of a network created by the CEOs, fail to stop disproportionately high compensations paid to the CEOs and other senior managers of such firms. Both studies further demonstrate that stock market reaction to the appointment of affiliated directors is negative.

Fich and Shivdasani (2006) argue that if no regulatory limits on multiple directorships are placed then the financial performance of firms can start declining. Therefore, both researchers favor exogenously imposed busyness limits. Sarkar and Sarkar (2009) examine the effect of multiple directorships on

firm performance in India. They find that independent directors holding multiple directorships do not experience any reduction in their ability to effectively monitor managerial actions, however, when inside directors hold multiple directorships a negative effect on firm value is observed. Jackling and Johl (2009) find that firms in India whose outside directors have many directorships experience deterioration of their financial performance. Both, Sarkar and Sarkar (2009) and Jackling and Johl (2009), agree that family owned business groups in India use the phenomenon of multiple directorships as a tool to strengthen their control. Similarly, Hoitash (2011) finds that independent directors serving on the firm boards and committees can develop several social ties with managements and CEOs, and as a result of such social ties the independent directors may not resist when CEOs receive generous non-performance compensation from the firm. Hoitash further finds, albeit contrary to the above finding, that firms experiencing strong social ties between the independent directors and senior managers are less likely to have a material weakness in their internal controls and quality of financial reporting.

3.2 Resource dependence theory, multiple directorships and firm performance

The second key theoretical foundation of the current dissertation rests on the resource dependence theory. The board of directors of a firm provides it with much-valued resources (Hillman & Dalziel, 2003). These resources can be in the form of both, human capital (education, experience, expertise, skills) and relational capital (network of ties to other firms, external environment and external contingencies). In this dissertation, the reputational capital of a firm is defined as a combination of human capital and relational capital of its directors. Higher level of human capital of corporate directors along with their network of relational capital can immensely benefit the firm they join (Berezinets et al., 2016; Virtanen, 2010; Ferris & Jagannathan, 2001). An important theoretical premise emanating from the current dissertation is that directors serving on multiple boards bring high-level reputational capital to firms that recruit them (Felicio et al, 2014; Baysinger & Butler, 1985; Pearce & Zahra, 1992). Similarly, it is also argued that multiple directorships accepted by directors indicate their increased demand in the market of corporate directors and therefore signify their reputational capital (Fama & Jensen, 1983b). The figure 3 below highlights the classification of corporate directors according to the agency theory and the resource dependence theory.

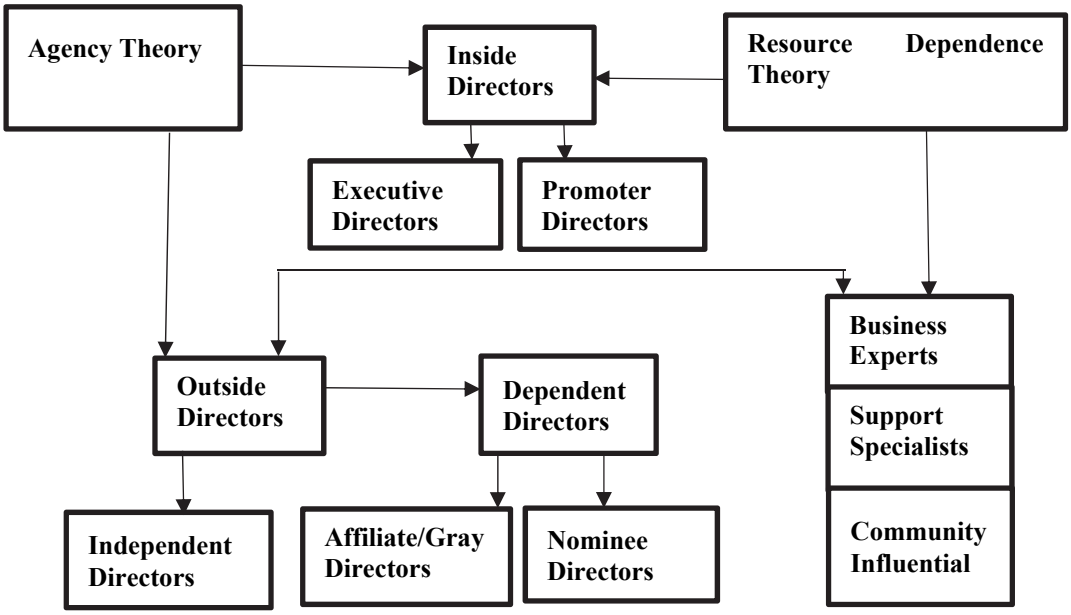

FIGURE 3 Classification of directors based on agency theory and resource dependence theory (compiled by the author)

According to Pfeffer and Salancik (1978), directors with high reputational capital can contribute to the firm, they are affiliated to, in four ways. First, directors, who have education, expertise and experience in certain core fields, for example, accounting, law, taxation and technology, contribute to the firm by providing their 'advice and counsel'. Second, directors with high reputational capital bring 'legitimacy' to the firm's actions and decision-making. Third, directors with high reputation capital often have well established 'communication channels' with the outside world, which helps the firm to obtain useful and objective information at the minimum costs. Lastly, reputational capital of directors helps firms in mobilizing resources, for example, financial resources, material inputs, legal advice and labor, on favorable terms (Machold & Price, 2013; Virtanen, 2010; Berezinets et al., 2016).

Several researchers (Daily & Dalton, 1994a, b; Pearce & Zahra, 1992; Baysinger & Butler, 1985; Ferris & Jagannathan 2001) validate the resource dependence dimension that the phenomenon of multiple directorships positively influences firm performance. Pearce and Zahra (1992) argue that an important determinant of the board composition of a firm is the nature of the strategic contingencies or factors that affect its operations, planning, decision-making and even its survival. The essence of strategic contingencies is the uncertainty. A firm that operates in a highly uncertain business environment can earn legitimacy of its investors and other stakeholders by recruiting directors who have already built up their reputational capital by serving on multiple boards of large public firms (Machold et al., 2011; Baysinger & Butler, 1985). Furthermore, high reputational capital of directors helps firms to manage rough times efficiently, when bankruptcy is approaching (Daily & Dalton, 1994a; Campa & Camacho-Miñano,

2015). Westphal (1999) emphasizes that the phenomenon of multiple directorships increases trust and friendship between the independent directors and firm management, which helps to promote a symbiotic business environment characterized by enhanced corporate collaborations and firm performance. However, critics of such *friendly relations* between the independent directors and firm management argue that busyness of independent directors can make them highly dependent on management in order to obtain perquisites and develop their own social ties (Lai et al., 2014; Adams & Ferreira, 2007). Therefore, multiple directorships of directors can be used as a tool to serve personal utility function of directors. Nevertheless, a higher litigation risk present in the post-SOX corporate governance environment dissuades both directors and management from following personal utility functions (Black et al., 2005; Klausner et al. 2005).

In contrast to the above two dimensions, some empirical studies find no relationship between directors holding multiple directorships and firm value. Ferris et al. (2003) do not find any evidence of the systematic relationship between the falling (rising) firm value as the average number of board seats held by directors, increases (decreases). When the causality is reversed, Ferris et al. (2003) find that improved firm performance further enhances the reputation of directors, which generates offers of directorships in other firms. Kiel and Nicholson (2006) study a sample of Australian firms and find no empirical evidence supporting the agency theory argument that holding multiple directorships negatively affects the financial performance of firms. One possible reason for the absence of any negative association between multiple directorships and firm performance is that firms that are closely related (within the same business group) to each other usually invite the same set of directors to their boards (a phenomenon known as *interlocking*). Apparently, directors serving on multiple boards appear to be over-committed due to their increased professional responsibilities; however, the ease of doing directorship may increase, because directors serving on multiple boards of firms, which are part of the same business group, are already aware of common corporate culture, governance system, and several other institutional characteristics. Similarly, firms within the same business group can also have similar industry and sectoral characteristics. Kiel and Nicholson (2006) also oppose regulatory limits on the number of directorships that an individual director can hold, because such limits often punish firms demonstrating improvements in their financial performance arising as a result of interlocking among directors.

Another important characteristic of the phenomenon of multiple directorships is that it is not confined to any specific ownership structure. The incidence of multiple directorships accepted by a firm's directors can be witnessed in the Anglo-Saxon model (Berle & Means, 1932) of ownership structure, characterized by diffused and dispersed shareholders (Ferris et al., 2003; Fich & Shivdasani, 2006; Kiel & Nicholson, 2006), and also in the German-Japanese model of ownership structure (Lee & Lee, 2014; Andres et al., 2013; Pietra et al. 2008), where firm ownership is dominated by a small number of large shareholders.

4 HYPOTHESES

The first article, a review of literature, investigates the factors, including independence, expertise and experience, which affect the effectiveness of the audit committees. This article also includes several other aspects, particularly the nature and composition of audit committees in India and regulatory developments related to them. Due to the review of literature nature of this article, no hypotheses were developed.

The second article is an empirical study and it maintains that corporate promoters in India dominate the ownership and control structure of firms in order to consolidate their position in the corporate echelons (Sarkar & Sarkar, 2012; Khanna & Mathew, 2010). The dominance of promoters is more prolific in the group-affiliated firms. Based on the above mentioned characteristic, it can be argued that in the promoters dominated group-affiliated firm, the promoters are likely to handpick their favorite board and committees' members, who in return can take initiatives to strengthen the position of promoters in the firm hierarchy (Hermalin & Weisbach, 1998). The above mentioned argument gathers more relevance in the Indian corporate settings, where a director can be on as many as ten boards of directors of publicly trading companies (MCA, 2013). Therefore, one may theorize based on the agency theory that if the firm promoters follow the above mentioned ploy of interlocking, then they may appoint their handpicked audit committee members on the multiple firms in the business group. It is pertinent to note that the promoters often employ the same audit firm in the group-affiliated firm, and as a consequence the familiarity and social ties between the promoters, audit committee members and audit firms can increase, which can result in poor monitoring of managerial actions and lower credibility of audit quality, and therefore, financial reporting quality can deteriorate (Johansen & Pettersson, 2013).

H_1: Multiple directorships of the audit committee members unfavorably affect quality of information (agency theory).

However, it can also be posited from an alternative argument, supported by the resource dependence theory, that the phenomenon of busyness of the audit

committee members is a reflection of their high reputational capital earned and accumulated over a period of time (Pfeffer & Salancik, 1978; Pearce & Zahra, 1992; Vafeas, 1999; Hillman & Dalziel, 2003). The audit committee members possessing higher reputational capital are more likely to be afraid of losing their reputational capital in the event of regulatory actions and adverse market reactions in response to the poor financial reporting quality and financial frauds committed by the firm (Helland, 2006; Ball, 2009). Furthermore, the audit committee members having higher reputational capital may have the attitude of skepticism as their reputational capital can be eroded due to the detection of financial errors or frauds committed by the firms. High reputational stakes of audit committee members may force them to *self-impose* a system of compliance, diligence and monitoring, and as a result the quality of financial reporting improves (Sharma & Iselin, 2012; Skinner & Srinavasan, 2012). Therefore, it can be hypothesized that the audit committee members of the firm serving on multiple boards enjoy the higher level of reputational capital and the quality of financial reporting of the firm improves.

H_2: Multiple directorships of the audit committee members favorably affect quality of information (resource dependence theory).

Similarly, the study of the association between the multiple directorships of the audit committee members and the financial reporting quality, may require to consider the intensity or quality of busyness. The audit committee is a specialized committee and its workload is relatively large and complex. Therefore, it can be posited that relatively busy audit committee members are not able to perform their core responsibilities efficiently and there is always a chance that quality of financial reporting is compromised (Tanyi & Smith, 2015; Méndez et al., 2015).

H_3: High intensity of busyness unfavorably affects the quality of financial reporting.

For the third article, the agency theory argument holds that there is a negative association between the busyness of corporate directors and firm performance. Furthermore, the negative impact of busyness on firm performance are valid for both inside and outside directors. For inside directors of a firm, first, their busyness in other firms may cause decline in the required time and attention necessary to perform various day-to-day managerial tasks, formulation and revision of plans, risk management actions and strategy assessment (Dalton et al., 2003); second, as their experience and knowledge are more about firm-specific operational activities, therefore, inside directors are not essentially good monitors of managerial actions in other firms (Klein, 1998a); third, the phenomenon of multiple directorships can be used as a mechanism to strengthen control of promoters and large shareholders in other firms within the same corporate group, which can result in the exploitation of minority shareholders (Dutta, 1997). Sarkar and Sarkar (2009) find that stock market reaction becomes adverse as the level of busyness of inside directors increases.

Similarly, when outside directors of the firm become over-committed by accepting multiple directorships in other firms, the financial performance of the firm can be negatively affected in the following ways. First, the ability of outside

directors to effectively monitor managerial actions of the firm reduces (Jackling & Johl, 2009; Tanyi & Smith, 2015); second, outside directors can experience the conflict of interests with other firms, especially when such directors are also serving on the boards of competitors; and due to this situation, firms can experience undue delays in their decision making process (Fich & Shivdasani, 2006); third, outside directors can be perceived to be following the perquisite consumption behavior (seeking financial and non-financial benefits) and not performing genuine monitoring of managerial actions (Dutta, 1997; Mathew, 2007); fourth, busy outside directors may find it difficult to understand the nature of operations, managerial actions, vision and mission, control mechanisms, and various board dynamics and related challenges of firms they are affiliated to (Kisgen et al., 2009); and fifth, similar to inside directors, outside directors may accept multiple directorships in order to enhance control of promoters over firms within a group; and this phenomenon is very common in the Indian corporate system (Chakrabarti et al., 2008; Chen et al., 2014).

Therefore, the first hypothesis of the third article is:

H_1. Multiple directorships held by corporate directors negatively affect firm performance (agency theory).

Researchers, such as Mehta (1955), find that the phenomenon of multiple directorships in India during the early phase of industrialization in India has been a consequence of the shortage of leadership and guidance that local private entrepreneurs experienced then. However, Dutta (1997) holds that even though the phenomenon of multiple directorships can solve the shortage of managerial talent, nonetheless, also recommends to place a limit on the corporate directors' busyness, because there is always a likelihood that some directors may join multiple boards in other firms in order to maximize their personal utility function, for example to earn extra income and develop their personal network in the market of corporate directors.

H_{1a}. Multiple directorships held by corporate directors of local private firms negatively affect firm performance (agency theory).

Regarding the role of government firms, Ahuja and Majumdar (1998) find that the government owned firms in India have better corporate governance standards, because the government owned firms have large size and produce goods and services, which at the best can be labelled as *necessities* (for example utilities). The government owned firms, due to the above mentioned reasons, attract an extensive system of regulatory monitoring and disclosure requirements that also includes the quality human resources they employ. On the other hand, Chibber and Majumdar (1998) find a negative relationship between the government ownership and firm performance. Kang and Zhang (2015) find that directors of a government owned firm and holding multiple directorships are more likely to abstain from board meetings, especially when they have good relations with the CEO.

H_{1b}. Multiple directorships held by corporate directors of government firms negatively affect firm performance (agency theory).

The second underlying theory in the current dissertation is the resource dependence theory (Daily & Dalton, 1994a, b; Pearce & Zahra, 1992; Hillman & Dalziel, 2003). A firm appointing board-level directors, who also serve on other corporate boards, adds to its resources in the form of both, human capital (education, experience, expertise, skills) and relational capital (network of ties to other firms, external environment and external contingencies). In the current dissertation, the combination of human and relational capital of directors is defined as reputational capital (Hundal, 2016). Firms operating in a relatively uncertain business environment can become beneficiaries by recruiting those directors, who not only have a higher level of human capital but also a well-developed relational capital network with other organizations and external contingencies. Similarly, large firms with complex business operations and organizational structures require board members possessing diverse skills, knowledge and experience to bolster decision making (Booth & Deli, 1996; Ferris & Jagannathan, 2001; Barzuza & Quinn, 2017). The directors serving on multiple boards can fulfil the above criteria; therefore, firms recruiting such directors are expected do better strategic decision-making amidst a high level of uncertainty in the business environment (Pearce & Zahra, 1992). Similarly, multiple directorships accepted by directors also signify their high level reputational capital in the market for corporate directors, which can be an important motivation for other directors to accept outside directorships. Multiple directorships held by corporate directors symbolize their reputational capital accumulated over the period of time, and firms can experience improvements in their operating profits and return on equity after they appoint such reputed directors on their boards (Fama & Jensen, 1983a, Ferris & Jagannathan, 2001). Similarly, the phenomenon of multiple directorships increases trust and friendship between the independent directors and the firm management, which can help to speed up, and improve decision making power of the firm board (Harris & Shimizu, 2004). Ferris et al. (2003) find that busy directors attend meetings regularly in order to consolidate their reputational capital, which results in the increased managerial accountability and better guidance provided to firms. Further, directors, who serve on multiple boards, promote several healthy practices among firms they are affiliated to, for example, exchange of skills, knowledge, and experiences and enhanced co-operation, and business relationships (Becher et al., 2016). Hermalin and Weisbach (1998) provide empirical evidence that directors affiliated to firms giving outstanding accounting and stock market performance are regarded as successful directors, and their demand in the market for corporate directors is often high. Conversely, directors on boards of firms giving poor accounting and stock market performance are less likely to be invited to join boards of other firms (Fama & Jensen, 1983b).

When a firm struggling with impending bankruptcy invites directors, who already hold directorships in other firms, it can not only thwart looming

bankruptcy situations, but also implement a restructuring process effectively by capitalizing reputational capital of its well-connected directors (Daily & Dalton, 1994a; Kaplan & Sorensen 2016). The firm's response to capitalize the reputational capital of directors serving on multiple corporate boards to combat an actual or potential financial distress situation can be either reactive (ex-post) or proactive (ex-ante). The findings of Daily and Dalton (1994a) emphasize the reactive response; however, firms can also invite such directors on their boards proactively in order to minimize the likelihood of such existential threats in the first place. Furthermore, Daily and Dalton (1994b) argue that a firm with directors connected to the external environment, especially those serving on the boards of financial institutions, is better positioned to face future financial challenges, as such directors can play an important role in arranging the right type of financial resources on favorable terms.

H_2. Multiple directorships held by corporate directors positively affect firm performance (resource dependence theory).

Ananchotikul (2008) views that foreign directors and ownership are considered as important catalysts by the recipient firms in upgrading their technologies, skills, and practices that in turn positively affect their performance. It may be argued that the phenomenon of multiple directorships positively impacts firm performance. In the Indian context, Patibandla (2006) and Hundal (2016) find that foreign ownership favorably affects firm value, however, Chibber and Majumdar (1999) hold that such favorable effect exists only when foreign ownership is relatively high.

H_{2a}. Multiple directorships held by corporate directors of foreign firms positively affect firm performance (resource dependence theory).

The intensity of busyness can be harmful to firm performance. The level of responsibilities and skills requirements is relatively higher in the case of specialized committees such as, audit, compensation, and nomination. Liao and Hsu (2013) find that cash remuneration paid to a CEO is decoupled from firm's performance when there is higher intensity of busyness. Contrary to this, Ferris et al. (2003) find that intensity of busyness affects firm performance favorably in the form of increased managerial accountability as directors serving on multiple committees attend meetings regularly. However, Ferris et al. (2003) do not rule out the possibility of enhanced compensation as a motivation to join multiple committee memberships.

H_3. Intensity of busyness unfavorably affects firm performance.

5 RESEARCH METHODOLOGY

5.1 Research methods

The first article, as a part of the current dissertation, is a review of literature and its principal objective is to explore several determinants, such as independence, expertise and experience, which can influence the effectiveness of audit committees. Similarly, several issues related to the audit committees in India have also been studied. The rationale of using the review of literature method in the first article is to explore and critically assess the characteristics of audit committee members in the extant literature and then compare and interpret them in the context of Indian corporate system. A variety of literature including different corporate governance systems, internal corporate governance mechanisms, managerial accountability and boards' accountability to the shareholders was searched and shortlisted at various stages. This was followed by an extensive literature review with respect to the roles, objectives, functions of the audit committees and issues pertaining to the independence, expertise and experience of the audit committee members, in general, and in the Indian context, in particular.

An important aspect of the review of literature of the first article has been various views related to the measurement of the independence of audit committees. First, whether an audit committee can be considered independent, when it is comprising of independent or outside directors. This aspect is of high significance, because both 'independents' and 'outsiders' are non-executive directors though, nonetheless, outside directors may have economic interests in the firm and as a result their unbiasedness may come under more scrutiny (Roe, 2004). Second, whether an audit committee can be considered independent, when it is exclusively comprised of independent or outside directors as against a

situation, when majority of audit committee members are independent or outside directors, and the remaining positions may be filled by the executive directors (BRC, 1999).

In the second and third article, the quantitative research methods are applied to analyze the effects of multiple directorships, first on financial reporting quality, and second, on firm performance, respectively. The principal motivations of applying quantitative research methods are to perform *in-depth* analysis and generalize results based on the larger samples by quantifying key variables (Field, 2013). In both articles, the phenomenon of busyness is measured as the board-level median of total directorships (number of board plus committee memberships), also referred to as median directorships, highlighting the number of outside directorships held by the majority directors, that is fifty percent, of a firm board of directors. The reason for measuring busyness at the firm board level and not at the individual director level is that 'directors do not govern, boards do'. The range of busyness starts at *three directorships* and ends at *ten*. The starting point of this range is three directorships, because the majority of empirical studies in the US settings consider three directorships as a measure of busyness. However, three directorships may well be too many in the USA but may not necessarily be *too many* in India due to the size (on average US firms are bigger than Indian firms) and complexity (the US firms have more joint ventures/technical collaborations/wholly owned subsidiaries abroad than Indian firms). According to the section 165(1) of the Companies Act of India a firm director cannot have more than ten directorship positions (MCA, 2013).

For the second and third article, the spline or piecewise multivariate regression method is applied to analyze the relationship between two variables that allows the slope of the relationship to change at specific points known as spline knots/nodes/cut-off points (Ahlberg et al., 1967; De Boor, 2001). In the context of both articles, the spline regression technique is designed to show the effects of different levels of busyness on firm performance and financial reporting quality, which may be favorable (according to the resource dependence argument) or unfavorable (according to the agency theory argument) or unrelated. This spline regression technique overcomes the limitation of using the exogenously given cut-off point of busyness (Hermalin & Weisbach, 1991; Campbell et al., 2015). Spline-1 and Spline-2 are representing different nodes of busyness that highlight whether a given level of multiple directorships can favorably or unfavorably affect firm performance and/or financial reporting quality.

5.2 Data

The final sample, for both article second and third article, comprises of the unbalanced panel of 3733 firm-years of non-financial firms. The sample firms are listed on either the Bombay Stock Exchange (BSE) or the National Stock Exchange (NSE) or both for the period of 2004-12. The sample of firms is further divided

into three sub-samples categorized on the basis of the ownership structure of firms including 2376 local private, 772 government and 585 foreign firm-years. The rationale of categorizing firms in three sub-samples is that even though the economic reforms initiated in the early 1990s in India have resulted in a major shift in the corporate ownership structure, away from the public sector and towards the private sector including local Indian and foreign firms, however, the government owned firms still play a highly significant role on the corporate spectrum of India (Committee on Corporate Governance, 2003). The data of the sub-sample of local private sector firms analyzed in the above mentioned articles belong to the group-affiliated. The reason for selecting the group-affiliated firms only in the sub-sample of local private sector is that although the group-affiliated firms constitute 40 percent of standalone firms in terms of number in the private sector in India, however, the group-affiliated firms are approximately six times larger than standalone firms in terms of asset base and seven times in terms of market capitalization (Sarkar & Sarkar, 2012). Similarly, foreign firms have already established their perceptible presence in the Indian corporate landscape and it is getting even stronger, owing to the economic reforms initiated in early 1990s (Sarkar & Sarkar, 2012). Therefore, the third sub-sample comprises of foreign firms. The data have been obtained from the Prowess database of the Center for Monitoring the Indian economy (CMIE).

5.3 Formulation and specification of variables of the second article

For the second article, the key explained/outcome/dependent variable is the firm-level quality of financial reporting measured by the discretionary accruals. In the accounting literature, the increasing level of discretionary accruals is associated with the diminishing quality of financial reporting (Bédard et al., 2004). Discretionary accruals are the difference between the total accruals and the non-discretionary accruals. The estimation of the non-discretionary accruals have been made by applying the following regression model given by Jones (1991).

$$DA_{it} = TA_{it}/A_{it-1} - [\alpha_1 (1/ A_{it-1}) + \alpha_2 (\Delta REV_{it}/A_{it-1}) + \alpha_3 (PPE_{it}/A_{it-1}) + \varepsilon_{it}] \quad (1)$$

DA_{it} = Discretionary accruals of i^{th} firm in t^{th} (current) period

TA_{it} = Total accruals of i^{th} firm in t^{th} (current) period. Total accruals are measured by subtracting cash flows from operations from net income before extraordinary items

A_{it-1} = Assets of i^{th} firm in $(t-1)^{th}$ (previous) period

ΔREV_{it} = Change in net sales of i^{th} firm in t^{th} (current) period

PPE_{it} = Gross value of Property, plant and equipment of i^{th} firm in t^{th} (current) period

ε_{it} =Error term

Jones (1991) expectation model has been applied to measure the non-discretionary accruals as below:

$$TA_{it}/A_{it-1} = \alpha_1(1/A_{it-1}) + \alpha_2(\Delta REV_{it}/A_{it-1}) + \alpha_3(PPE_{it}/A_{it-1}) + \varepsilon_{it} \quad (2)$$

The second term of the equation 1 is estimated by the equation 2 and the difference between them represents discretionary accruals. All the terms in the accruals expectations model are scaled by the lagged value of assets in order to reduce heteroscedasticity (Jones, 1991). The formula of deriving total accruals is as below:

TA_t = [ΔCurrent Assets$_t$ - ΔCash$_t$] - [ΔCurrent Liabilities$_t$ - ΔCurrent Maturities of Long-Term Debt$_t$ - ΔIncome Taxes Payable$_t$ - Depreciation and Amortization Expense$_t$.

The change (Δ) is computed between the current time (t) period and the previous time (t – 1) period (Jones, 1991).

In the second article the following multivariate regression model has been formed to test the effects of busyness of the audit committee members on the quality of financial reporting.

$$DA_{it} = \alpha_{it} + \beta_1(\text{Spline-1})_j + \beta_2(\text{Spline-2})_j + \beta_3(\text{Median committee-board size})_{it} + \beta_4(\text{Board size})_{it} + \beta_5(\text{Independent directors proportion})_{it} + \beta_6(\text{AC chair expertise})_{it} + \beta_7(\text{R\&D intensity})_{it} + \beta_8(\text{Advertisement intensity})_{it} + \beta_9(\text{Trade intensity})_{it} + \beta_{10}(\text{Debt-Equity ratio})_{it} + \beta_{11}(\text{Market-capitalization})_{it} + \beta_{12}(\text{NAS to total revenue of auditor})_{it} + \text{error term} \quad (3)$$

The formulae to calculate discretionary accruals have been given in equation (1) and (2). The other variables given in equation (3) are explained as below:

Spline-1- Suppose the financial reporting quality, measured by the discretionary accruals (dependent variable), is a function of busyness (independent variable), *ceteris paribus*, then 'x' is the observed audit committee level median directorship and the above mentioned functional relation is estimated at different endogenous spline knots/nodes/cut-off points (x_j).

Spline-1 = x, if $x < x_j$; = x_j, if $x \geq x_j$

This coefficient of the Spline-1 variable at j^{th} (j varies from 3 to 10) node shows the effect of audit committee level median directorships (x) below a given node (x_j) on the discretionary accruals. Spline-1 equals the observed number of audit committee level median directorship if the same is smaller than the given spline value ranging from 3 to 10. Similarly, Spline-1 equals the given node or spline or cut-off point if it is smaller than the observed number of audit committee level

median directorship. The underlying assumption of Spline-1 is that if busyness of an audit committee members exceeds a certain cut-off point, it can cause agency costs on the firm. The expected sign of the Spline-1 coefficient is positive.

Spline-2- This coefficient of the Spline-2 variable at jth (j varies from 3 to 10) node/spline/cut-off point shows the effect of audit committee level median directorships (x) at and above a given node (x_j) on the discretionary accruals. Spline-2= 0, if $x < x_j$; = $(x–x_j)$, if $x \geq x_j$. The underlying assumption of the Spline-2 is that the busyness of directors of an audit committee beyond a certain node can actually improve the quality of information due to the reputational capital of audit committee members. The expected sign of the Spline-2 coefficient is negative.

Median committee to board size (Median committee-board size)- A third variable of busyness in the current dissertation is known as 'Median committee to board size' measuring the intensity or quality of busyness. This variable posit that when the board/audit committee member of a firm serves on specialized committees, such as audit committee, remuneration committee, and nomination committee of other firms, then it is expected that the board/audit committee member in question will find his/her workload more demanding and complex than when he/she accepts the same number of positions on *the general* board of directors (Tanyi & Smith, 2015; Méndez et al., 2015). This firm-level measure is equal to the median committee directorships undertaken by the audit committee members of a firm, scaled by the board size. The expected sign of the coefficient of this variable can be negative (resource dependence argument) or positive (agency theory argument).

Board size- The larger boards are more likely to have more and diverse reputational capital and are expected to experience better monitoring and control, which can result in higher quality of financial reporting (Dalton et al., 1999; Goilden and Zajac, 2001). On the other hand, the CEOs of firms having larger boards can find it easier to influence outside directors and win their loyalty (Jermias & Gani, 2014; Guest, 2009). Therefore, it can be argued that firms having larger boards experience lower quality of financial reporting. The logarithmic values of board size are taken in order to avoid linearity, and no sign of the coefficient of the board size is predicted.

Independent directors proportion- The independent directors of a firm have a strong motivation to monitor the firm management in order to enhance their reputational capital in the labor market of corporate directors. This variable is calculated as the ratio of the number of independent directors to the board size of a firm. The squared values are taken in order to minimize the linearity problem and the predicted sign of this variable is negative.

Audit committee chairperson financial expertise (AC chair expertise)- The SOX Act (2002) requires that a firm must disclose in the SEC filings that its audit committee chairperson and other committee members fulfil the education criteria in the field of finance/accounting. Several studies give empirical evidence that firms, whose audit committees are chaired by the directors having education and training in the field of finance and accounting, experience higher quality of

financial reporting (Abbott et al., 2004; Bédard et al., 2004). This variable is binary/categorical by nature, carrying the value '1', if the chairperson of the audit committee has financial/accounting qualification, '0' otherwise. The variable is expected to have negative sign.

Debt-equity ratio- Also known as leverage ratio, the debt-equity ratio is calculated by dividing total value of debt with total market value of outstanding equity capital. Sarkar and Sarkar (2012) hold that in India debt plays an important place in the capital structure of firms, and a firm board has a strong motivation to strengthen its internal control system by recruiting more independent members in the audit committee in order to have cordial relationship with its debt holders in general and banks in particular. The purpose of the above move is to increase the reliability of the accounting numbers in order to obtain debt on the favorable terms (Sarens & Abdolmohammadi, 2011). Therefore, a negative association can be predicted between leverage and discretionary accruals.

Ratio of NAS revenue to total revenue of auditor- The section 139 of the Companies Act of India (MCA, 2013) does not permit auditors to do several types of NAS for their client firms (also subsidiaries and holding companies) and some of the examples of such NAS are accounting and book keeping, investment advisory/banking, and internal audit services. The rising ratio of the NAS revenue to the total revenue that an auditor earns from a given client firm also underpins the diminishing independence of an audit committee, weaker monitoring, and control of managerial actions and lower quality of financial reports (Simunic, 1984; Beck et al., 1988). The predicted sign of this variable on firm performance is positive.

Research and development (R&D) intensity and Advertisement intensity- These two variables measure firms' growth orientation and bonding costs incurred by firm managers (Ang et al., 2000; Easterbrook, 1984). Bonding costs underlines the agent's commitment to the firm, possibly to give positive signals to investors and expect positive reaction of stock market in return (Jensen & Meckling, 1976). Both, research and development intensity and advertisement intensity are calculated by dividing respective expenditures by sales revenue. The predicted sign of both variables is negative.

Trade intensity- Trade intensity shows how actively equity shares of a firm are traded in the stock market. This variable is calculated by dividing the number of shares traded by the total number of shares outstanding. Firms having active stocks are less likely to indulge in the earnings management activities as such actions can invite unfavorable reaction of the stock market (Fan & Wong, 2002). The predicted sign is negative.

Market-capitalization- Firm size is measured by market-capitalization (log values). Market-capitalization is obtained by multiplying the year ending market price of a share by the number of shares outstanding. Big firms are less likely to use earnings management practices due to the potential loss of reputation and the consequent adverse market reaction in terms of falling stock prices (Carey & Simnett, 2006). The predicted sign is negative.

5.4 Formulation and specification of variables of the third article

In the third article the following multivariate regression model has been formed to test the effects of busyness of corporate boards of directors on the financial performance of the firms.

$$\text{Performance Variable}_{it} = a_{it} + \beta_1(\text{Spline-1})_{it} + \beta_2(\textit{Spline-2})_{it} + \beta_3(\text{Comm-BS})_{it} + \beta_4(\text{BS})_{it} + \beta_5(\text{Pr-Ind-Dir})_{it} + \beta_6(\text{Pr-Prom-Dir})_{it} + \beta_7(\text{Pr-Prom-Own})_{it} + \beta_8(\text{Pr-Forgn-Own})_{it} + \beta_9(\text{D/E})_{it} + \beta_{10}(\text{NAS Ratio})_{it} + \beta_{11}(\text{R\&D-intensity})_{it} + \beta_{12}(\text{Advert-intensity})_{it} + \beta_{13}(\text{Trd-intensity})_{it} + \beta_{14}(\text{MarCap})_{it} + \text{error term} \quad (4)$$

In the third article the Tobin-Q (TQ) is taken as the principal performance variable. TQ can be obtained by dividing the sum of the market value of equity and debt by the replacement cost of assets. However, in India, as in many other developing countries, it is difficult to obtain the market value of debt because a large proportion of the corporate debt is institutional debt, which is not actively traded in the debt market. Therefore, in the third article a proxy of TQ has been created, which is calculated by taking the book value of debt and the book value of assets in place of their market values (Khanna & Palepu, 2001; Sarkar & Sarkar, 2000). Several other performance variables, such as market-to-book-value ratio (MBVR), net value added to asset ratio (NVAAR) and return on assets (ROA), have also been analyzed in order to test the robustness of TQ, the principal performance variable.

The following is the description of those explanatory variables analyzed in third article, which have also been analyzed in the second article. The calculation related issues of such variables have already been discussed in the sub-section 5.3.

Spline-1- Suppose the financial performance of firms (dependent variable) is a function of busyness (independent variable), *ceteris paribus*, then 'x' is the observed board level median directorship and the above mentioned functional relation is estimated at different endogenous spline knots/nodes/cut-off points (x_j).

$$\text{Spline-1} = x, \text{ if } x < x_j; = x_j, \text{ if } x \geq x_j$$

This variable is premised on the agency theory. A negative coefficient implies that as the firm-level median directorships approach a given node (x_j) then the busyness of directors at the given node may be considered *too high* and as a result firm performance reduces. The node at which the relation between firm performance and board busyness turns negative can then be identified as the endogenous cut-off point of multiple directorships.

Spline-2- This variable is premised on the resource dependence theory. Like Spline-1 variable Spline-2 variable can also take two values, that is Spline-2= 0, if $x < x_j$; = $(x–x_j)$, if $x \geq x_j$. A positive coefficient implies that as the firm-level median

directorships are at or exceeding a given node, firm performance continues to improve, therefore, implying that the firm directors are adding to firm performance despite additional directorship assignments that they have opted for.

Median committee to board size (Comm-BS)- This is a measure of the intensity or quality of busyness. The level of responsibilities and skills requirements are higher in the case of specialized committees such as audit, compensation, and nomination. Liao and Hsu (2013) find that cash remuneration paid to CEOs is decoupled from firms' performance when there is a higher intensity of busyness. The expected sign of the coefficient of this variable is negative (agency theory argument).

Board size (BS)- The larger boards with more and diverse reputational capital can positively impact the financial performance of firms. Positive sign of the coefficient of the board size is predicted.

Independent directors proportion (Pr-Ind-Dir)- The independent directors of a firm have a strong motivation to monitor the firm management in order to enhance their reputational capital in the labor market of corporate directors. The predicted sign is positive.

Debt-equity (D/E) ratio- A higher D/E ratio (leverage ratio) raises the threshold level of performance that managers are required to produce in order to ensure a firm's solvency. Therefore, a higher D/E ratio encourages managerial discipline (Jensen & Meckling, 1976). On the other hand, a higher D/E ratio can push the firm more toward insolvency owing to the higher level of financial performance pressures imposed on its managers (Titman & Wessels, 1988). Therefore, no prediction is made about the effect of this variable on the firm value.

Non-audit fees to total fees of auditor (NAS Ratio)- A higher share of NAS in total fees paid by the firm to its auditor suggests the firm can influence the independent functioning of its statutory external auditor, and such move can negatively influence the financial performance of firms (Culpan & Trussel, 2005). An increased NAS ratio, a measure of agency cost, may invite a negative reaction from its investors. The predicted sign of this variable on firm performance is negative.

Research and development intensity (R&D-intensity) and Advertisement intensity (Advert-intensity)- A higher proportion of expenditure on R&D and advertising indicates that managerial actions are growth orientated and futuristic (Chauvin & Hirschey; 1993, Easterbrook, 1984). Second, the above variables are used as measures of bonding costs. A higher proportion of bonding costs demonstrates an agent's commitment and loyalty to the principal, and therefore, offers a solution to the adverse selection problem (Jensen & Meckling, 1976). The predicted sign of the above two variables is positive.

Trade intensity (Trd-intensity)- Trade intensity shows how actively equity shares of a firm are traded in the stock market. It is expected that firms with a relatively active stock trading record experience improved performance (Denis & Kadlec, 1994). The predicted sign is positive.

Market-capitalization (MarCap)- It can be argued that a larger firm size is accompanied by improved financial performance (Goddard et al., 2006). The predicted sign of the MarCap coefficient is positive.

Furthermore, the following three additional explanatory variables have been analyzed in the third article.

Promoter directors' proportion (Pr-Prom-Dir)- This variable measures the promoters' control aspect in the firm and is calculated by taking the ratio of the number of promoter directors to the board size of a firm. According to one argument, as the proportion of promoter directors increases in the board then the vertical type of agency costs is less likely to occur and the firm value can rise (Roe, 2004). On the contrary, it is also argued that an increase in the proportion of promoter directors can lead to the horizontal type of agency costs, and as a result firm performance can decline (Roe, 2004). No prediction is made about the sign of this coefficient.

Promoters' ownership proportion (Pr-Prom-Own)- This variable is measured by dividing the number of promoter owned equity shares by the total number of equity shares issued by the firm. It may be argued that a higher share ownership of promoter directors motivates them to perform better monitoring of managers, which in turn can positively affect firm performance (Jensen & Meckling, 1976; Oded & Wang, 2010). However, the counter-argument is that share ownership of promoter directors beyond a certain level can lead to *the consumption-effect*, whereby directors owning a higher level of shares in a firm can initiate wealth expropriation actions (Mathew, 2007). Chakrabarti et al. (2008) find that in India, the promoters can jeopardize minority shareholders' interests by issuing non-voting preferential shares. No prediction is made about the sign of this coefficient.

Foreign ownership proportion (Pr-Forgn-Own)- Higher share ownership among foreign investors can lead to better monitoring and higher firm performance (La Porta et al., 1999). The predicted sign of this variable on firm performance is positive.

From the perspective of overall dissertation, it is worth mentioning that, first, a variety of literature, focusing theoretical and empirical dimensions, have been reviewed. The first article is an explicit example of understanding core theoretical issues of corporate governance, in general, and internal control mechanisms, in particular. Both the second and third articles continue to explore theoretical aspects further and also make *in-depth* analysis with the help of quantitative research methods, which are more suitable from the viewpoint of the nature of overall dissertation, as one of the objectives of the current dissertation is to challenge the exogenously given limits of busyness. The inclusion of the quality of busyness variable, robustness tests and a wide range of firm specific variables in the empirical models are expected to bring more reliability to the overall analysis process. A relatively large sample of Indian firms and sub-samples of firms, categorized on the basis of firm ownership, can help to provide comprehensive and deeper understanding of Indian corporate sector.

6 SUMMARIES OF THE ARTICLES

The following is the summary of three articles included in the current dissertation.

6.1 Article 1: Independence, expertise and experience of audit committees: some aspects of Indian corporate sector

The first article (Hundal, 2013) is a review of literature exploring the determinants, including independence, expertise and experience, which affect the effectiveness of the audit committees with respect to the financial reporting quality, especially in the light of Indian regulatory system. This article also include several other aspects, particularly the nature and composition of audit committees in India and regulatory developments related to them. The first article brings the agency theory perspective to the fore by providing the argument that with a relatively high proportion of independent directors in the boards and audit committees, firms can enhance objectivity, reliability and transparency of their published financial reports and disclosures; and generally investors and other stakeholders of such firms respond favorably to such developments (Duchin et al., 2010). Woidtke and Yeh (2013) and Klein (2000) find that with the increased independence of boards and audit committees, firms can experience favorable reaction in the stock market in the form of increase in their market capitalization. A possible reason for this positive reaction of investors is that the incidence of inflating the accounting earnings in financial statements can decrease once the independence of boards and audit committees increases (DeFond & Jiambalvo, 1991; Xie et al., 2003). Similarly, the independent audit committees can challenge the over-dominance of CEOs by increasing the effectiveness of monitoring and control mechanisms; as a response to such measures the managerial discretion

can be curtailed, for example, the likelihood of managerial manipulation of financial data in order to claim undeserving bonuses and other rewards can diminish (Klein, 2000; Houlthausen et al., 1995).

Another theoretical aspect related to the agency theory that the first article establishes is the complementarity and substitutability between the independence of audit committees and alternative corporate governance measures (DeFond et al., 2005). The BRC (1999) report highlights that the independent functioning of the audit committee of a firm reflects the independence of its board of directors, as it is highly unlikely that a firm board characterized by substantial managerial influences and discretions can allow the audit committee to function independently. Therefore, an independent audit committee can be considered as a substitute to some other internal corporate governance mechanisms implemented by a firm board of directors. Klein (2000) supports the above mentioned idea of substitutability as she finds a negative relationship between the audit committee independence and the need for alternative corporate governance mechanisms, therefore, she underlines that once a firm has an independent audit committee, it may not require alternative corporate governance mechanisms. However, Klein, in the same study, also raises a question about the reverse substitutability that is whether alternative corporate governance mechanisms can also replace independent audit committees. Notably, no study finds any of the alternative corporate governance mechanisms as substitute to the independent audit committees, possibly because the credibility of the financial reporting is immense, and cannot be ignored and members of audit committees are not only expected to be independent but also possess specific skills, qualifications and expertise. The above mentioned factors can make an independent audit committee irreplaceable.

Dhaliwal et al. (2010) and Krishnan and Lee (2009), on the other hand, support the complementarity dimension of the agency theory, which implies that managerial discretion can be curtailed effectively if the functioning of independent audit committees is complemented by the other measures of internal corporate governance. For example, board of directors, internal auditors and corporate executives are other important internal corporate governance mechanisms that can support to enhance the effectiveness of the independently functioning audit committee of a firm. Similarly, from the resource dependence perspective the association between the financial information quality and the stock market reaction becomes significantly positive pronounced when the independent directors on boards of directors and audit committees have higher human capital (Gopinath & Allen, 2010).

6.2 Article 2: Busyness of audit committee directors and quality of financial information in India

The second article (Hundal, 2016) is an empirical study and it examines, first, the association between multiple directorships of audit committee members and quality of financial reporting in India, second, whether endogenously determined levels of busyness of the audit committee members provide better insights than those limits, which are exogenously mandated by regulators. The second article highlights that the audit committee, as one of the key internal corporate governance mechanisms, is required to ensure that the financial statements and disclosures published by the firm are prepared according to the legal requirements and accounting standards set by the relevant regulatory and other professional bodies and display a comprehensive and true picture of the financial health of the firm. An independent audit committee can ensure fairness of financial information and promotes a culture of accountability within the organizational structure of firms (BRC, 1999). An independent audit committee can check the possible *collisions* between the external auditors and the firm managers by ensuring that it obtains all the relevant information from the firm managers and subsequently provides the same information to the external auditors so that the latter can verify credibility and relevance of information. Similarly, to avoid any possible *collusions* between the external auditors and the firm managers, the independent audit committee plays a key role in determining several issues, for example, the scope of the auditing services, the audit fees, the NAS engagements between the firm and external auditors (Sarkar & Sarkar, 2012). In the article a key underpinning is that the number directorships (boards and committees) taken up by the audit committee members of a firm in other firms is an important determinant of the independence of the audit committee. Agency theory postulates that firms appoint independent directors to reduce agency costs (Jensen & Meckling, 1976). The presence of independent directors on an audit committee can ensure objectivity, truthfulness and fairness of the financial data and other information. Nonetheless, if such directors are busy on boards and committees of other firms then the quality of financial data can be jeopardized. In line with the agency theory, it can be argued that as the number of outside directorships of the audit committee members of a firm increases, their effectiveness to review financial statements, and to ensure the independent implementation of the audit process diminishes (Ferris et al., 2003). Over-committed directors may find it difficult to do tasks entrusted to them due to the scarcity of time and attention (Kahneman, 1973; Eysenck & Keane, 1990; Fiske, 1995). It can be posited from the above argument that when corporate directors allocate their attention across various activities, in the capacity of boards and committees members in multiple firms, their attention gets divided and as a consequence the quality of financial reporting deteriorates. According to an alternative argument, backed by the resource dependence theory, the incidence of audit committee members serving on multiple boards and/or committee

reflects the reputational capital they carry in the market for corporate directors (Fama & Jensen, 1983a). Vafeas (1999), Watts and Zimmerman (1983) and Ball (2009) maintain that board and audit committee members of a firm, when serving on multiple boards have high stakes and any wrongdoing on their end can jeopardize their *hard earned* reputational capital, which is accumulated over a period of time. Therefore, busy directors work independently and take due care and diligence of tasks entrusted to them, and resultantly the quality financial information may improve.

For the second and third article the final sample comprises of the unbalanced panel of 3733 firm-years of non-financial firms. The sample firms are listed on either the Bombay Stock Exchange (BSE) or the National Stock Exchange (NSE) or both for the period of 2004-12. The sample of firms is further divided into three sub-samples categorized on the basis of the ownership structure of firms including 2376 local private, 772 government and 585 foreign firm-years in order to include ownership structure in the analysis, which is an important firm-level characteristic. For the second and third article, the spline or piecewise multivariate regression method is applied to show the effects of different levels of busyness on firm performance and financial reporting quality, which may be favorable (according to the resource dependence argument) or unfavorable (according to the agency theory argument) or unrelated. This spline regression technique overcomes the limitation of using the exogenously given cut-off point of busyness (Hermalin & Weisbach, 1991; Campbell et al., 2015).

The findings show that for the foreign, government owned firms, and full sample, the busyness of audit committee members does not affect the financial reporting quality adversely before the median audit committee members at the firm-level turns six, however, for the local private firms, the same phenomenon is observed not before five. An interesting aspect of the above findings is that the agency costs, in the form of poor quality of financial reporting, measured by the discretionary accruals, appear before reaching the regulatory limit of maximum ten directorships. At the same time, in the second article, favorable effects of multiple directorships on the financial reporting quality are also ascertained with the help of endogenously determined range of busyness levels. The sub-samples comprising of foreign firms, local private sector firms and full sample firms experience improvements in their financial reporting quality at the lower level of busyness of the audit committee members, whereas, for the government owned firms, such beneficial effect does not appear. The overall inference that can be drawn is that the lower level of busyness of the audit committee members at the firm-level is beneficial to firms, however, the higher level of busyness of the same is detrimental to the financial reporting quality. Nevertheless, the third variable of busyness, that is median committee to board size, measuring the intensity of busyness, provides mixed results. For the sub-samples of government firms, local private firms and full sample firms, the intensity of busyness unfavorably affects the financial reporting quality at a relatively higher level of audit committee members' busyness, whereas, for the sub-samples of foreign firms the favorable effect of the same variable is significant only at a lower level busyness.

6.3 Article 3: Multiple directorships of corporate boards and firm performance in India

The third article (Hundal, 2017) also finds its theoretical foundations in the agency theory and the resource dependence theory. A key argument made according to agency theory is that the independence of corporate directors is influenced by the busyness of boards, among other things. According to the busyness hypothesis, developed by Ferris et al. (2003), as the number of directorships of board members of a firm increases, they find themselves over-committed, and as a result firm performance can be adversely affected (Méndez et al., 2015). Busy directors can find it hard to give required time and attention necessary to perform their various day-to-day managerial tasks, formulation/revision of plans, risk management and strategy assessment (Dalton et al., 2003). Second, over-committed board members may find their ability to effectively monitor managerial actions of the firm reduced (Jackling & Johl, 2009; Tanyi & Smith, 2015). Third, in several institutional settings, such as in India, where promoters have substantial control over the group of firms, corporate directors can be asked by promotors to opt for multiple directorships of affiliated firms within the corporate group. The purpose of such maneuver is to strengthen the control of promoters, and large shareholders, which can result in the exploitation of minority shareholders and poor firm performance (Dutta, 1997). Fourth, several directors take multiple directorships in order to seek financial and non-financial benefits (networking) only (Dutta, 1997; Mathew, 2007).

The second theoretical underpinning in the third article is the resource dependence theory (Daily & Dalton, 1994a, b; Pearce & Zahra, 1992; Hillman & Dalziel, 2003). Multiple directorships signifies increased reputational capital of directors, and the importance of such capital rises further when firms are operating in a highly uncertain business environment. Similarly, firms having large size and complex business operations, and organizational structures often seek board members, who possess high level reputational capital (Booth & Deli, 1996; Ferris & Jagannathan, 2001; Barzuza & Quinn, 2017). Furthermore, Ferris et al. (2003) find that busy directors attend meetings regularly in order to consolidate their reputational capital, which results in increased managerial accountability, and better guidance provided to firms.

The findings reveal that for sub-sample of local private firms and for full sample, busyness of corporate directors adversely affects firm-level performance. For local private firms and full sample, the board level busyness of directors is detrimental to firm performance even before reaching the maximum limit of multiple directorships. Furthermore, for local private firms, the above mentioned negative effects start appearing at the busyness cut-off point of five and for full sample the same appears at spline node six. For sub-samples of foreign and government firms, board busyness positively affects the firm value throughout, whereas, for full sample, the same positive effect does not extend beyond the

busyness limit of four. With regard to the intensity of busyness, the findings show that in sub-sample of local private firms, the negative effects appear at the busyness level of four directorships, however, for sub-sample of government firms and full sample, the negative effects of the intensity of busyness do not appear before the spline node of six. Interestingly, for full sample and each of three sub-samples, empirical findings contradict the limits of busyness, which are exogenously imposed by the regulator. Therefore, the finding reiterates that 'one size does not fit all'.

7 DISCUSSION, CONTRIBUTIONS AND CONCLUDING REMARKS

The current dissertation aims to explore how the phenomenon of busyness of corporate boards of directors and audit committee members affects firm performance and financial reporting quality in the light of the agency theory and the resource dependence theory in India. The dissertation also explores whether the number of multiple directorship, the non-conventional measure of boards of directors and audit committees independence, provides more insights in comparison to the conventional measures of independence of corporate boards and committees. Furthermore, the above association is investigated by applying the endogenously determined nodes of busyness and comparing against the exogenously prescribed busyness limits by regulators. This endogenous-exogenous debate is highly relevant in a country like India, because exogenously imposed busyness limits may not reflect the true institutional settings of firms such as the size and ownership structure. Another objective of the dissertation is to study how the intensity or quality of busyness is associated with firm performance and financial reporting quality. The intensity of busyness highlights the difference of rigor involved in various types of directorship assignments.

7.1 Discussion, contributions and conclusions based on individual articles

The first article (Hundal, 2013) sheds light on the attributes of audit committees' members including, independence, expertise and experience, and their impact on the financial reporting quality, especially in the light of the Indian regulatory system by reviewing a diverse range of literature. It has been studied in the first article that independently functioning audit committees have a significant influence on the improvement of quality of financial reporting, which in turn enhances the informativeness of financial information of firms. The informativeness implies that both, existing and potential investors positively

respond to the high quality financial information. Furthermore, this article points out that, when studying the association between the independence of audit committee members and financial reporting quality, it is important to recognize and incorporate institutional settings and other firm characteristics in the overall discussion. The above mentioned association in the light of institutional settings and other firm characteristics becomes even more prominent in a country like India, where ownership structure, internal controls, capital market characteristics and regulator development are unique. Nonetheless, the first article draws several limitations in the extant literature and suggests further research possibilities that can be explored. First, it is not fully established in the empirical literature whether outside directors' investment stakes in the firm and audit committee independence are substitute to each other or it is so that the former determines the latter in order to enhance the financial reporting quality. Further investigation regarding the independence of audit committees is needed in the light of managerial entrenchment and minority shareholders exploitation. Similarly, the article highlights that the role of regulators in India is majorly confined to advocate independence of the audit committees *per se*, however, the regulators in India and in the similar corporate settings do not explicitly state the different dynamics of independence of audit committees' members that can reflect on the working mechanism of an audit committees. In other words, an audit committee can be assumed to be fully independent, nonetheless, the roadmap that the audit committee must follow to ensure the quality standards of financial information of the firm is under explained and ambiguous. Similarly, there is a need to do more research by bringing other dimensions, for example, frequency of audit committee meetings, cost-benefit analysis of audit committee independence and experience, skills, and expertise of directors, in the ongoing academic discussion. Similarly, more research is needed to study whether audit committees should be exclusively comprised of independent directors or only majority of them is enough. Some of the future research suggestions as highlighted in the first article are studied and analyzed in the second article.

The second article (Hundal, 2016), in continuation of some of the core aspects highlighted in the first article, initiates the discussion by demonstrating the significance of objective, truthful and relevant financial information that investors and other stakeholders of firms utilize in order to make rational economic decisions. The audit committee, a part of the internal corporate governance mechanism of firms, aims to ensure that the financial statements and related disclosures are prepared according to the legal requirements and accounting standards set by the regulators and professional bodies. An audit committee, which is independent of managerial influences, is expected to function efficiently and effectively. The number of directorships (boards and committees) accepted by the audit committee members of a given firm in other firms is an important determinant of the independence of the audit committee. The agency theory argument follows that as the number of outside directorships of the audit committee members of a firm increases, their effectiveness to review financial statements and question the managerial actions diminishes. However,

according to the resource dependence theory, the phenomenon of multiple directorships of the audit committee members is associated with their high level human and relational capital, collectively known as the reputational capital. Based on the empirical findings of the second paper an inference can be drawn that at the lower (higher) level of busyness of the audit committee members at the firm-level the financial reporting quality of firms improves (deteriorates).

The second article contributes to the body of literature in multiple ways, first, the endogenously determined busyness levels explain the association between multiple directorships of audit committee members and the quality of financial reporting better than the busyness limits exogenously imposed by regulators; second, despite applying the endogenous levels of busyness in the analysis for the full sample and sub-samples, the results reveal that 'one size does not fit all', that is the cut-off points of busyness highlighting the optimum level of busyness for the different ownership groups are not uniform, therefore, the article incorporates the institutional settings, for example ownership structure, in which firms operate; third, this article, along with the number of multiple directorships of the audit committee members *per se*, also recognizes the nature of multiple directorships and analyzes its effects on the financial reporting quality, therefore, the article suggests that the regulators should not recommend a single upper limit of busyness of directors of a firms even for the same ownership structure, as such limits do not take into account the intensity of busyness of board, and committee members; and lastly, the article is one of the few studies in the settings of an emerging economy, such as India, and inferences drawn on the basis of the findings of this article can be useful for countries having comparable corporate environments. The major limitation of the second article is that has not applied alternative measures of the quality of financial information in the empirical analysis; therefore, robustness of the explained variable has not been tested. Similarly, in this article private sector firms in India are comprised of group-affiliated firms only. The conclusions drawn based on the empirical analysis of the group-affiliated firms may not be applicable for the standalone firms, for example, promoters, in order to strengthen their position in the group of firms, play a vital role in encouraging corporate directors to opt for directorships in the other group affiliated firms, nonetheless, the promoters in the standalone firms may not have the same motivation to encourage their directors to seek directorships in other firms.

The third article (Hundal, 2017) examines, first, how the busyness of corporate directors influences firm performance in India in the light of the two alternative theoretical perspectives, that is, the agency theory and the resource dependence theory, and second, the extent of the relationship between busyness of directors and firm performance analyzed through the endogenously determined busyness levels, third, the association between the intensity of busyness and firm performance. The findings of the third paper reveal that for the sub-sample of local private firms and for the full sample, busyness of corporate directors start affecting the firm-level performance adversely even before reaching the exogenously stipulated maximum limit of multiple

directorships by the regulators. However, for the foreign, and government firms board busyness positively affects the firm value throughout, whereas, for full sample, the same positive effect does not extend beyond lower level of busyness. On the other hand, the intensity of busyness negatively affects firm performance, at the different levels of busyness for the sub-sample firms, categorized based on their ownership structure, and the full-sample firms. Overall, both favorable and unfavorable effects of the directors' busyness on firm performance are explained better with the help of endogenously applied busyness levels in comparison to the exogenously imposed busyness limits by the regulators.

The third article makes several contributions to the body of literature. First, the current article is one of the few studies conducted in the setting of an emerging economy like India, and the findings of the current article can be useful to study the similar relationship in other emerging markets with a corporate governance structure similar to that of India. Second, the article highlights the relevance of endogenously determined levels of busyness as against those limits imposed exogenously by regulators. Furthermore, the busyness limits are not only determined for full sample but also separately for each of the ownership groups studies in the dissertation, that is, local private firms, foreign firms and government firms. Therefore, the article recognizes the institutional settings and ownership characteristics of firms. Last, the article also explores the effects of promoters' ownership and control, a peculiar feature of Indian corporate settings, on firm performance.

Nonetheless, the third article has several limitations and further research is required to overcome them. First, the effect of busyness on firm performance can be studied by creating multiple categories of directors, such as executive, non-executive and affiliate directors. Second, alternative measures of busyness can be tested in future research. Third, more research is needed to explore different dimensions of the reputational capital of directors. Lastly, in this article private sector firms in India are comprised of group-affiliated firms only, however, in the future studies standalone firms can also be studied when analyzing the effects of busyness on firm performance.

7.2 Overall dissertation discussion, contributions and conclusions

For the overall dissertation, the findings align with the objectives of the dissertation. Underlying theories studied in the dissertation, that is the agency theory and the resource dependence theory, play an instrumental role in problematizing several aspects related to the corporate governance mechanisms, forming research questions and hypotheses, creating variables, building analysis models, benchmarking findings and finally discussion based thereon. The findings also highlight that researchers need to, first, go beyond the conventional measures of independence of boards of directors and committee members and

identify factors that signify the very independence of boards and committees, and second, develop alternative measures of independence of corporate boards and committee. The phenomenon of multiple directorships has been identified and analyzed as the key determinant as well as a non-conventional measure of the independence of boards and committees. The empirical findings of the articles provide *in-depth* information pertaining to the effects of busyness on firm performance and financial reporting quality, which the conventional measures of independence of corporate boards and committees do not provide. Another overall finding of the current dissertation is that the effects of busyness on firm performance and financial reporting quality have been investigated by applying the endogenously taken various levels of busyness on different sub-samples, categorized on the basis of ownership structure, and full sample as against maximum limit to multiple directorships exogenously prescribed by regulators. With the inclusion of the intensity of busyness aspect, the above findings have gained even more relevance and better explanations. The empirical results not only highlight the relevance of determining endogenous levels of busyness for the firms belonging to different ownership structure but also recognize the significance of the nature of multiple directorships. The findings suggest that even recommending an endogenously determined single upper level of busyness for firms belonging to the same ownership structure may not be a flawless move unless the intensity of busyness of board, and committee members at the firm-level is taken into consideration.

Overall, the theoretical linkages between the three articles included in this dissertation are explained in the figure 4. In this figure an arrow-head denotes *the determined factor*, whereas, an arrow-tail signifies *the determining factor*. On the basis of diverse literature reviewed *the path 1* and *path 2* theoretical linkages have been formed. Other things being equal, the path 1 theoretical linkages highlight that firm performance and financial reporting quality are considered to be dependent on the independence of the firm directors *per se*. The frequently used conventional measures of the independence of board (committee) in the empirical research has been the proportion of independent directors of a firm in its board (committee). However, the path 2 theoretical linkages go further and identify that firm performance and financial reporting quality depends on multiple directorships, other things being equal; and the phenomenon of multiple directorships is also considered to be as one of the determinants of the independence of the corporate directors (thick lines). In other words, the phenomenon of multiple directorships can be considered, first, as a non-conventional measure of the independence of corporate boards of directors and committees and second, a determinant of the independence of the corporate directors. Similarly, the intensity or quality of busyness can also affect the independence of corporate directors and considered as a non-conventional measure of the independence of corporate boards of directors and committees.

In the given theoretical linkages in figure 4, it is assumed that firm performance and quality of financial reporting mutually affects each other. The argument follows that one the one hand a better performing firm strives to

produce high quality financial reports in order to avoid any adverse reaction of the corporate governance mechanism in general and the external ones in particular (also refer to figure 1). On the other hand, a firm producing high quality financial reports can enhance its reputation in the market and therefore experience favorable stock market reaction and other financial performance indicators.

The phenomenon of multiple directorships is affected by the relational and the human capital, altogether known as the reputational capital, among other determinants, which further affects the effectiveness of the board of directors and audit committee members (Berezinets et al., 2016). Higher (lower) reputational capital of a corporate director can increase (decrease) his/her demand in the market of corporate directors. Similarly, reputational capital provides impetus to the effectiveness of board of directors and audit committee of a firm.

The articles covering various theoretical linkages given in the figure 4 below are marked as I, II and III.

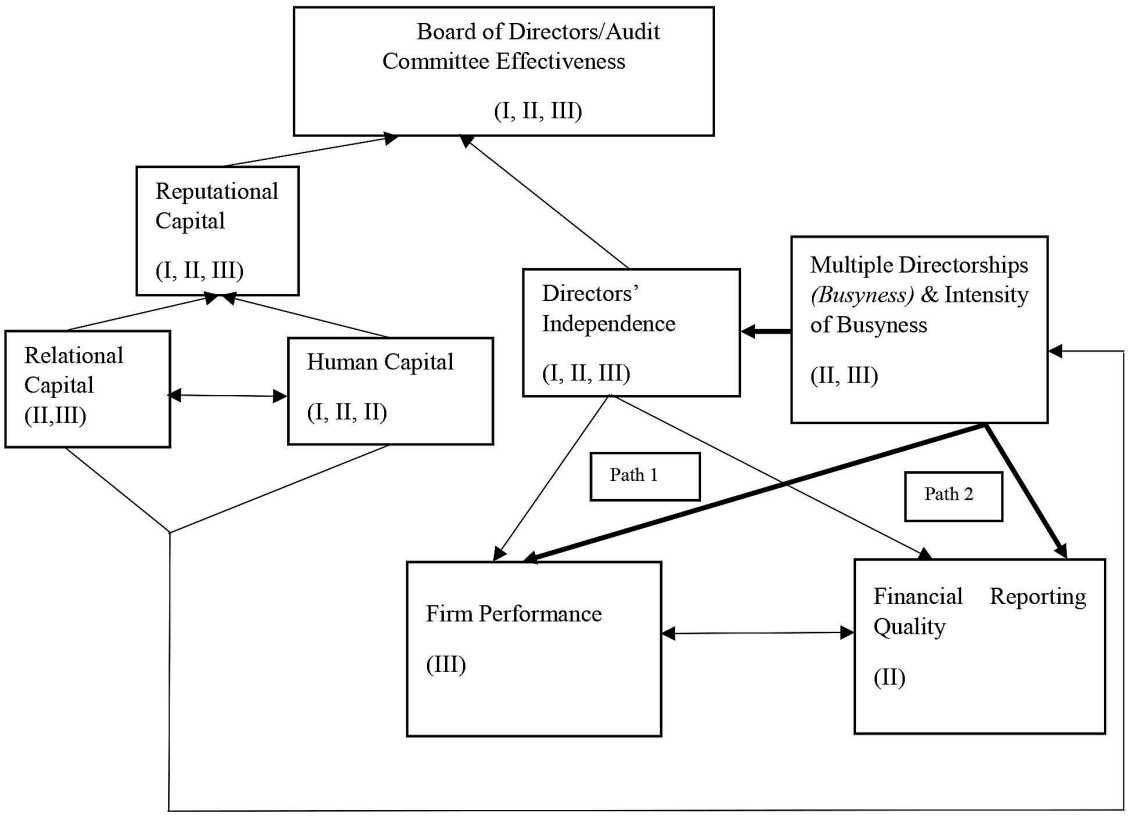

FIGURE 4 Relationship between three articles included in the dissertation in the light of agency theory and resource dependence theory (compiled by author)

Note: Numerals I, II and III in the above figure are referring to the articles as mentioned in the list of original articles.

7.3 Reliability and validity

An important aspect of an empirical research is to ensure that measurement error is kept to the minimum. This can be done by studying properties of various measures of a given phenomenon followed by choosing those measures, which have the maximum confidence. Validity, therefore, implies choosing the measures, which measures the phenomenon correctly so that the conclusions drawn based on such measures are not biased.

In the current dissertation, validity aspect is highly imperative as it is tested in the current dissertation whether endogenously applied spline nodes, as represented by Spline-1, and Spline-2 variables, are the valid measure of, first, busyness of corporate directors, and second, financial performance and financial reporting quality of firms, in comparison to the conventional measures of independence of boards of directors.

There are four types of validity that have been tested in the current dissertation-external validity, internal validity, construct validity and criterion validity. *External validity* refers to the extent to which the findings of a particular study can be generalized across populations, contexts and time (Birnberg et al., 1990; Modell, 2005). In quantitative research generalizability element of the findings exists if the empirical findings are significant and the inferences are drawn with respect to the future events. However, Lukka and Kasanen (1995) and Lindsay (1995) question the generalizability rhetoric heavily tilted in favor of quantitative research analysis, in general, and statistical significance tests, in particular. The genesis of the above criticism of heavy reliance on statistical significance backed generalizability rhetoric is that statistical sophistications cannot replace the relevance of theoretical knowledge, the nature of research problems and the formation of research questions. In the current dissertation, several arguments drawn from the first article and the empirical findings of the second article and third article can be generalized for the countries having comparable corporate environment. Similarly, in the current dissertation the generalizability rhetoric is based on the key theoretical arguments drawn from two well established and at the same conflicting theoretical arguments drawn from the agency theory and the resource dependence theory; and these theories have substantial impact on the research objectives, review of literature, hypotheses formation and empirical model building.

Internal validity is a type of validity that refers to the credibility of the causal relationships between explanatory and explained variables. The internal validity is *validated* through the empirics derived from the data. Birnberg et al. (1990) highlight that in order to obtain external validity, it is important to obtain higher internal validity first. The findings of the second, and third article are in conformity with the internal validity requirements. The findings of three sub-samples and full sample confirm the causal relationships between the busyness of audit committee members/board of directors and the financial reporting quality/firm performance variables. The confirmation holds even further, first,

when empirics obtained at various splines/nodes are compared, and second, when different performance variable are incorporated to the empirical models in order to test their robustness.

Construct validity answers the question whether the theoretical concepts applied in a study represent the real life phenomena (Modell, 2005). In the quantitative research construct validity implies whether the inferences drawn are based on the variables which are measured and analyzed in such a way that they truly corroborate the hypotheses, which in turn are based on the theoretical concepts needed to find answers to the research questions. The phenomenon testing the construct validity involves three distinct steps; first, clear definitions and measures of variables used in the study, second, forming hypotheses in accordance to the theoretical concepts and their empirical evidences as studied in the review of literature, and third, testing hypotheses empirically and positioning the findings in line with the research questions by citing clear reasoning and justification.

In the current dissertation several theoretical concepts, for example, board and audit committee busyness, quality of busyness, firm performance and financial reporting quality, are needed to answer various research questions. These variables are constructed and measured in such a way that they are reflective of their hypotheses, which are not only formed on the basis of a variety of theoretical concepts but also tested through the application of rigorous empirical test and stronger reasoning. The findings that busyness affects firm performance and financial reporting quality at different splines favorably and unfavorably are positioned with respect to the two key theoretical perspective and previous empirical studies.

Criterion validity is whether an instrument is measuring what it claims to measure (Field, 2013). In the current dissertation, criterion validity signifies the theorization and formulation of Spline-1 and Spline-2 variables constructed according to the agency theory and the resource dependence theory, respectively. For example, the underlying argument of the Spline-1 variable, which is according to the agency theory premise, is that the busyness of directors beyond a certain level can be detrimental to firm performance and financial reporting quality. The formulation of Spline-1 variable also signifies that any busyness beyond a given node may affect the firm unfavorably. The findings of the second article shows that for the three sub-samples (foreign,, government and local private firms) and full sample the detrimental effects of the busyness of audit committee members start arising much before arriving at the maximum busyness limit of ten, as prescribed by regulators in India. Similarly, the findings of the third article show that for local private firms and full sample, the unfavorable effects of board level busyness on firm performance (measured by the proxy of TQ) start appearing before reaching the regulatory limit. Based on these findings it can be inferred that Spline-1 variable successfully detect the agency costs related to multiple directorships, which exogenously prescribed busyness limits may not detect and disclose.

Similarly, the underlying argument of the Spline-2 variable, which is according to the resource theory premise, is that the busyness of directors help to bring reputational capital to their firms even beyond the exogenously given busyness limits, which are provided by regulators The formulation of the Spline-2 variable also signifies the phenomenon that any busyness beyond a given node can still affect the firm favorably. Nonetheless, the findings of the second article shows that for the sub-samples of foreign firms, local private firms and full sample firms, the favorable effects of the busyness of audit committee members on the financial reporting quality of firms is witnessed only at the lower level of busyness, whereas for the government owned firms, the favorable effects of busyness of audit committee members never appear. Furthermore, the findings of the third article show that for the sub-samples of foreign firms and government firms, the board busyness positively affects firm performance throughout. The validity of the Spline-2 variable, theorized and measured according to the resource dependence arguments, lies in the empirical evidence that the favorable effects of busyness of corporate directors do not stop even when reaching the prescribed busyness limit of ten.

Reliability is another important consideration in the field of academic research. Reliability refers to the ability of the measure of a variable to produce the same results under the same conditions. Therefore reliability underscores repeatability of the findings. Reliability is dependent on three criteria-first, whether the given measure of a variable produces the same findings on other occasions too; second, the data analyzed to produce a certain set of outcomes is also obtainable to other researchers; and third, the process of making interpretations from the raw data and drawing inferences based thereon is amply explained and transparent (Field, 2013).

It can be argued in the current dissertation that all the above-mentioned criteria are met; first, the various measures of variables, for example measures of busyness (Spine-1, Spline-2 and Intensity of Busyness), financial performance (TQ, MBVR, NVAAR and ROA), are capable of producing the same findings on any other occasion provided that the theorization process of these variables, time period of the data and measures of the above-mentioned variables remain the same; second, any other researcher can produce the same results since the data is publicly available, *ceteris paribus*; and third, the process of formulation of variables and their measurement corresponding to the hypotheses is thoroughly disclosed and transparent, therefore, given the analysis model and other things remaining the same, the reliability of inferences and conclusions is expected to be high.

YHTEENVETO (SUMMARY IN FINNISH)

Tässä laskentatoimen väitöskirjassa tarkastellaan Intiassa toimivien yritysten hallitusten ja tarkastusvaliokuntien jäsenten tehtävien kuormitusta (busyness), riippumattomuutta, yritysten taloudellista toimintaa ja talousraportoinnin laatua. Väitöskirjan tavoite on analysoida, miten jäsenten samanaikaiset tehtävät useiden yritysten hallituksissa ja niihin liittyvissä valiokunnissa (kuormitus/busyness) vaikuttavat hallitusten ja valiokuntien riippumattomuuteen, joka vuorostaan vaikuttaa yritysten taloudelliseen toimintaan ja talousraportoinnin laatuun. Väitöskirja esittää aiemmasta tutkimuksesta poiketen, että johtajien kuormitus vaikuttaa riippumattomuuteen, ja kuormitus riippumattomuuden mittarina selittää yritysten toiminnan tuloksellisuutta ja talousraportoinnin laatua. Tutkimuksessa kuormitusta tarkastellaan useiden erilaisten, esimerkiksi yrityksen sisäisesti määriteltävissä olevien, rajojen avulla sen sijaan, että ilmiötä tarkasteltaisiin pelkästään viranomaisten määrittelemää tiettyä (esim. lakisääteistä) kuormitusrajaa käyttäen. Yritysten taloudellisen toimintakyvyn, raportoinnin laadun, hallituksen jäsenten kuormituksen ja riippumattomuuden välisiä suhteita tarkastellaan kehittyvän markkinan, Intian, kontekstissa, kun suurin osa aiemmasta tutkimuksesta tarkastelee vastaavia suhteita kehittyneiden markkinoiden kontekstissa. Aihetta tarkastellaan kahden keskenään osittain ristiriitaisen teoreettisen viitekehyksen, agenttiteorian ja resurssiriippuvuusteorian, valossa.

Väitöskirja koostuu johdannosta ja kolmesta toisiinsa liittyvästä julkaistusta artikkelista, jotka tarjoavat pääasiassa kvantitatiiviseen analyysiin perustuvaa näyttöä johtajien ja tarkastusvaliokuntien jäsenten kuormituksen vaikutuksista yrityksen toimintakykyyn ja talousraportoinnin laatuun. Artikkelit ovat seuraavat:

I. Hundal, Shab (2013). 'Independence, expertise and experience of audit committees: some aspects of Indian corporate sector', *American International Journal of Social Science*, Vol. 2, No. 5, pp. 58-75.

II. Hundal, S. (2016) 'Busyness of audit committee directors and quality of financial information in India', *International Journal of Business Governance and Ethics*, Vol. 11, No. 4, pp. 335–363.

III. Hundal, S. (2017). 'Multiple directorships of corporate boards and firm performance in India', *Corporate Ownership & Control*, Vol. 14, No. 4, pp. 150-164.

Tutkimuksen aineisto koostuu 3 733 listatusta yrityksestä, jotka on noteerattu Bombayn arvopaperipörssissä (Bombay Stock Exchange, BSE) tai Intian kansallisessa arvopaperipörssissä (National Stock Exchange, NSE) tai molemmissa. Aineisto kattaa ajanjakson 2004–2012. Yritysaineisto on jaettu kolmeen tarkasteltavaan luokkaan yritysten omistusrakenteen mukaan. Luokat ovat paikalliset intialaiset, ulkomaalaisomisteiset ja valtio-omisteiset listatut yritykset

Ensimmäinen artikkeli on kirjallisuuskatsaus. Aiempaan aiheesta tehtyyn tutkimukseen perustuen artikkelissa tarkastellaan, miten tarkastusvaliokunnan riippumattomuus, asiantuntemus ja kokemus Intian kontekstissa vaikuttaa talousraportoinnin laatuun. Toinen artikkeli on empiirinen tutkimus, joka tutkii tarkastusvaliokunnan jäsenten kuormituksen vaikutusta talousraportoinnin laatuun. Tarkastusvaliokunnalla on, osana yrityksen hallintoa (Corporate Governance), tärkeä rooli talousraportoinnin laadun parantamisessa. Kolmas artikkeli on myös empiirinen tutkimus ja sillä on kolme tavoitetta. Ensinnäkin, tavoitteena on tutkia hallitusjäsenyyksien määrästä johtuvan kuormituksen ja yrityksen taloudellisen toiminnan välistä yhteyttä. Toisena tavoitteena on analysoida, selittävätkö sisäsyntyisesti määrittyvä hallituspaikkojen lukumäärä, omistusrakenne ja muut institutionaaliset seikat talousraportoinnin laatua paremmin kuin viranomaisten sääntelyyn perustuva hallituspaikkojen lukumäärä. Kolmas tavoite on tutkia yhteyttä johtajien kuormituksen intensiivisyyden ja yrityksen toiminnan tuloksellisuuden välillä.

Artikkeleissa kuvatut empiiriset tulokset luovat uutta tietoa, joka koskee kuormituksen yhteyttä yritysten toimintaan ja talousraportoinnin laatuun, ja perinteisiin hallitusten ja tarkastusvaliokuntien riippumattomuuden mittareihin nähden. Kuormituksen vaikutuksia yritysten toimintaan ja talousraportoinnin laatuun tarkastellaan käyttämällä johtajien kuormitukselle sisäisesti määriteltyjä rajoja, mikä tarjoaa realistisempaa ja tarkoituksenmukaisempaa tietoa kuin viranomaisten ulkoapäin määrittelemiä rajoja käyttäen. Kun lisätään kuormituksen intensiteetti (erilaisten tehtäväroolien, kuten raskaina pidettyjen valiokuntapaikkojen, määrä) tarkastelun kohteeksi, tulokset tarjoavat monipuolisia ja hienojakoisia selityksiä yrityksen hallituksen jäsenten kuormituksen vaikutuksista yrityksen toimintakykyyn ja talousraportoinnin laatuun. Lisäksi väitöskirjan johdanto-osa tarkastelee ilmiöön liittyvien käsitteiden suhteita sekä esittelee näkökulmia jatkotutkimusta ajatellen.

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ORIGINAL PAPERS

I

INDEPENDENCE, EXPERTISE AND EXPERIENCE OF AUDIT COMMITTEES: SOME ASPECTS OF INDIAN CORPORATE SECTOR

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Independence, Expertise and Experience of Audit Committees: Some Aspects of Indian Corporate Sector

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Abstract

The current study is based on the review of literature to analyses how independence, expertise and experience of audit committees can influence the quality of financial reporting. After studying a vast and diverse range of literature pertaining to the audit committees and governance issues, an effort has been made through this study to demonstrate several aspects of independence of audit committee, for example, informativeness, CEO's power, frequency of meetings, substitutability and complementarity with alternative corporate governance mechanisms, directors' share ownership, earning management etc. Similarly a wide range of literature based on utility of financial and accounting knowhow and experience of audit committee members has been reviewed. An attempt is made to establish association litigation risk that the firm faces and market reaction, to the firm's appointment of audit committee members with accounting and financial expertise and experience. This study also includes the various aspects of audit committee in India, based on regulations, corporate governance reforms and the limited number of empirical research findings. Lack of independence, expertise and experience of audit committees have rendered them less effective in performing their oversight functions. The Companies Bill (2009), a major governance reform, has not become an 'Act' as it is delayed due to political apathy, and at the same time some interim reforms have eroded the independence of audit committees even further. There is ad-hocism and vagueness in reference to corporate governance reforms in general and auditing process in particular.

Keywords: Audit Committee, Financial and Accounting Expertise and Experience, Earning Management, Informativeness.

Introduction

A system of good corporate governance fosters a system of accountability. The essence of the audit committee is based on *two strands of accountability*; first, management's accountability to the board, second, board's accountability to the shareholders. The audit committee's role stems directly from the board's *oversight* function as it oversees, both, internal as well as external, audit processes of the firm (Collier and Gregory, 1999; Bédard et al., 2004; Lee et al., 2004). One of the foremost functions of the audit committee is to review the financial data of the company on continuous basis and strengthen internal accounting controls, in order to enhance reliability and integrity of financial reporting. A good system of corporate governance requires a thorough co-ordination among the three constituents of audit viz. the board, the internal auditors and the external auditors. The audit committee participates, not only in the process whereby management disseminate information to the auditors and releasing unbiased information reducing information asymmetry between insiders and outsiders; but also play an important role in ensuring that statutory auditors are not in the influence of management. Therefore audit committees can be used as a mechanism to reduce agency problems faced by firms, (Jensen and Meckling, 1976). The composition and functioning of the audit committee play significant role in influencing quality of financial reporting (Vicknair et al., 1993; Cadbury, 1995). Several studies and reports have emphasized that the audit committees should consist of independent non-executive directors, who are less likely to be influenced by the management, and therefore, can carry out financial reporting process more effectively (Beasley 1996; Blue Ribbon Committee, 1999).

This study is an effort to systematically arrange a diverse range of studies covering multiple aspects of independence, expertise and experience of the audit committees of the publicly traded companies. This is one of

the very few review of literature based studies of audit committees which bring theoretical underpinnings in the Indian context.

Section 1 of the paper highlights the association between directors' independence and audit committee independence, whereas; section 2 throws light on association between knowledge and expertise of corporate directors, and independent functioning of audit committees. Section 3 recapitulates core aspects of discussion in sections 1 and 2 in the Indian corporate landscape.

1. Director Independence

Directors' independence is a very important factor for the *fair* and *objective* functioning of the audit committees. Blue Ribbon Committee (BRC, 1999) recommended all the major U.S. stock exchanges in 1999 to encourage participating companies to constitute audit committees exclusively comprised of independent directors, but at the same time the BRC left the discretionary power to appoint inside directors with the company whenever it can *justify* such appointments. Also, the BRC exempts small listed firms from having exclusively independent audit committees. Sarbanes-Oxley Act (SOX, 2002) on the other hand is very categorical in mandating that any company having audit committee with less than 100 percent independent in the audit committee members can be de-listed (Romano, 2005). As per the SOX (2002), an audit committee is to be constituted entirely of independent directors. Such increased requirements of having an independent audit committee not only act as a corporate governance mechanism to mitigate unwanted interventions and conflicting pressures of powerful groups in the firm, but also to improve oversight and monitoring of executives. It may be argued that an independent-outside director who has no pecuniary consideration with the firm, other than his/her fee, is less likely to be influenced by the management, (SOX, 2002). A director can be *outsider as well as dependent too*, *"….for example consultants, lawyers, financiers etc., who often receive compensation for services rendered to the firm other than in their capacity as outside directors",* Vafeas, (2001). The fact that executive directors *(insiders)* and dependent-outsider directors *(gray)* may not assert their professional judgments and views independently; therefore, there are good reasons to raise doubts the unbiased working of the audit committee consisting of insiders and gray directors, (Baysinger and Butler, 1985; Byrd and Hickman, 1992). According to the Birla Committee (2000)[1], *"a qualified and independent audit committee should be set up by the board of a company. This would go a long way in enhancing the credibility of the financial disclosures of a company and promoting transparency".*

Therefore, it is expected that with the relatively high proportion of independent directors in the boards and audit committees, would enhance the objectivity, reliability and transparency of the financial reporting and disclosures; which in turn would strengthen investors' confidence, (Duchin et al., 2010).

About measurement issue, it has been observed that majority of studies use either or both of the following measures of board independence. The first one is a binary measure and reckons an audit committee independent when all of its members are independent as defined by SOX (2002). The second measure is the ratio of independent members to total size of audit committee.

It has been attempted in some studies to establish association between independence of audit committee and *informativeness* attribute of accounting information. According to Yeh and Woidtke (2007), among others, one example of earning informativeness is the *responsiveness* of cumulative abnormal stock returns to changes in measures of accounting performance. In her study Klein (2000) analyses a sample of 803 large US firms over a two-year period between 1991-93, and shows that by giving more independence to the audit committees companies can improve informativeness of their accounting information which in turn positively affects the market value of the firm. Yeh and Woidtke (2007) analyze a sample of the largest 450 listed companies; evenly taken in Hong Kong, Singapore and Malaysia; measured on the basis of market capitalization for the year 2000; and show that higher the ownership concentration, measured by the voting rights that controlling shareholders hold, the lower is the level of earnings informativeness. The relationship between ownership concentration and earnings informativeness gets even more pronounced once the independent directors are having financial expertise, which implies that board's human capital may be possibly used to strengthen interests of blockholders. Yeh and Woidtke (2007) further find that *pros* of increased reliability and informativeness, brought about by the combination of financial expertise and independence of audit committee, can more than offset the *cons* associated with concentrated control. One of the main finding of this study is that the benefits of an independent audit committee are not fully utilized unless the audit committee owns financial expertise too. Both, financial expertise and independence of audit committee can strengthen investor confidence in accounting information, particularly

when ownership is concentration is very high, a common characteristic of corporate sector especially in Asia, (Gopinath and Allen, 2010). The major limitation of this study is that it does not *reason out* why there are insignificant audit committee effects for the firms with lower ownership concentration.

There is no unanimity among the researchers regarding the success of the audit committee in ensuring objectivity and integrity in the financial reporting. Wild (1994) and Yeh and Woidtke (2007) provide evidence of increased informativeness of the financial information of firms after their audit committees have been formed. DeFond and Jiambalvo (1991), and Xie et al. (2002) show that the incidence of inflating accounting earnings in financial statements is less for the companies that have audit committees. On the other hand, Klein (1998a), Beasley (1996), and Dechow et al. (1996) find no association between having of audit committees by firms and the resulting improved performance, and the likelihood of *engineering* revenues by such firms. However, the Treadway Commission[1] reports that 69 percent of the publicly traded companies were found to be involved in the fraudulent financial reporting cases brought by the SEC from the period 1981 to 1986, and therefore, there was nothing much that audit committees did to prevent companies from indulging in earning management practices. Klein (1998b) suggests that future studies should focus on developing more conclusive relationship of financial frauds with audit committee composition and its activities. Similarly, further studies are required to investigate if the litigation risks of getting sued by the investors or the regulators, due to *lacunae* in financial reporting, can make firms to improve their quality of financial reporting *(informativeness)* and making audit committees independent.

Similarly, the firms where the CEOs are dominating have less likelihood of having independent audit committees, (Klein, 2000). Houlthausen et al. (1995) present evidence that dominating CEO are relatively more successful in producing target accounting results and therefore, claiming higher remuneration package including bonus plans based on accounting numbers. An independent audit committee can thwart such wealth expropriation actions of the CEO. Similarly shareholders would have incentives to limit the CEO's ability to do so. Another factor that can increase CEO domination is his performance. A *highflyer* CEO may consider independent audit committee as a mechanism that may curtail his/her bargaining power in the firm. The level of CEO getting monitored by the board is an outcome of a bargaining process between the CEO and the board of directors. Hermalin and Weisbach (1998) present a theoretical model to examine CEO's bargaining power in the firm and the level of monitoring that he/she receives from the board. Their results show that more successful CEO can weaken the independence of the board and the committees (audit, remuneration and nominating committees in particular), as enhanced performance improves the CEO's bargaining strength which provides him/her the motivation to lower his/her firm monitoring, and in the middle of euphoria of firm performance less *outrage* is expected from the board members and other investors.

Klein, (1998b), identifies and examines possible economic factors that can cause variations in the audit committee composition and activities. Klein, (1998b) takes a sample of 771 firms for a two-year period of 1991-93 and show that even though 97.9 percent of all audit committees for the large U.S. firms have at least one outside independent director, more than half of the sample firms also have at least one affiliated director and nearly 5 percent firms were having top executives in their audit committees, and therefore, flouting the key recommendation of the Treadway Report which state that audit committees be comprised solely of independent directors. Besides, over 60 percent of the firms in the sample violate another important requirement of the Treadway Commission that audit committees must meet four or more times per year. Klein (1998b) argues that *stronger CEOs* ensure the presence of insiders or affiliated directors in the audit committees, in accordance with their posture to keep key board committees in their control, and at the same time undermine the importance of audit committee by not following the required frequency of meeting.

Klein (1998b) also attempted to investigate a very interesting question if there is any linkage between the audit committee composition and the *degree of contracting* between shareholders and senior claimants. Theoretically, the senior claimants, e.g. institutional lenders, can insist to include higher level of audit committee independence in the debt covenants, (Watts and Zimmerman, 1990). The statistical findings of Klein (1998b) do not support this relationship.

Klein (2000) also investigates economic benefits that a firm can claim by having independent audit committee. There is a negative association between *cash compensation* that CEO can draw from the company and audit committee independence. Similarly the study shows empirical evidence that more *frequent* meetings bring about more independence to the audit committees. Abbott et al. (2004) frequent meetings of the audit committee

coupled with independence are associated with a lower incidence of fraud. There is some evidence that more frequent meetings are associated with better-governed firms. For example, McMullen and Raghunandan (1996) find that audit committees of firms with SEC enforcement actions or earnings restatements are less likely to have frequent meetings. *This area of research is relatively under-explored, albeit frequency of meetings can be a very important determinant of audit committee's efficient working.*

Many studies have attempted to answer the question if the governance of audit committee, for example, independence, acts as a *complement* or *substitute* to the alternative corporate governance measures (DeFond et al., 2005). The BRC (1999) argues that working of the audit committee reflects the working of the overall board, therefore, an independent board is expected to have an independent audit committee too, and it is highly unlikely that a firm with too much of managerial influence on the board would allow the audit committee to function independently. There are several studies that have provided evidence in support of governance attributes of audit committees and those of alternative measures for being *complement* (Klein, 2002a; Beasley and Salterio, 2001). Klein (2000) examines another interesting question if there is any degree of *substitutability* between the audit committee independence and the alternative corporate governance mechanisms[2]. There is a negative relationship observed between audit committee independence and alternative corporate governance mechanisms, which implies that alternative corporate governance mechanisms should mitigate the need for the firm to have an active, independent audit committee.

DeFond et al. (2005) argues that future researchers can investigate different corporate governance methods by taking into account *complement*arity and *substitutability* of such methods, and the resulting effect on the firm performance. Similarly, several business, financial, legal and political factors may affect above association, which can be another potential area of research.

Vafeas (2001) argues that as the directors share ownership increases their motivation to protect shareholders interests also increases to deter managers from expropriating shareholders wealth, which can be done by managers through earnings management practices, in order to claim higher level of compensation (Hermalln and Weisbach, 1991; Shivdasani, 1993). Therefore, with the presence of shareholder members in the audit committee, it can be expected that company would improve quality of financial reporting. The counter argument is that due to large equity stakes, audit committee members may *collude* with management in manipulating the financial results, and therefore, jeopardizing the interests of smaller shareholders. As Vafeas (2001) shows above phenomenon by putting forward that there exists *"a non-monotonic relation between the likelihood of an audit committee appointment and an outside director's equity investment in the firm, with the incentive effect prevailing for low ownership levels, and the entrenchment effect dominating thereafter"*.

A number of studies have looked at the relation between the audit committee independence and earnings management. Klein (2002) examines if the audit committee and the board characteristics are related to earnings management practices of managers, by using a two year sample of 692 S&P 500 companies, and she finds that by increasing independence of both audit committees and corporate boards, the value of abnormal accruals declines. Since the effectiveness of the audit committee must be understood in the overall corporate governess spectrum that is followed by the firms, therefore, Klein (2002) investigates whether abnormal accruals are related to other board characteristics; and finds that when the percentage of outside directors on the board declines and the board is consisted of less than fifty percentage of outside directors, there is significantly increase in abnormal accruals.

Healey and Wahlen (1999) analyze how standard setters and regulators decide the extent of judgment that can be used by the company management in financial reporting. They have attempted to review a variety of literature to address the questions that the regulators and standard setters very often confront, such as; magnitude and frequency of any *earnings management*, specific accruals and accounting methods used for earnings management and its motives. The findings indicate that earnings management occurs for a variety of reasons for example, to influence stock market perceptions, to increase management's compensation, to reduce the likelihood of violating lending agreements and to avoid regulatory intervention. They further argue that implications of earning management practices are the function of accounting standards that are used to manage earnings; relative frequency of managerial communication of the judgment to manage earnings to the firm performance, to investors; the effect of earnings management on the resource allocation of the firm; factors limiting earnings management, for example, effective disclosure policies reduces the likelihood of in earnings management practices. *Healey and Wahlen (1999) suggest that future studies should provide evidence on the extent and scope of earnings*

management in order to facilitate regulators and standard setters to evaluate the effectiveness of current disclosure standards and the measures meant to minimize earning management. Second, future studies should focus on the standards that increase effectiveness of communication between managers and investors.

Xie et al. (2002) have studied the data of 110 S&P 500 index companies for each of the years 1992, 1994, and 1996 and find that the likelihood as well as frequency of earnings management is less in corporate boards that consist of more independent outside directors and directors with corporate experience. Also, the proportion of audit committee members with corporate or investment banking backgrounds is negatively related to the level of earnings management. Similarly, there is a negative association between levels of earnings management and the frequency of boards and audit committees meetings. This reflects that the effectiveness of monitoring and quality of financial reporting can be enhanced if board and audit committee are actively functioning.

There is a problem with the study of Xie et al. (2002) that the results cannot be interpreted by establishing a causal link between board and audit committee composition and earnings management because of the endogeneity problem (Hermalin & Weisbach, 2003). An active and financially oriented board and audit committee may influence the level of earnings management, but the level of earnings management may also influence the subsequent selection of board and audit committee members. *Therefore, future studies can explore causal link, a step further of manifesting associative link between the board characteristics and earnings management*.

Klein (2006) analyzes, by taking a sample of 687 S&P 500 publicly-traded U.S. companies for the period of 1992-93, if audit committee and board characteristics influence earnings management practices followed by the companies. The underlying assumption of the study is that as the compliance to good governance practices increases the incidence of earnings management declines, as emphasized in many reports of the regulators and stock exchanges such as the NYSE[3], the NASDAQ[4] and the SEC[5]. A non-linear negative relation is found between audit committee independence and earnings manipulation. Above association is significant only when the majority of members of audit committee are non-independent (executives and gray) directors. No significant reduction takes place in the incidence of earnings management when the audit committee is comprised of independent directors exclusively. This finding is not in accordance with the recommendations of most of, albeit much publicized, *the best corporate governance practices* documents. This implies that incremental decline in the incidence of earnings management is insignificant from the point where audit committee has majority of independent directors, probably because *just majority* is enough to keep a check on unhealthy practices, and any further induction of independent directors in the audit committee would bring about less marginal decline in the incidence of earnings management. Besides, some other alternative governance practices also discourage the incidence of earnings management. For example, CEO being not sitting in the compensation committee, level of the CEO's shareholdings and presence of a big outside block-holder on the board's audit committee are also found to be negatively associated with the incidence of earnings management by the firm, (Klein, 2000).

Abbott et al. (2003) examine the association between audit committee characteristics and the ratio of non-audit service fees to audit fees, by taking a sample of 538 firms complying fee disclosure rules as required by the Securities and Exchange Commission (SEC) for the year 2001. Abbott et al. (2003) hypothesize*,"…. audit committees that are independent and active financial monitors have incentives to limit non-audit service fees, relative to audit fees, paid to incumbent auditors, in an effort to enhance auditor independence in either appearance or fact"*. This hypothesis is based on three fundamental assertions. First, the BRC (1999) and other regulations have empowered audit committees not merely to limit non-audit service contracts that the company management can give to its statutory auditors, but also to exercise the decision rights necessary to be a stakeholder when such contracts need to be approved. Second, Abbott and Parker (2000, 2001) and Carcello and Neal (2000, 2003) give empirical evidence that independent and active audit committees is a manifestation of measures to reduce firm-specific agency cost variables. The analysis indicates that audit committees comprised solely of independent directors, meeting at least four times annually, are significantly and negatively associated with the ratio of non-audit service fees to audit fees. This evidence is consistent with independent audit committee members perceiving a high level of non-audit service fees as an indicator of firm-specific agency cost.

Abbott et al. (2003) find that companies with audit committees that are constituted exclusively of independent directors, and that meet at least four times a year, are likely to have lower non-audit service fees to audit fees ratios. The results are in line with the SEC and other regulatory measures, giving more powers to the audit committee in matters related to accounting and auditing. *Further, Abbott et al. (2003) suggest that the future*

studies should be carried out in analyzing the association of non-audit fees and (1) audit opinions for companies in financial distress, (2) the likelihood of financial statement restatements, (3) SEC enforcement actions, and (4) auditor changes and resignations.

The major limitation of their study is the possibility that management's unwillingness to comply with good corporate governance practices can affect the audit committee characteristics and choices related to auditor services. Bronson et al. (2009) examine a sample of 208 firms and raise a very interesting question of *how much independence that an audit committee must have* to effectively perform its core function of oversight of the financial reporting process. Finding answer to this question is very important as the requirement of Section 301 of the SOX (2002) which requires a listed company to maintain an audit committee exclusively comprised of independent directors as there is a lot of debate if this requirement can be made lenient for smaller and foreign companies. Proponents of relaxing audit committee independence argue that the costs of having an audit committee that is completely independent of management can outweigh the potential benefits arising out of wholly independent audit committee (Lamb, 2005). There can be various types of *costs* that firms incur when employing independent directors e.g. search costs, directors' and officers' liability insurance premiums, director fees, costs associated with expanding the board, and the loss of board effectiveness through the potential replacement of affiliated directors who possess certain industry- or firm-specific knowledge by independent directors who lack such knowledge, (Donaldson, 1990; Donaldson and Davis, 1991; Kiel and Nicholson, 2003). Bronson et al. (2009) show their results to suggest that the benefits of audit committee independence are consistently achieved only when the audit committee is *completely independent*, therefore, reiterating prior research findings that independence of the audit committee can be sacrificed if the composition of the audit committee leaves room for the managerial influence. There is a possibility that this study has not identified all potential correlated omitted variables. *Therefore analyzing the cost of having the independent audit committees is a relatively under-explored area.*

DeFond and Francis (2005) contest the popular *notion* that independent directors are better monitors of management behavior than non-independent directors. This notion is based more on conventional wisdom and anecdotes, and less on empirical support, (Bhagat and Black, 1999; Dalton et al., 1998). Some studies find evidence that in certain settings firm value increases when non-independent directors are appointed (Rosenstein and Wyatt, 1997; Klein, 1998a). The possible explanations for this phenomenon are first, non-independent directors have higher firm-specific knowledge. Second, some non-independent directors have greater incentives to improve firm performance by monitor management than outsiders (Rosenstein and Wyatt, 1997). *Hence, it can be a very interesting question to explore if audit committee with less than 100 percent independence can still be termed as independent.*

Beasley and Salterio (2001) examine the relationship between characteristics of boards of directors and audit committees across a sample of 627 publicly traded Canadian firms. Their results show characteristics of the company board have bearing on those of audit committee too. An independent board significantly reflects itself in terms of independence of the audit committee. The companies with a larger board size and where CEO and chairperson are separate are more likely to have independent directors in the audit committee voluntarily beyond the mandated *minimum threshold*. Beasley and Salterio suggest that further research is needed to examine the causal links, not mere association, between audit committee quality and other governance mechanisms. Also, the quality of monitoring and characteristics of the audit committee needs more investigation. Therefore, independence of an audit committee stems from the overall board's independence.

2. Knowledge and Expertise

The BRC (1999) recommended all the major U.S. stock exchanges to implement the requirement that their member firms must have *financially literate*[6] audit committee members. Securities and Exchange Commission (SEC) has emphasized that financial expertise on audit committees would *enhance the effectiveness of the audit committee in carrying out its financial oversight responsibilities,* (SEC, 1999)[7]. The SOX (2002) mandates listed companies to have at least one person in the audit committees who must have specified expertise in the field of accounting and finance*, "The Commission shall issue rules, as necessary or appropriate in the public interest and consistent with the protection of investors, to require each issuer, together with periodic reports required pursuant to sections 13(a) and 15(d) of the Securities Exchange Act of 1934, to disclose whether or not, and if not, the reasons therefore, the audit committee of that issuer is comprised of at least one member who is a financial expert, as such term is defined by the Commission",* SOX (2002).

Similar recommendations recognizing the significance of accounting and financial knowledge and expertise of audit committee members in order to enhance efficacy of the audit committees, can be found in the other popular literature of corporate governance guidelines,(e.g. Combined Code on Corporate Governance[8], 2008; UNCTAD[9], 2006; OECD[10], 2008; Be´dard et al., 2004; Krishnan, 2005; Dhaliwal et al., 2006).

DeZoort (1997) in a survey of oversight functions performed by 500 audit committee members of 134 companies listed with the NYSE, the AMEX and the NASDAQ/NMS, shows that members appreciate if they are working in audit committees where all the members have necessary expertise in overseeing areas related to accounting, finance, auditing, taxation, law etc. Wolnizer (1995) argues that oversight functions of audit committees can be classified in three groups viz. financial reporting (including controls), auditing and other corporate governance measures (e.g. communications between the board and the external auditors). The major finding of DeZoort (1997) is in conformity with several others studies that even though the oversight functions of the audit committees are duly recognized, however, many committees are unable to perform the key functions due to the lack of required knowledge and expertise (DeZoort, 1998; McMullen, 1992; Kalbers and Fogarty, 1993). In certain companies, such as banking organizations, the regulations like Federal Deposit Insurance Corporation Improvement Act (FDICIA, 1991)[11], have made it mandatory for the audit committee members to possess required experience and know-how. *DeZoort (1997) also suggest that future research should make more critical assessment of the audit committee composition, types of expertise and financial reporting quality, besides examine the divergence of publicly disclosed responsibilities of the audit committees with those followed.*

In another study DeZoort (1998) takes a sample of 87 audit committee members and examines if experience affects audit committee members' oversight judgments. The selected members completed an internal control oversight task in order to evaluate and determine whether experience facilitated comparability with a criterion group of external auditors. The results indicate that both general and task specific experience made a significant difference in the audit committee members' internal control assessments. An interesting finding of this evaluation exercise has been that the experienced members are capable of making internal control judgments something similar to those of statutory auditors than their counterparts without such experience.

DeZoort (1998) explores various kinds of advantages that experienced members have over their inexperienced colleagues, therefore, affecting the audit committee functioning. First, experience enhances the *judgment* power of the audit committee members. Experienced audit committee members possess relevant technical knowledge due to prior training, performance, review and feedback (GAO, 1991; Harrison, 1992). Second, audit committee members with auditing experience show the *consistency* levels that are comparable to those of auditors. The studies of Ashton and Brown (1980), Ettenson *et al.* (1987) and Messier (1983) highlight that the amount of variation explained among a group of auditors increased with work experience. Similarly, experienced members can make effective usage of the *cues* that they get while checking the financial statements, whereas, their lesser experienced colleagues may not identify/utilize relevant cues. Third, the experienced members of audit committees have high degrees of *self-insight*, which means committee members, owing to their oversight experience, are better equipped to identify the specialized cues systematically; and understand, interpret and communicate such specific cues in their judgment processes or policies. Fourth, there is likelihood of *consistency* or *consensus* among the audit committee members, which implies that they would make the same judgment given the same information and similar business environment factors. DeZoort (1998) shows that above mentioned advantages are available to companies where audit committee members are relatively experienced. The study is not free from certain limitations. First, the study is too much focused on the experience of the audit committee members and does not recognize the other elements of expertise such as ability, knowledge etc. Second, this study acknowledges experience of the individual members only, whereas, the audit committee works as a group, therefore, diligence is needed inferring the results for audit committee experience and expected improvements in the quality of financial reporting, as a result. Third, taking external auditors as benchmark to compare the oversight tasks of the experienced members of the audit committees is vague and even exaggerated. *There is need to make further research on the aspects such as; if cautiousness of the inexperienced members in their assessment of internal controls results in the rise in the strength of the audit committee as a group, and if such increased effectiveness is for general or specific tasks*.

McDaniel et al. (2002) conduct an experiment in which they prepare two categories of participants, doing role playing of audit committee members. The two categories are *financial experts* (audit managers) and *financial*

literates (recent Executive M.B.A. graduates). McDaniel et al. (2002) evaluate whether financial experts' judgments related to financial reporting quality vary from those of financial literates in their experiment, and it does then what are the underlying reasons for such variation. There are significant differences how the experts and the literates obtain, decipher and interpret the same piece of information as given in the financial reporting. Common wisdom can lead people to assume that experts' *episode based* knowledge about financial reporting quality reflects their first-hand experiences of relevant problems as well as second-hand experiences gained through, for example, interactions with other experts. Whereas, literates' *episode based* knowledge is assumed to rely more on *second-hand sources*, such as relevant case studies reported in the media. Therefore, above differences are likely to impact the way experts and literates react, as followings-*(1) assessing overall financial reporting quality and incorporating underlying characteristics of reporting quality into such assessments and (2) identifying and evaluating critical reporting issues,* (McDaniel et al., 2002).

McDaniel et al. (2002) show that literates have been more likely than their expert colleagues, to raise concern about the reporting treatments for *high-salience* financial statement items, i.e., items getting more focus in the business press or items distinguished by their unusual, non-recurring nature. Experts have been having higher probability to raise concern over items related to recurring business activities that have received lesser attention of business press. Therefore, each group is likely to have different perspectives of key issues while attending audit committee meetings, and different ideas to assess financial reporting quality, Jonas and Blanchet (2000). McDaniel et al. (2002) suggest that future studies need to examine how different types of financial experts perceive quality of financial reporting. They, like many others researchers, have taken auditors as financial experts, as auditors meet the criteria of the SOX (2002) and the BRC (1999) to be termed as financial experts. It can be an interesting area of future research if the other financial experts in the company, for example the chief financial officer (CFO), also have the similar perceptions about the quality of financial reporting. This study is based on different perspectives brought in the audit committee meetings and differences in evaluations of the financial reporting quality, by the experts and literate. *The future studies can also incorporate non-financial aspects such as those related to experience and knowledge of specific sector, industry, market etc. (Krishnamoorthy et al., 2002)*.

Krishnan and Lee (2009) have examined the determinants of the choice of company to induct persons having accounting and financial expertise in the audit committees, in a sample of 802 *Fortune* 1000 companies, based on the data of the year 2004. Their major finding is that there is positive association between the litigation risk faced by the firms and the likelihood to have accounting and financial experts in audit committees, given that firms are having relatively high level of corporate governance. Above mentioned positive association is not observed for the firms afflicted with weaker governance standards. *One possible area of further research is determining equilibrium association of litigation risk and accounting expertise, as litigation risk may discourage the potential candidates with requisite expertise to take up audit committee jobs.*

DeFond et al. (2005) find that the market reacts positively the appointment of accounting and financial experts to the audit committee, given that pre-appointment corporate governance standards of the firms are relatively high. Above relationship holds true in only one direction as market does not significantly react to the appointment of non-experts to the audit committee even if they are experienced. Davidson et al. (2004) also demonstrate similar results. *In general, the market reaction to the appointment of expert on the audit committee is not very much explores field of research.*

DeFond et al. (2005) highlight that researchers face difficulty in testing if financial expertise improves corporate governance of the firms as the concept of *accounting financial expertise* is, one, not well defined and, second, even if defined is full of marked differences. *"….the initial SOX promulgations recommended a fairly narrow definition of financial expertise, the final rules had a much broader definition, and neither of these definitions quite captures the idea of ''financial literacy'' that is required by the major stock exchanges",* DeFond et al. (2005). There is very little room in the proxy statements and press releases about the disclosure of director attributes including required expertise to become the member of the audit committee. Besides, the final draft of the SOX (2002) leaves discretion with the board in deciding whether a certain audit committee candidate is eligible to be called as an expert. *There is need to have a standard definition of accounting financial experts in order to make more objective and meaningful interpretations of the research findings.* Krishnan and Lee (2009) find that even though there are obvious benefits of having accounting and financial experts in the audit committee a sizeable proportion of firms do not have such experts on their audit committees.

Besides, they find that expertise of accounting and finance is mutually exclusive, in other words, it should not be presumed that an audit committee having accounting expertise would also have financial expertise (vice-versa too), either in the same person or different. A possible reason for this could be that not all firms see the benefits arising out of such expertise. The major limitation of this study is for being based on a sample taken from *Fortune* 1000 companies, therefore, it may be difficult to generalize results. *Therefore, the research question that accounting and finance expertise are mutually exclusive when assessing the quality of financial reporting can be further explored.*

Dhaliwal et al. (2006) find that firms with accounting financial experts are less likely to engage in earnings management and that this association is much stronger for firms with high corporate governance standards. Therefore, audit committee with accounting financial expertise can be viewed as an outcome of the already followed good governance practices such as board independence, minority shareholders rights protection, quality financial reporting and disclosures etc. *Similarly, a firm enjoying higher corporate governance standards can attract experienced and expert candidates seeking audit committee positions.*

Krishnan and Lee (2009) have highlighted that association between the appointment of accounting financial experts on the audit committee and quality of financial reporting must be understood in a very important theoretical premise. First, the association between the two may be based on the complementarities of various elements of pre-existing mechanism of corporate governance that help improve financial reporting and therefore create or strengthen the situations where firms appoint accounting financial experts. Second, it could be that there are no complementarities, but firms with bad governance and high litigation risk simply cannot attract accounting financial experts. *"This may suggest firms hoping to accrue benefits from appointing an accounting financial expert to their audit committees should also work on improving other aspects of their corporate governance",* Krishnan and Lee (2009).

3. Audit Committees in India

It is often argued that the auditing system in India is comprehensive and is thoroughly backed by the law in order to maintain the impartiality, objectivity and independence of statutory auditing process. Unfortunately, it has been observed over the time that the auditing system in India has become susceptible to various types of accounting manipulations, irregularities and leakages, therefore, harming the interests of investors and other stakeholders (Ganguli, 2001). There have been series of regulatory reforms undertaken to improve corporate governance in the wake of *liberalization, privatization and globalization* process started in early 1990s in India. Two major developments have been experienced with respect to the audit committees in India, one, related to the composition of the audit committees and second, to the authority of these committees to execute their decisions. The original Clause 49[12] regulations required the audit committee to have a minimum size of three and to be comprised exclusively of non-executive directors with majority of them being independent. The Clause 49 that was first notified in February 2000 required all the publicly traded companies must have the audit committee and specified its roles and functions. The revised version of Clause 49[13], notified in October 2004, but came into effect from January 1, 2006, is an updated version highlighting the role, power and functions of the audit committee. The Companies Bill (2009) has also listed down the power and functions of the audit committee which were not specified under the Companies Act of 1956[14].

The revised Clause 49 removed the non-executive director requirement and instead specified that the audit committee have a minimum of three members with two-thirds of them being independent. The Companies Bill, 2009 (will become act once passed by the parliament of India) also endorses the same provisions of the size and composition of audit committee as recognized by the revised Clause 49. The major contentious issue related to the audit committees in India is lack of *independence and power.* Very often boards overrule decisions made by audit committees, besides; audit committees have weaker position in situations where there is conflict between boards and auditors. The other issues are lack of *expertise and experience* that audit committee members must have. Sarkar and Sarkar (2010) hold that once Companies Bill, 2009 is passed by the Indian parliament, the new law would, hopefully, redress above pitfalls. Until this new law is passed by the politicians, the regulators such as Securities & Exchange Board of India (SEBI) and stock exchanges can take the lead by requiring companies to incorporate certain practices in the listing agreements which strengthen the efficacy of audit committees.

3.1 Role and Power of Audit Committee in India:

In India, Clause 49 specifies powers that audit committees can exercise including seeking outside legal advice and other professional expertise, and investigate any activity within its terms of reference. The principle role of the audit committee is to ensure the oversight of the company's financial reporting process so that financial information is objective, correct and reliable. The audit committees must provide their recommendations to their respective board for matters relevant to the appointment, re-appointment, replacement or removal of the statutory auditor. Similarly audit committees should recommend their boards in matters such as fixing fee of the statutory auditors (audit and non-audit) and approval of all non-audit services contracts.

Another very important area that audit committee in India must improve is to review, jointly with the management, periodic financial statements before they are sent to the board of directors for the approval. The subject matter of review, in particular, can be about changes in the accounting policies of the company, post-audit adjustments required to be made in the financial statements, legal and regulatory compliance pertaining to financial statements, audit qualifications, related party transactions, internal audit etc. The audit committee must communicate with management; for example when internal auditors either suspect or unearth fraudulent business practices, failure of internal control systems etc. Similarly, an effective post-audit dialogue with the statutory auditors is required in order to ascertain issues (if any) related to the financial reporting and disclosure and working out the possible corrective mechanism.

3.2 Independence of Audit Committees:

According to the Clause 49 of the SEBI[15] Act and section 158 of the Companies Bill[16] (2009), all listed companies must have an audit committee with the following characteristics of size and composition:

i. *The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors;*
ii. *All members of audit committee shall be financially literate[17] and at least one member shall have accounting or related financial management expertise[18];*
iii. *The chairman of the audit committee shall be an independent director;*
iv. *(iv)The chairman of the audit committee shall be present at the Annual General Meeting to answer shareholder queries;*
v. *The audit committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee;*
vi. *The company secretary shall act as the secretary to the committee;*
vii. *The company is required to disclose the composition of the audit committee in its director's report.*

Unfortunately, Clause 49 is not able to clarify the key benchmarks to become the member of audit committee i.e. '*financially literate'* and *'accounting or related financial management expertise'*. Such expressions are vague, open ended and subjective. In comparison, SEC[19] as per section 406 and 407 SOX (2002), has been able to lay down more structured and well defined attributes that the audit committee members must have. The companies in the US are required to disclose, when filing financial statements with the SEC, that audit committee is consisted of members having required experience and education background.

Clause 49 further requires that the audit committee of a listed company should meet at least four times in a year and the time gap between the two successive meetings should not be more than four months. The quorum of the meetings to be either two or one third of the members of the audit committee, whichever is greater, but there should be a minimum of two independent members present in order to ensure fair and objective decision making.

The directors are expected to devote certain minimum time period to the company board(s) that they serve. In situations where directors cannot spend requisite, possibly due to their multiple outside directorships in other companies, the effectiveness of the committees would be thwarted.

Section 146 of the Companies Bill (2009) fixes the maximum number of directorships that a director of a publicly traded company in India can take up to fifteen, whereas, Clause 49 restricts the number of committee memberships to ten and the number of chairmanship to five. However, no separate restrictions exist for directors serving multiple audit committees, (Sarkar and Sarkar, 2010).

3.3 Is Audit Committee Losing Independence in India?

A review of the sequence of regulations shows that there has been a steady dilution of the independence requirement with respect to the audit committee. The original Clause 49 regulations required the audit committee to be constituted of minimum three members, all of them being non-executive directors with majority of them being independent. The revised Clause 49 stipulates that audit committee should be still comprised of minimum three members and two-thirds of them being independent directors. For example, if the audit committee is made of minimum three members then the number of independent directors, as per both versions of Clause 49, would be two. The difference is of the nature of directorship of third member. As per original version the third member would be a non-executive director, but according to the revised version it may be an executive director. Therefore, the revised Clause 49 regulations of the audit committee pave the way for the company's executive directors to be part of the audit committee. As the ownership structure of Indian corporate sector is dominated by the promoter owners who already enjoy considerable clout over the corporate boards and committees, and revised Clause 49 has further widened the scope of promoters/executives to intervene, influence and override the decisions of audit committees. The Companies Bill, 2009 follows the revised Clause 49 regulations. A pertinent question arises is whether independence of the audit committee is forsaken, particularly when the executive director is the one who is '*financially literate'* and possesses *'accounting or related financial management expertise'*, but not necessarily truly independent. Therefore, there is a danger that *genius* getting misused to erode corporate wealth.

Example (Table 1): Independent Directors in the Audit Committee

No. of Audit Committee Members	No. of Independent Directors (Original Clause 49)	No. of Independent Directors (Revised Clause 49)
3	2	2
4	3	3
5*	3	4
6	4	4
7**	4	5
8	5	6
9	5	6

** For the audit committee sized 5 there would be more independent directors as per revised Clause 49 than under original Clause 49.*

*** If the audit committee size exceeds 6, the number of independent directors as per revised Clause 49 would 'always' be more than under original Clause 49. It should be remembered that not many companies would have such large audit committees as the average audit committee size in India was 3.62 (2008), as per the sample of 395 out of top 500 Indian companies (Source: Annual Reports of Companies, SANSCO).*

The managerial influence in the audit committee can also be understood in the context of regulatory developments. Section 158 (9) of the Companies Bill (2009)[20] and J.J. Irani Committee Report (2005)[21] that clearly state that board can overrule the decisions of the audit committee in the matters related to hiring, oversight, compensation, and removal of the outside auditors. This is in contrast with SOX Act (2002) implemented by SEC under Rule *10A-3*[22] which empowers audit committee to be directly responsible for *the appointment, compensation, retention and oversight* of the statutory auditor and each such statutory auditor *must* report directly to the audit committee. At the same time the *Parliamentary Standing Committee* which is examining the Companies Bill 2008, has suggested the Ministry of Corporate Affairs of India that the head of the audit committee should be a chartered accountant[23] (CPA equivalent in the USA) and independent directors representing the audit committees to be held liable[24] for actions taken by the management. This proposal, if accepted, would increase the accountability of the audit committee but at the same time would put independent directors under much strain when Clause 49 has already paved the way for the executive directors to the audit committees.

Even if not empirically tested, there is a general perception that a very significant proportion of the audit committee directors in India, though independent, are at the early stage of their directorship career, and hence they may not stand upright against managerial discretions. Similarly, if in a company such *greenhorn* independent director is also an accounting financial expert, then this would mount even more pressure on him, whereas, the other two *benchwarmer* directors would add free-rider dimension to the whole issue. As pointed out before, this area of research, in the Indian context, is almost unexplored.

It is also important to understand the independence of the audit committee in the light of independence of the overall board of directors. Clause 49 requires a board should be comprised of only one-third of independent directors when a non-executive director is the chairman. Similarly, if a board is chaired by an executive director, Clause 49 regulations require independent directors to consist of at least fifty percent of the board size. In both situations the balance of power is in favor of insiders. When cleared by the parliament of India, the Companies Bill (2009) will become act then; and will further dilute independence of the board as the current bill sets a lower limit of independent directors in the corporate boards to be one-third, regardless of the fact that board is chaired by the executive or non-executive director.

Al-Mudhaki and Joshi (2004), examine the various aspects of the audit committee such as composition, functions, the effects of meetings and the criteria used in the selection of members by Indian listed companies. Their survey shows that only 56.2 percent of companies have established a full-fledged audit committee, even though it has been a mandatory requirement under Clause 49[25]. It is further shown that only 14.6 percent audit committees were having independent non-executive directors, therefore, managerial intervention through gray directors has the potential to undermine the independence of the audit committees in India. One of the major limitations of this study is that the empirical analysis only go to the extent of establishing associations but does not further in order to determine *causal* links with the help of more comprehensive models. Similarly, the sample size studied is small.

A large number of independent directors, working in a controlled corporate culture in India, view their role principally as *strategic advisors* to the promoters, the executive boards and the audit committees (Khanna and Mathew (2010). The underlying arguments of such strategic advisory role can be derived from the *resource-dependence theory*, which advocates the role of *board capital* to contribute towards value of the firm through the human capital (experience, expertise, reputation) and relational capital (network of ties to other firms and external contingencies, and communication channels) of the directors, (Hillman and Dalziel, 2003; Dalton et al., 1999; Pfeffer, 1972). The role of strategic advisors can be performed in multiple ways viz. business experts[26], support specialists[27] and community influentials[28], (Daily and Dalton, 1994a, 1994b). The resource-dependence theory assumes a great deal of significance to the individual committees and overall board when a firm is working in highly competitive environments. Another aspect of the role of independent directors in India is their perception that they neither can, due to lack of time or resources or training, nor want, due to increased liability of directors and potential loss of amicability, to act as watchdog over the actions of promoters and executives (Khanna and Mathew (2010). According to Indian legal system, directors' liabilities[29] are not merely limited to civil actions but criminal lawsuits can also be filed against them. The collapse of Satyam, a global IT firm of India, in 2009, has proved to be a watershed in the domain of corporate regulations in India. Many researchers argue that the underlying reasons behind the collapse of Satyam have been very much same as those responsible for the infamous Enron scandal. There have been very few instances, in *pre-Satyam period*, when erring directors were actually convicted or imprisoned. However, *post-Satyam* developments have increased the perceived risk of facing legal actions in the minds of the directors. An unprecedented exodus witnessed, in the wake of Satyam scam, has been the resignations of over 620 independent directors of Indian companies in 2009, (Khanna and Mathew (2010). *Therefore, audit committee members can be under extra stress while doing their core job, and this may even deter eligible candidates to take up directorships in the audit committees.*

Conclusions

It has been found in several studies that independently functioning audit committees can enhance quality of financial reporting, and which in turn increases informativeness of financial reports as existing and potential investors react to the information conveyed through financial statements. But there are several dimensions to this association between independence of audit committee and quality of financial reporting. For example, much is required to be explored whether outside director's equity investment in the firm provides independence to the audit committees through aligning the interests of executives with those of others, or if such investments are

undertaken to enhance managerial entrenchment and exploit minority shareholders. Similarly, the role of regulators is not very clear as they advocate independent functioning of the audit committees but do not really explain how audit committees can increase quality of financial reporting, assuming that such committees have already reached threshold of minimum level of independence. In other words, regulators put more emphasis on the independence of audit committee in per se, but they do not provide clear mechanisms (e.g. frequency of committee meetings, and experience, skills and expertise of directors) which can actually improve the truthfulness and objectivity of financial reports.

Similarly, emphasis of majority of studies is exploring associative link between independence of audit committees and quality of financial reporting. Much is required to establish causal link between independence of audit committees and quality of financial reporting. The independence of audit committees is undoubtedly useful, but not costless. Therefore, when studying linkages between independence of audit committees and quality of financial reporting, costs and benefits of having independent audit committees can also be studied. Something similar to above, the extent of independence required, whether audit committees should be comprised of independent directors only or only majority of independent directors is enough, requires further analysis. Furthermore, studies exploring link between independence of audit committees and quality of financial reporting, can take into account institutional settings such as ownership structure, internal controls adopted by firms, capital market characteristics etc.

For India, the regulatory developments require to ensure that audit committee independence is of utmost importance if investors' faith is to be sustained. The recent corporate failure of Satyam, has given a jolt to the investors in general and foreign investors in particular. Amendments in the current companies act should be made without further delay in order to provide a clear message to the firms, investors and other stakeholders.

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Endnotes

1. The Securities and Exchange Commission (SEC) first recommended the establishment of audit committees comprised of non-executive board members in 1940 (Accounting Series Release no. 19). The Treadway Commission advocated the establishment of audit committees comprised solely of independent directors in their October 1987 report entitled *"Report of the National Commission on Fraudulent Financial Reporting."*
2. Klein (2000)studies two alternative corporate governance mechanisms. First, percentage of the CEO's shareholdings in the firm, duly recommended by the Blue Ribbon Committee as an effective measure of corporate governance. Second, a large non-executive block-holder (at least 5% shareholdings) in the audit committee can be a substitute to the independent director. Guiding Principles for Audit Committee Best Practices; related to key roles, communication and information flows; can be found at http://www.nyse.com/content/publications/1043269645707.html
3. Similarly http://www.nyse.com/pdfs/finalcorpgovrules.pdf highlight the final corporate governance rules of the New York Stock Exchange approved by the SEC on November 4, 2003, and meant to be codified in Section 303A of the NYSE's Listed Company Manual.
4. *Report and Recommendations of Blue Ribbon Committee (BRC) on Improving the Effectiveness of Corporate Audit Committees*, An in-depth and comprehensive report jointly published by the NYSE and the NASDAQ (including AMEX). Full report can be found on http://www.nasdaq.com/about/Blue_Ribbon_Panel.pdf.
5. Standards Relating to Listed Company Audit Committees, published by the Securities and Exchange Commission (SEC), can be found on http://www.sec.gov/rules/final/33-8220.htm.
6. . *Report and Recommendations of Blue Ribbon Committee (BRC) on Improving the Effectiveness of Corporate Audit Committees*, An in-depth and comprehensive report jointly published by the NYSE and the NASDAQ (including AMEX). Full report can be found on http://www.nasdaq.com/about/Blue_Ribbon_Panel.pdf.
7. Securities and Exchange Commission (SEC, 1999) AMEX Rulemaking: Order Approving Proposed Rule Change Amending the Audit Committee Requirements and Notice of Filing and Order Granting Accelerated Approval of Amendments No. 1 and No. 2 Thereto. Available at: http://www.sec.gov/rules/sro/am9938o.htm.
8. The Financial Reporting Council (FRC), UK, has issued *The Combined Code on Corporate Governance*, now known as *The UK Corporate Governance Code.*

9. *Guidance on Good Practices in Corporate Governance Disclosure* have been published by the United Nations Conference on Trade and Development (UNCTAD) in 2006, under the aegis of UNO, New York and Geneva.
10. *Using the OECD Principles of Corporate Governance: A Boardroom Perspective,* published by Organisation For Economic Co-Operation And Development (OECD) in 2008.
11. Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991, FDICIA has increased the power and authority of the financial corporations in laying down the requirements to become the member of the audit committee. http://www.fdic.gov/regulations/laws/important/index.html.
12. Security and Exchange Board of India (SEBI). Original Clause 49 regulations about the composition of audit committee can be found on http://www.sebi.gov.in/circulars/2000/CIR102000.html.
13. Document containing revised Clause 49 regulations can be found on http://www.sebi.gov.in/circulars/2004/cfdcir0104.pdf.
14. The Companies Act of India (1956) will continue to be the principle legal document until replaced by the Companies Bill (2009) (See 'The Economic Times' http://articles.economictimes.indiatimes.com/2011-02-21/news/28617927_1_greater-shareholder-democracy-internal-corporate-processes-companies-bill). This two part companies act can be found on http://www.mca.gov.in/Ministry/actsbills/pdf/Companies_Act_1956_Part_1.pdf and http://www.mca.gov.in/Ministry/actsbills/pdf/Companies_Act_1956_Part_2.pdf.
15. Key characteristics of size and composition of the audit committee can be seen on http://www.sebi.gov.in/circulars/2004/cfdcir0104.pdf.
16. The Companies Bill (2009), Ministry of Corporate Affairs, Government of India, is awaiting approval of the parliament. Section 158 of the bill sketches the issues related with size and composition of the audit committee. The complete document is available on http://www.mca.gov.in/Ministry/actsbills/pdf/Companies_Bill_2009_24Aug2009.pdf.
17. By *financially literate* means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows. Details are available on http://www.sebi.gov.in/circulars/2004/cfdcir0104.pdf.
18. The details of financial or accounting expertise, requisite professional certification in accounting or any other comparable experience or background are available on http://www.sebi.gov.in/circulars/2004/cfdcir0104.pdf.
19. Securities and Exchange Commission (SEC), disclosure required by sections 406 and 407 of the Sarbanes-Oxley Act of 2002. Full text of the document can be found on http://www.sec.gov/rules/final/33-8177.htm.
20. Section 158(9) states that board may not accept the recommendations of the audit committee and such non-acceptance must be disclosed with relevant reasons in the board's report as given in the annual report of the company. Refer to http://www.mca.gov.in/Ministry/actsbills/pdf/Companies_Bill_2009_24Aug2009.pdf.
21. J.J. Irani (2005) report on company law is the basis of the Companies Bill (2009). The report is available on http://www.primedirectors.com/pdf/JJ%20Irani%20Report-MCA.pdf.
22. Sarbanes-Oxley Act (2002) gives details of the audit committee's rights and responsibilities. Report available on http://www.sec.gov/rules/final/33-8220.htm.
23. "Audit committees in India have to be financially literate", *Business Today*, August 23 2009.
24. "Audit committee heads may not get protection", *Business Standard*, July 11, 2010.
25. Original Clause 49 was replaced by the revised Clause 49 in October 2004, but the latter was not in practice until January 1, 2006.
26. This type of directors includes current/retired executives of other *for-profit* organizations, and directors who serve on other large corporate boards. These directors can contribute to the firm through their expertise, knowledge and personal contacts, acquired by working as board member in other firms. For details refer to Mace, Myles L. (1971), Directors: myth and reality, *Boston, Division of Research, Graduate School of Business Administration, Harvard University*, ISBN 0875840949.
27. Support specialists provide expertise and linkages in specific, distinct and identifiable areas that provide support to the firm's strategies but do not create the basis of forging such strategies. They can provide support for senior management in areas requiring specialized expertise such as capital markets, law, insurance, public relations etc. Support specialists are differentiated from business experts as the former are equipped with specific expertise and/or ability to access and decipher information related to environmental contingencies, and therefore, are expected to assist in strengthening competitive strategy of the firm, but at the same time may not have general management experience. For example, legal and finance experts can bring much value to the firm's strategic decision making.
28. Community influential include directors who possess knowledge about or influence over important non-business organizations, and includes retired politicians, university or other institutional representatives, and officers of social organizations. Their expertise and influence, in addressing issues related to community and social groups/institutions, can help the firm to understand non-business perspectives.
29. Legal system of India does not distinguish between the liabilities of any category of directors of a company viz. executive, gray, independent.

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II

BUSYNESS OF AUDIT COMMITTEE DIRECTORS AND QUALITY OF FINANCIAL INFORMATION IN INDIA

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Busyness of Audit Committee Directors and Quality of Financial Information in India

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Abstract: The audit committees, as a part of the internal corporate governance mechanisms, play an important role to enhance the financial reporting quality. The busyness of audit committee members of a firm in boards and committees of other firms can affect its independent functioning, ceteris paribus. The current study examines, first, the association between multiple directorships of audit committee members and quality of financial reporting in India, second, whether endogenously determined busyness limits of busyness of the audit committee members provide better insights than those exogenously mandated by regulators. The study finds that endogenously determined busyness limits of sub-samples and the full sample explain the association between multiple directorships of audit committee members and financial reporting quality in a better way than those stipulated by regulators. Further, a lower (higher) level of busyness of audit committee members enhances (deteriorates) financial reporting quality of firms.

Keywords: Financial reporting quality, busyness of directors, agency theory, resource dependence theory, India, accruals, audit committee, reputational capital, extended interlocking, spline regression.

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1. Background

There is an extensive body of research exploring the association between the independence of audit committee members and the financial reporting quality (Abbott et al., 2000; 2004; DeZoort et al., 2002; Bedard et al., 2004; Raghunandan and Rama, 2007; Sharma et al., 2009; Dhaliwal et al., 2010). An important determinant of the independence of audit committees is the phenomenon of audit committee members serving on multiple boards. However, the association between the independence of audit committee members and the financial reporting quality is relatively less researched (Sharma and Iselin, 2012). In the current study I explore, first, the association between the phenomenon of multiple directorships (also referred as 'busyness' in the current paper) of audit committee members and the financial reporting quality, measured by the discretionary accruals, by analyzing data of Indian publicly traded corporates, categorized as local private, foreign and government owned firms; second, whether endogenously determined cut-off points/nodes of busyness, incorporating firm ownership characteristics, provide better insights when compared with the exogenous limits of busyness mandated by the regulator in India; and lastly, whether the *nature* of busyness also affect the financial reporting quality along with the *number* of it.

The current study derives its theoretical foundations from the agency, and resource dependence theories. An argument following from the agency theory is that an increased busyness level of the audit committee members of a firm on boards and committees of other firms can create paucity of time and focus, which are necessary ingredients to perform highly specialized tasks related to the audit committee, including ensuring objectivity and truthfulness of financial statements; and consequently financial reporting quality may deteriorate (Ferris et al., 2003; Sharma and Iselin, 2012). An alternative argument following from the resource dependence theory is that the multiple directorships of audit committee members of a firm underscores their high levels of reputational capital, which these directors acquire through their human capital and relational capital. Therefore, it may be argued that when busy directors join the audit committee of the firm, then such directors, due to the amount and diversity of their accumulated experience, skills, knowledge, among other things, can understand financial health of the firm and effectively monitor managerial actions and resultantly the quality of financial reports can increase (Pfeffer and Salancik, 1978; Hunton and Rose, 2008; He and Yang, 2014). Major contributors to the human capital are education, experience, skills, training and expertise of directors; whereas those to the relational capital are network of ties with other organizations and external contingencies accumulated over time (Hillman and Dalziel, 2003). In the current paper, the human capital and the relational capital put together is termed as *the reputational capital* of directors.

In the post-Sarbanes-Oxley (SOX) environment, there has been a significant increase in corporate governance responsibilities and liabilities of boards of directors in many countries including India (MCA, 2013). Similarly, there has been a significant increase in the responsibilities of audit committee members, particularly in the context of oversight of financial reporting process, monitoring of managerial actions, internal audit and control system, auditors' selection and rotation, transparency regarding audit and non-audit services (NAS) fees, auditors' independence, and performance evaluation and issues related to whistle-blowers (Sharma and Iselin, 2012). At the same time, the amount of scrutiny and monitoring that the audit committees invite from regulators, analysts, institutional investors, and other capital market participants have also increased unprecedentedly (Sharma and Iselin, 2012). The section 177 of the Companies Act of India (MCA, 2013) has expanded the scope of responsibilities of the audit committees in India,

and currently an audit committee is also required to give its recommendations on the matters related to appointment of auditors and monitor their independence and performance, approve related party transactions, and scrutinize inter-corporate borrowings and investments.

According to the clause 292A of the Indian Companies Act of 1956 (MCA, 1956), a public company having a paid-up capital not less than fifty million rupees must have an audit committee comprised of at least three directors and two-thirds of its directors to be non-executive. The Section 275 of the above law also required limiting maximum number of directorships in the publicly traded firms to fifteen, which was later increased to twenty. Nevertheless, there were many ambiguities, and exceptions in the law and directors could easily exceed their number of directorships over twenty (Hundal, 2013). The Securities and Exchange Board of India (SEBI), the principal financial regulator of India, recognized in the clause 49 of the listing agreement between a firm and a stock exchange in India that in order to improve quality of financial reporting, it was important to enhance the independence of the audit committees by changing their composition (SEBI, 2000). The clause 49 required an audit committee to have a minimum size of three and comprised exclusively of non-executive directors with majority of them must be independent directors. However, the revised clause 49 excluded the requirement of the non-executive directors and instead stipulated that the audit committee must have a minimum of three members with two-thirds of them to be independent directors (SEBI, 2004). A significant regulatory development witnessed in year 2013 has been the approval of the Companies Act of India by the Indian parliament, and now this new law requires an audit committee to have a minimum of three directors with independent directors forming a majority. Furthermore, the Companies Act 2013 removed the requirement of the independent director to chair the audit committees. An insight appears from the above mentioned regulatory developments that several revisions have actually paved the way for executive directors to become chairs and members of audit committees in India. In promoter dominated corporate settings, such developments can put even more pressure on the independent functioning of audit committees. Regarding the multiple directorships, the section 165(1) of this newly introduced regulation states that, "No person, after the commencement of this Act, shall hold office as a director, including any alternate directorship, in more than twenty companies at the same time: Provided that the maximum number of public companies in which a person can be appointed as a director shall not exceed ten" (MCA, (2013), 97).

In the current paper I have applied the spline regression technique (see Ahlberg et al., 1967; De Boor, 2001) in the empirical analysis in order to endogenously determine cut-off points of multiple directorships from three to ten. Sarkar and Sarkar (2012) argue that since three directorships is the recommended number of outside directorships in the US, many empirical studies even in the non-US settings have also taken three directorships as a measure of busyness. This is a major limitation observed in the extant literature. The range of busyness in the current paper ends at ten, as this is the maximum number of directorships that a corporate director can take up according to the section 165(1) of the Companies Act of India (MCA, 2013). In order to recognize differences in corporate institutional settings among firms based on their ownership structure, the full sample is categorized into three sub-samples, that is local private, foreign and government firms. It is noticeable that after the economic policy of liberalization was initiated in 1991, Indian corporate sector has witnessed remarkable expansion of the private sector, which can be further categorized as local private and foreign firms, however, at the same time the government sector is still maintaining its traditional dominance (Sarkar and Sarkar 2012). This is the reason for doing empirical analysis by

taking three sub-samples as well as full sample, as the phenomenon of busyness can affect different firms differently.

For the sub-samples and full sample, the busyness of audit committee members adversely affects the financial reporting quality at a lower level of busyness, although at different cut-off points, than those specified by regulator. Similarly, the foreign, local private sector firms, and the full sample firms experience improvements in the financial reporting quality only at the lower level of busyness. The intensity of busyness affects the financial reporting quality of the government, local private firms and full sample unfavorably at a relatively higher level of audit committee members' busyness, whereas, the favorable effects occur only to the foreign firms, albeit, at a lower level of busyness.

The current paper makes several contributions to the extant literature, first, the endogenously determined busyness limits explain the association between the multiple directorships of audit committee members and the quality of financial reporting better than those exogenously prescribed by regulators; second, despite applying the endogenous limits of busyness in the analysis for the full sample and sub-samples, the results reveal that 'one size does not fit all', that is the cut-off points of busyness, highlighting the optimum level of busyness for the different ownership groups, are not uniform across sub-samples; third, along with the number of multiple directorships of the audit committee members, the nature of multiple directorships also affects the financial reporting quality; and lastly, the current paper is one of the few studies in the settings of an emerging economy, such as India, and the findings of this paper can be useful for countries having comparable corporate landscape.

The remainder of the paper is divided into the following sections: prior literature and hypotheses development, research design, empirical findings and discussion and conclusions, and future research.

2. Prior Literature and Hypotheses Development

After witnessing a series of corporate failures, notably Enron, at the beginning of the 21st century, the Securities and Exchange Commission (SEC, 2002) of the USA placed additional emphasis on revamping internal corporate governance system, particularly audit committees, in order to improve quality of financial reporting, and increase accountability of firm decision makers. Even before corporate failures, the Blue Ribbon Committee (BRC) advocated making the audit committees more effective and powerful, in order to ensure that firm managements would adopt and follow a sound system of internal controls and procedures, assess managerial actions objectively through various reviews, and disclosures and make truthful assessment of financial reports (BRC, 1999).

The audit committee is one of the various internal corporate governance mechanisms, and its principal objective is to ensure that the financial statements and disclosures are prepared according to the legal requirements and accounting standards, in order to portray a comprehensive and true picture of the financial health of the firm (Sarens and Abdolmohammadi, 2011). The audit committee ensures fairness of financial information, and promotes a culture of accountability within the organizational structure of firms (BRC, 1999). The audit committee "…helps to ensure that management properly develops and adheres to a sound system of internal controls, that procedures are in place to objectively assess management's practices and internal controls, and

that the outside auditors, through their own review, objectively assess the company's financial reporting practices" (Standards Relating to Listed Company Audit Committees, (2003), 69).

The audit committee interacts with the external auditors and firm managements in order to perform its core functions. To overcome any possible *collisions* between the two, the audit committee ensures that the firm managers provide all the relevant documents and other information to external auditors in order to check the authenticity of financial data. Similarly, to avoid any possible *collusions* between the external auditors and the firm managers, the audit committee recommends the scope of the auditing services, the amount of audit fees and the NAS engagements between the firm and external auditors (Antle, 1982; Sarkar and Sarkar, 2012). Antle (1982) argues that collusions between the firm managers and the external auditors can lead to another dimension of the agency theory called two-agent model, whereby, an agent (manager) hires another agent (external auditor), theoretically, to enhance the credibility of information, however, in reality, both agents are able to collude in order to enhance and protect their personal interests, and therefore, inflict the agency costs on the firm. The verification done by the external auditors provides legitimacy to the financial information provided by the firm managers; however, the independence of implementation of this process can be questioned due to managerial interventions and business interests of mangers and auditors.

The audit committee can perform its functions efficiently, when it is able to operate independent of managerial influences (DeZoort et al., 2002). According to the BRC, "Members of the audit committee shall be considered independent if they have no relationship to the corporation that may interfere with the exercise of their independence from management and the corporation" (BRC, (1999), 10). The SOX (2002) mandates an audit committee to be exclusively comprised of independent directors, and it directs the national securities exchanges and the national securities associations to prohibit the listing of firms that do not comply with the audit committee requirements of independence.

An important determinant of the independence of the audit committee of a firm is the number of directorships (boards and committees) taken up by its members in other firms. It can be postulated from the agency theory (Jensen and Meckling, 1976) that a firm by inducting independent directors on an audit committee can ensure objectivity, truthfulness and fairness of its financial reports. Nonetheless, as the number of outside directorships of the audit committee members of a firm increases, their effectiveness to review financial statements may diminish and as a result quality of the financial data may deteriorate (Sharma and Iselin, 2012; Ferris et al., 2003). The busyness of the audit committee members can adversely affect quality of financial reporting in two ways. First, busy audit committee members may not have enough time to verify truthfulness and fairness of financial reports. There is no denying the fact that specialized skills, knowledge, and experiences of audit committee members are important determinants of the quality of financial reporting, however, such *virtues* can be of little value if the audit committee members become overcommitted by taking up multiple directorships and as a result do not have sufficient time to effectively monitor, and oversight financial reporting process (Jiraporn et al., 2009; Ahn et al., 2010). Tanyi and Smith (2015) oppose additional directorships accepted by the audit committee members of a firm, because in the post-SOX scenario the responsibilities of audit committee members have substantially increased, therefore, additional directorships can inhibit the audit committee members to perform their stipulated responsibilities. To supplement their argument, Tanyi and Smith (2015) provide evidence that the average number of times an audit committee

holds its meetings in a year has increased from 3.2 in 1998 to 8.2 in 2004 (Linck et al., 2009) and audit committee's per meeting duration that used to be ninety minutes in the pre-SOX period has risen to five hours in the post-SOX era (Beasley et al., 2009).

Second, when monitoring the financial reporting process, the busy audit committee members may not pay attention to certain strategic aspects and such omissions can be harmful to the firm. Financial reporting is not an end in itself, as it plays important roles in the formulation, implementation, reviews, and revisions of corporate policy, planning, and strategies and decision making, among other things. Generally, the process of receiving and processing information, followed by actions based thereon pertaining to a given task, restricts the similar process with respect to other tasks due to scarcity of attention (Kahneman, 1973; Eysenck and Keane, 1990; Fiske, 1995). Similarly, it can be posited from the above statement that when the audit committee members of a firm are serving on boards of other firms, they may experience lack of attention, and as a result they neither have in-depth understanding of financial reports nor draw inferences about the interplay between the key financial characteristics/results and other aspects of firms. Due to lack of attention of audit committee members, not only quality of financial reports is compromised but even further, such reports lose their utility in the corporate policy, planning and decision making. Tanyi and Smith (2015) find that the financial reporting quality of firms deteriorates when their audit committee chairpersons and financial expert members are busy. Above finding underlines that *busy experts* of audit committees may find it difficult to focus on their key tasks and as a result the financial reporting quality declines. Similarly, based on the analysis of a large sample of Australian firms, Méndez et al. (2015) find that increased busyness of the audit committee members of a firm limits their capacity to monitor managerial actions, and effectiveness to implement internal control mechanisms, which lowers the quality of financial reports. The above study further finds that busyness of directors at the overall board level is associated with disproportionately higher CEO remuneration, and lower pay-performance sensitivity.

He and Rong (2014) give empirical evidence that the audit committee members in regulated firms have fewer directorships in other firms in comparison to their counterparts in unregulated firms. Following reasons can be postulated why audit committee members in regulated firms have fewer directorships in other firms, first, regulated firms are larger in size, and more complex business organizations, therefore, the audit committee members do not have much time and other resources to take up additional directorships in other firms beyond a certain level, and second, the audit committee members of regulated firms, generally, have longer tenure of affiliation due to certain firm specific characteristics of regulated firms. The audit committee members invest relatively more time and efforts in understanding the complexity and other dynamics of the regulated firms, and these firms find it difficult to find replacement of such members, who become privy to several firm specific characteristics. He and Rong (2014) provide empirical support to above arguments as they find lower level of earnings management practices at the lower level of the busyness of audit committee members in regulated industries.

A counter argument to the above follows that despite serving on multiple firm boards and committees, the audit committee members can still ensure the quality of financial reporting, because firms that appoint them in the audit committee can also provide them with the subordinate staff, and other related services so that the audit committee can still perform its core tasks efficiently; nonetheless, *too busy* audit committee directors can find it difficult to coordinate their multiple tasks, and crosscheck whether accountants have followed compliance with respect to the

accounting standards, and legal requirements. The potential loss of reputation and litigation risks can act as deterrents to the audit committee members of a firm from taking too many directorships in other firms (Skinner and Srinavasan, 2012).

In a country like India, promoters including individuals and firms, occupy a pivotal place with respect to the ownership, and control structure of firms (Sarkar and Sarkar, 2012; Khanna and Mathew, 2010). Based on the study of Hermalin and Weisbach (1998), it can be argued that in a corporate ownership structure, which is dominated by business groups, similar to that of India, the powerful CEOs may handpick and appoint those audit committee members of the firm on boards of other group-affiliated firms, who are, generally, loyal to them and poor monitors, in order to consolidate their position. Such phenomenon, known as interlocking, gathers even more relevance in a country like India, where a director can join as many as ten boards of directors of listed companies (MCA, 2013). It can be posited from the agency theory that if promoters follow the above mentioned maneuver of interlocking, then a likely by-product may emerge in the form of lower monitoring of managerial actions and consequently lower quality of the financial reports. Furthermore, the phenomenon of *'extended interlocking'* can also be observed with the auditor joining *the trio* including promoters, executives and audit committee members of the firm. In this arrangement of extended interlocking, the promoters, who have substantial control over firm executives, may appoint their favorite audit committee members on the multiple firms in the business group, and their social ties gets further fillip with the inclusion of auditors of their choice. Johansen and Pettersson (2013) find that in the interlocked relationship audit committee members and promotors generally employ the same audit firm in the business group firms. The increasing familiarity between the participants of the extended interlocking can result in lesser monitoring of managerial actions and diminishing credibility of audit quality, which can result in lower financial reporting quality.

In several countries, regulatory provisions, such as Section 177(4) of the Companies Act of India 2013, provides for explicit approval of audit committees in the matters pertaining to appointment, reappointment, and remuneration of external auditors (MCA, 2013). Such economic dependence of audit firms is capable of bringing them closer to the audit committees, who are assumed to be already in the influence of the promoters. Furthermore, an audit committee is also supposed to monitor auditor performance, and give its approval before the public release of financial statements of the firm. Nonetheless, based on some studies (e.g., Chen et al., 2014), it can be expected that in an extended interlocking system, the level of diligence, and oversight applied by the audit committees, in order to check the auditor performance, may be weaker. In several empirical studies, including that of Zang and Emanueal (2008), the proportion of the non-audit revenue to total revenue earned by the auditor from a client firm is used as a measure of extended interlocking. Based on the above discussion following hypothesis is tested:

H_1: Multiple directorships of the audit committee members unfavorably affect quality of information (agency theory).

However, according to an alternative argument, backed by the resource-dependence theory, directors of a firm can perform their core responsibilities efficiently if they have a high quality of human capital (experience, expertise, skills) and relational capital (network of ties to other firms, external environment and external contingencies) of such members (Pfeffer and Salancik, 1978;

Pearce and Zahra, 1992; Hillman and Dalziel, 2003). In the current paper, I have named the sum of the human capital and the relational capital as *the reputational capital*. In particular, the audit committee functions require specialized skills, experience, and expertise, and also interactions with the external environment; therefore, it can be maintained that the phenomenon of busyness can provide a platform to audit committee members whereby they can update and enhance their reputational capital. Fama and Jensen (1983) hold that similar to that of firms; reputation carried by directors in the labor market of corporate directors is highly significant. Accordingly, it can be argued that among other determinants the phenomenon of multiple directorships facilitates the audit committee members to enhance their reputational capital in the market of corporate directors. Several studies provide empirical support for the claim that the audit committee members, serving on multiple boards, experience increase in their reputation (Vafeas, 1999, 2001; Perry and Peyer, 2005).

Vafeas (1999) considers multiple directorships as a proxy for the reputational capital of board/committee directors, which is earned and accumulated over a period of time; therefore, such directors have the fear of losing their reputational capital due to regulatory actions, and adverse market reactions in the event of their negligent behavior, and poor performance (Watts and Zimmerman, 1983; Ball, 2009). For example, when a regulator identifies some errors and accounting standards violations, and asks the firm to make necessary rectifications in the financial statements issued by it, then the audit committee members of such firm are not only highly likely to relinquish their audit committee seat in the firm but are also less likely to receive invitations to join boards and committees of other firms. Similarly, it can be inferred, based on the findings of Helland (2006), that the labor market of corporate directors rewards those audit committee members with additional directorships, who detect/prevent financial frauds.

It is further reasoned that in order to perform their roles and responsibilities objectively non-executive board members, in general, and audit committee members, in particular, are not expected to collude with the firm management. For audit committee members, in order to play their role in ensuring fairness and truthfulness of the financial reporting process, it is very important to have the attitude of skepticism. It is conjectured that when audit committee members of a firm have directorships in other firms, they have less dependence (for example, meeting fees) on a particular firm, therefore, busy audit committee members are more likely to maintain *arm's length* distance from the firm executives and enhance their reputation (Kaplan and Reishus, 1990). The audit committee members, holding multiple directorships, are relatively more concerned of the potential litigation risk, and erosion of their reputation in the event of detection of financial errors/frauds. Such high stakes are capable of bringing the behavioral aspects of audit committee members in the forefront, as they may *self-impose* a system of compliance, skepticism, diligence and monitoring, which may be even more stringent than the statutory requirements, in order to ensure that financial statements are true, objective and unbiased (Sharma and Iselin, 2012; Skinner and Srinavasan, 2012). Sharma and Iselin (2012) further posit that some audit committee directors, owing to their higher reputation capital, symbolized by multiple directorships, can be relatively upfront in demanding the required information and unobstructed communication with external auditors, and other components of internal corporate governance system, from the firm management. Therefore, multiple directorships may enhance effectiveness of the audit committee, resulting in increased informativeness of financial data. He and Rong (2014) find that for firms functioning in unregulated industries, there is an inverse relationship between additional directorships of their audit committee members and earnings management practices.

It is further argued that since regulators and professional bodies require the audit committee members to have specialized qualifications, experience, and expertise, therefore, such requirements make them 'scarce resources'. Sarkar and Sarkar (2012) have highlighted that the phenomenon of busyness of audit committee members can be a solution to the problem of scarcity of managerial talent. Similarly, it can also be posited from the resource dependence theory that the interlocking mechanism used by a firm's promoters can bring various benefits to it. By appointing the audit committee members of a firm on other boards within a business group, promoters can make efficient utilization of their managerial resources and thus offset the deficiency of managerial talent, which is a big limiting factor in a country like India (Sarkar and Sarkar 2012).

Similar arguments can also hold true for the extended interlocking arrangement. It may be possible that firm auditors and promoters develop difference of opinion, for example, on the matters pertaining to the financial reporting compliance; however, in such situation the audit committee can mediate between them and diffuse any potential conflict (Chen et al., 2014; DeZoort et al., 2003). Similarly, due to their finance and accounting background, both education and professional, first, the audit committee members of a firm can be more effective in helping auditors to develop understanding regarding various firm specific characters, and second, auditors can explain their audit policy to the audit committee members in a more meaningful manner. Such cooperation between the audit committee members, and auditors may result in the latter experiencing lesser pressure to perform their core responsibilities and also building trust between the auditors and the firm. The following hypothesis, based on the favorable effects of the busyness of audit committee members, is tested.

H_2: Multiple directorships of the audit committee members favorably affect quality of information (resource dependence theory).

When studying the association between the multiple directorships of the audit committee members and the financial reporting quality, it is also important to consider the nature of busyness along with its number. The amount and complexity of workload is relatively higher when corporate directors are members of specialized committees, for example, audit, committee and compensation committee. Ferris et al. (2003) highlight that higher compensation can motivate directors to accept committee memberships in other firms, and such directors may find it difficult to perform the tasks entrusted to them. Tanyi and Smith (2015) and Méndez et al. (2015) also show similar findings.

H_3: High intensity of busyness unfavorably affects the quality of financial reporting.

It is important to study the association between busyness of audit committee members and financial reporting quality in the light of ownership structure of firms. The equilibrium level of busyness depends on multiple firm-specific characteristics, requirements, and objectives, therefore, the limits to audit committee members' busyness should be determined endogenously (Demsetz and Lehn, 1985). Several other studies (e.g. Hermalin and Weisbach, 2003; Tanyi and Smith, 2015) find empirical evidence to support the above argument that the optimum board/committee structure is endogenously determined as it is sensitive to institutional settings of the firm and prescribed exogenous limits by the regulator are less effective in enhancing financial reporting quality.

3. Research design

3.1 Sample size and data

The analysis of the current paper is based on a final sample of an unbalanced panel of 3733 firm-years of non-financial publicly traded companies listed on the Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) over the period of 2004-12. The full sample of 3733 firm-years is further divided into sub-samples of firms categorized on the basis of their ownership including 2376 local Indian private, 772 government and 585 foreign[1] firm-years. The initial dataset contained 5386 firm-years, however, 701, 505, and 447 firm-years observations pertaining to Indian private, government, and foreign firms, respectively, were lost due to non-availability of the data. The major unavailable data in the corporate governance reports were details about busyness of audit committee directors (628 firm-years), and financial expertise (242 firm-years) of the chairperson of audit committees. Similarly, in the financial statements, major omissions of the data were pertaining to expenditure on the NAS (272 firm-years), research and development (234 firm-years), and advertisement (277 firm-years).

The data have been obtained from Prowess database, a proprietary of the Center for Monitoring the Indian economy (CMIE). In addition to the data obtained from Prowess, information on accounting indicators, equity ownership, stock market variables, and other firm characteristics for analysis, have been obtained from, annual reports of firms, particularly financial statements and corporate governance reports, the SEBI, the BSE and the NSE.

3.2 Empirical methodology and constructs

The definitions, and measurement issues related to explained, and explanatory variables are discussed below-

3.2.1 Performance variables

Earnings management practices, carried out by a firm, determine its quality of accounting information. In this paper, I have used discretionary accruals as a proxy of the magnitude of earnings management, hence, quality of accounting information. Discretionary accruals are obtained by subtracting non-discretionary accruals from total accruals. Non-discretionary accruals are estimated by using a regression model that regress total accruals on several explanatory variables.

In the current paper, I have used discretionary accruals as a measure of earnings management (Bedard et al., 2004).

Discretionary accruals are measured by applying model given by Jones (1991).

$$DA_{it} = TA_{it}/A_{it-1} - [\alpha_1 (1/ A_{it-1} + \alpha_2 (\Delta REV_{it}/A_{it-1}) + \alpha_3 (PPE_{it}/A_{it-1}) + \varepsilon_{it}]$$

DA_{it} = Discretionary accruals of i^{th} firm in t^{th} (current) period

[1] Foreign firms also include those established by the Non-resident Indians (NRIs).

TA_{it} = Total accruals of i^{th} firm in t^{th} (current) period. Total accruals are measured by subtracting cash flows from operations from net income before extraordinary items
A_{it-1} = Assets of i^{th} firm in $(t-1)^{th}$ (previous) period
ΔREV_{it} = Change in net sales of i^{th} firm in t^{th} (current) period
PPE_{it} = Gross value of Property, plant and equipment of i^{th} firm in t^{th} (current) period
$\mathcal{E}_{it}$ =*Error term*

Jones' (1991) expectation model is used to measure non-discretionary accruals as below:

$$TA_{it}/A_{it-1} = \alpha_1 (1/ A_{it-1}) + \alpha_2 (\Delta REV_{it}/A_{it-1}) + \alpha_3 (PPE_{it}/A_{it-1}) + \varepsilon_{it}$$

The term $[\alpha_1 (1/ A_{it-1} + \alpha_2 (\Delta REV_{it}/A_{it-1}) + \alpha_3 (PPE_{it}/A_{it-1})]$ represents the estimated value of the term TA_{it}/A_{it-1}. Jones (1991) argues that the terms PPE_{it} and ΔREV_{it} signify changes in nondiscretionary accruals caused by changing economic environment. Change in revenue affects change in working capital, which, in turn affects TA. Revenue is exogenous as it reflects economic realities; therefore, one may argue that revenue is an objective measure of corporate performance. Nonetheless, according to an alternative argument revenue can be endogenous too, for example managers have strong motivation to overstate/understate revenue in accordance to their own utility function (Marciukaityte and Szewczyk, 2011).

The term PPE_{it} in the expectations model controls for the proportion of total accruals arising due to nondiscretionary depreciation expense. The rationale for using gross value of property, plant, and equipment instead of change in it is that total depreciation expense is included in the total accruals measure. Similarly, all terms in the accruals expectations model are scaled by lagged assets in order to lessen heteroscedasticity (Jones, 1991). The difference between actual and estimated values of TA_{it}/A_{it-1} denotes discretionary accruals.

Total accruals are calculated as the change in non-cash working capital before income tax payable less total depreciation expenses. Jones (1991) provides a formula of deriving total accruals as below:
TA_t = [ΔCurrent $Assets_t$ - $\Delta Cash_t$] - [ΔCurrent $Liabilities_t$ - ΔCurrent Maturities of Long-Term $Debt_t$ - Δincome Taxes $Payable_t$ - Depreciation and Amortization $Expense_t$. The change (Δ) is computed between time periods t and t - 1.

Jones (1991) highlights that estimated TA as given in the expectation model represents normal accruals, therefore, the total amount of accruals has been taken in the model as against change in total accruals.

3.2.2 Busyness variables

Following three busyness variables are below:
1. Spline 1 Directorships (Spline-1),
2. Spline 2 Directorships (Spline-2),
3. Median Committee to Board Size (Comm-BS)

The spline regression technique overcomes the limitation of using an exogenously determined cut-off point of busyness. In this technique, changes in the slope at two pre-determined specific points, known as spline knots/nodes/cut-off points, are endogenously determined (Ahlberg et al., 1967).

Busyness is measured as the audit committee level median of total directorships (board plus committees); hereafter referred as median directorships, showing the number of outside directorships held by majority i.e. fifty percent of the audit committee. Spline nodes range between three to ten directorships taken up by directors. The range starts with 'three' directorships as majority of empirical studies in the US, and even in non-US settings, take three directorships as a measure of busyness. The range ends with ten as this is the maximum number of directorships that a corporate director can take up according to the section 165(1) of the Companies Act of India (MCA, 2013). Also, the Act does not distinguish between board and committee memberships.

The spline coefficients are calculated as suppose the financial reporting quality (dependent variable) is a function of busyness (independent variable), then 'x' is the observed audit committee level median directorship and the above mentioned functional relation is estimated at different endogenous spline knots/nodes/cut-off points. The Spline-1 and the Spline-2 can be defined as below:

Spline-1 = x, if $x < x_1$
= x_1, if $x \geq x_1$

Spline-2 = 0, if $x < x_1$
= $(x-x_1)$, if $x \geq x_1$

1. Spline-1- This coefficient of the Spline-1 variable at j^{th} (j varies from 3 to 10) node/limit shows the effect of audit committee level median directorships (x) below a given node/limit (x_1) on the discretionary accruals. A positive coefficient implies that when the audit committee level median directorships are even less than a given endogenous node/limit, the busyness of directors at the given level is associated with increasing discretionary accruals, signifying decline in the quality of accounting information. Here, the underlying assumption is that busyness of directors of an audit committee beyond a certain limit can inflict agency costs on the firm.

2. Spline-2- This coefficient of the Spline-2 variable at j^{th} (j varies from 3 to 10) node/limit shows the effect of audit committee level median directorships (x) at and above a given node/limit (x_1) on the discretionary accruals. A negative coefficient implies that when audit committee level median directorships exceed a given node/limit, the discretionary accruals diminish, and the quality of accounting information improves. Here, the underlying assumption is that the busyness of directors of an audit committee beyond a certain limit can actually improve the quality of information due to their enhanced reputational capital.

3. Median committee to board size (Median committee-board size)- This is a measure of the intensity of busyness. It may be posited that when an audit committee member of a firm serves on specialized committees, such as audit committee, remuneration committee, and nomination committee, of other firms then it is expected that the audit committee member will find his/her workload more than when he/she accepts the same number of positions on *the general* board of directors. The findings of Tanyi and Smith (2015) and Méndez et al. (2015) provide empirical support to the above argument. This firm level measure is equal to the median committee

directorships undertaken by the audit committee members of a firm, scaled by the board size. The expected sign of the coefficient of this variable can be negative (resource dependence argument) or positive (agency theory argument).

3.2.3 Corporate governance variables
The following corporate governance variables are included in this paper:

1. Board size- Dalton et al. (1999) and Goilden and Zajac (2001) highlight that board size affects firm performance favorably. The larger boards are more likely to have more and diverse reputational capital, and experience effective monitoring and control, which may result in higher quality of financial reporting process. On the other hand, Jermias and Gani (2014) and Guest (2009) find that it is relatively easier for the CEOs of firms having larger boards to influence outside directors and win their loyalty. Therefore, it can be assumed that firms with larger boards have lower quality of financial reporting. In the current study log values of board size are taken in order to avoid linearity, and no sign of the coefficient of the board size is predicted.

2. Independent directors proportion- The independent directors of a firm have a strong motivation to monitor the firm management in order to enhance their reputational capital in the labor market of corporate directors. *'Like board, like committees',* implies that if a board of directors is relatively independent then it is more likely to induct independent directors in the committees too. Donnelly and Mulcahy (2008) find that an independent board itself plays an important role in reducing the information asymmetries between owners and managers. It is predicted that such board through its actions, and cooperation with the audit committee, can improve the quality of financial reports. This variable is calculated as the ratio of the number of independent directors to the board size of a firm. The squared values are taken in order to minimize the linearity problem, and the predicted sign is negative.

3. Audit committee chairperson financial expertise (AC chair expertise)- The role of the chairperson of an audit committee is highly demanding. In the post-SOX scenario this role has increased manifolds. One of the most important objectives of an audit committee is to ensure that financial reporting quality and internal risk management is of the highest order, and in order to achieve this objective efficiently the chairperson of an audit committee is required to spend a large amount of time and attention. Tanyi and Smith (2015) underscore that the workload of an audit committee chairperson is substantially higher than an ordinary member of the same committee. The SOX Act (2002) requires that a firm must disclose in SEC filings that its audit committee chairperson and other committee members fulfil the education criteria in the field of finance. Several studies give empirical evidence that an audit committee chairperson, who has education in the field of finance and accounting, can perform such a challenging job in a more efficient manner. Abbott et al. (2004) and Bedard et al. 2004) find that firms having audit committees chaired by financial experts, experience less earnings management, and accounting restatements. In the current paper, this variable is a binary with the value '1', if the chairperson of the audit

committee has financial/accounting qualification, '0' otherwise. The predicted sign of this variable is negative.

4. Debt-equity ratio- The principal-agent problem also exists between debt holders and management (Jensen and Meckling, 1976). Sarkar and Sarkar (2012) hold that in India debt plays an important place in the capital structure of firms. Therefore, a firm board in order to have cordial relationship with its debt holders, especially banks, can strengthen its internal control system, particularly by inducting more independent members in the audit committee. An independent audit can play an important role in increasing the reliability of the accounting numbers and mitigating monitoring costs of debt holders, therefore, the firm can obtain more debt at competitive terms (Sarens and Abdolmohammadi, 2011). Therefore, a negative association can be predicted between leverage and discretionary accruals. In the current paper, leverage is measured as a ratio of total value of debt to total market value of outstanding equity capital.

5. Ratio of NAS revenue to total revenue of auditor- The current paper takes this ratio as the measure of extended interlocking. The section 139 of the Companies Act of India (MCA, 2013) disallows auditors to perform several types of NAS for their client firms (also subsidiaries and holding companies), including accounting and book keeping, investment advisory/banking, and internal audit services. However, there are several other types of services that audit firms can still do for their client firms. In the extended interlocking relationship, the audit committee members, and promotors often employ the same auditor in various firms in the business group (Johansen and Pettersson, 2013). The audit committees, executive directors and promoters of the client firms may prefer their audit firms to do the NAS too. However, a rising ratio of the NAS revenue to the total revenue of an auditor earned from a given client firm may also underpin diminishing independence of audit committee, weaker monitoring and control of managerial actions and lower quality of financial reports (Simunic, 1984; Beck et al., 1988). Zang and Emanueal (2008) find that when the relative share of NAS revenue to total revenue that an auditor earns from the client firm increases, it may imply that economic interests of an auditor are highly ingrained in the firm, and resultantly the auditor is less likely to challenge earnings management actions of managers. The predicted sign of this variable on firm performance is positive.

3.2.4 Firm Level Control Variables

In order to control for firm specific characteristics, the following variables have been added to the model:

1. Research and development (R&D) intensity and 2. Advertisement intensity- Among control variables, research and development intensity and advertisement intensity are calculated by dividing respective expenditure on both items by sales revenue. These two variables are measures of firm growth as well bonding costs of managers (Ang et al., 2000; Easterbrook, 1984). Bonding costs are a part of agency costs, and are costs incurred by the agent in order to reflect his commitment to the firm. Such costs may also be incurred in order to give positive signals to investors and expect positive reaction of stock market (Jensen and Meckling, 1976). The predicted sign of both variables is negative.

3. Trade intensity- Trade intensity shows how actively equity shares of a firm are traded in the stock market. This variable is calculated by dividing the number of shares traded by the total number of shares outstanding. Firms having active stocks are less likely to do earnings management as such action can invite stock market ire (Fan and Wong, 2002). The predicted sign is negative.

4. Market-capitalization- Firm size is measured by market-capitalization (log values). Market-capitalization is obtained by multiplying the market value of a share by the number of shares outstanding, at the end of the year. Big sized firms are less likely to use earnings management practice due to potential loss of reputation (Carey and Simnett, 2006). The predicted sign is negative.

The ordinary least square (OLS) regression technique is used to estimate the following functional relationship of the model:

$$DA_{it} = \alpha_{it} + \beta_1(\text{Spline-1})_j^2 + \beta_2(\text{Spline-2})_j + \beta_3(\text{Median committee-board size})_{it} + \beta_4(\text{Board size})_{it} + \beta_5(\text{Independent directors proportion})_{it} + \beta_6(\text{AC chair expertise})_{it} + \beta_7(\text{R\&D intensity})_{it} + \beta_8(\text{Advertisement intensity})_{it} + \beta_9(\text{Trade intensity})_{it} + \beta_{10}(\text{Debt-Equity ratio})_{it} + \beta_{11}(\text{Market-capitalization})_{it} + \beta_{12}(\text{NAS to total revenue of auditor})_{it} + \text{error term}$$

4. Empirical findings and discussion

From table 1 it can be noticed that the predicted sign of α_2 is positive, because the working capital is expected to increase with the increase in the sales revenue. Similarly, the predicted sign of α_3 is negative; because a higher amount of fixed assets produces higher depreciation expenses and deferred taxes, and as a result total accruals, measured by subtracting cash flows from operations from earnings before extraordinary items, decrease (Klein, 2002). From table 1, it can be seen that the expected and the realized coefficients have same signs. Nonetheless, α_2 and α_3 are significant for the full sample and sub samples, except for the sub sample of government owned firms. This finding indicates that the local private and foreign firms, in India, have the tendency to inflate (deflate) their income by increasing their sales revenue (expenditure on fixed assets). Based on the findings, given in table 1, it can be interpreted that the incidence of earnings management, measured by the discretionary accruals, has been relatively prominent in the local private and foreign firms in India. There has been no prediction made about the sign of α_1, however, the same has been found to be negative for the local private sector firms, and positive for the foreign and the government sector firms.

-Insert Table 1 here-

Tables 2 to 5 highlight relationship between the busyness of audit committee members and the quality of financial reporting for sub-samples foreign, government, and local private firms and for

[2] Spline-1 and spline-2 variables represent firm-level busyness nodes from three to ten.

the full sample. In tables 2 to 5, the spline nodes in the horizontal columns, (a) to (h), indicate the busyness level of the audit committee members, ranging from three to ten.

-Insert Table 2 here-

In table 2, results of *the Spline-1* coefficient show that for the foreign firms, listed in the Indian stock exchanges, there is a positive association between the audit committee members' busyness and the discretionary accruals. Nonetheless, this association becomes significant at the spline node six and onwards, implying that as the median directorships of audit committee members of a foreign firm turns six, the coefficient of discretionary accruals becomes significant. This result can be explained with the agency theory argument that busy audit committee members either do not have time to perform tasks entrusted to them and/or they lack the required focus to perform relatively complex tasks related to audit committees. This finding also indicates that some audit committee members may use multiple directorships as a tool to enhance their own economic interests in the market of corporate directors. As a result of the busyness of audit committee members, there is an adverse effect on the quality of financial reporting. Noticeably, the positive association between the audit committee members' busyness and the discretionary accruals continues to remain significant up-to the final cut-off point of ten, which is the maximum busyness limit as per the Companies Act of India 2013 (MCA, 2013). Therefore, this finding is in conflict with the level of multiple directorships allowed by the regulator in India. A corporate director of a publicly traded firm can be on boards of other publicly traded firms in India as long as the total of such directorships does not exceed ten. However, *the Spline-1* variable indicates that the quality of financial reporting starts deteriorating only when an audit committee director of the foreign firm in India assumes six outside directorships, albeit, the law allows him/her to have ten such assignments. Therefore, when ownership structure is acknowledged, the endogenously determined busyness limit (cut-off point six) provides better insight than that of exogenous limit (ten directorships) determined by regulators.

The Spline-2 variable has been found to be significant, although at a very low level (cut-off point five). This finding implies that at a relatively low level of busyness the outside directorships accepted by an audit committee member can be beneficial to the firm in the form of better financial reporting quality. This finding can be backed up by the resource dependence theory that as the busyness level of audit committee members increases, they apply more diligence, and caution and do much improved monitoring of the managerial actions, which results in lower earning manipulation, nonetheless, this *virtue* cannot be obtained limitlessly by the firms. As *the Spline-1* variable shows above, at node six and above the harmful effects of multiple directorships start surfacing. Similar to the findings of *the Spline-1* variable, the cut-off point of five of *the Spline-2* variable, upholds that an endogenously determined limit of busyness of directors provides better understanding of the association between multiple directorships of audit committee directors and financial reporting quality than the one prescribed by the regulators.

For *the Median committee- board size* ratio, measuring the intensity of busyness, the findings show that from the cut-off point three to five the committee assignments (for example, audit committee, remuneration committee, and nomination committee, and not merely serving on general boards of directors) taken up by the audit committee members of the firm in other firms successfully lowers

the level of discretionary accruals, and thus improves quality of financial reports of the firm. However, this effect of this variable ceases to be significant beyond the spline node five. This result indicates that not only *the number* of busyness but also *the nature* of busyness, incorporating the demanding nature of workload in specialized committees, affects the quality of financial reporting. The above finding can also be explained with the help of the resource dependence theory (Hillman and Dalziel, 2003). The audit committee members due to their skills, expertise, experience, linkage to the external contingencies are better equipped to smother earnings manipulation practices, however, only up-to a certain limit, and beyond such limit the agency costs may neutralize beneficial effects of the resource dependence theory.

Similarly, *the AC chair expertise* variable is associated with the improved quality of financial information at all the nodes indicating the busyness of audit committee members. The workload of an audit committee chairperson is highly demanding and financial skills oriented (Tanyi and Smith, 2015). The results show that irrespective of the busyness level of the audit committee members, the financial expertise of the audit committee chairperson plays a significant role to improve the quality of financial data. However, at the higher level of busyness the significance level starts diminishing indicating a possible trend. Similarly, the findings of *the NAS to total revenue of auditor*, the measure of extended interlocking, highlights its positive association with the discretionary accrual through all the spline nodes. The rising ratio of *the NAS to the total revenue* earned from a given client firm implies over economic dependence of the audit firm on its client and shrinking independence of the audit committee with respect to monitoring and control of managerial actions. Zang and Emanueal (2008) also find similar results in their study. The coefficients of *the Board size, Independent directors proportion and Debt-Equity ratio* have been found to be insignificant. Even though a bigger board of directors is assumed to be having relatively diverse reputational capital, and is more likely to produce objective financial results (Dalton et al., 1999; Goilden and Zajac, 2001), nonetheless, ensuring the credibility of financial reporting is a highly skill based function and the mere presence of more members in the board does not automatically imply high quality financial reporting. On the contrary, the audit committee members due to their specialized skills, education and expertise have a higher level of proficiency to perform such function more efficiently. Similarly, *the Independent directors proportion* coefficient is also insignificant. A possible explanation of this finding is that even though an independent board is expected to reduce information asymmetries between owners and managers (Donnelly and Mulcahy, 2008) and high quality of financial reporting contributes to eliminate such asymmetries, nonetheless, the phenomenon of multiple directorships of audit committee members, even at lower spline nodes, may act as a limiting factor and render independent directors relatively ineffective. The same explanation also holds true for the insignificant effect of *the debt-equity ratio* on the financial reporting quality.

Furthermore, *the R&D intensity and the Advertisement intensity* variables also indicate to have favorable effects on the financial reporting quality up-to spline node eight and throughout, respectively. Both variables are indicatives of firms' growth and bonding costs of managers (Ang

et al., 2000; Easterbrook, 1984). The signals indicating managers' loyalty/alignment to the firm's interests and its growth orientations have a favorable association with the objective and true financial information of the firm. The results of the variable *Trade intensity* show that firms having relatively active stock have better quality of financial information but not after the busyness level exceeds spline node six. This finding is similar to that of Fan and Wong (2002), and implying that firms whose stocks are traded actively have to face investors' ire relatively more if they indulge in earnings management practices. In the current paper, the firm size is measured by the log values of *Market-capitalization*, and the results indicate that bigger firms have lower incidence of earnings management due to fear of loss of reputation (Carey and Simnett, 2006).

-Insert Table 3 here-

Table 3 highlights the association between discretionary accruals and the busyness of audit committee members of the government owned firms in India. The coefficient of *Spline-1* variable turns significantly positively at node six showing deteriorating financial reporting quality at the increased level of busyness of audit committee members. The association gets even stronger as the busyness increases further. The coefficients of *Spline-2* variable remain insignificant throughout the spline nodes, highlighting that the reputational capital of directors does not play any role in improving quality of the financial data. A possible reason for such finding is that for a government owned firms the appointment of directors on its boards is relatively driven by bureaucratic factors rather than the reputational capital of directors. The coefficient of the third variable of busyness, *the Median committee- board size* ratio turns positive and significant at the spline node six and becomes even more significant at the subsequent spline nodes. This finding implies that not only *the number* of busyness of the audit committee members adversely affects the quality of financial reporting but also *the nature* of busyness. The outside specialized committee memberships of boards of directors can absorb a substantial amount of time and attention of the audit committee members of the firm and resultantly the financial reporting quality of the firm is adversely affected.

Similarly, *the effect of the Independent directors proportion* variable is favorable on the quality of financial data of the government owned firms throughout the spline nodes. The appointment of executive directors on the government owned firms is a bureaucratic matter (Sarkar and Sarkar, 2012), however, the independent directors, who also form a majority in the audit committees, may put more emphasis to improve the financial reporting quality even at a higher level of busyness in order to enhance their reputational capital. The variable *Debt-equity ratio* is having an insignificant effect on the quality of financial reporting. The government owned firms, generally, do not have the same kind of concerns in the matters pertaining to their financing. Therefore, this variable, which essentially underlines the capital structure of firms does not influence financial reporting quality irrespective of busyness of the audit committee members. Similarly, the effects of *the AC chair expertise* and *the Board size* are also insignificant. The peculiar institutional settings of the government owned firms can be attributed to these results. Similarly, the finding of *the NAS to total revenue of auditor*, measuring the extended interlocking, shows a positive association with the discretionary accrual throughout the spline nodes. The auditors' economic interests on client firms adversely affect the financial reporting quality at all cut-off points of audit committee members' busyness.

The coefficient of variables, *the R&D intensity* and *the Advertisement intensity*, both measuring bonding costs incurred by executives and growth orientation of firms, show their adverse effect on the financial reporting quality. Many agency theorists (for example, Jensen and Meckling, 1976; Easterbrook, 1984) have debated whether monitoring and bonding can be substitutes. A popular argument in the agency theory highlights that if agents incur bonding costs, then their alignment with the utility function followed with that of the principal increases. The findings show that bonding costs not only fail to substitute the monitoring of corporate executives but they are even associated with deteriorated financial reporting quality. Possibly, firm managers even use expenditures on advertisement and R&D to manipulate discretionary accruals for their vested interests. The insignificant coefficient of the variable *Trade intensity* further highlights the unique institutional settings in which the government owned firms' shares are traded. Similar to the findings in the case of foreign firms, the coefficients of the *Market-capitalization* indicate that bigger firms have lower incidence of earnings management due to fear of loss of reputation.

-Insert Table 4 here-

Table 4 shows the association between discretionary accruals and busyness of audit committee members of local private sector listed firms in India. The coefficient of *Spline-1* variable becomes significantly positive at the spline node five and it gets even stronger as the busyness level of the audit committee members increases further. *The Spline-2* variable, highlighting 'good effects' of the busyness of the audit committee members, as mentioned in the resource dependence theory, is significantly negative up-to spline node four. This finding implies that at a relatively low level of busyness, the audit committee members of local private firms in India are relatively motivated by the reputational capital effect and as a result they monitor and control managerial actions with due diligence and effectively check the objectivity and truthfulness of financial reports of firms, however, at a higher level of busyness (the spline node of five and above) they may be lacking time and focus required to perform their core responsibilities. Similarly, the coefficient of the third variable of busyness, *the Median committee- board size* ratio turns positive and significant at the spline node six and becomes even more significant at the subsequent spline nodes.

Similarly, *the effect of the Independent directors proportion* variable is favorable on the quality of financial data of the local private firms, however, not after the spline node five. The Indian corporate sector is dominated by the promoter owned firms, and in such firms the role of independent directors may not be effective in maintaining the quality of financial reports, especially at the higher level of busyness of audit committee members. The variable *Debt-equity ratio* is having significant effect on improving of financial reports throughout. Due to high relevance of debt in the capital structure of the local private sector firms in India, it is utmost important for such firms to reveal their real financial health by disclosing objective financial data of the firm in order to strengthen their ties with the institutional lenders (Sarkar and Sarkar, 2012). The increasing *Debt-equity ratio* implies more managerial discipline irrespective of the busyness of the audit committee of the firm. Similarly, the effect of *the AC chair expertise* is favorable on the quality of financial data, albeit up-to the spline node six. The financial expertise of the audit committee chairperson can play an important role in mitigating earnings management practices,

however, at an increased level of the busyness of audit committee members, the coefficient turns insignificant. Similarly, the coefficient of *the NAS to total revenue of auditor*, measuring extended interlocking, signifies its positive association with the discretionary accrual through all the spline nodes. The rising ratio of *the NAS to the total revenue* earned by an audit firm from its client firm underlines over economic dependence of the audit firm on its client, and also diminishing independence of the audit committee in the matters pertaining to monitoring and control of managerial actions. The coefficient *of Board size* of the local private firms indicates that larger board size is associated with the enhanced financial reporting quality and this finding gets the support of Dalton et al. (1999) and (Goilden and Zajac 2001), who argue in favor of larger boards' diversity and level of reputational capital, which play an important role in better monitoring and improved financial reporting process. Furthermore, *the R&D intensity and the Advertisement intensity* variables also indicate their *good effects* on the financial reporting quality throughout and up-to spline node eight, respectively. Both variables indicate that when interests of managers are aligned with those of firms and when firms endeavor to grow, the financial reporting quality improves. Similarly, the variable *Trade intensity* shows that firms having relatively active stock have better quality of financial information. The local private firms having highly active stocks may invite a more negative reaction of investors if such firms do not pay any attention to improving their financial data. The coefficient of *Market-capitalization* variable, measuring the firm size, indicates that bigger firms have lower incidence of earnings management due to fear of loss of reputation, however, not beyond the spline node six.

-Insert Table 5 here-

Table 5 shows the association between discretionary accruals and busyness of audit committee members for the full sample. The coefficient of *Spline-1* remains significantly positive throughout only when starting from the spline node six. The variable *Spline-2,* highlighting *virtues* of busyness of audit committee members, according to the resource dependence theory, is significantly negative up-to the spline node four. Furthermore, the coefficient of *Median committee- board size* also gets significantly positive starting from the spline node six. Overall, the analysis of the above three busyness variables reveals that at the lower level of busyness (up-to the spline node four), the busyness of audit committee members helps to enhance financial reporting quality; whereas, at the relatively higher level of busyness (six and above), the same has a detrimental effect on financial reporting quality.

The Board size helps to enhance financial reporting quality but only up-to spline node six. Similarly, *the Independent directors proportion* affects the financial reporting quality favorably throughout. Similarly, *the AC chair expertise* is associated with improved financial information but not after the spline node seven. The coefficient of *Debt-equity ratio*, signifying the corporate capital structure, has an improvement effect on the quality of financial reporting up-to node five. On the other hand, *the NAS to total revenue of auditor* has an unfavorable effect on financial reporting quality up-to node four. Surprisingly, for all the sub-samples, this variable affects financial reporting quality adversely throughout the busyness level of audit committee members. An explanation to the above aberration observed in the full sample is that the interlocking between the promoters and audit committee members does not transform into extended interlocking due to the possible loss of reputation of audit committee directors and adverse reaction of investors.

The coefficient of *the R&D intensity* affects the financial reporting quality favorably throughout, whereas those of *the Advertisement intensity, the Trade intensity,* and *the Market-capitalization* (firm size) have the same effect up-to a relatively lower level of busyness (spline node four).

-Insert Table 6 here-

Table 6 summarizes the endogenously determined busyness limits of the audit committee members based on the effects of such busyness on the financial reporting quality, measured by discretionary accruals. The effects of the association between the busyness of audit committee members and the quality of financial reporting are reported in this table from the agency, and resource dependence theoretical perspectives. Neither, endogenously determined limits of busyness of sub samples nor that of the full sample are in conformity with the exogenously prescribed limits of the regulator in India.

5. Conclusions and future research

Shareholders and several other stakeholders of firms seek to use objective financial information in order to observe firms' actions and their effects on them, in order to make rational decisions. The audit committee, a part of the internal corporate governance mechanism of firms, aims to ensure that the financial statements and related disclosures are prepared according to the legal requirements, and accounting standards set by regulators and professional bodies. An audit committee can perform its functions efficiently, when it is able to operate independent of managerial influences. Among other things, the number of directorships (boards and committees) accepted by directors of a given firm in other firms is an important determinant of the independence of the audit committee. The agency theory argument follows that as the number of outside directorships of the audit committee members of a firm increases, their effectiveness to review financial statements, and question the managerial actions diminish. However, according to the resource dependence theory, the phenomenon of multiple directorships of the audit committee members is associated with their enhanced human and relational capital, collectively known as the reputational capital. The current paper has examined, first, whether multiple directorships of the audit committee members affect quality of financial data in India, and second, whether endogenously determined limits of busyness of the audit committee members explains their association with the financial reporting quality better than those by the exogenous limits prescribed by the regulator. In an emerging country like India, where the foreign, and local private sector have been showing continuous growth, government owned firms have been maintaining their traditional importance, and at the same time their ownership structure and other institutional settings are markedly different, it is also important to study the association between multiple directorships of the audit committee members and the financial reporting quality based on the sub-samples along with the full sample.

The study shows that for the foreign, government owned firms, and full sample, the busyness of audit committee members does not affect financial reporting quality adversely before the median audit committee members at the firm level turns six, however, for the local private firms, the same phenomenon is observed not before five audit committee memberships. An interesting feature of the findings of the current paper is that the agency costs, in the form of poor quality of financial reporting, proxied by the discretionary accruals, emerge before reaching the regulatory limit of maximum ten directorships. Similarly, in the current paper the endogenously determined range of multiple directorships of audit committee members also highlight their favorable effects on the

financial reporting quality. The sub-samples of the foreign, local private sector firms and the full sample firms experience improvements in financial reporting quality at the lower level of busyness of the audit committee members, whereas, for the government owned firms, such beneficial effect never reaches at any point in the entire range of spline nodes. Overall, it can be concluded based on the analysis of the Spline-1 and the Spline-2 that the lower level of busyness of the audit committee members can be beneficial to firms; however, the same at the higher level of busyness can be detrimental to the financial reporting quality.

Similarly, the third variable of busyness i.e. median committee to board size, measuring the intensity of busyness, indicates mixed results. For the sub-samples of government, and local private firms and full sample, the intensity of busyness unfavorably affects the financial reporting quality at a relatively higher level of audit committee members' busyness, whereas, for the sub samples of foreign firms the favorable effect of the same variable is significant at a lower level.

The current paper contributes to the extant literature in several ways, first, the endogenously determined busyness limits explain the association between multiple directorships of audit committee members and the quality of financial reporting better than those exogenously recommended by regulators; second, despite applying the endogenous limits of busyness in the analysis for the full sample and sub-samples, the results reveal that 'one size does not fit all', that is the cut-off points of busyness highlighting the optimum level of busyness for the different ownership groups are not uniform, therefore, the current paper incorporates the institutional settings in which firms operate; third, this paper, along with the number of multiple directorships of the audit committee members in per se, also recognizes the nature of multiple directorships and analyzes their effects on the financial reporting quality, therefore, the regulator should not recommend a single upper limit of busyness of directors of a firm as such limits do not take into account the intensity of busyness of board, and committee members; and lastly, the current paper is one of the few studies in the settings of an emerging economy, such as India, and inferences drawn on the basis of the findings of this paper can be useful for countries having comparable corporate landscape.

The current paper has certain limitations too. First, the current paper is not considering alternative measures of the quality of financial information; therefore, robustness of the explained variable cannot be determined. Second, despite recognizing that the intensity of busyness is an important contribution of this paper, nonetheless, the current paper does not study the effect of busyness of the audit committee members of the firms in the same committee of other firms. The reason for this limitation is that the available data in the current study is only pertaining to the busyness of the audit committee members of a firm in other firms, categorized as 'boards' and 'committees', and no further break up of 'committees' is available.

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Table 1: Comparison of coefficients of discretionary accruals for sub-samples and overall sample (Data: 2004-12)

Coefficients[a]	Expected Sign	Sub-sample 1 (Private Local)	Sub-sample 2 (Foreign)	Sub-sample 3 (Government)	Overall sample
α_1	?	-1210.551** (-11.42)	1150.293*** (24.11)	2352.319** (7.88)	-0.007 (-0.881)
α_2	+ve	0.521** (3.78)	2.563*** (173.77)	0.011 (0.712)	0.265** (13.235)
α_3	-ve	-0.547** (-3.98)	-0.021** (-6.22)	0.002 (0.121)	-0.223** (-11.191)

N (Firm-Years)		2376	585	772	3733

[a] Jones (1991) expectation model (1991) model has been applied to estimate coefficients of discretionary accruals. The model is as below:

$TA_{it}/A_{it-1} = \alpha_1 (1/ A_{it-1}) + \alpha_2 (\Delta REV_{it}/A_{it-1}) + \alpha_3 (PPE_{it}/A_{it-1}) + \mathcal{E}_{it}$

*** p < 0.001, ** p < 0.01, * p < 0.05, and † p < 0.1 (t-statistics appear in parentheses)

Table 2: Association between discretionary accruals and busyness of audit committee members-foreign firms (Data: 2004-12)

Note: #OLS estimates are shown in above table (t-statistics appear in parentheses).

Discretionary variable (dependent variable)	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
	Spline Node=3	Spline Node=4	Spline Node=5	Spline Node=6	Spline Node=7	Spline Node=8	Spline Node=9	Spline Node=10
Intercept	31.222*** (126.387)	31.118*** (123.686)	31.118*** (123.686)	30.101*** (118.118)	29.229*** (114.283)	26.056*** (110.009)	26.056*** (110.009)	26.033*** (108.119)
Spline-1	0.131 (1.141)	0.142 (1.152)	0.147 (1.168)	0.160† (1.477)	0.205* (2.045)	0.206* (2.053)	0.206* (2.053)	0.206* (2.056)
Spline-2	-0.155† (-1.432)	-0.155† (-1.432)	-0.157† (-1.439)	-0.142 (-1.149)	-0.131 (-1.141)	-0.129 (-1.129)	-0.121 (-1.117)	-0.121 (-1.117)
Median committee-board size	-0.189* (-1.952)	-0.167† (-1.537)	-0.159† (-1.465)	-0.149 (-1.184)	-0.142 (-1.152)	-0.140 (-1.137)	-0.140 (-1.137)	-0.140 (-1.137)
Board size	0.001 (0.058)	0.001 (0.058)	0.001 (0.058)	0.001 (0.058)	0.001 (0.058)	0.001 (0.058)	0.001 (0.058)	0.001 (0.058)
Independent directors proportion	0.001 (0.866)	0.001 (0.866)	0.001 (0.866)	0.001 (0.866)	0.001 (0.866)	0.001 (0.866)	0.001 (0.866)	0.001 (0.866)
AC chair expertise	-0.269** (-2.832)	-0.269** (-2.834)	-0.269** (-2.832)	-0.257* (-2.223)	-0.227* (-2.129)	-0.228* (-2.138)	-0.226* (-2.111)	-0.226* (-2.111)
R&D intensity	-0.205* (-2.048)	-0.205* (-2.048)	-0.197* (-1.996)	-0.167† (-1.612)	-0.167† (-1.612)	-0.167† (-1.611)	-0.147 (-1.169)	-0.147 (-1.169)
Advertisement intensity	-0.011** (-8.465)	-0.013** (-8.667)	-0.013** (-8.667)	-0.009** (-6.056)	-0.009** (-6.056)	-0.005** (-4.998)	-0.001* (-2.222)	-0.001* (-2.219)
Trade intensity	-0.001† (-1.537)	-0.001† (-1.538)	-0.001† (-1.538)	-0.001† (-1.538)	0.000 (-1.154)	0.000 (-1.154)	0.000 (-1.154)	0.000 (-1.154)
Debt-Equity ratio	0.000 (0.091)	0.000 (0.091)	0.000 (0.091)	0.000 (0.091)	0.000 (0.091)	0.000 (0.091)	0.000 (0.091)	0.000 (0.091)
Market-capitalization	-0.334** (-5.435)	-0.312** (-5.257)	-0.253** (-2.442)	-0.223* (-2.053)	-0.223* (-2.053)	-0.223* (-2.053)	-0.179† (-1.623)	-0.167† (-1.545)
NAS to total revenue of auditor	0.195* (2.011)	0.195* (2.011)	0.195* (2.011)	0.195* (2.011)	0.195* (2.011)	0.195* (2.011)	0.195* (2.011)	0.195* (2.011)
Adjusted R^2	0.42	0.44	0.44	0.42	0.42	0.44	0.45	0.45
N (Firm-Years)	585	585	585	585	585	585	585	585

*** p < 0.001, ** p < 0.01, * p < 0.05, and † p < 0.1.

Table 3: Association between discretionary accruals and busyness of audit committee members-government firms (Data: 2004-12)

Discretionary variable (dependent variable)	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
	Spline Node=3	Spline Node=4	Spline Node=5	Spline Node=6	Spline Node=7	Spline Node=8	Spline Node=9	Spline Node=10
Intercept	9.998*** (29.086)	9.998*** (29.086)	9.972*** (26.183)	9.961*** (23.118)	9.961*** (23.118)	9.961*** (23.118)	9.961*** (23.118)	9.961*** (23.118)
Spline-1	0.831 (1.121)	0.842 (1.172)	0.847 (1.221)	0.972† (1.621)	1.124* (2.123)	1.132** (2.636)	1.132** (2.636)	1.132** (2.636)
Spline-2	-0.001 (-0.942)	-0.001 (-0.942)	-0.001 (-0.942)	-0.001 (-0.942)	-0.001 (-0.942)	-0.001 (-0.942)	-0.001 (-0.942)	-0.001 (-0.942)
Median committee- board size	0.842 (1.267)	0.842 (1.267)	0.842 (1.267)	1.017* (2.239)	1.038** (3.771)	1.038** (3.771)	1.258** (8.668)	1.269** (9.771)
Board size	-0.001 (-0.619)	-0.001 (-0.619)	-0.001 (-0.619)	-0.001 (-0.619)	-0.001 (-0.619)	-0.001 (-0.619)	-0.001 (-0.619)	-0.001 (-0.619)
Independent directors proportion	-2.229** (4.026)	-2.237** (4.817)	-2.242** (5.026)	-2.242** (5.026)	-2.244** (5.087)	-2.254** (5.126)	-2.256** (5.137)	-2.267** (5.289)
AC chair expertise	-0.063 (-1.089)	-0.063 (-1.089)	-0.063 (-1.089)	-0.066 (-1.093)	-0.061 (-1.044)	-0.053 (-1.001)	-0.053 (-1.001)	-0.053 (-1.001)
R&D intensity	1.031* (2.048)	1.029* (2.008)	1.028* (1.994))	1.026* (1.848)	1.026* (1.848)	1.021* (1.778)	1.012* (1.665)	1.012* (1.665)
Advertisement intensity	1.213** (8.267)	1.213** (8.267)	1.213** (8.267)	1.212** (8.203)	1.210** (8.056)	1.207** (7.765)	1.206** (7.722)	1.206** (7.722)
Trade intensity	0.000 (-1.184)	0.000 (-1.184)	0.000 (-1.184)	0.000 (-1.184)	0.000 (-1.184)	0.000 (-1.184)	0.000 (-1.184)	0.000 (-1.184)
Debt-Equity ratio	0.000 (0.313)	0.000 (0.313)	0.000 (0.313)	0.000 (0.313)	0.000 (0.313)	0.000 (0.313)	0.000 (0.313)	0.000 (0.313)
Market-capitalization	-0.352** (-5.039)	-0.352** (-5.039)	-0.352** (-5.039)	-0.353** (-5.117)	-0.354** (-5.276)	-0.354** (-5.276)	-0.352** (-5.038)	-0.352** (-5.037)
NAS to total revenue of auditor	0.525** (7.631)	0.525** (7.631)	0.525** (7.631)	0.525** (7.631)	0.525** (7.631)	0.525** (7.631)	0.525** (7.631)	0.525** (7.631)
Adjusted R^2	0.33	0.36	0.36	0.35	0.34	0.36	0.36	0.35
N (Firm-Years)	772	772	772	772	772	772	772	772

Note: #OLS estimates are shown in above table (t-statistics appear in parentheses).

*** $p < 0.001$, ** $p < 0.01$, * $p < 0.05$, and † $p < 0.1$.

Table 4: Association between discretionary accruals and busyness of audit committee members-private firms (Data: 2004-12)

Discretionary variable (dependent variable)	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
	Spline Node=3	Spline Node=4	Spline Node=5	Spline Node=6	Spline Node=7	Spline Node=8	Spline Node=9	Spline Node=10
Intercept	10.281*** (80.650)	10.293*** (80.723)	10.311*** (81.293)	10.313*** (81.446)	10.311*** (81.293)	10.311*** (81.293)	10.313*** (81.446)	10.313*** (81.446)
Spline-1	0.423 (1.223)	0.427 (1.257)	0.511† (1.588)	0.823* (2.319)	1.106** (6.123)	1.132** (8.636)	1.132** (8.636)	1.133** (8.707)
Spline-2	-0.951† (-1.542)	-0.951† (-1.542)	-0.821 (-1.212)	-0.819 (-1.142)	-0.808 (-1.117)	-0.801 (-1.009)	-0.801 (-1.009)	-0.801 (-1.009)
Median committee- board size	0.542 (1.137)	0.616 (1.202)	0.736 (1.279)	1.012* (2.023)	1.023** (5.971)	1.023** (5.971)	1.046** (6.467)	1.046** (6.467)
Board size	-0.246† (-1.319)	-0.297† (-1.489)	-0.321* (-2.219)	-0.593** (-3.787)	-1.116** (-8.227)	-1.213** (-9.852)	-1.229** (-10.511)	-1.237** (-10.819)
Independent directors proportion	-0.767† (1.526)	-0.642† (1.301)	-0.617† (1.287)	-0.526 (1.209)	-0.516 (1.171)	-0.507 (1.089)	-0.492 (0.847)	-0.488 (0.809)
AC chair expertise	-0.937* (-2.299)	-0.877* (-1.889)	-0.863* (-1.733)	-0.856† (-1.547)	-0.721 (-1.167)	-0.662 (-1.023)	-0.653 (-0.901)	-0.637 (-0.827)
R&D intensity	-1.431** (9.248)	-1.414** (9.057)	-1.313** (8.648)	-1.302** (8.329)	-1.251** (8.079)	-1.237** (7.848)	-1.231** (7.273)	-1.229** (7.157)
Advertisement intensity	-0.877* (-1.889)	-0.877* (-1.889)	-0.857* (-1.722)	-0.857* (-1.722)	-0.857† (-1.629)	-0.849† (-1.547)	-0.626 (1.209)	-0.523 (-1.077)
Trade intensity	-1.018** (-3.370)	-1.018** (-3.370)	-1.023** (-3.579)	-1.024** (-3.613)	-1.022** (-3.512)	-1.019** (-3.439)	-1.018** (-3.370)	-1.018** (-3.370)
Debt-Equity ratio	-1.126*** (-26.434)	-1.115*** (-23.129)	-1.114*** (-22.481)	-1.116*** (-23.229)	-1.107*** (-20.673)	-1.111*** (-21.841)	-1.109*** (-21.533)	-1.112*** (-22.227)
Market-capitalization	-0.352* (-1.835)	-0.312* (-1.733)	-0.224† (-1.622)	-0.209† (-1.553)	-0.145 (-1.176)	-0.143 (-1.121)	-0.125 (-1.041)	-0.124 (-1.003)
NAS to total revenue of auditor	0.578** (8.076)	0.578** (8.076)	0.578** (8.076)	0.578** (8.076)	0.578** (8.076)	0.578** (8.076)	0.578** (8.076)	0.578** (8.076)
Adjusted R^2	0.46	0.46	0.46	0.47	0.48	0.49	0.49	0.49
N (Firm-Years)	2376	2376	2376	2376	2376	2376	2376	2376

Note: #OLS estimates are shown in above table (t-statistics appear in parentheses).

*** $p < 0.001$, ** $p < 0.01$, * $p < 0.05$, and † $p < 0.1$.

Table 5: Association between discretionary accruals and busyness of audit committee members-full sample (Data: 2004-12)

DA (dependent variable)	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
	Spline Node=3	Spline Node=4	Spline Node=5	Spline Node=6	Spline Node=7	Spline Node=8	Spline Node=9	Spline Node=10
Intercept	15.762*** (81.629)	15.467*** (76.923)	15.401*** (75.411)	15.353*** (73.632)	15.311*** (72.392)	15.302*** (70.122)	15.113*** (69.887)	14.944*** (69.229)
Spline-1	0.423 (0.675)	0.427 (0.727)	0.711 (1.023)	1.023† (1.302)	1.121* (1.819)	1.127* (1.923)	1.132* (2.236)	1.133* (2.319)
Spline-2	-0.949† (-1.532)	-0.957† (-1.572)	-0.841 (-1.257)	-0.816 (-1.221)	-0.805 (-1.203)	-0.799 (-1.192)	-0.799 (-1.192)	-0.799 (-1.192)
Median committee-board size	0.542 (1.169)	0.516 (1.133)	0.667 (1.243)	1.012* (2.223)	1.801** (5.771)	1.722** (4.561)	1.734** (5.119)	1.721** (4.112)
Board size	-0.246† (-1.319)	-0.297† (-1.452)	-0.321* (-2.219)	-0.246† (-1.323)	-0.221 (-1.119)	-0.187 (-0.877)	-0.145 (-0.711)	-0.123 (-0.619)
Independent directors proportion	-1.396** (5.199)	-1.386** (4.787)	-1.396** (5.199)	-1.399** (5.442)	-1.396** (5.199)	-1.395** (5.112)	-1.395** (5.112)	-1.395** (5.112)
AC chair expertise	-0.831* (-1.349)	-0.877* (-1.889)	-0.851* (-1.665)	-0.846† (-1.541)	-0.846† (-1.541)	-0.762 (-1.188)	-0.653 (-1.065)	-0.637 (-1.027)
R&D intensity	-1.030** (8.248)	-1.022** (7.901)	-1.017** (7.447)	-1.016** (6.931)	-1.011** (6.551)	-1.009** (6.448)	-1.007** (6.319)	-1.007** (6.319)
Advertisement intensity	-0.857† (-1.629)	-0.849† (-1.547)	-0.661 (-1.242)	-0.603 (-1.037)	-0.603 (-1.037)	-0.601 (-0.842)	-0.576 (-0.676)	-0.576 (-0.676)
Trade intensity	-0.657† (-1.432)	-0.626† (-1.301)	-0.601 (-1.165)	-0.587 (-1.114)	-0.544 (-1.025)	-0.521 (-0.972)	-0.517 (-0.923)	-0.513 (-0.905)
Debt-Equity ratio	-0.432** (-6.434)	-0.419** (-5.117)	-0.265* (-2.167)	-0.129 (-1.174)	-0.126 (-1.014)	-0.123 (-1.002)	-0.123 (-1.002)	-0.123 (-1.002)
Market-capitalization	-0.047† (-1.635)	-0.042† (-1.533)	-0.034 (-1.222)	-0.031 (-1.115)	-0.028 (-1.009)	-0.028 (-1.009)	-0.028 (-1.009)	-0.028 (-1.009)
NAS to total revenue of auditor	0.082* (2.176)	0.066† (1.626)	0.047 (1.222)	0.047 (1.222)	0.047 (1.222)	0.047 (1.222)	0.047 (1.222)	0.047 (1.222)
Adjusted R^2	0.56	0.59	0.59	0.57	0.60	0.59	0.59	0.59
N (Firm-Years)	3733	3733	3733	3733	3733	3733	3733	3733

Note: #OLS estimates are shown in above table (t-statistics appear in parentheses).

*** $p < 0.001$, ** $p < 0.01$, * $p < 0.05$, and † $p < 0.1$.

Table 6: Association between discretionary accruals and busyness of audit committee members-summary findings full sample (Data: 2004-12)

Effect of AC Busyness on	Bad Effects (agency theory)	Good Effects (resource-dependence theory)
Foreign Firms (585 firm-years)	≥6	None
Government Firms (772 firm-years)	≥6	≤5
Local Private Firms (2376 firm-years)	≥5	None
Overall Sample (3733firm-years)	≥6	≤4

III

MULTIPLE DIRECTORSHIPS OF CORPORATE BOARDS AND FIRM PERFORMANCE IN INDIA

by

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CORPORATE GOVERNANCE IN ASIA

SECTION 3

MULTIPLE DIRECTORSHIPS OF CORPORATE BOARDS AND FIRM PERFORMANCE IN INDIA

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Abstract

The purpose of the paper is to investigate, first, the association between multiple directorship assignments (busyness) undertaken by corporate directors and firm performance, second, whether endogenously determined limits of multiple directorships, highlighting the ownership structure and other institutional settings, explain the above association better than those by exogenously mandated by regulators and third, the association between the nature of busyness and firm performance. The study develops measures of busyness in the light of the agency and resource dependence theories. The spline regression technique is applied in order to reflect institutional settings of a large sample and sub-samples of firms classified as local private, foreign and government firms in India. For local private firms, the association between the number of directorships and firm performance becomes negative before reaching the maximum number of directorships set by legislation, whereas, for foreign and government firms, the same continues to remain positive throughout. Endogenously determined cut-off points of busyness reflect institutional settings of firms, which may remain masked otherwise. The findings of the current paper can be useful to study the same phenomenon in other emerging markets having corporate governance, and ownership structures similar to that of India. The effect of busyness can be different on different firms; however, exogenously fixed regulatory limits do not reflect their institutional settings. The current paper is an attempt to fill in this research gap.

Keywords: Corporate Governance, Multiple Directorships, Board of Directors, Agency Theory, Resource Dependence Theory, Promoters, Ownership, Control

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1. INTRODUCTION

In modern publicly traded corporations, the commitment of directors is not restricted to only one firm, and corporate directors can hold multiple directorships simultaneously (Jackling and Johl, 2009). Nonetheless, it is important to investigate how many directorships corporate directors can hold, because, if no limits are placed on multiple

directorship assignments accepted by directors of a firm in other firms then as a result such directors can become *too busy*, and their *busyness* can adversely affect firm performance (Shivdasani and Yermack, 1999; Fich and Shivdasani, 2006; Council of Institutional Investors, 2013; Aguilera and Crespi-Cladera, 2016).

The principal objectives of the current paper are to examine, first, how the busyness of directors impacts firm performance in India in the light of the two alternative theoretical perspectives, that is, agency theory and resource dependence theory, and second, to what extent the relationship between busyness of directors and firm performance hold endogenously. For example, promoters'[18] ownership, and control underline important characteristics of firms in India and exogenously determined regulatory busyness limits may not incorporate such characteristics. The third objective of the current paper is to study how *the intensity* of busyness is associated with the firm performance, that is when a director of a firm accepts a certain number of multiple directorships in other firms as member of specialized committees, for example, audit committee, compensation committee and nominating committee, then the amount and nature of work he/she is expected to do are relatively demanding in comparison to a situation when such director joins only general board of directors of the same number of firms, other things being equal.

Using the unbalanced panel data of 3733 firm-years between 2004-12 of non-financial listed firms in India and applying multivariate spline regression method, the findings reveal that for local private firms, the negative association between the number of directorships and firm performance starts long before the maximum limit of directorships prescribed by regulators is reached, whereas, for the foreign and government firms, the positive association between the two continues even when the limit of maximum busyness is reached. Similarly, promoters' ownership and control affect the firm performance of firms belonging to local private, foreign and government sectors differently. However, except for the foreign firms, the negative effect of the intensity of busyness on firm performance starts before the maximum permissible limit of multiple directorships.

The current paper contributes to the body of literature in a variety of ways. First, the current paper applies endogenously determined limits to multiple directorships for the full sample and sub-samples categorised based on ownership structure, therefore, questions the validity of exogenously determined regulatory limits. Second, the current paper analyzing the association between multiple directorships and firm performance is one of the few studies in the settings of an emerging economy, such as India as most of the similar studies have been carried out in the US and similar settings (Fich and Shivdasani, 2006; Ferris et al., 2003). Third, the current paper also explores the effects of promoters' ownership and control, a peculiar and prevalent feature of Indian corporate settings, on firm performance. The current study makes two theoretical contributions too (Basu and Sen, 2015). First, in the current study relatively *'visible'* concept of board independence, often measured by the proportion of independent directors on the board (e.g. Costello and Wittenberg-Moerman, 2011) is substituted by the busyness of corporate directors, which is one of the determinants of independence of boards. Second, the current paper contributes a new concept of intensity of busyness, which defines busyness from the rigor, and responsibility requirements of various functions performed by corporate directors, which is different from a mere number of directorships they hold.

The remainder of the paper is divided into the following sections: Section 2 highlights the background of multiple directorships and the corporate governance system in India. Section 3 highlights theoretical background, literature review and hypotheses development. Sections 4 addresses various aspects related to research design, whereas Section 5 presents results and discussion based thereon. Section 6 is about conclusions, limitations and future research suggestions.

2. CORPORATE GOVERNANCE SYSTEM AND MULTIPLE DIRECTORSHIPS IN INDIA

The Indian corporate governance system is a hybrid in nature as it incorporates characteristics of two different dimensions of corporate governance, namely *the vertical dimension*, also known as the outside, Anglo-Saxon and market-based governance system (Roe, 2004); and *the horizontal dimension*, also known as the inside, European and bank-based governance system (Roe, 2004). Many researchers have given the following arguments in support of their claim that the Indian corporate governance system is similar to the vertical dimension of corporate governance. First, India has the largest number of listed companies in the world, second, the participation level of small investors in India is not as insignificant as in other emerging economies, third, the stock markets in India are very active and relatively developed, and fourth, the takeover market is very active, even when compared with developed economies like Germany and Japan (e.g. Shaun, 2007; Dutta, 1997; Sarkar and Sarkar, 2012). Furthermore, Sarkar and Sarkar (2012) also draw several parallels between the Indian governance system and the horizontal dimension of corporate governance by giving the following arguments. First, ownership concentration in India is highly skewed in favour of promoters, second, the proportion of widely held companies is lower when compared with other emerging economies in East Asia, and Europe, and third, financial institutions play an important role as a source of external finance (both debt and equity).

A significant feature of the corporate governance system in India is that the ownership and control structure of firms are highly skewed in favour of promoter-owners (promoter, hereafter). Promoters include individuals, families, firms, and

[18] According to the section 69 of the Companies Act of India (MCA 2013), a promoter is a person "…who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise…" (p.9). More than 40 percent of sample firms in India have at-least one promoter director on the board, and promoter directors also chair the board of directors of more than 30 percent of firms (Sarkar and Sarkar 2000).

government bodies. A significant feature of promoter-dominated corporate ownership structure is that it strives to maximise their control over a firm for a given level of ownership (Aguilera and Crespi-Cladera, 2016; Chakrabarti et al., 2008; Sarkar and Sarkar, 2000). Promoters can enhance their control disproportionately of their ownership by the following two ways (Basu and Sen, 2015). First, by appointing those directors in the firm X, who are either serving on boards of other firms within the business group that the firm X is also affiliated with. Second, by appointing those directors in the firm X, who although are not belonging to the same business group, however, belonging to firms having strong business linkages with the firm X. The high level of ownership concentration and promoters dominance pave the way for the phenomena of pyramiding and tunnelling[19] as well as earnings management (Mathew, 2007; Chakrabarti et al., 2008; Hundal, 2016).

The phenomenon of multiple directorships in India can be attributed to supply constraints in the market of corporate directors that started soon after 1947 when India became an independent nation. Due to the paucity of experienced, qualified, and reputed corporate leadership in a newly independent nation, firms started approaching relatively successful and experienced directors to join their boards and it was soon not uncommon to find some directors on more than 50 corporate boards (Mehta, 1955). However, the section 275 of the Companies Act of India (MCA, 1956) was the first step to specify a maximum number of directorships to fifteen, later on increased to twenty that corporate directors could hold in publicly traded firms. The Securities and Exchange Board of India (SEBI), (an equivalent to the SEC in the USA) in its guidelines, known as *the Clause 49*, recommended that no director would become a member of ten boards or serve as the chairperson of more than five committees across all firms. Nevertheless, because the legislation did not include private firms, unlimited companies, and non-profit organisations (except subsidiaries or holding companies of a publicly traded firm), the Companies Act of India paved the way for the actual number of multiple directorships to easily exceed the regulatory limit. In addition, the imposed limit was purely exogenous, as it was adjusted in relation to the average level of multiple directorships in the USA and the UK, therefore, ignoring the differences in institutional settings of firms (Bhabha, 1952).

Ever since the economic reforms initiated in the early 1990s in India, there has been a major shift in the corporate ownership structure from the dominance of public sector to the private sector, including both local Indian and foreign firms (Committee on Corporate Governance, 2003). Above-mentioned developments have necessitated major changes in the corporate governance system of India including multiple directorships. According to the section 165(1) of the Companies Act of India (MCA, 2013: 97) "No person, after the commencement of this Act, shall hold office as a director, including any alternate directorship, in more than twenty companies at the same time: Provided that the maximum number of public companies in which a person can be appointed as a director shall not exceed ten".

A major limitation of the corporate governance system in India is that several regulatory provisions are in conflict with each other. For example, the Companies Act of India (2013) specifies maximum limit of busyness to ten (MCA, 2013), whereas the revised clause 49 restricts the same to seven with effect from 2014 (Ernst & Young, 2014).

3. THEORETICAL BACKGROUND, LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

The current paper derives its theoretical underpinnings from two well known, albeit mutually conflicting theories- the agency theory, and the resource dependence theory. According to agency theory, one of the principal functions of corporate boards is to function independently and detect and deter discretionary managerial actions through a system of monitoring, and control on behalf of investors and other stakeholders of firms (Eisenhardt, 1989). A key argument made in this paper is that the independence of corporate directors is influenced by the busyness of boards, among other things. Ferris et al. (2003) have developed the busyness hypothesis that postulates that as their number of directorships increases, corporate directors become over-committed. According to the agency theory, the busyness of corporate directors adversely affects firm performance (Méndez et al., 2015).

The negative impacts of busyness are valid for both inside and outside directors. For inside directors of a firm, their busyness in other firms may cause decline in the required time and attention necessary to perform their various day-to-day managerial tasks, formulation/revision of plans, risk management and strategy assessment (Dalton et al., 2003); second, as their experience and knowledge are more about firm-specific operational activities, therefore, inside directors are not essentially good monitors of managerial actions in other firms (Klein, 1998); third, they are willing to *(or asked to)* take up multiple outside directorships in other firms within the corporate group as a mechanism to strengthen control of promoters, and large shareholders, which can result in the exploitation of minority shareholders (Dutta, 1997). Sarkar and Sarkar (2009) find that stock market reaction becomes adverse as the level of busyness of inside directors increases.

Similarly, when outside directors of a given firm become over-committed by accepting multiple directorships in other firms, the following harmful effects can arise. First, the ability of outside directors to effectively monitor managerial actions of the firm reduces as the busyness of outside directors increases (Jackling and Johl, 2009; Tanyi

[19] Pyramiding is a common practice in India, and other Asian countries and is used to create a top–down chain of control over multiple firms through an ownership structure, which allows more control over a firm for a given level of ownership in it. Tunneling can be defined as the act of transferring assets and profits out of firms by the controlling shareholders for their own benefit. Tunneling encompasses the sale of the firm's assets, transfer pricing advantageous to the controlling shareholder, excessive executive compensation, loan guarantees, insider trading etc. (See La Porta et al., 1999).

and Smith, 2015); second, outside directors can experience a conflict of interests and trigger the distrust of other firms, especially when these directors are also serving on the boards of competitors, and this can result in firms experiencing undue delays in decision making (Fich and Shivdasani, 2006); third, outside directors can be perceived to be following *perquisite consumption behavior* (seeking financial and non-financial benefits) and not performing genuine monitoring of managerial actions (Dutta, 1997; Mathew, 2007); fourth, busy outside directors may find it difficult to understand the nature of operations, managerial actions, vision and mission, control mechanisms, and various board dynamics and related challenges of their affiliated firms (Kisgen et al., 2009); and fifth not only similar to inside directors but also very common in Indian corporate system, outside directors may accept multiple directorships in order to enhance control of promoters over firms within a group (Chakrabarti et al., 2008; Chen et al, 2014).

Fich and Shivdasani (2006) advocate regulatory limits on multiple directorships in order to check the erosion of a firm's value, and they find that multiple outside board directorships start affecting firm performance adversely, however, only when the majority of directors hold three or more board positions, therefore, the phenomenon of busyness and its effects on firm performance should be understood in reference to busyness of overall board and not in the context of an individual director. Based on the findings of Fich and Shivdasani (2006) it may be interpreted that, first, the incremental impact of additional directorships on firm value is not constant and second, regulators should prescribe some limits on additional directorships that corporate directors can hold; however, such limits must incorporate the institutional settings in which firms operate, for example, ownership structure, firm size, nature of the business, board composition etc.

The second underlying theory in the current paper is resource dependence theory (Daily and Dalton, 1994a, b; Pearce and Zahra, 1992; Hillman and Dalziel, 2003). A firm appointing board-level directors, who also serve on other corporate boards, adds to its resources in the form of both, human capital (education, experience, expertise, skills) and relational capital (a network of ties to other firms, external environment and external contingencies). In the current paper, the combination of the human and relational capital of directors is defined as reputational capital (Hundal, 2016). Firms operating in a relatively uncertain business environment can be benefitted by recruiting those directors, who not only have a higher level of human capital but also a well-developed relational capital network with other organisations and external contingencies. Similarly, large firms with complex business operations and organisational structures require board members with diverse skills, knowledge, and experience, to bolster decision making (Booth and Deli, 1996; Ferris and Jagannathan, 2001; Barzuza and Quinn, 2017). The directors serving on multiple boards fulfil the above criteria; therefore, firms recruiting such directors can do better strategic decision-making amidst a high level of uncertainty (Pearce and Zahra, 1992). Similarly, multiple directorships accepted by directors also signify their reputational capital in the market for corporate directors, which can be an important motivation for other directors to accept outside directorships (Fama and Jensen, 1983). Ferris et al. (2003) find that busy directors attend meetings regularly in order to consolidate their reputational capital, which results in increased managerial accountability, and better guidance provided to firms. Further, directors, who serve on multiple boards, promote several healthy practices among firms they are affiliated to, for example, exchange of skills, knowledge, and experiences and enhanced co-operation, and business relationships (Becher et al. 2016). Hermalin and Weisbach (1998) provide empirical evidence that directors affiliated to firms giving an outstanding accounting and stock market performance are regarded as successful directors, and their demand in the market for corporate directors is high. Conversely, directors on boards of firms giving a poor accounting and stock market performance are less likely to be invited to the boards of other firms (Fama and Jensen, 1983).

When a firm struggling with impending bankruptcy invites directors, who already hold directorships in other firms, it can not only thwart looming bankruptcy situations but also implement a restructuring process effectively by capitalising reputational capital of its *well-connected* directors (Daily and Dalton, 1994a; Kaplan and Sorensen 2016). The firm's response to capitalise the reputational capital of directors serving on multiple corporate boards to combat an actual/potential financial distress situation can be either *reactive (ex-post) or proactive (ex-ante)*. The above finding of Daily and Dalton emphasises the former; however, firms can also invite such directors on their boards proactively in order to minimise the likelihood of such existential threats in the first place. To support the latter argument, Daily and Dalton (1994b) argue that a firm with directors connected to the external environment, especially those serving on the boards of financial institutions, is better positioned to face future financial challenges, as such directors can play an important role in arranging the right type of financial resources and on favorable terms. In a similar vein, Ferris and Jagannathan (2001) find that the multiple directorships held by corporate directors symbolize their reputational capital accumulated over time, and firms experience improvements in their operating profits and return on equity after they appoint such reputed directors on their boards. The phenomenon of multiple directorships increases trust and friendship between the independent directors and firm management and help decision making the power of boards (Harris and Shimizu, 2004).

Pfeffer and Salancik (1978) argue that board capital, specifically, adds to the following four types of benefits to firms:

1) Advice and Counsel: Professionals such as lawyers, accountants, senior managers of other firms, former government officials, and community leaders serving on a corporate board contribute valuable expertise, experience, and skills to its executives (Baysinger and Butler, 1985; Gales and Kesner, 1994).

2) Legitimacy: A firm's reputation can be affected by the reputation of those serving on its board of directors. The high level of reputational capital of directors confers legitimacy to actions of the firm (Boyd, 1990; Dalton et al., 1999).

3) Communication Channels: A firm having effective channels of communication with external organisations helps it in obtaining timely and valuable information, which further helps in minimizing transaction costs that the firm incurs while operating in an uncertain business environment. The high quality of relational capital at board level facilitates such channels of communication and the flow of information. Hillman et al. (1999) showed that when directors established connections with the U.S. government or financial institutions, the shareholders' value increases. Similarly, the interlocking of directorates also plays an important role in disseminating information within firms (Barzuza and Quinn, 2017; Wu, 2017; Hillman and Dalziel, 2003; Au et al., 2000).

4) Resources Mobilisation: A combined effect of the above three points is that board capital can be helpful in acquiring resources from external organisations (e.g., financial markets), and stakeholder groups (e.g., customers, suppliers, and communities).

Based on literature pertaining to various theoretical underpinnings, regulatory developments and prior empirical findings, the followings two hypotheses are formed:

H_1. Multiple directorships held by corporate directors negatively affect firm performance (agency theory).

H_2. Multiple directorships held by corporate directors positively affect firm performance (resource dependency theory).

Mehta (1955) finds that during the early phase of industrialisation in India local private entrepreneurs experienced a shortage of leadership and guidance, and the practice of multiple directorships provided a solution to this problem to some extent. Jaiswall and Bhattacharyya (2016) find that remuneration attributed to board and CEO characteristics in both private and public sectors does not influence firm performance. Dutta (1997) recommends to place a maximum limit on directors' busyness as many directors, who take up multiple directorships in other firms, may have the motivation to enhance their personal utility, for example, to earn extra income and develop their personal network in the market of corporate directors. Similarly, Jackling and Johl (2009) and Hundal (2016) find that increased busyness of board of directors in the Indian private firms results in the lower monitoring of managerial actions, which further results in poor firm performance and deterioration in the quality of financial reporting.

H_{1a}. Multiple directorships held by corporate directors of local private firms negatively affect firm performance (agency theory).

Regarding the role of government firms, Ahuja and Majumdar (1998) find that government-owned firms in India have better corporate governance standards because such firms due to their larger size are exposed to a high level of regulatory monitoring, requiring more disclosures and attracting high-quality human resources. On the other hand, Chibber and Majumdar (1998) find a negative relationship between the government ownership and firm performance. Kang and Zhang (2015) find that government directors holding multiple directorships are more likely to abstain from board meetings, especially when they have good relations with the CEO or are serving on boards of less regulated firms.

H_{1b}. Multiple directorships held by corporate directors of government firms negatively affect firm performance (agency theory).

Ananchotikul (2007) views that foreign directors and ownership are considered as important catalysts by the recipient firms in upgrading their technologies, skills, and practices that in turn positively affect their performance. It may be argued that the phenomenon of multiple directorships positively impacts firm performance. In the Indian context, Patibandla (2006) and Hundal (2016) find that foreign ownership favourably affects firm value, however, Chibber and Majumdar (1999) hold that such favourable effect exists only when foreign ownership is relatively high.

H_{2a}. Multiple directorships held by corporate directors of foreign firms positively affect firm performance (resource dependency theory).

The intensity of busyness can be harmful to the firm performance. The level of responsibilities and skills requirements is relatively higher in the case of specialised committees such as audit, compensation, and nomination. Liao and Hsu (2013) find that cash remuneration paid to a CEO is decoupled from firm's performance when there is the higher intensity of busyness. Contrary to this, Ferris et al. (2003) find that intensity of busyness affects the firm performance favourably in the form of increased managerial accountability as directors serving on multiple committees attend meetings regularly. However, Ferris et al. (2003) do not rule out the possibility of enhanced compensation as a motivation to join multiple committee memberships.

H_3. The intensity of busyness unfavorably affects firm performance.

4. RESEARCH DESIGN

4.1. Sample Size and Data

The data of the final sample is comprised of an unbalanced panel of 3733 firm-years of non-financial firms listed on the Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) over the period of 2004-12. The full sample is further divided into three sub-samples of non-financial firms categorised on the basis of their ownership structure including 2376 local private, 772 government, and 585 foreign[20] firm-years. The rationale of categorizing firms in three sub-samples is that even though the economic reforms initiated in the early 1990s in India, have resulted in a major shift in the corporate ownership structure, away from the public sector and towards the private sector, including local Indian and foreign firms, however, the

[20] Foreign firms also include those established by Indian expatriates known as the Non–resident Indians (NRIs).

government-owned firms still play a highly significant role on corporate spectrum of India (Committee on Corporate Governance, 2003). The local private sector firms analysed in the current paper are group-affiliated. In terms of number, group-affiliated firms constitute 40 percent of standalone firms, in the private sector in India. However, group-affiliated firms are approximately six times larger than standalone firms in terms of asset base, and seven times in terms of market capitalization (Sarkar and Sarkar, 2012). For this reason, the sub-sample of local Indian firms include the group-affiliated private sector firms only. Similarly, foreign firms have already established their perceptible presence in the Indian corporate landscape and it is getting even stronger, thanks to economic reforms initiated in the early 1990s (Sarkar and Sarkar, 2012). Therefore, the third sub-sample comprises of foreign firms. The data has been obtained from the Prowess database of the Center for Monitoring the Indian economy (CMIE).

4.2. Empirical Methodology and Constructs

The definitions and measurement issues related to multivariate model, dependent, and independent variables are discussed below-

4.2.1. Spline Regression Multivariate Model

The spline or piecewise regression technique is used to analyse the relation between two variables that allows the slope of the relation to change at specific points known as spline knots/nodes/cut-off points (Ahlberg et al., 1967; De Boor, 2001). In the context of the current paper, the spline regression technique can show the effect of different levels of busyness on firm performance, favourably (the resource dependence argument) or unfavorably (the agency theory argument). This technique overcomes the limitation of using the exogenously determined cut-off point of busyness and therefore reflect institutional settings of firms. The node at which the relation between firm performance and multiple directorships turns negative can then be identified as the level of board busyness that starts affecting firm performance adversely (Hermalin and Weisbach, 1991; Campbell et al., 2015).

4.2.2. Performance Variables

Tobin-Q (TQ) is defined as the ratio of the sum of the market value of equity and debt, to the replacement cost of assets. However, in India, as in many other developing countries, the calculation of TQ is difficult primarily because a large proportion of the corporate debt is institutional debt that is not actively traded in the debt market. Following several existing studies, such as Khanna and Palepu (2001), and Sarkar and Sarkar (2000), a proxy for TQ is used in this paper, which is calculated by taking the book value of debt, and the book value of assets in place of market values. The TQ is influenced by a firm's growth opportunities. This effect is controlled by including expenditure on Research and Development (R&D), and advertising as explanatory variables in the multivariate model. In order to test the robustness of performance variable various other performance variables are also included in the empirical analysis and these include: Market-to-book-value ratio (MBVR), Net value added to asset ratio (NVAAR) and Return on assets (ROA)

4.2.3. Busyness Variables

Busyness is measured as the board-level median of total directorships (number of the board plus committee memberships) that is hereafter referred to as *median directorships*, showing the number of outside directorships held by the majority, that is, fifty percent of the board. Busyness is measured in relation to the firm board, and not in relation to directors, as *'directors do not govern, boards do'* (Kiel and Nicholson, 2006). Spline nodes range between three and ten directorships taken up by directors. The range starts with 'three' directorships as the majority of empirical studies in the USA, and even in non-US settings, take three directorships as a measure of busyness. However, three directorships may well be too many in the USA but may not necessarily be excessive in India, due to the size (on the average US firm are bigger than those in India), and complexity (e.g., the US firms have more joint ventures/technical collaborations/wholly owned subsidiaries abroad than Indian firms). The range ends with ten as this is the maximum number of directorships that a corporate director can take up according to section 165(1) of the Companies Act of India (MCA, 2013).

If 'y' is the firm performance (dependent variable), and 'x' is a busyness measure (independent variable), and their relation is estimated by the spline linear regression method at the node, say x_1. Sarkar and Sarkar (2009) in their study have formulated two spline variables (spline 1 and spline 2) as below:

$$\begin{aligned} \textit{Spline-1} &= x, \textit{ if } x < x_1 \\ &= x_1, \textit{ if } x \geq x_1 \\ \textit{Spline-2} &= 0, \textit{ if } x < x_1 \\ &= (x\text{-}x_1), \textit{ if } x \geq x_1 \end{aligned}$$

The ordinary least square (OLS) regression technique is applied to estimate the following functional relationship of the model:

$$\begin{aligned} (\text{Performance Variable})_{it} = \alpha_{it} &+ \beta_1(\text{Spline-1})_{it} + \beta_2(\textit{Spline-2})_{it} + \beta_3(\text{Comm-BS})_{it} + \beta_4(\text{BS})_{it} + \beta_5(\text{Pr-Ind-Dir})_{it} + \\ \beta_6(\text{Pr-Prom-Dir})_{it} &+ \beta_7(\text{Pr-Prom-Own})_{it} + \beta_8(\text{Pr-Forgn-Own})_{it} + \beta_9(\text{D/E})_{it} + \beta_{10}(\text{NAS Ratio})_{it} + \beta_{11}(\text{R\&D-} \\ \text{intensity})_{it} &+ \beta_{12}(\text{Advert-intensity})_{it} + \beta_{13}(\text{Trd-intensity})_{it} + \beta_{14}(\text{MarCap})_{it} + \text{error term} \end{aligned} \quad (1)$$

Table 1. Description of variables

Variables	*Label*	*Definition*	*Hypotheses*	*Predicted Effect*
A. Dependent Variables				
Tobin-Q proxy	TQ	Sum of market value of equity plus book value of debt, divided by book value of assets.		
Market-to-book-value ratio	MBVR	Firm's market capitalization divided by its book value.		
Net value added to asset ratio (NVAAR)	NVAAR	Net value added of firm scaled by book value of its assets		
Return on assets	ROA	Net income of a firm divided by book value of its assets		
B. Independent Variables				
Busyness Variables:				
Spline 1 Directorships	Spline-1	A negative coefficient at a given node implies firm performance is adversely affected at that level of firm-level median directorships (agency theory).	H_1, H_{1a} and H_{1b}	-
Spline 2 Directorships	Spline-2	A positive coefficient at a given node implies firm performance is favorably affected at that level of firm-level median directorships (resource dependence theory).	H_2 and H_{2a}	+
Median Committee to Board Size	Comm-BS	Intensity of busyness is derived by dividing firm-level median committee directorships by the board size.	H_3	-
Promoters' ownership, and control variables:				
Promoter directors' proportion	Pr-Prom-Dir	Ratio of the number of promoter directors to the board size of a firm. This variable underlines promoters' control	H_{1c} and H_{2b}	±
Promoters' ownership proportion	Pr-Prom-Own	Ratio of the number of promoter owned equity shares to the total number of equity shares issued	H_{1d} and H_{2c}	±
Other corporate governance variables:				
Board size	BS	Number of board members of a firm (log values)		+
Independent directors' proportion	Pr-Ind-Dir	Ratio of the number of independent directors to the board size of a firm		+
Foreign ownership proportion	Pr-Forgn-Own	Ratio of the number of equity shares owned by foreign investors to the total number of equity shares issued		+
Debt-equity ratio	D/E	Capital structure of firm calculated by dividing debt by equity (both book values)		±
Firm-Level control variables:				
Research and development intensity	R&D-intensity	Ratio of the firm-level R&D expenditure to the sales revenue		+
Advertisement intensity	Advert-intensity	Ration of the firm-level expenditure on advertising to the sales revenue		+
Trade intensity	Trd-intensity	Ratio of the number of shares traded to the total number of shares outstanding		+
Market-capitalization	MarCap	Multiplying the market value of a share and the number of shares outstanding (log values)		+

5. RESULTS AND DISCUSSION

Table 2 depicts the mean values of firm performance (dependent variable), and independent variables categorised as busyness, corporate governance, and some firm-level control variables. Regarding the busyness variables, Table 2 shows that the mean numbers of total directorships (board memberships plus committee memberships) per firm are 79.35, 78.86 and 67.36 for local private, foreign and government firms respectively. The value of the same statistic for the full sample is 75.62. Furthermore, foreign firms have the highest (lowest) percentage of outside (inside) directors, whereas local private firms have the highest (lowest) percentage of inside (outside) directors. Government-owned firms have the largest board size (12.78) followed by local private (12.18) and foreign firms (10.64). With regard to the composition of boards of directors, results show that foreign firms have the highest percentage of independent/outside directors, followed by government and local private firms. Regarding the ownership structure, the results show that ownership concentration is highest among the foreign firms, as promoters and their group ownership is 69.99 percent, whereas, for the local private firms, ownership is relatively dispersed.

Table 3 shows the pairwise correlation highlighting the association between all variables used in the analysis of this paper including, performance variables, that is TQ (Y1), MBVR (Y2), ROA (Y3) and NVAAR (Y4) and busyness, promoter ownership and control, corporate governance, and firm-level control variables (independent variables, X1 to X14). With reference to the independent variables, except for the correlation coefficients of promoter directors' proportion (X4) with promoters' ownership proportion (X5), and independent directors' proportion (X6), both with a 10 percent level of significance, no other pairwise coefficient correlation is significant. Therefore, the empirical results are not affected by the multicollinearity problem. On the other hand, the correlation coefficients between different performance variables are significantly positive.

Table 2. Mean values of firm performance (dependent), and independent variables

Variables	*Local Private Firms*	*Foreign Firms*	*Government Firms*	*Total Sample*
A. Performance Variables (Mean Numbers)				
1. Tobin-Q	2.17	2.53	2.33	2.33
2. Market to Book Value Ratio	2.39	2.75	3.34	2.78
3. Net Value Added to Asset Ratio (number)	0.31	0.38	0.46	0.38
4. Return on Assets (Percentage)	7.31	9.38	8.45	8.31
B. Busyness Variables (Mean Numbers)				
1. Board memberships of directors per firm	53.11	52.88	45.29	50.71
2. Committee memberships of directors per firm	26.24	25.98	22.07	24.91
3. Number of Total Directorships (1+2) Per Firm	*79.35*	*78.86*	*67.36*	*75.62*
C. Governance Variables (Mean Numbers)				
1. Board Size (number)	12.18	10.64	12.78	11.86
2. Composition of Board (percentage of total board)				
i. Independent Directors	52.75	63.38	57.24	57.51
ii. Affiliated Directors	17.22	11.31	12.68	13.97
iii. Outside Directors (i+ii)	*69.97*	*74.69*	*69.92*	*71.48*
iv. Executive Directors	20.22	16.49	19.09	18.68
v. Promoters Non-Executive Directors	9.81	8.82	10.99	9.84
vi. Inside Directors (iv+v)	*30.03*	*25.31*	*30.08*	*28.53*
3. Ownership Structure (percentage of total paid-up capital)				
i. Resident Individual Investors	23.55	19.78	16.94	20.37
ii. Indian Financial Institutions	13.97	9.14	9.64	11.13
iii. Government Investors	8.53	7.09	59.92	23.38
iv. Resident Corporate Bodies	36.69	9.08	7.56	19.13
v. Foreign Institutional/Individual Investors	8.09	54.74	5.77	22.39
vi. Promoters & Promoter Group	45.26	69.99	59.93	57.58
vii. Public Shareholdings	54.67	28.94	40.01	42.03
4. Debt-equity ratio	0.86	0.79	0.76	0.81
5. Non-audit fees to total auditor fees ratio	0.21	0.16	0.14	0.17
D. Firm Level Control Variables (Mean Numbers)				
1. R&D Intensity (percentage)	2.95	3.54	2.44	2.99
2. Advertisement-intensity (percentage)	2.49	3.15	2.14	2.6
4. Trade-intensity ratio	0.58	0.56	0.53	0.56
5. Market-Capitalization (Million Rupees®)	76822.67	73223.89	81177.97	76963.79

Note: @ The 52-week range of one US dollar in terms of Indian Rupees for the time period between 2 August 2015 to 1 August 2016 has been between 63.7150 - 68.7887. http://www.bloomberg.com/quote/USDINR:CUR (Accessed 2 August 2016).

Table 3. Pairwise correlation table of variables

	X1	*X2*	*X3*	*X4*	*X5*	*X6*	*X7*	*X8*	*X9*	*X10*	*X11*	*X12*	*X13*	*Y1*	*Y2*	*Y3*	*Y4*
X1	1	.089	.057	-.041	-.009	.115	-.004	-.005	.005	.001	.001	.000	-.010	-.233**	-.112*	-.232*	-.103*
X2	.089	1	-.016	.062	.103	.089	.000	-.009	.001	.007	-.004	.004	.007	-.127*	-.005	-.116*	-.005
X3	.057	-.016	1	-.082	-.112	-.134	.012	-.003	.005	-.005	-.002	.003	-.001	-.176†	.003	.005	.203*
X4	-.041	.062	-.082	1	.102†	-.109†	.009	-.009	.006	-.007	-.005	.000	-.007	.021**	.142*	.052†	.193*
X5	-.009	.103	-.112	.102†	1	-.109	.034	.006	.008	-.007	-.010	-.001	-.002	.011†	.010	-.010	.127*
X6	.115	.089	-.134	-.109†	-.109	1	.007	.004	-.013	.009	.003	-.003	.013	-.006	.023†	.138*	.009
X7	-.004	.000	.012	.009	.034	.007	1	.000	.004	.012	.011	.009	.006	.008	.013†	.012†	.003
X8	-.005	-.009	-.003	-.009	.006	.004	.000	1	.024	-.005	.001	-.002	-.002	.688**	.591**	.454**	.344**
X9	.005	.001	.005	.006	.008	-.013	.004	.024	1	.002	-.004	-.002	.005	.042	.421**	.601**	.291**
X10	.001	.007	-.005	-.007	-.007	.009	.012	-.005	.002	1	.011	.000	-.029	-.042*	-.001	-.167*	.000
X11	.001	-.004	-.002	-.005	-.010	.003	.011	.001	-.004	.011	1	-.012	-.053	.121**	.112†	.003	.006
X12	.000	.004	.003	.000	-.001	-.003	.009	-.002	-.002	.000	-.012	1	.003	-.142*	-.003	-.003	-.119*
X13	-.010	.007	-.001	-.007	-.002	.013	.006	-.002	.005	-.029	-.053	.003	1	.232**	.003	.215*	.128*
Y1	-.233**	-.127*	-.176†	.021**	.011†	-.006	.008	.688**	.042	-.042*	.121**	-.142*	.232**	1	.792**	.859**	.759**
Y2	-.112*	-.005	.003	.142*	.010	.023†	.013†	.591**	.421**	-.001	.112†	-.003	.003	.792**	1	.787**	.719**
Y3	-.232*	-.116*	.005	.052†	-.010	.138*	.012†	.454**	.601**	-.167*	.003	-.003	.215*	.859**	.787**	1	.638**
Y4	-.103*	-.005	.203*	.193*	.127*	.009	.003	.344**	.291**	.000	.006	-.119*	.128*	.759**	.719**	.638**	1

*Note: *** p < 0.001; ** p < 0.01; * p < 0.05. and † p < 0.1*

X1: Median Directorships, X2: Median committee to board size, X3: Board size, X4: Promoter directors proportion, X5: Promoters ownership proportion, X6: Independent directors proportion, X7: Foreign ownership proportion, X8: Research & development intensity, X9: Advertisement intensity, X10: Non-audit fees to total fees of auditor, X11: Trade intensity, X12: Debt-equity ratio, X13: Market-capitalization.

Y1: Tobin-Q, Y2: Market-to-book value ratio, Y3: Return on assets, Y4: Net Value Added to Asset Ratio

Table 4 highlights the effects of busyness and other explanatory variables on TQ, the principal performance variable (dependent), for the full sample. Similarly, this table explains impacts of the busyness variables and other explanatory variables on MBVR, NVAAR, and ROA in order to check the robustness of the association between board busyness and firm performance. The negative relationships between median firm-level total directorships, on the one hand, and all four performance measures, on the other, have been found to be significant. Similarly, the intensity of

busyness negatively affects firm performance (TQ and ROA). The above two results support the agency theory argument that the increased board busyness, negatively affects firm performance, both, *quantitatively* and *qualitatively*. The phenomenon can be termed *quantitative* as an increasing number of median outside directorships accepted by firm directors can make them over-committed and thus leave them with relatively less time and other resources available to devote to the firm. Similarly, the above phenomenon can be termed *qualitative* because an increasing ratio of median committee memberships to firm board size indicates that when a director joins a committee instead of a *general* board of directors he/she can find his/her professional responsibilities more challenging and demanding.

Table 4. Effects of busyness, governance, and control variables on firm performance (TQ, MBVR, NVA to asset ratio and ROA)

Dependent variables	*TQ*	*MBVR*	*NVAAR*	*ROA*
Intercept	1.125 (1.035)	-0.026 (-0.318)	-0.004 (-0.156)	0.008 (0.577)
Med-Dir	-0.713* (-1.662)	-0.252† (-1.369)	-0.102† (-1.567)	-0.113† (-1.612)
Comm-BS	-0.519† (-1.448)	-0.002 (-0.038)	-0.000 (-0.128)	-0.076† (-1.435)
BS	-0.576† (-1.595)	-0.004 (-0.098)	0.483* (2.112)	0.439 (1.267)
Pr-Ind-Dir	-0.403 (-1.257)	0.122† (1.314)	0.000 (0.137)	0.197** (8.039)
Pr-Prom-Dir	1.202** (6.271)	0.069† (1.289)	0.0981* (1.767)	0.196* (2.322)
Pr-Prom-Own	0.746* (2.325)	0.041 (0.332)	0.064† (1.323)	-0.092 (-0.978)
Pr-Forgn-Own	0.025 (0.268)	0.073* (1.968)	-0.004 (-0.278)	0.072† (1.392)
D/E ratio	-0.502† (-1.336)	-0.008 (-0.266)	-0.067† (-1.383)	-0.022 (-0.681)
NAS ratio	-0.766* (-1.819)	-0.006 (-0.207)	-0.007 (-0.356)	-0.007† (-1.287)
R&D-int	0.561† (1.497)	0.441** (6.031)	0.046† (1.287)	0.054† (1.345)
Advert-int	0.108 (0.789)	0.382** (5.044)	0.054† (1.319)	0.092† (1.539)
Trd-int	1.109** (4.271)	0.102† (1.295)	0.016 (0.679)	0.002 (0.413)
MarCap	0.809** (3.671)	0.031 (0.301)	0.114** (7.513)	0.113* (2.228)
Adjusted R^2	0.53	0.37	0.43	0.41
N	3733	3733	3733	3733

Note: OLS estimates are shown in above table (t-statistics appear in parentheses).
**** p < 0.001; ** p < 0.01; * p < 0.05, and † p < 0.1*
TQ: Tobin-Q; MBVR: Market-to-book value ratio; NVAAR: Net Value Added to Asset Ratio; ROA: Return on assets; Med-Dir: Median Directorships; Comm-BS: Median committee to board size; BS: Board size; Pr-Ind-Dir: Independent directors proportion; Pr-Prom-Dir: Promoter directors proportion ; Pr-Prom-Own: Promoters ownership proportion; Pr-Forgn-Own: Foreign ownership proportion; D/E ratio: Debt-equity ratio; NAS Ratio: Non-audit fees to total fees of auditor; R&D-intensity: Research & development intensity; Advert-intensity: Advertisement intensity; Trd-intensity: Trade intensity; MarCap: Market-capitalization.

The positive association of both Pr-Prom-Dir and Pr-Prom-Own with the firm performance variables highlights that investors react positively to the promoters' control over the board and ownership of the firm. The coefficient of BS negatively affects firm value measured by TQ, however, the effect is positive in the case of NVAAR. On the one hand, larger boards can be prone to unnecessary delays, and complications, for example, with respect to planning and operations. On the other hand, larger boards lead to enriched board resources, which in turn support formulating better plans and running operations successfully. The positive coefficient of Pr-Ind-Dir shows that as the proportion of independent directors increases, the firm performance (MBVR and ROA) improves. The coefficient of Pr-Forgn-Own affects MBVR and ROA positively. Furthermore, the impact of R&D-int, Advert-int, Trd-int and MarCap is found to be positive in terms of firm performance. However, the coefficient of the D/E ratio, which highlights the firm's capital structure, and the NAS ratio negatively affect firm performance.

Table 5 highlights the association between firm performance of local private sector firms and board busyness. The coefficient of spline-1 turns negative and significant at the median directorships at spline-node-5 and continues to be ever more significant up-to node 10. The interpretation of the above finding is that at the busyness level of five directorships and above, corporate directors in local private Indian firms may find it difficult to perform the tasks entrusted to them efficiently and as a result firm value is eroded. Furthermore, the above finding contradicts the regulatory provision under the Companies Act of India that the "maximum number of public companies in which a person can be appointed as a director shall not exceed ten" (MCA, 2013:97). Regarding the intensity of busyness, the variable Comm-BS becomes negative and significant

once the median number of directorships reaches a cut-off point of four, and this trend continues as the number of directorships increases further. This result implies that at a busyness level of below four, it is immaterial whether the majority of directors of a firm are only members of other firms' boards or participate on specific committees of such firms; however, when a majority of directors of a firm increase their committee memberships in other firms to four, the directors find it difficult to perform tasks requiring specialized skills and/or to devote time and effort to the specific committees of other firms. For Pr-Prom-Dir, the result indicates that as busyness level is increasing from spline-node-5, investors of a firm start perceiving a higher proportion of promoter directors on its board as a sign of vital firm-specific information possessed by directors, and higher control of promoter directors over the firm board ensures that such strategic information remain within given corporate group. A similar argument holds for Pr-Prom-Own too. Based on the above findings of local private sector firms in India H_{1a} and H_3 can be accepted.

Table 5. Effects of busyness, governance, and control variables on firm performance (measured by TQ) in the private sector in India

TQ (dependent variable)	*(a)*	*(b)*	*(c)*	*(d)*	*(e)*	*(f)*	*(g)*	*(h)*
	Spline Node=3	Spline Node=4	Spline Node=5	Spline Node=6	Spline Node=7	Spline Node=8	Spline Node=9	Spline Node=10
Intercept	0.137 (1.109)	0.137 (1.109)	1.135 (1.076)	1.135 (1.076)	0.137 (1.109)	1.136 (1.091)	1.131 (0.882)	1.129 (0.769)
Spline-1	-0.621 (-1.187)	-0.667 (-1.272)	-0.762† (-1.616)	-0.764† (-1.639)	-0.789* (-2.249)	-0.789* (-2.291)	-0.791* (-2.309)	-0.792* (-2.321)
Spline-2	0.037 (0.668)	0.037 (0.668)	0.035 (0.621)	0.035 (0.621)	0.033 (0.547)	0.033 (0.547)	0.033 (0.547)	0.033 (0.547)
Comm-BS	-0.741 (-1.279)	-1.008* (-2.309)	-1.008* (-2.309)	-1.112** (2.367)	-1.116** (2.549)	-1.117** (2.611)	-1.119** (2.692)	-1.119** (2.692)
BS	-0.372 (-1.121)	-0.372 (-1.121)	-0.372 (-1.121)	-0.403 (-1.167)	-0.421 (-1.225)	-0.508* (-1.467)	-0.509* (-1.514)	-0.528* (-1.626)
Pr-Ind-Dir	-0.865 (-1.184)	-0.881 (-1.277)	-1.313* (-2.119)	-1.345* (-2.321)	-1.521** (-4.698)	-1.589** (-5.887)	-1.675** (-6.698)	-1.779** (-8.127)
Pr-Prom-Dir	0.069 (0.821)	0.073 (0.991)	0.083† (1.291)	0.084† (1.311)	0.084† (1.311)	0.085† (1.345)	0.085† (1.345)	0.085† (1.345)
Pr-Prom-Own	0.045 (0.628)	0.045 (0.628)	0.045 (0.628)	.052 (0.712)	0.076† (1.284)	0.076† (1.284)	0.076† (1.284)	0.076† (1.284)
Pr-Forgn-Own	0.039 (0.515)	0.039 (0.515)	0.039 (0.515)	0.039 (0.515)	0.039 (0.515)	0.039 (0.515)	0.039 (0.515)	0.039 (0.515)
D/E ratio	-0.082† (-1.423)	-0.076† (-1.322)	-0.059† (-1.301)	-0.052 (-0.927)	-0.052 (-0.927)	-0.051 (-0.865)	-0.047 (-0.796)	-0.047 (-0.796)
NAS ratio	-0.532 (-1.277)	-0.532 (-1.277)	-0.532 (-1.277)	-0.711* (-1.723)	-0.716* (-1.819)	-0.717* (-1.882)	-0.719* (-1.914)	-0.719* (-1.914)
R&D-int	0.062† (1.378)	0.061† (1.356)	0.059† (1.301)	0.051 (1.239)	0.051 (1.239)	0.051 (1.239)	0.051 (1.239)	0.051 (1.239)
Advert-int	0.043† (1.201)	0.043† (1.201)	0.043† (1.201)	0.034 (0.675)	0.034 (0.675)	0.031 (0.581)	0.029 (0.524)	0.029 (0.524)
Trd-int	1.101** (2.327)	1.104** (2.362)	1.106** (2.362)	1.109** (2.419)	1.111** (2.457)	1.113** (2.484)	1.116** (2.549)	1.116** (2.549)
MarCap	0.893* (2.009)	0.893* (2.009)	0.894* (2.079)	0.894* (2.079)	0.894* (2.079)	0.896* (2.197)	0.896* (2.197)	0.898* (2.231)
Adjusted R^2	0.53	0.53	0.54	0.56	0.54	0.54	0.55	0.55
N	2376	2376	2376	2376	2376	2376	2376	2376

Note: OLS estimates are shown in above table (t-statistics appear in parentheses).

**** p < 0.001; ** p < 0.01; * p < 0.05, and † p < 0.1*

TQ: Tobin-Q; Comm-BS: Median committee to board size; BS: Board size; Pr-Ind-Dir: Independent directors proportion; Pr-Prom-Dir: Promoter directors proportion ; Pr-Prom-Own: Promoters ownership proportion; Pr-Forgn-Own: Foreign ownership proportion; D/E ratio: Debt-equity ratio; NAS Ratio: Non-audit fees to total fees of auditor; R&D-intensity: Research & development intensity; Advert-intensity: Advertisement intensity; Trd-intensity: Trade intensity; MarCap: Market-capitalization.

Table 6 shows that for foreign firms, their corporate directors holding multiple directorships enhance firm performance. The coefficient of the spline-2 variable remains significantly positive at all busyness levels, that is, from spline node three to ten. This finding is aligned with resource dependence theory, as directors serving on multiple boards represent their high level of reputational capital, which can result in a positive effect on firm performance. This result, similar to that obtained in the case of local Indian private firms (Table 5), also contradicts the wisdom of setting a regulatory limit of ten directorships in India (MCA, 2013), albeit in the opposite direction. For local Indian private firms, the regulatory limit of ten directorships is *too big*; whereas for foreign firms, the results suggest there is more scope for directors to join additional boards. Regarding the intensity of busyness, *Comm/BS* is insignificant, implying that when directors of a foreign firm in India join other firms' boards it does not affect the firm's performance negatively. The above findings support H_{2a}.

Table 6. Effects of busyness, governance, and control variables on firm performance (measured by TQ) in the foreign sector in India

TQ (dependent variable)	*(a)*	*(b)*	*(c)*	*(d)*	*(e)*	*(f)*	*(g)*	*(h)*
	Spline Node=3	Spline Node=4	Spline Node=5	Spline Node=6	Spline Node=7	Spline Node=8	Spline Node=9	Spline Node=10
Intercept	2.028 (0.676)	2.126 (0.831)	2.126 (0.831)	2.126 (0.831)	2.126 (0.831)	2.126 (0.831)	2.126 (0.831)	2.126 (0.831)
Spline-1	0.021 (0.462)	0.021 (0.462)	0.024 (0.571)	0.024 (0.571)	0.024 (0.571)	0.023 (0.512)	0.023 (0.512)	0.021 (0.462)
Spline-2	0.991† (1.376)	0.982† (1.365)	0.992† (1.376)	1.065* (2.119)	1.071* (2.176)	1.077* (2.201)	1.079* (2.243)	1.081* (2.281)
Comm-BS	0.001 (0.071)	0.001 (0.071)	0.001 (0.071)	0.001 (0.071)	0.001 (0.071)	0.001 (0.071)	0.001 (0.071)	0.001 (0.071)
BS	0.117 (0.683)	0.143 (0.769)	0.143 (0.769)	0.175 (0.872)	0.214† (1.283)	0.235† (1.297)	0.235† (1.297)	0.235† (1.297)
Pr-Ind-Dir	0.412* (2.253)	0.373* (2.221)	0.312† (1.339)	0.294† (1.301)	0.172 (0.545)	0.166 (0.482)	0.154 (0.422)	0.143 (0.335)
Pr-Prom-Dir	0.992† (1.371)	0.992† (1.371)	0.992† (1.371)	0.993† (1.382)	1.013† (1.425)	1.032* (1.679)	1.044* (2.021)	1.045* (2.098)
Pr-Prom-Own	-0.005 (-0.424)	-0.005 (-0.424)	-0.005 (-0.424)	-0.005 (-0.424)	-0.005 (-0.424)	-0.005 (-0.424)	-0.005 (-0.424)	-0.005 (-0.424)
Pr-Forgn-Own	0.044† (1.282)	0.044† (1.282)	0.045† (1.291)	0.045† (1.291)	0.048† (1.311)	0.048† (1.311)	0.048† (1.311)	0.049† (1.326)
D/E ratio	0.001 (0.434)	0.001 (0.434)	0.001 (0.434)	0.001 (0.434)	0.001 (0.434)	0.001 (0.434)	0.001 (0.434)	0.001 (0.434)
NAS ratio	-0.21** (-2.563)	-0.21** (-2.563)	-0.19** (-2.356)	-0.19** (-2.356)	-0.16* (-2.203)	-0.16* (-2.203)	-0.15* (-2.123)	-0.15* (-2.123)
R&D-int	1.447** (8.868)	1.451** (8.941)	1.457** (9.627)	1.463** (9.992)	1.461** (9.911)	1.459** (9.867)	1.459** (9.867)	1.459** (9.867)
Advert-int	0.032 (1.221)	0.031 (1.165)	0.029 (1.123)	0.029 (1.123)	0.029 (1.123)	0.028 (0.823)	0.028 (0.823)	0.027 (0.535)
Trd-int	0.000 (-0.054)	0.000 (-0.054)	0.000 (-0.054)	0.000 (-0.054)	0.000 (-0.054)	0.000 (-0.054)	0.000 (-0.054)	0.000 (-0.054)
MarCap	1.197** (6.549)	1.197** (6.549)	1.193** (6.447)	1.192** (6.376)	1.192** (6.376)	1.192** (6.376)	1.191** (6.296)	1.191** (6.296)
Adjusted R^2	0.38	0.37	0.38	0.38	0.39	0.38	0.39	0.39
N	585	585	585	585	585	585	585	585

Note: OLS estimates are shown in above table (t-statistics appear in parentheses).

**** p < 0.001. ** p < 0.01. * p < 0.05, and † p < 0.1. TQ: Tobin-Q; Comm-BS: Median committee to board size; BS: Board size; Pr-Ind-Dir: Independent directors proportion; Pr-Prom-Dir: Promoter directors proportion ; Pr-Prom-Own: Promoters ownership proportion; Pr-Forgn-Own: Foreign ownership proportion; D/E ratio: Debt-equity ratio; NAS Ratio: Non-audit fees to total fees of auditor; R&D-intensity: Research & development intensity; Advert-intensity: Advertisement intensity; Trd-intensity: Trade intensity; MarCap: Market-capitalization.*

Table 7. Effects of busyness, governance, and control variables on firm performance (measured by TQ) in the government sector in India

TQ (dependent variable)	*(a)*	*(b)*	*(c)*	*(d)*	*(e)*	*(f)*	*(g)*	*(h)*
	Spline Node=3	Spline Node=4	Spline Node=5	Spline Node=6	Spline Node=7	Spline Node=8	Spline Node=9	Spline Node=10
Intercept	1.113 (0.574)	1.111 (0.523)	1.111 (0.523)	1.111 (0.523)	1.112 (0.591)	1.112 (0.591)	1.112 (0.591)	1.113 (0.574)
Spline-1	-0.002 (-0.396)	-0.003 (-0.427)	-0.003 (-0.427)	-0.002 (-0.396)	-0.003 (-0.427)	-0.004 (-0.487)	-0.004 (-0.487)	-0.004 (-0.487)
Spline-2	1.457** (6.443)	1.461** (6.729)	1.465** (7.222)	1.471** (8.443)	1.471** (8.443)	1.476** (9.025)	1.479** (9.443)	1.481** (9.624)
Comm-BS	-0.501 (-1.106)	-0.501 (-1.106)	-0.513 (-1.233)	-0.579† (-1.867)	-0.623† (-2.028)	-0.662† (-2.089)	-0.704* (-2.192)	-0.704* (-2.192)
BS	-0.147† (-1.335)	-0.147† (-1.335)	-0.148† (-1.387)	-0.149† (-1.427)	-0.149† (-1.427)	-0.151† (-1.503)	-0.154† (-1.589)	-0.155† (-1.621)
Pr-Ind-Dir	0.069 (0.899)	0.071 (0.924)	0.071 (0.924)	0.071 (0.924)	0.073 (0.934)	0.075 (0.954)	0.076 (1.112)	0.076 (1.112)
Pr-Prom-Dir	-0.051 (-0.683)	-0.053 (-0.737)	-0.051 (-0.683)	-0.049 (-0.627)	-0.048 (-0.563)	-0.051 (-0.683)	-0.051 (-0.683)	-0.052 (-0.706)
Pr-Prom-Own	0.131† (1.298)	0.131† (1.298)	0.131† (1.298)	0.132† (1.309)	0.132† (1.309)	0.132† (1.309)	0.133† (1.321)	0.133† (1.321)
Pr-Forgn-Own	0.129† (1.287)	0.129† (1.287)	0.129† (1.287)	0.125 (1.223)	0.124 (1.205)	0.124 (1.205)	0.123 (1.176)	0.123 (1.176)
D/E ratio	-0.623* (-2.043)	-0.623* (-2.043)	-0.631* (-2.087)	-0.632* (-2.098)	-0.632* (-2.098)	-0.633* (-2.126)	-0.634* (-2.143)	-0.636* (-2.157)
NAS ratio	-0.003 (-0.451)	-0.002 (-0.379)	-0.002 (-0.379)	-0.001 (-0.265)	-0.001 (-0.265)	-0.001 (-0.265)	-0.001 (-0.265)	-0.001 (-0.265)
R&D-int	0.006 (0.163)	0.008 (0.191)	0.008 (0.191)	0.008 (0.191)	0.011 (0.256)	0.011 (0.256)	0.013 (0.317)	0.013 (0.317)
Advert-int	0.048 (0.642)	0.051 (0.719)	0.051 (0.719)	0.048 (0.642)	0.048 (0.642)	0.048 (0.642)	0.049 (0.681)	0.049 (0.681)
Trd-int	0.077† (1.285)	0.077† (1.285)	0.077† (1.285)	0.065 (0.823)	0.065 (0.823)	0.063 (0.782)	0.062 (0.763)	0.062 (0.763)
MarCap	1.225** (4.443)	1.227** (4.591)	1.227** (4.591)	1.229** (4.656)	1.229** (4.656)	1.231** (4.721)	1.233** (4.862)	1.237** (5.112)
Adjusted R^2	0.31	0.29	0.29	0.31	0.32	0.32	0.31	0.31
N	772	772	772	772	772	772	772	772

Note: OLS estimates are shown in above table (t-statistics appear in parentheses).

**** p < 0.001; ** p < 0.01; * p < 0.05, and † p < 0.1. TQ: Tobin-Q; Comm-BS: Median committee to board size; BS: Board size; Pr-Ind-Dir: Independent directors proportion; Pr-Prom-Dir: Promoter directors proportion ; Pr-Prom-Own: Promoters ownership proportion; Pr-Forgn-Own: Foreign ownership proportion; D/E ratio: Debt-equity ratio; NAS Ratio: Non-audit fees to total fees of auditor; R&D-intensity: Research & development intensity; Advert-intensity: Advertisement intensity; Trd-intensity: Trade intensity; MarCap: Market-capitalization.*

Table 7 exhibits that for government firms, multiple directorships held by the corporate directors increases firm performance. The coefficient of the spline-2 variable remains significantly positive throughout at all busyness levels up to spline-node-10. Perhaps, this is the most unexpected result, as, with regard to the busyness of corporate directors of government firms, it might be expected that proliferation of bureaucracy in the public sector of India would suggest directors' busyness is underpinned by the agency theory argument more than the resource dependence argument, and that firm value would reduce as the busyness of directors increases. However, the argument that follows in support of the above finding is that in a public sector company, directors are appointed by a ministry or similar statutory body on the basis of merit, and the CEOs have the less discretionary power to handpick directors. Once again, this finding questions the wisdom of the regulatory requirements limiting the number of directorships to ten in India (MCA, 2013). The coefficient of Comm-BS affects firm value negatively at busyness level six and beyond. The increasing coefficient of Comm-BS implies that when the intensity of busyness increases, there is a negative effect on firm value, at the higher level of busyness. Based on the above findings H_{1b} is rejected and H_3 is accepted.

Table 8 highlights the effects of multiple directorships, and governance and control variables on firm performance firms in the full sample. The coefficients of spline-1 and spline-2 affect firm value negatively (at spline-node-6 and above) and positively (at spline-node-4 and below), respectively. In other words, multiple directorships affect a firm favourably only up to the level of four directorship assignments in other firms. On the other hand, multiple directorships affect a firm unfavourably when its directors take up six or more directorship assignments in other firms. This result highlights the interplay of agency, and resource dependence theory when studying the relationship between multiple directorships and firm value. The coefficient of Comm-BS affects firm value negatively at a multiple directorship level of six or above. For the overall sample H_1 and H_3 are true at a relatively higher level of busyness, however, H_2 is valid only at lower levels.

Table 8. Effects of busyness, governance, and control variables on firm performance (measured by TQ) for the full sample

TQ (dependent variable)	*(a)*	*(b)*	*(c)*	*(d)*	*(e)*	*(f)*	*(g)*	*(h)*
	Spline Node=3	Spline Node=4	Spline Node=5	Spline Node=6	Spline Node=7	Spline Node=8	Spline Node=9	Spline Node=10
Intercept	1.442 (1.271)	1.442 (1.271)	1.441 (1.223)	1.441 (1.223)	1.439 (1.187)	1.439 (1.187)	1.439 (1.187)	1.439 (1.187)
Spline-1	-0.342 (-1.196)	-0.342 (-1.196)	-0.414 (-1.277)	-0.512* (-2.221)	-0.739** (-4.337)	-0.752** (-4.889)	-0.786** (-5.442)	-0.814** (-6.296)
Spline-2	0.221* (1.891)	0.219* (1.843)	0.182 (1.262)	0.159 (1.198)	0.154 (1.165)	0.139 (1.112)	0.135 (0.923)	0.123 (0.773)
Comm-BS	-0.323 (-1.167)	-0.363 (-1.221)	-0.422 (-1.281)	-0.776** (-5.345)	-0.791** (-5.481)	-0.797** (-5.526)	-0.797** (-5.526)	-0.799** (-5.614)
BS	-0.303 (-1.034)	-0.303 (-1.034)	-0.329 (-1.127)	-0.421 (-1.225)	-0.509† (-1.554)	-0.528† (-1.623)	-0.571* (-2.291)	-0.577* (-2.324)
Pr-Ind-Dir	-0.363 (-1.219)	-0.378 (-1.243)	-0.378 (-1.243)	-0.403 (-1.257)	-0.403 (-1.257)	-0.509* (-2.212)	-1.441** (-6.698)	-1.441** (-6.698)
Pr-Prom-Dir	0.082† (1.345)	0.079† (1.323)	0.076† (1.309)	0.074† (1.299)	0.074† (1.299)	0.072† (1.287)	0.055 (1.239)	0.047 (1.178)
Pr-Prom-Own	0.081† (1.331)	0.076† (1.309)	0.073† (1.295)	0.052 (0.712)	0.047 (0.657)	0.047 (0.657)	0.039 (0.562)	0.039 (0.562)
Pr-Forgn-Own	0.023 (0.422)	0.023 (0.422)	0.022 (0.403)	0.022 (0.403)	0.023 (0.422)	0.022 (0.403)	0.021 (0.361)	0.021 (0.361)
D/E ratio	-0.046 (-0.765)	-0.047 (-0.801)	-0.051 (-0.867)	-0.052 (-0.927)	-0.085** (-2.824)	-0.083** (-2.622)	-0.083** (-2.622)	-0.083** (-2.622)
NAS ratio	-0.703* (-1.723)	-0.711* (-1.762)	-0.714* (-1.791)	-0.715* (-1.823)	-0.716* (-1.871)	-0.717* (-1.896)	-0.718* (-1.914)	-0.718* (-1.914)
R&D-int	0.083† (1.378)	0.082† (1.356)	0.079† (1.321)	0.078† (1.302)	0.078† (1.302)	0.073† (1.287)	0.073† (1.287)	0.073† (1.287)
Advert-int	0.037 (0.521)	0.037 (0.521)	0.037 (0.521)	0.037 (0.521)	0.037 (0.521)	0.037 (0.521)	0.037 (0.521)	0.037 (0.521)
Trd-int	0.786** (3.346)	0.862** (5.137)	0.934** (6.723)	0.934** (6.723)	1.008** (7.111)	1.101** (7.472)	1.104** (7.723)	1.104** (7.723)
MarCap	0.893* (2.228)	0.893* (2.228)	0.894* (2.261)	0.894* (2.261)	0.896* (2.291)	0.896* (2.291)	0.897* (2.303)	0.898* (2.322)
Adjusted R^2	0.61	0.63	0.64	0.66	0.63	0.63	0.63	0.63
N	3733	3733	3733	3733	3733	3733	3733	3733

Note: OLS estimates are shown in above table (t-statistics appear in parentheses).

**** p < 0.001; ** p < 0.01; * p < 0.05, and † p < 0.1*

TQ: Tobin-Q; Comm-BS: Median committee to board size; BS: Board size; Pr-Ind-Dir: Independent directors proportion; Pr-Prom-Dir: Promoter directors proportion ; Pr-Prom-Own: Promoters ownership proportion; Pr-Forgn-Own: Foreign ownership proportion; D/E ratio: Debt-equity ratio; NAS Ratio: Non-audit fees to total fees of auditor; R&D-intensity: Research & development intensity; Advert-intensity: Advertisement intensity; Trd-intensity: Trade intensity; MarCap: Market-capitalization.

6. CONCLUSIONS, LIMITATIONS AND FUTURE RESEARCH SUGGESTIONS

The results show that for the sub-sample of local private firms and for the full sample, the busyness of corporate directors adversely affects firm level performance. For local private firms and the full sample, the board level busyness of directors is detrimental to the firm performance even before reaching the maximum limit of multiple directorships. Furthermore, for the local private firms, the above mentioned negative effect starts at the busyness cut-off point of five and for the full sample the same starts at spline node six. For the sub-samples of foreign and government firms, board busyness positively affects the firm value throughout, whereas, for the full sample, the same positive effect does not extend beyond the busyness limit of four. With regard to the intensity of busyness, the findings show that in the sub-sample of local private firms, the negative effect starts at the very low level of busyness of four directorships, however, for the sub-sample of government firms and the full sample, the negative effect of the intensity of busyness does not begin before the spline node of six. Interestingly, for the full sample and each of the three sub-samples, empirical findings contradict the limits imposed by the regulator. Therefore, *'one size does not fit all'*.

About theoretical contributions, first, the association between the busyness of corporate directors and firm performance is problematized and analysed through the interplay of two distinct and, arguably, conflicting theoretical arguments are drawn from the agency, and resource dependence theories. Second, the current study highlights the importance of factors, such as multiple directorships, that determine the independence of boards.

In terms of practical contributions, first, the current study is one of very few conducted in the setting of an emerging economy like India, and the findings of the current paper can be useful to study the similar relationship in other emerging markets with a corporate governance structure similar to that of India. Second, current paper highlight relevance of endogenously determined limits of busyness as against those imposed exogenously by regulators. Furthermore, the busyness limits are not only determined for the full-sample but also separately for each of the ownership groups, that is, local private, foreign and government firms. Therefore, the current paper recognises the institutional settings and ownership characteristics of firms. Third, the current paper also explores the effects of promoters' ownership and control, a peculiar feature of Indian corporate settings, on firm performance.

Nonetheless, the current paper has several limitations and further research to overcome them. First, the effect of busyness on firm performance can be studied by creating multiple categories of directors, such as executive, non-executive and affiliate directors. Second, alternative measures of busyness can be tested in future research. Third, measure reputational capital of directors can be explored in future studies. Lastly, in the current paper private sector firms are comprised of group-affiliated firms only, however, in the future studies, standalone firms can also be studied when analysing the effects of busyness on firm performance.

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