

# Are Independent Directors Really “Independent” In Indian Companies in the Digital Era

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## Abstract:

The concept of Independent Directors was introduced as a voluntary mechanism in the US during 1950s with the belief that a board with some level of independence will introduce objectivity in decision making, add to the diversity and advisory capabilities of the Board and hence improve performance of the company. The forerunner of Independent Directors under the current corporate law in India can be seen in the recommendations made by the Kumaramangalam Birla Committee (1999), Naresh Chandra Committee (2002), Narayana Murthy Committee (2003). Further to these proposals the term Independent Director was introduced for the first time in India when the Securities and Exchange Board of India (SEBI) incorporated Clause 49 of the Listing Agreement. The independent directors are required ensure that there is due diligence in the over all financial and executive decisions of the company they are associated with.

As per provision under Companies Act, 2013 Independent directors have to act as watch dogs and protect the interests of minority shareholders as well as other stakeholders and ensure that the legal and regulatory norms are fulfilled. Independent Directors do not represent in the actual corporate decision-making. The position of the independent director is one most counterpoise position against the managerial domination of the corporate boards. But fact remains that the independent directors are not truly independent and issues such as promoters giving bribes to speed up corporate decisions ends up in poor board performance. Though digitalisation has helped the corporate to be transparent, being transparent remains in papers and fact remains that the promoters dominate the functioning of the corporates .

**Keywords:** Independent directors, Clause 49, promoters, digitalisation

The idea of independent directors came to existence with the intention to bring transparency and accountability in corporates. As per provision under Companies Act, 2013 Independent directors are required to acts as watch dogs and ensure that the interest of the minority shareholders of the organisation and the other stakeholders of the company are taken care of. The independent director is also expected to ensure that the organisation follows the legal and regulatory framework. The Independent Directors should take active participation in the decision making process of the organisation in such a way that the minority and others are taken care of.

“The position of the independent director is one most counterpoise position against the managerial domination of the corporate boards” (Eisenberg, 2005)

This position has the highest threshold in respect of corporate governance and or prevent corporate fraud or white collar crimes as being an independent director they are also expected to bring out, misappropriation, non-compliance with legal provisions, malpractices etc. in front of regulatory bodies.

As they are supposed to work in public interest, they should be guided only by their conscience rather than any other concern. Further, the independent directors have to manage all the financial and executive decisions of the company they are associated with. As per the roles and responsibility of Independent Director, they have to handle two broads, and sometimes they play opposing roles one, monitors of controlling shareholders that work on behalf of minority shareholders; second as the brain trust, consultant, or “strategic advisor to the controlling shareholder.” Vikramaditya Khanna & Shaun J. Mathew, independent directors as monitors of controlling shareholders

Under the monitoring role, independent directors are expected to assist and address corporate governance concerns of the required entities. This role is significant because, in jurisdictions like India, minority holders seem to have limited legal rights and to represent minority shareholder in required entities, independent directors can help to prevent business decisions that may not benefit the controlling stockholders at the expense of minority stockholders. For example, independent Directors monitor all the related-party transactions, which is in direct conflict of interest of the controlling stockholders

In addition, independent directors in order to protect the interests of minority shareholders and reduce extractions by controlling shareholders through “publicising, or threatening to publicise, majority shareholder abuses” even if the independent directors have limited power to decide important issues without the consent of the controlling stockholder.

THE REGULATOR – “CLAUSE 49 OF SEBI”...

In India, the SEBI monitors and regulates corporate governance of listed companies through Cl. 49 of the Listing Agreement. Cl. 49 of the Listing Agreement is influenced by the Sarbanes-Oxley Act of 2002 which has been enacted in ... The United States of America and the New York Stock Exchange regulations. In 2003, SEBI has launched a landmark initiative towards achieving the higher corporate ... governance standards. Under this initiative SEBI has defined Independent Director under Cl. 49 as : Independent Directors are those directors who do not have a pecuniary relationship with the company, its promoters, management or its subsidiaries, which may affect the independence of their judgment. clause 49 has prescribed certain duties for independent directors under which that they are supposed to review company efforts whether they are in compliance with all applicable laws and

laying down a general code of conduct. However, Clause 49 imposes the most specific requirements for independent directors who also serve on the audit committee. Specific duties of audit committee members include supervising the financial reporting process, matters related to the appointment of the statutory auditor, reviewing financial statements with management before ... submitting them to the board, reviewing the internal control systems, reviewing internal investigations on suspected fraud, reviewing the whistle-blower mechanism (if any), reviewing disclosure on use of proceeds from public issuance of securities, reviewing disclosures on related party transactions, and other related matters... Most of the listed companies are required to comply with Cl. 49 of the Listing Agreement, which mandates that independent directors should constitute 50 percent of their Boards; otherwise the defaulting companies will have to face severe penalties.

As per the broad survey, corporate governance practices of Indian firms require significant room for improvement in the function of independent directors. The major deterrent to the corporate governance in India is the conventional dominance of major stakeholders that they are "individual family dominated". The promoters of the company act as the dominant shareholders because the promoters' shareholding is spread across several friends and relatives. Therefore, promoters, as dominant shareholder has immense power to transfer the assets between group companies and to carry preferential allotments of shares to themselves. The problem used to arise because there were no effective legislations to deal with the minority interest however it seems that there are certain provisions in the recent promulgated Companies Act, 2013.

Another crucial issue in relation to independent directors in India is that the majority of shareholders appoint independent directors. Noticeable, in India, most of the huge corporation's shareholders are either individuals or family members. Further, the major fall back and serious threats to transparency and accountability comes because India companies are mostly family dominated. Therefore, the major stakeholders in most of these enterprises are family members who do not find it compelling to reveal sufficient information to the independent directors... Therefore for independent directors, to keep a check on the accountability and transparency becomes an arduous task especially because they attended very few meetings per year that are to a large extent ceremonial in nature. Hence it is not possible for independent directors to fully comprehend the issues before the board, as most of the large business structures are often conglomerates having diverse interests and investments. After the Satyam fiasco, nearly 350 independent directors resigned from their positions across India. This was the biggest signal to the investors that something is not well within the board. The resignation of Independent directors in considerable proportion is a signal that they do not feel confident of facing the consequences of the conduct of their companies... This may be because they either have knowledge of illegal conduct and have failed to influence the board to counter-act effectively or because they are not in control of the happenings of the company. It finally brings to the paradox that "Can independent

directors be said to be independent if their jobs are in the hands of the promoters?". Besides, in the context of family-dominated Indian companies, where the promoters' interests often over-shadow those of the shareholders, the independent directors may not be in a position to exert sufficient influence.... There are several other reasons for Independent Directors not being cited in a monitoring role, including the lack of time, resources, or training; concern that performing as monitors could undermine board collegiality and functioning; and the high potential for direct liability .In the major problem in India with respect to Independent Directors is that there is no value addition or compliance to oversight that these boards

## SUGGESTIONS IN ORDER TO ENHANCE POWER OF INDEPENDENT DIRECTOR IN INDIA

Independent Directors must play a vital role in incorporating good corporate governance. There is a large area of improvement in the role, power and selection of Independent Directors in Indian Companies. Primarily, there is a need for "Nomination Committee". Like in US and UK the nomination committees consist of independent directors and it is mandatory as per the requirements of leading stock exchanges.

With controlling shareholder influence, the aforesaid nomination committee would urge the independent director to function in the interest of minority shareholder decision and for election of independent directors and in the constituencies that elect them, proposals would involve a change in the voting process.

Once this is implemented, nomination committees would unlikely to pick a candidate who does not have the tacit acceptance of a controlling shareholder. It would be an embarrassment after all if the person nominated by the nomination committee fails to muster enough votes at a shareholders meeting due to opposition from the controlling shareholders. Nevertheless, a nomination committee process would be superior to the current system of direct elections (without an independent nomination process). A rigorous and transparent nomination process could minimise the influence of controlling shareholders.

Second, there should be minority shareholder participation in Independent Director Elections. Minority shareholder participation should be introduced through two principal methods:

- (i) cumulative voting by shareholders; and
- (ii) election of independent directors by a "majority of the minority"

Minority shareholder participation in elections of directors in general and independent directors would have significant advantages due to following reasons:

Minority shareholders would obtain representation on the board of directors, as they are unable to do so in the straight voting process.

If minority shareholders elect independent directors, then they will obtain knowledge about various policy decisions that are being discussed on the board. Knowledge itself is a significant advantage, and it is of special significance where public disclosure of company information is not advanced in the relevant jurisdiction. This bears significance in India where the availability of company information is yet not as wide as it is in the outsider economies. Independent directors will be truly independent (of management and controlling shareholders) and hence accountable to the minority shareholders as such directors have been elected by that constituency. Minority shareholders' voice will be heard on the board through independent directors elected by Independent directors will have incentives to monitor the activities of management and controlling shareholders against transactions that create conflicts of interest.

Third, the legislature should draw a line between the Independent Directors and Executive Directors by defining their roles and responsibilities and demarcate their liabilities. If the company does any scandals or fraud the independent directors should be personally liable. Independent Directors cannot be held liable for cases pertaining to, for instance, bounced cheques. They should be only responsible for matters that ought to come to the board of an organisation. However, issues such as promoters giving bribes to expedite registration never reach directors to ascertain such information. If the Independent directors show due diligence, the law should exempt them from all types of liabilities for the actions of the board or the managing director they may not be aware of

Fourth, remuneration of Independent directors should be decided by a regulatory body like SEBI based on the size of the company or decided by institutional investors holding a significant stake in the company.

## CONCLUSION

The objectives of corporate governance cannot, perhaps, be as effectively met without the inclusion of independent directors in the larger scheme of things. Under Clause 49 SEBI should also come as a reminder to directors that they are fiduciaries towards the shareholders, hence there should be continuous efforts being made to make them more accountable. The inclusion of independent directors is a check on the management of companies as an oversight mechanism. Their ability to contribute to the board's deliberations is a bonus to voice the minority interests.