

CHALLENGES TO EFFICIENT WORKING OF INDEPENDENT DIRECTORS

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Abstract

Independent directors are appointed in a company to supervise the executive board of the company. Institution of independent directors play a crucial role in ensuring the director's accountability for their actions, independent directors are appointed on the board of the company in the capacity of trustees of shareholders who would protect their interests in the company. However, there are issues persisting with their actual independence in the company. There have been plethora of scams both in India and in other jurisdictions where the role of independent directors could have prevented them from happening had the independent directors been vigilant and performed their functions as per the standards. Hence, it has been argued that there are various issues subsisting within the institution of independent directors, this paper is an attempt to indentify the issues plaguing them and hampering their effective functioning and it also attempts to provide a framework to counter the issues so identified.

Keywords: Corporate governance, transparency, accountability, information asymmetry.

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INTRODUCTION

A company in order to attract investors and for ensuring investment, should have an image of credibility with regards to the quality corporate governance and effective and unbiased board of directors and in order to attain quality corporate governance and effective board of directors, presence of independent director is of prime importance.¹ An independent director is a director who is independent from the management of the company and is present on board as a trustee and to safeguards the rights and interests of the shareholders of the company.²

On one hand, independent directors in the company are expected to emphasize on the efficiency, adequacy and management of risk. On the other hand, he is also expected to further and protect

¹ Indrajit Dube & Aparup Pakhira, *Role Of Independent Director In Corporate Governance – Reference To India*, (Corporate Board: Role, Duties & Com position / Volume 9, Issue 1, 2013), http://www.virtusinterpress.org/IMG/pdf/10-22495_cbv9i1art5.pdf,

² (Corporate Board: Role, Duties & Com position / Volume 9, Issue 1, 2013), http://www.virtusinterpress.org/IMG/pdf/10-22495_cbv9i1art5.pdf,

the interests of non-controlling shareholders, he is also expected to be observant enough to identify the weaknesses within the functioning of the company and bring about the required changes.

We already know that even though independent directors were there when Enron, Satyam, world com took place, they were not vigilant enough and lacked commitment to unfold the scam that were being carried out in their presence. Nowadays, challenges and responsibilities of independent directors are increasing because government now wants all the independent directors to have their judgment and opinion regarding all the actions that are taken by the directors on the board regarding how the company has performed, management of risk and strategies with regards to the same strategy, appointments of key managerial personnel and the code of conduct of directors and in order to institute an alternate perspective regarding the performance of the board of directors and the senior management.³

As the reports and surveys suggest, corporate governance failure happens because of a key reason that there is a huge difference between the actual performances of independent directors in general and expectation which non-controlling shareholders have from independent directors.⁴ This gap can only be filled and shortened when independent directors seriously try to do justice to their duties and responsibilities.

Very recently, Securities and Exchange Board of India (SEBI) had set up Uday Kotak committee for strengthening corporate governance regime in India. Report has very recently come out and it has suggested key changes such as a much more inclusive role of independent directors in the company, appointment of non-executive directors for chairmanship and a higher emphasis on improving corporate governance in the company by ensuring greater transparency and disclosure requirements.⁵

1. CHAPTER I - ROLE OF INDEPENDENT DIRECTOR IN CORPORATE GOVERNANCE

The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and the Companies Act, 2013, respectively, currently serve as the primary regulatory frameworks for the role and duties of independent directors. When the Chairperson of the Board of Directors for a listed firm is a non-executive director, at least one-third of the Board of Directors must be independent, and if there is no regular non-executive Chairperson for the listed organisation, at least half of the Board of Directors must be independent..⁶

The importance of the institution of independent directors in the governance cannot be overemphasized. Globally, it is being realised and recognised that a pivotal position is held by the independent directors with respect to survival and overall growth of the corporation as they have a

³ Ravi Thakur. *Post Satyam Case: A Study of impact on role of independent directors* Available at <http://www.ijssrm.in/v4-i2/2%20ijssrm.pdf.m> (Last seen on 6/11/19)

⁴ Indrajit Dube & Aparup Pakhira, *Role Of Independent Director In Corporate Governance – Reference To India*, (Corporate Board: Role, Duties & Com position / Volume 9, Issue 1, 2013), http://www.virtusinterpress.org/IMG/pdf/10-22495_cbv9i1art5.pdf,

⁵ Jayshree P. Upadhyay, Livemint, *Sebi panel led by Uday Kotak proposes corporate governance reforms*, <https://www.livemint.com/Money/MWHMT9Uwt7xxvrFamx4GWP/Sebi-panel-to-submit-report-on-independent-directors-evalua.html>, (Last seen on 6/11/19)

⁶ SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Regn. 17(1)(b).

role to safeguard the shareholders and also tend to provide a competitive advantage to the company.

- Role towards shareholders

Independent directors have to bring independency and transparency in the working of the company, essentially the working mechanism. This is so because the minority shareholders are not equipped to deal in the affairs of the company and therefore, it is the prerogative of the independent directors as the minority shareholder look forward to the independent directors for the transparency in the working.⁷

Further if there is any decision which may adversely affect the rights of the employees or the shareholders, then the independent directors should take pro active role in such matters and therefore the welfare of the stakeholders should be considered. Also, they are required to continuously review the related party transactions undertaken by the company and ensure that the whistle blower policy is efficient.⁸

- Role in various Committees

In the Companies Act, 2013, mandatory provisions are present for the appointment of independent directors in the following committees:

1. The Audit Committee
2. The Risk Management Committee
3. The Nomination and Remuneration Committee
4. Stakeholder's grievance Committee
5. The CSR committee

Having independent directors in the committee ensures better "corporate governance" in the company as the "independent directors" in these committee form a major part of the committees mentioned above and therefore have the right to review and check the decision taken by the company and its executives and whether the decision taken are in the interest of the shareholders or not.⁹

- Role towards Board Members

The independent director has to ensure at all times that the important matters and concerns of the

⁷ Nikita Hora, (2017), *Are Independent Directors Really "Independent" in Indian Companies dominated by Promoters?* Available at [https://www.ey.com/Publication/vwLUAssets/Corporate_governance_for_changing/\\$FILE/Corporate_governance_for_changing_regulatory_scenario_and_the_role_of_the_independent_director_EYFINDEPENDENTDIRECTORS.pdf](https://www.ey.com/Publication/vwLUAssets/Corporate_governance_for_changing/$FILE/Corporate_governance_for_changing_regulatory_scenario_and_the_role_of_the_independent_director_EYFINDEPENDENTDIRECTORS.pdf) (last seen on 28/10/2017).

⁸ Yogesh Malhan, mondaq, *Independent Directors- Under The Companies Act, 2013*, <http://www.mondaq.com/india/x/295386/Contract+Law/Independent+Directors+Under+The+Companies+Act+2013> (last seen on 07/11/2019).

⁹ Shabiya Ali Ahlam, 2014, *How important is the role of an independent director*, Available at <http://www.ey.com/in/en/services/assurance/fraud-investigation---dispute-services/corporate-%20governance--role-of-independent-directors> (last seen on 4/11/2019).

company are addressed properly and in an efficient manner by the “Board of directors” of the company. The duties & objectives that are applicable for executive directors of the company are also applicable to the non-executive directors. However, the major difference being the time and skill that is devoted by the executive director as in the case of independent directors, both the time as well as degree of care and skill is used to a lesser extent.¹⁰

2. CHAPTER II - ISSUES SURROUNDING INDEPENDENT DIRECTORS IN RECENT TIMES

There have been several cases of business mismanagement and a lack of corporate governance in Indian enterprises in recent years. Due to this, concerns concerning the independent directors' responsibility and the effectiveness of this institution in the governance of the firms have been raised. There have been several cases where independent directors have left the firm after it started having problems, frequently claiming that they did so for personal reasons.¹¹ These issues have been discussed in detail in this section.

- Failure to flag irregularities

Lately there have been many instances where Independent directors have failed to keep a check on mismanagement this can be due to many reasons such as lack of knowledge about their role & responsibilities or about the things going on in the company, little or no incentives for the same.

When Infrastructure Leasing and Financial Services (IL&FS) fell behind on payments, a number of independent directors resigned. During the specified time, none of these directors has offered any good justification for their impending resignation. The Ministry of Corporate Affairs (MCA) questioned why they failed to raise warning signs when they might have readily detected the management's wrongdoings. The IL&FS Risk Management Committee, which also included independent directors, had not held a single meeting in the preceding four years..¹²

Regarding the function of independent directors in corporate governance, this presents important issues. When things go wrong, they frequently can be observed fleeing rather than doing their duties to protect the interests of the minority and expose fraud. Which takes us to the following problem.

- Increasing rate of resignations

As per “Nseinfobase”, in Nifty 500 companies, 317 independent directors have quit in the year 2019.¹³

One major reason for this may be heavy personal liabilities levied upon them in cases where they are supposed to take some action so it is often seen that independent directors have been resigning

¹⁰ Meenu Gupta, *Independency of Independent Directors in Corporate Governance*, Available at <https://www.icsi.edu/media/portals/86/Independent%20Directors.pdf> (last seen on 4/11/2019).

¹¹ Jayshree P. Upadhyay, *Why Independent Directors are Rushing for the Exit Door*, Livemint, (19-12-2018), <https://www.livemint.com/Companies/bntAau6XcAhPftZ5yCVx7O/Why-independent-directors-arerushingfortheexit-door.html>, (last seen on 6/11/2019).

¹³ Kala Vijayraghavan & Maulik Vyas, *More independent directors take the exit fearing legal scrutiny*, TheEconomic Times (21-06-2018), https://economictimes.indiatimes.com/articleshow/69883746.cms?from=mdr&utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst, (last seen on 5/11/2019).



from companies in which there are chances or anticipation of a fraud or wrongdoing taking place in the company.

Recent case of resignation by Mr. Chandrashekharan, director of Yes Bank Ltd. also raises questions as to the exit of Independent Directors under questionable circumstances. In this case, Yes Bank was compelled to recant its claim that Chandrashekhar's resignation was due to "personal grounds" and apologise to the stock markets. He had expressed his dissatisfaction with the recent occurrences and the way they were handled at the time in a WhatsApp message.

Therefore there is a need to have greater safeguards for Independent directors in this regard, as stated by Mr. M Damodaran, the then chairman of SEBI (Securities and Exchange Board of India), that deserving candidates may be compelled to leave the organisation, undermining a system that was meant to bring balance to the boardroom.

- Information asymmetry

Independent sources of information do not exist for independent directors. They rely on data provided by the business, as well as external and internal auditors who are employed by the business but chosen by the board of directors. What auditors certify vs what independent directors are expected to accomplish, however, differs significantly. Therefore, the requirements placed on independent directors by India's Companies Act, 2013, are fundamentally faulty. Independent directors are required to fulfil increasingly difficult fiduciary obligations, yet they lack the means to do so.

- Powers incongruent with responsibilities bestowed upon them

Although expectations for independent directors have not altered, they have recently grown quickly. When a firm is in trouble, it sometimes seems to be overlooked that an independent director is a non-executive who has information asymmetry compared to executive directors. The board's job is to provide direction. It would be incredibly unfair to portray independent directors as though they had cooperated or conspired when they were at most negligent.

CHAPTER III - SUGGESTIVE FRAMEWORK FOR INDEPENDENT DIRECTORS

There are following improvements which can be made within the institution of independent directors to ensure that they can perform their functions in a better manner:

- Improving the mode of Appointment of independent directors

It has been noted that promoter, friend, or acquaintance recommendations are frequently used to nominate non-executive directors or independent directors. To guarantee the selection of the best candidate, there is a lack of a defined, transparent, and clearly stated system of appointment. It is challenging for Independent Directors to accomplish their goal of preserving the interests of minority shareholders because there is no formal mechanism for the appointment of Independent Directors, unlike the selection of Executive Directors. Additionally, the method used to assess the effectiveness of Independent Directors needs to be enhanced.

- Reduced Liability and an Increased Authority of Independent Directors

The fact that Independent Directors are given very little authority while carrying a great deal of

responsibility is one of the key causes of the numerous incidents that have occurred recently. It is deemed unjust to hold Independent Directors accountable for any act of commission or omission that is equivalent to that of the Executive Directors throughout the organization's daily operations, they shouldn't be made to suffer the results of the company's daily operations and decisions because they aren't aware of them. As a result, it is necessary to increase the Independent Directors' authority..¹⁴

- Increased Participation of Women in the Board

It has been noted that there are few women on Indian company boards, despite the fact that board composition and gender diversity are significant determinants of the effectiveness of the board. Therefore, it is recommended that women's participation be promoted in order to increase company performance and diversity.

- Building a Neutral database of Independent Directors for appointment

It is advised that a trustworthy dataset with the credentials of Independent Directors be introduced. In order to map the appropriate experience and competency in accordance with the Company Board's requirements The directory ought to contain details about the directors' backgrounds, qualifications, and willingness to serve on boards as independent directors.

- Organize training programs for newly appointed directors

As working of different organizations is different and unique, on appointment, the company must take steps in order to acquaint the independent directors with the work culture of and policies of the organization, and let them get to know the rules and regulations of the company.

- Check the overlapping regulations

Another problem is the complexity of the laws and regulations governing their position and interests, as well as the overlap between the provisions of several regulatory bodies. Therefore, it is advised to analyse the provisions and make any necessary revisions if there are any overlaps.¹⁵

- Stringent laws for exit of Independent Directors from the company.

A director may resign from his position as per Section 168 of the Companies Act of 2013 by providing the company with a written notice of his intent to do so. The company must inform the RoC of the resignation upon receipt of such notice, and information regarding the resignation must be included in the report of directors that is brought before the general meeting that immediately follows.¹⁸

Independent directors must give the company detailed justification for their departure within 7 days, however the change also specifies that the resignation will not take effect until 30 days after the company receives the notice of resignation.

¹⁴ Bhumesh verma, *Independent Directors: Role, Responsibilities, Effectiveness*, (19-12-2018), <https://www.scconline.com/blog/post/2019/07/12/independent-directors-role-responsibilities-effectiveness/> (last seen on 6/11/2019).

¹⁵ International journal of pure and applied mathematics (Volume 119 No. 17 2018), *A Study on Role of Independent Directors in Protecting the Rights of Minority Shareholders*, available at <http://www.acadpubl.eu/hub/>



- Removal of Unfit Independent Directors

Government should have the authority to assess independent directors in light of their failure to uphold their fiduciary duties, and based on the results, file a request for their dismissal with the NCLT. The person would be permanently barred from holding any office on the Board as a result of such a dismissal.

- Declaration of Independence to be filed with the RoC (Registrar of Companies)

Currently, the declaration must only be made at the first Board meeting in which the independent director participates as a director. Thereafter, it must be made at the first Board meeting of every fiscal year or whenever there is a change in circumstances that could affect the independent director's status. This declaration should also be submitted to RoC so that appropriate oversight can be provided periodically.¹⁶

3. CONCLUSION

As discussed earlier, independent directors are a crucial part of the corporate governance machinery of any company, therefore it is essential to ensure that this institution performs its duties efficiently. Hence, the need is felt to introduce major reforms in the laws governing them. The same was the result of the recommendations of the recently furnished report by

Uday Kotak Committee. However, just by making stringent norms of corporate governance for independent directors cannot be observed, since the answer to all the questions being raised on this institution lately regarding its inability to deal with increasing white collar frauds.

This is mainly because of reasons such as they are not involved in regular decision making of the company, so they are genuinely not aware about many things and also there is very little or no positive motivation / intention for them to take extra efforts in order to keep proper check on functioning of the management. One thing that has to be kept in mind while talking about independent directors is that they would be able & willing to perform their functions properly only if they are assured they would be protected by the law.

¹⁶ International journal of pure and applied mathematics (Volume 119 No. 17 2018),
A Study on Role of Independent Directors in Protecting the Rights of Minority Shareholders, available at <http://www.acadpubl.eu/hub/>