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Independent Directors vis-à-vis Corporate Governance

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In the global corporate governance movement, independent directors have played a growing role. This expanded boardroom representation has effectively served as a forerunner for achieving a fair balance between individual, societal, and economic interests. Furthermore, their presence has been recognized as a disincentive to fraud, mismanagement, poor resource utilization, inequality, and lack of accountability. However, there has been much criticism of independent directors' performance, with many blaming their inability to perform to their full potential on a lack of a favorable "boardroom culture" and the existence of those persons who are not likely to raise their voices contrary to the current. This article will discuss the notion of independent directors and their relationship to corporate governance in Indian business culture, including their appointment, duties, and responsibilities, as well as the growth of the concept and practical experiences. It will aim to identify the flaws in the current method and make recommendations that involve not just structural improvements but also a shift in corporate India's mentality.

Keywords: *directors, corporate, governance.*

INTRODUCTION

The board ensures that key managers and stockholders are "balanced." The directors have fiduciary responsibilities under the law. The Directors have a responsibility of care (due diligence in decision-making) as well as a duty of loyalty (to the shareholders). Their actions will be assessed by the courts in accordance with their business judgement. Boards of directors are critical to a company's success. Nobody can afford the "luxury of unilateral mistakes, lethargic firms, and isolationism" in today's globe. "Companies that are unable to compete will perish." In terms of the board's authority, the American Bar Association's Model Business. According to the Corporation Act, "*Subject to any limitations set down in the articles of incorporation, all corporate powers shall be exercised by or under the authority of, and the corporation's business and affairs shall be conducted under the direction of, its board of directors. In other words, as the stockholders' representatives, the board of directors has authority. The board of directors gives management authority to carry out the company's goal*." *Solomon and Solomon(2004)* believed that a company's success hinged on its ability to be well-governed. "Every aspiring company seeks a well-operating and competent board of directors. The board of directors of a company is its heart, and like a heart, it must be healthy, fit, and well-cared for in order for the company to function properly. The benefits of having a strategic board are undeniable. It enables a company to gain valuable expertise, facilitates financing, and as well as facilitates strategic relationships. It also acts as a think tank to establish accountability and strategic thinking, attracts the best employees, expedites exposure to new ideas, balances stockholders' interests, helps to avoid mistakes, and handles the change proactively. The higher the director's involvement, the smaller the board. An independent director is a person who has been selected to the board of directors in order to ensure that his or her viewpoint is not internally centered. Independent directors are playing a bigger role than ever before in balancing the interests of shareholders and management." Since the 1990s, a growing number of professional non-executive directors (NEDs) have emerged, and CEOs are beginning to recognize the value of these highly experienced individuals. In publicly traded corporations, an independent board of directors is viewed as a critical component of the country's corporate governance standards. Board independence has become so important in corporate governance that it is nearly unavoidable. As a result, in recent years, governance reform has increasingly pinned hope and duty on independent directors to allow improved governance standards. "The Cadbury Committee Report has influenced corporate governance standards in a number of nations, including Canada, Japan, France, Hong Kong, South Africa, Australia, Malaysia, and India, to name a few. Similarly, the necessity of independent directors in the United States has prompted changes in corporate governance laws in a number of countries. This was essentially a reaction to ensure that corporate governance problems like those involving Enron and WorldCom did not occur in their respective countries."[1]

Every listed public company must have at least one-third of its entire number of directors be Independent Directors, according to section 149(4) of the Companies Act, 2013;(Singh 2015).[2] The demand for independent directors has grown as the number of minority shareholders has expanded. Corporate governance has seen several changes in recent years, with the concept of Independent Directors being one of the most significant. Following the Satyam scam in 2009, the position of Independent Directors was severely harmed both in India and abroad. A large number of independent directors resigned from their positions, highlighting the independent directors' powerlessness in Indian corporate governance. Independent Directors had a very poor role in corporate governance controlled by promoters and controllers. Independent directors must have certain minimal standards, according to the International Finance Corporation's definition.[3] To protect the integrity of decision-making, the standard must be maintained while hiring independent directors. The independent directors must be unaffected by the circumstances in order to make neutral decisions.[4]

WHO IS AN INDEPENDENT DIRECTOR?

An independent director must meet some minimal standards, according to the International Finance Corporation (IFC).[5] Only individuals who have not worked for the company or its affiliated parties in the five years before the date of appointment shall be considered for appointments, according to the policy. They should also not be associated with a business that serves as a consultant or adviser to the company as well as a significant client or supplier. They should not have any personal service contracts with the business, its affiliates, or senior

[1] Vikas Maheshwari, 'Role of Independent Director in Corporate Governance' (2020) 6(7) EPRA International Journal of Multidisciplinary Research (IJMR)
[2] Avtar Singh, *Company Law* (17th edn, Eastern Book Company 2018)
[3] 'IFC Indicative Independent Director Definition' (*IFC*) <https://www.ifc.org/wps/wcm/connect/b3f84d89-541a-45cc-a7db-41a20c021763/IFC_Indicative_Independent_Director_Definition_062719.pdf?MOD=AJPERES&CVID=mKqqtnW> accessed 1 August 2021
[4] Maheshwari (n 1)
[5] IFC (n 3)

management, and they should not be connected with a non-profit organisation that gets significant money from the company. "If any of the firm's executives serve on the Board of Directors or are members of the immediate family of someone who is, or has been, employed as an executive officer by the business in the past five years, IDs should not be hired as executives of another company." The Securities and Exchange Board of India issued similar suggestions for the appointment of IDs (SEBI). SEBI's requirements, on the other hand, are less stringent than those of the IFC.[6]

"According to SEBI,[7] an independent director is a non-executive director who has no material pecuniary relationships or transactions with the company, its promoters, directors, senior management, or any other alliances, aside from receiving the director's remuneration, that could affect the direction's independence." They cannot be connected to the company's promoters or anyone who has held a management position on the board of directors or one level below the board of directors or been an executive in the previous three financial years. "They should also not have been a partner, executive, or connected with an audit firm associated with the corporation in the previous three years. They should not be a material supplier, a service provider, a consumer, a lessor or lessee, or a significant shareholder in the company."[8]

IMPORTANCE OF INDEPENDENCY OF INDEPENDENT DIRECTORS

A director's role on the board of directors is to ensure that the interests of shareholders are safeguarded and to lead management's actions to maximise shareholder value. The makeup of the board, which supports independent and objective board performance, is a critical factor in achieving such objectives. However, according to the literature, boards of directors are unable to defend shareholders' interests owing to poor openness and disclosure in board procedures, majority ownership of promoters, and other reasons. The board should be made up of independent individuals to guarantee smooth and efficient operation. It is also shown that board independence and firm performance are related in the sense that a more independent

[6] Manu Sharma, 'Role of Independent Directors in Corporate Governance' (2020) 8 Pen Acclaims
[7] Securities and Exchange Board, Equity Listing Agreement 2000, cl 49 (A) (iii)
[8] Sharma (n 6)

board with better corporate transparency requirements leads to increased investor interest, enhanced corporate image, and increased shareholder value. The high-profile Enron and WorldCom scandals exposed the board's lack of commitment to shareholders and raised questions about independent directors' role in ensuring that management practises are aligned with the company's long-term strategic goals. "The independence of independent directors will aid in connecting management's interests with those of shareholders and improving decision-making quality. Furthermore, since independent directors would be people unfamiliar to management, an impartial evaluation of the firm's performance will guarantee good corporate behaviour and governance processes all over the globe."[9]

INDEPENDENT DIRECTORS vis-à-vis CORPORATE GOVERNANCE

As the saying goes, governance is about directing a firm in the correct direction. Former SEBI chief Mr. M. Damodaran described corporate governance as a continuous activity that goes beyond the bounds of the regulation. He meant that governance necessitates behaviours for which the legal mandate should only serve as a starting point. Companies must follow these procedures not out of fear of being fined, but because a lack of such governance will result in a reduction in their ability to attain true profitability. Others have portrayed corporate governance in a variety of ways; some see it as a journey rather than a destination, while others have compared it to "trusteeship." Regardless of differing approaches, the subject and goal of corporate governance remain unquestioned, especially when it comes to the function of independent directors. The IDs are a part of the larger corporate governance system. They are chosen to guarantee that the board is functional and balanced. There is no arguing that the board of directors (BoDs) is the most important instrument for corporate governance compliance and that its oversight is crucial. The IDs contribute to the board by providing constructive feedback on policy decisions and plans. Furthermore, they establish responsibility by examining management performance. Their independence, due to a lack of association that could influence their decisions, permits individuals to complete these activities more quickly. While they are responsible for the company's actions, they are less likely to be influenced by

[9] Meenu Gupta, 'Independency of Independent Directors in Corporate Governance' (*ICSI*, 2021) <https://www.icsi.edu/media/portals/86/Independent%20Directors.pdf> accessed 08 August 2021

personal interests in those acts. Because of the aforementioned attributes, they are in a unique position to examine the company's procedures, despite the fact that they are traditionally seen as "adversaries" on the board. However, as independent directors have come to realize that they bring something more to the table, their viewpoint has gradually grown more accepted, implying that in the long term, independent directors bring a more balanced perspective.[10]

It's worth noting that a lot of work has gone into encouraging the selection of independent directors through institutional rules. The New York Stock Exchange, for example, requires that a majority of a listed company's board of directors be made up of independent directors, who must meet certain criteria.[11] Furthermore, firms listed on a stock exchange are required to have committees such as the Corporate Governance Committee, the Audit Committee, and others, all of which must be made up entirely of independent directors. Since the practice of appointing IDs has been acknowledged as a valid technique of strengthening corporate governance transparency, a growing number of countries have implemented comparable criteria.[12]

INDEPENDENT DIRECTORS IN INDIAN COMPANIES

"All corporate governance codes address who should and should not be on the board of directors. Any corporate unit may effectively administer and supervise its activities if the board of directors is properly balanced. Every member of the board should understand his or her function and responsibilities. It is critical for successful governance to have a clear direction, i.e., what is the role of the board of directors, management, and executives? The board should have a good mix of executive and non-executive directors. This offers the advantage of combining the executives' in-depth knowledge of the company's day-to-day operations with the non-executive directors' broad experience." Almost all codes, whether executive or nonexecutive, play a significant influence in the selection of board members. They

[10] Vinod Kothari, 'Role and Responsibilities of Independent Directors under the Companies Act, 1956 (*Vinod Kothari Blog*, 2006) <https://vinodkothari.com/2013/03/role-and-responsibilities-of-independent-directors-under-the-companies-act-1956-may-2006/> accessed 08 August 2021
[11] Martin Wheatley, 'Corporate Governance - Time to Take Stock' (*SFC*, 14 October 2006) <https://www.sfc.hk/sfc/doc/EN/speeches/speeches/06/mw_061014.pdf> accessed 08 August 2021
[12] Sharma (n 6)

should be chosen on the basis of their abilities and the corporate unit's overall goals. “The board should comprise nonexecutives of sufficient skill and number for their views to carry considerable weight in the board's decisions,” according to the Combined Code (1998). Independent non-executive directors are still defined as individuals who are "independent of management and free from any business or other relationship that could materially interfere with the exercise of their independent judgement," according to this Committee. Maintaining an independent element on the board is critical for good governance. All corporate governance standards establish explicit guidelines for the percentage of the board that must be kept independent. Non-executive directors shall make up at least one-third of the board of directors in the United Kingdom, with the majority of non-executive directors being independent.[13]

PERFORMANCE MEASUREMENT OF INDEPENDENT DIRECTORS

“The teams' and individuals' output is measured. Measuring is not done at the board level in most organizations. The majority of organizations have no idea what should be measured at the board level. Furthermore, the director's efforts provide outcomes that span years rather than being limited to the present year.” It's possible that this is because filmmakers don't want to be judged. The criteria for measuring the independent director's efforts or inputs should be measured using a soft technique (rather than rigidly) to reflect how his contribution is appreciated. “It has been suggested that independent directors assess themselves using a matrix that compares their effectiveness in each function to the relevance of that role. To make successful use of self-appraisal, the independent director should explain what their vital tasks are with the board members.” The matrix can be used to rank the importance and efficacy of abilities or competences. This type of analysis can indicate areas of importance to the board and areas where the independent director's participation is lacking, which should prompt a debate among the board and the development of remedial measures. An area of the problem can be discovered using the assessment technique, and solutions such as training, access to critical information, and more time availability can be devised. The evaluation also aids in determining the reason for the resignation or dismissal. This would disclose if the independent

[13] Maheshwari (n 1)

director was ineffective or was compelled to quit because he posed too much of a challenge to the executive management. Other ways include the chairman's evaluation, team members' evaluations, shareholder feedback, and secret feedback, among others.[14]

DIFFERENTIATION BETWEEN EXECUTIVE DIRECTORS AND INDEPENDENT DIRECTORS

“The evidence on the relationship between outside independent directors and company success is mixed. Some studies have found a link between having more outside independent directors on the board and improved firm performance (Barnhart et al. 1994; Daily and Dalton, 1992; Schellenger el ah, 1989), while others have found no such link (Barnhart et al. 1994; Daily and Dalton, 1992; Schellenger el ah, 1989). (Barnhart et al. 1994; Daily and Dalton, 1992; Schellenger el ah, 1989). (Hermalin and Weisbach, 1991; Fosberg, 1989; Molz, 1988; Hermalin and Weisbach, 1991; Hermalin and Weisbach, 1991; Hermalin and Weisbach, 1991 Other empirical study, on the other hand, suggested that an independent outside director serves as a key shareholder champion.” In tender offers for bidders, outside independent directors oversee the board of directors, which helps shareholders more (Byrd and Hickman, 1992). Outside independent directors, according to Beasley (1996), reduce the risk of financial statement fraud. Despite having eleven independent members on its 14-member board, Enron, according to Bhagat and Black (2007), was unable to avoid wealth loss. As a consequence, boards with a high degree of independence may not be suitable. A board should instead be made up of a mix of inside, independent, and affiliated directors. Inside directors are conflicted yet well-informed, while independent directors are generally unaware of the business. Han and Wang (2004) investigated the relationship between board structure and company performance using a sample of 490 publicly listed Chinese firms. They found a connection between company performance and three factors: director pay, stock ownership by directors, and the presence of independent directors. Choi, Park, and Yoo (2005) examined the connection between board independence and company performance in South Korea and found that independent outside directors had a significant positive effect on firm performance.

[14] *Ibid*

Huang, Hsu, Khan, and Yu (2003) looked at how the Taiwanese stock market responded to foreign directors being appointed. The tests' findings show that the announcements elicit a significant favourable reaction. "Outside director nominations seem to be more beneficial for a country with weak corporate governance. Panasian, Prevost, and Bhabra (2004) looked at the effect of the Dey Committee guidelines, which require a majority of independent directors on Canadian boards. They found evidence that adopting this rule enhanced performance not just for businesses that became compliant, but also for companies that were compliant all the time and had a greater percentage of outsiders on their boards. According to Bhagat and Blade, there is no compelling evidence that increasing board independence corresponds with improved company profitability (1999). Brown and Caylor (2004) created Gov-Score, a 51-factor composite measure of corporate governance that includes audit, board of directors, charter/bylaws, director education, CEO and director pay, ownership, progressive practices, and state of incorporation, among others. They found that businesses with better governance are more profitable and pay their shareholders more money. The usefulness of outside directors, according to Block (1999), is highly debated. Outside directors enhance the interests of shareholders, according to Bhagat, Brickley, and Coles (1987); Fama (1980); Fama and Jensen (1983); Gibbs (1993); and others. Others, on the other hand, believe the reverse to be true. The announcement of an outside director's appointment (up to a critical mass) is still regarded as supportive of shareholder interests and likely to produce favourable abnormal returns, according to their results."[15]

NEED OF THE HOUR: ANALYSIS ON THE REQUIREMENT OF INDEPENDENT DIRECTORS?

SEBI's new recommendations were met with strong opposition. The scarcity of qualified employees was cited as the most compelling argument against its implementation.[16] The section stipulates those independent directors must make up half of a company's board of directors, and failure to do so might result in severe fines. Furthermore, it was stated that

[15] Maheshwari (n 1)

[16] N Venkiteswaran, 'Independent Directors, Key to Corporate Governance' (*Business Line*, 2011) <https://www.thehindubusinessline.com/todays-paper/tp-opinion/Independent-directors-key-to-corporate-governance/article20282637.ece> accessed 09 August 2021

directors who would only attend a few board meetings would be obstructive to the board's working since they would profess their expertise without fully understanding the business of the board. Furthermore, independent directors may not be in a position to exert the necessary influence in a family-owned corporation.

The first reason can be discarded outright since it is unthinkable that in a country like India, finding a suitable person would be too difficult. Even if this is the case, there is no reason to believe that there is enough talent to appoint directors but not independent directors. With the right training, this deficiency might be readily overcome, paving the door for stronger corporate governance. . The second argument, on the other hand, could be flipped on its head. To play an effective role, India must continue to increase institutional support for independent directors, allowing them to participate more with the board of directors and be more vocal with their comments.[17] It has been demonstrated that independent directors' significant involvement within the company is the only reason they have been successful in averting potential disasters and promoting shareholder accountability. Such assistance must continue. While the exact amount of the board that must be made up of such IDs is debatable, the value of having a significant number is unquestionable.[18]

FAMOUS CASES

1. Critical Analysis of Tata Sons Case

The decision to remove Mr. Cyrus Mistry from his position as chairman of Tata Sons has sparked controversy and jeopardized the Tata family's perceived ethical leadership in India Inc. Mr. Mistry has received unanimous support from the independent directors on the board of IHCL (Indian Hotels Company Limited). Because boards are collectively responsible, the independent directors, as well as Mr. Mistry, are equally liable for mismanagement. All problems, according to Mr. Cyrus, are caused by legacy issues and hotspots. What factors influenced the independent directors of IHCL and Tata Chemicals to support Mr. Mistry? Do they have access to the truth? If that's the case, why did they remain silent for so long,

[17] *Ibid*
[18] Sharma (n 6)

allowing problems to fester? Why are they backing Mr. Mistry since they have been jointly accountable for IHCL's problems since the year 2000? Is it true that the independent directors' choice to support Mr. Mistry satisfies the goal of good governance? Is their behavior safeguarding the value of the company's stock? Is it possible for a divided board to increase or decrease shareholder value? The corporate structure of the Tata Group, which was in place for almost 50 years under the leadership of Mr. J. R. D. Tata and then for over 20 years under Mr. Ratan Tata, embodied the best corporate governance practices. By establishing himself as the lone Tata Sons representative on the boards of Tata operational firms, Mr. Mistry purposefully undermined this long-established corporate structure. It's worth noting that the Governance Guidelines Framework, which Mr. Mistry himself introduced in 2015, has a section stating that all Tata workers should promptly resign from all Tata entities where they are serving as Non-Executive Directors after their employment ends. As a result, when Mr. Mistry stepped down as Executive Chairman of Tata Sons, he should have immediately resigned from all other boards of directors, as per his own instructions. Yet, in flagrant violation of the Governance Guidelines Framework, he has opted not to do so.

2. Critical Analysis of Satyam Case

Even if an outstanding independent board of directors exists, they may not be able to perform their duties successfully if the prerequisites for proper performance are not present. The Satyam case exemplifies some of the reasons why independent directors' efficacy in India may continue to be questioned.

Satyam Computer Services Limited (recently renamed Mahindra Satyam) is a renowned Indian information technology services firm. At the end of 2008, Satyam's promoters, represented by Mr. Ramalinga Raju and his family, held around 8% of the company's shares, while the remaining shareholding was diffused. The Bombay Stock Exchange and the National Stock Exchange both list their securities. The company's securities are also cross-listed on the New York Stock Exchange. Satyam had to meet not only Clause 49's obligations, but also those of the Sarbanes-Oxley Act and the NYSE Listed Company Manual. Satyam was quite proud of its corporate governance procedures. Satyam had a majority independent board at the relevant period (end 2008), therefore exceeding Clause 49's standards. Its board of directors was made up of the following individuals:

Executive Directors - B. Ramalinga Raju, Chairman; B. Rama Raju, Managing Director and Chief Executive Officer; Ram Mynampati, Whole Time Director;

Non-Executive, Non-Independent Directors -Prof. Krishna G. Palepu, Ross Graham Walker Professor of Business Administration at the Harvard Business School

Independent Directors - Dr. Mangalam Srinivasan, management consultant and a visiting professor at several U.S. universities; Vinod K. Dham, Vice President, and General Manager, Carrier Access Business Unit, of Broadcom Corporation; Prof. M. Rammohan Rao, Dean, Indian School of Business; T. R. Prasad, former Cabinet Secretary, Government of India; and V. S. Raju, Chairman, Naval Research Board and former Director, Indian Institute of Technology, Madras.

Three executive directors, five independent directors, and one grey (or affiliated) director made up the board. Four were academics, one was a government employee, and the last was a corporate executive among the non-executives. At a high level, very few Indian boards can boast such a diverse group of independent directors. Three executive directors, five independent directors, and one grey (or affiliated) director made up the board. Four were academics, one was a government employee, and the last was a corporate executive among the non-executives. At a high level, very few Indian boards can boast such a diverse group of independent directors.

The Maytas Transaction- Satyam's board of directors approved a $1.6 billion purchase of Maytas Infra ($300 million) and Maytas Properties ($1.3 billion) in 2008. The attempted acquisition was viewed as an attempt by the Raju family to take advantage of Satyam's cash resources, as the transaction would have left Satyam with a $400 million debt. The fraud which was committed in Financial Statements at Satyam Corporation

CONCLUSION

In the grand scheme of things, the objectives of corporate governance may not be realized without the presence of independent directors. This is especially more appealing in light of India's booming economy, which has seen unprecedented amounts of money flow into enterprises from both within and outside the country. With the expansion of business, there is a growing expectation that Indian companies will adhere to greater corporate governance norms in a way that is transparent to shareholders. A long-standing desire for increased openness in the methods and functioning of the Indian market and firms is now being answered through a variety of new suggestions, one of which is a welcome expansion of the use of identification cards. Cl. 49 of the Listing Agreement should serve as a reminder to the board of directors that they are responsible to the company's shareholders, not management. They have a fiduciary duty with their investors, and demonstrating the absence of fraud or bad faith is insufficient to waive such commitments. Instead, such a relationship necessitates affirmative action. Furthermore, there are many things that are not clarified in the listing agreement, such as what happens if it is discovered at a later date that the ID on the board is not truly independent; what happens to the boars' judgement in such situations. However, in the next years, IDs should be expected to cooperate more actively. At the same time, investors must use their rights to actively participate in their demands and expectations for the greatest degree of governance.