

# Independent Directors- Going Forward



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Independent Directors are playing an increasingly important role in the Corporate Governance framework in India particularly in the last decade. At the same time, the risks and liabilities attached to Independent Director role have become very onerous, and they are not well protected by adequate D&O

insurance coverage. This will make it very difficult to attract talented and experienced Independent Directors to serve on Boards. The recent developments relating to Independent Directors, such as in PNB, and IDBI cases are very unfair and are likely to weaken corporate governance in India.

In the past many companies in India, particularly the top ones, were very well governed but many others were not. In the second category, in the good old days, Boards used to be Gentlemen's Club filled with friends and cronies of Promoters who was generally the Board Chairmen. Sons and nephews of the Chairman had a birthright to join the Board. The Board discussions were polite and perfunctory. All decisions were taken by the Chairman and the management. The Directors merely rubber stamped them. Some time there was no physical Board meeting but a Paper board meeting, and the minutes reflected presence of Board members and unanimous Board decisions. Women entered the Board room only to serve tea or coffee.

In the Board meetings there was no debate or dissenting opinions. Asking a question in a Board meeting was in very bad taste and answering it even worst. In any case, all Board members were of similar background, relatives and friends of the Chairmen and some retired employees, and trusted lawyers or accountants. Statutory auditors were appointed based on their relationship with the management and pliability. Business dealings with parties related to the Directors and management were totally acceptable. There was never any consideration of minority shareholders rights. If they didn't like what was going on, minority shareholders could vote with their feet and sell their shares.

Satyam and Raju drastically changed these cosy arrangements and shook up the such Boards. In the US, Enron surface cracks in the system and led to Sarbanes Oxley Act.

In India, the Companies Act 2013 and various SEBI regulations over the last decade ushered a lot of important changes and strengthened Corporate Governance

framework. Recent additional provisions mandated by SEBI on the recommendation of Kotak Committee will make very positive contribution in future.

Among many other measures taken in the last decade, the role and importance of Independent Directors in Boards is the most important development which has made the greatest impact in enhancing Corporate Governance. The Act and SEBI regulations specify the qualifications, selection, role and responsibilities, compensation and liabilities of Independent Directors.

However, a troubling imbalance has emerged such that Independent Directors are being charged with excessive and impractical responsibilities relating to compliance matters of the company. Such compliance related responsibilities rightfully belong to promoters, management, statutory auditors and internal auditors and not to Independent Directors. The role and responsibilities mandated for Independent Directors under the Act and SEBI requirements are almost impossible to fulfill even by the most knowledgeable and diligent persons. Independent directors do not have enough information and are not involved in day to day workings of the company to be able to perform such exacting compliance and control role.

Independent directors, in most cases, spend 10 to 15 days in a year attending Board and Committee meetings and perhaps equal number of days on other Board related matters. They get the Board / committee papers a few days in advance and base their decisions on that information and on management recommendations. All that can be reasonably expected from Independent Directors is to apply their mind and judgement in the best interest of all the stakeholders of the company, particularly the minority shareholders. If some times, things go wrong with the company, Independent Directors should be held liable only if they have intentionally acted against the interest of the company or for illicit personal enrichment.

While the Act and SEBI regulations have largely viewed the Independent Directors as watch dogs to ensure compliance and control, their real contribution has been other very important areas of Corporate Governance such as long term corporate strategy, CEO appointment and performance monitoring, talent development and succession planning, risk management, technology, M&A, Capital raising, engendering corporate culture of equal opportunity, meritocracy, innovation, balancing the interests of various stake holders including minority shareholders.

Independent Directors bring to the Board diverse skills and experience in different fields such as business, government, banking, law, accounting, international business, corporate governance, technology, HR, etc. Boards with directors of diverse back grounds and complementary skills working as a team can make great

contribution to long term growth and prosperity of the company and value creation for shareholders. Having women directors has also had a very positive impact. IN PNB and IDBI fraud cases, the investigative agencies and the courts have treated Independent Directors in a very unfair manner. They are being held accountable for misdeeds of crooked promoters and corrupt management and punished as guilty by mere association. This needs to get changed to ensure that knowledgeable and reputed persons accept positions of Independent Directors and contribute to further improving Corporate Governance in India.

A few specific suggestions.

1. An amendment to Companies Act 2013, and SEBI regulations such that Independent Directors are held liable if they have knowingly acted against the best interest of the company or for illicit personal enrichment. There should be prohibition against attaching their bank accounts and personal assets or putting them in hardship (as it happened in PNB case) unless their complicity is established.
2. Rather than general Directors and Officers Insurance, Independent Directors should have specific, separate,

insurance which is tailored to their obligations and liabilities, protects them and provides relief to them under adverse circumstances.

3. Independent Directors are generally not well compensated considering their role and responsibilities, liabilities and most importantly the contributions they make in growth and prosperity of the company. Unlike management they cannot be given stock options and thus participate in the value creation for shareholders. One logical way to determine the level of their compensation is to link it with the compensation of the CEO of the company. On the premise that Independent Directors as a group make at least as much contribution to performance and the growth of the company as the CEO, the combined annual commission paid to Independent Directors as group should be at least equal to the Cost to the Company of CEO. For example, if the total compensation for the CEO, including value of stock options, is 2 Cr, and there are 5 Independent Directors on the Board, then the commission payable to each of them should 40 Lakhs.
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