

Do we really need Independent Directors?



Dr. Amrish Gupta
Sr. Professor-Finance &
Accounting Area
Fore School of Management

Does presence of Independent Directors on the company boards can really improve their corporate governance? Before answering this question we need to examine whether they can at all be really independent. After all who chooses and appoints them? Obviously the promoters and majority shareholders. Will the promoters like, among other things, to:

1. Share confidential business information with strangers?
2. Have a deterrent, trouble monger and hindering figure on its board?
3. Accept that outsiders can teach them better the way business is done?
4. Trust that an ID will remain fair to them?

These are some of the fears and apprehensions about the institution of IDs, and not for nothing. They really hold water.

Therefore in a situation where promoters are forced by laws and regulations to broad base their company boards by inducting IDs, whom they will induct? Naturally persons well known to them and whom they can have full trust in that they will not act against their interests. Or in other words, persons who are *ready to sign on the dotted lines and thus just decorate the board*. The legal compliance is thus done and expectation of independent supervision takes a back seat.

I mention here a case to put forth my point. A listed company has appointed four earlier employees of its other group companies as IDs. There are four board committees set up to comply with corporate governance norms. The only members of these four committees are these four IDs. Every one chairs one or the other committee. Perfect regulatory compliance is thus there. But can these IDs who have earlier worked under the command of the same promoters, and earned their bread and butter from them, be expected to raise their voice against their decisions? Certainly they cannot. They will just attend the minimum number of meetings prescribed and their rights and responsibilities just end there. I believe there are large numbers of such cases.

Let me further present the data on independent directors available at primedirectors.com database site. As on date (6th August 2018) 18564 profiles have been hosted

on this website for search by companies looking for IDs. The profiles consist of highly qualified professionals. PRIME has analysed these profiles as under:

1. 725 are/were civil servants
2. 877 are IIM graduates
3. 283 are/were professors at IITs/IIMs/IISc
4. 1659 are graduates from foreign universities (including Harvard, Wharton, Kellogg and Stanford)
5. 1480 hold Doctorates
6. 5319 are Chartered Accountants, 2461 are Company Secretaries, 881 are Cost Accountants
7. 3108 are Lawyers and 239 are Medical Doctors
8. 5190 are Engineers of which 1285 are from IITs and 227 from BITS
9. **736 are already holding 1195 independent directorships on listed companies**
10. 85% have more than 10 years' experience

Talent thus seems to be abundantly available. There is no dearth of it. However point no. 9 supports my view that companies would not appoint strangers to their boards.

The next issue is the effectiveness of IDs. Even if we assume that in large corporates IDs play more than just the decorative role, can they play it effectively? To be effective they need to be equally, if not more, knowledgeable and experienced as the promoters are and as deeply engrossed in the affairs of the company as the promoters are. Can they be? Definitely not. Can a week or two's orientation programme lead them to become corporate supervisors? Can it lead them to be able to *decipher the promoters' intentions and read in between the lines*? No, not at all. What do we expect from them then?

Let me elaborate my point and let me confine to financial reporting for this purpose. Large corporations need to employ large number of professional finance experts like Chartered Accountants, Cost Accountants, Company Secretaries, MBAs and information technology experts to support them. The elaborate financial accounting and management system spanning across corporate office, numerous plants, other offices and branches of a big company is bound to be extremely engaging, complicated and complex. The final annual report is the culmination of these complexities. The adoption of International Financial Reporting Standards (IFRSs) as Indian Accounting Standards (Ind ASs) has led to further complications in financial accounting, reporting and auditing. Even if all the 4-5 members of the audit committee of a large Organisation are all finance professionals, is it possible for them to *fully comprehend the financial results of the company* readied by hundreds of Chartered Accountants and *apprehend what willful wrong, if any, has gone into them* through so many channels is any body's guess. What effectiveness the

minority shareholders then expect of them and actually get from them?

Going further these IDs normally attend 4 meetings of their respective committees in a year. These *'once in a quarter directors'* are presented with the agenda prepared by the executive management for discussions and approval. Do they play a serious role in forming the agenda? *Are they really pro-active or can they really be pro-active* might be the subject matter of research. I would like to quote here some extracts from the news item *"Two independent directors resign from IDBI's board"* published in the Times of India, New Delhi, 15 May, 2018:

Days after being named in an FIR by the Central Bureau of Investigation (CBI) two independent directors on the IDBI Bank board, S. Ravi and Ninad Karpe, have stepped down from their post, saying part-time board members only played a limited role in the overall process.

Karpe wrote in his resignation letter, "The proposals are recommended by the management and discussed in the executive committee of the board and the minutes are placed before the entire board. Part-time independent directors (PIDs) use their judgement based on the information /inputs in the agenda and submission/presentation made by the management. I am anguished that PIDs are being treated at par with the management of the bank and are being held responsible for commercial decisions".

If the IDs do not own or are not in a position to own responsibility for decisions taken by them jointly with the management board, are they really needed? What for? It is not just the IDBI, a large number of corporates have seen the exit of IDs in recent times for more or less similar reasons.

Business Standard, Mumbai, 13 June 2018 reported:

"Auditors are not the only ones calling it quits. With increasing instances of high-profile corporate frauds, accounting discrepancies and application of global anti-corruption laws, independent directors are finding the going tough. More than 1,000 independent directors (IDs) have quit since January last year (2017), data from Prime Database show. That number is likely to go up substantially in 2019 when a number of IDs' terms are reviewed for renewal".

The next issue is remuneration to independent directors. If they are not compensated adequately for the discharge of enormous responsibilities cast upon them, why should they accept independent directorships? Therefore, depending from company to company, they are now being paid hefty commission running even into crores of Rupees apart from meeting fees and ESOPS. This is a catch 22 situation. *If they are paid they are no more independent and if they are not paid why should they work?* The institution of independent directors and insistence that they should chair various corporate governance committees to ensure a fair treatment to the minority shareholders thus seem to be a farfetched imagination.

The recent corporate happenings have raised a serious concern about the independent directors. Satyam earlier and now the kingfisher, IDBI, PNB and ICICI scandals are a clear pointer towards the failure of independent directors. Question arises why there are serious failures on the part of the supervisory management. Are they not provided full information by the executive management? Are they kept in the dark? Are they not able to read in-between the lines? Or they do not understand the nitty gritty of the businesses of the companies on whose boards they sit? *Do they sit on the boards just for meeting fee, commission and ESOPs?* There is a growing feeling that mandatory independent directorships do not serve the intended purposes.

Ultimately what we need is not just *legally independent directors* but persons of high *character, courage* and *conviction* with a *deep sense of accountability* as directors, whether independent or non-independent. Presence of outside eminent people on the corporate boards of leading Indian industrial houses, appointed voluntarily, has been a phenomena dating long back to the establishment of the institution of *mandatory corporate governance*. And experience with the post corporate governance era suggests that the earlier system had been really working better.

These are personal views of the author.
