

Independent Directors- The Direction for the next decade



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Evolution spread over 2 decades

The concept of independent directors is a logical evolution of the principle of the divestiture of ownership and management of the companies. This concept aims to cure the information asymmetry, contain the agency cost, and foster overall corporate governance. It has become perhaps the most important, discussed, debated, criticised, and implemented the concept of corporate governance.

The history of the institution of Independent Directors in India is around 2 decades old. The Kumar Mangalam Birla Committee 1999 introduced this concept for the first time for the listed companies. The Companies Act, 2013 extended this concept for unlisted companies.

These 2 decades have seen the concept evolve and go from strength to strength. The first decade saw the concept be applicable only to listed companies and

develop very gradually. The second decade saw some fresh thinking being introduced into the mix. Overall, there has been wider applicability, refinement in the eligibility criteria, and a more systematic way of appointing independent directors through the creation of the Independent Directors' Databank. This was a great milestone in the development of the profession of Independent Directors.

The Ministry of Corporate Affairs and SEBI are committed to implementing this ID regime in the manner most suitable to the Indian scenario. With this background, it is apposite to take a view of the coming decade and what challenges may be faced by the Independent Directors.

The coming decade

The 2020s are shaping up to be quite a radical and uncharted territory for companies and individuals alike. The key challenges of this decade are changing geopolitical scenarios, a pandemic which refuses to slow down, the rise of disruptive technologies, and devastating climate change.

Businesses often survive and thrive in uncertain times but the present levels of uncertainty appear to be above normal. They may warrant significant changes in the business to be continued. The Independent Directors are likely to play a key role in designing and implementing the strategies to cope with the changes. Academic research globally has seen 2 broad trends. The first trend is to identify the specific areas where the Independent Directors have added value and the second trend is that of criticizing the Independent Directors when being treated as a panacea for all corporate ills. This article decidedly follows the first trend in its approach.

While the past two decades have focused more on the eligibility and the appointment of the Independent Directors, the coming decade is likely to focus more on the statutory role of the Independent Directors. Though the present statutes envision the role of Independent Directors, it has not played out as per the plan. The coming decade shall see a sharper focus on the roles of the independent directors with increased accountability not only from the regulators but also from key stakeholders like minority shareholders and institutional investors.

The independent directors are a linchpin in tackling the challenges outlined above.

Adding resilience and adaptability to the Board

In order to make a company resilient and adaptable to possible changes, it is important that the Board of Directors are themselves adaptable and resilient. Such traits are to be added by the Independent Directors by virtue of their being independent to the organization.

These two virtues can be seen as a universal antidote to chaos. Resilience and adaptability depend more upon a keen view of the macro factors affecting the business rather than having a microscopic view. Granted that the Independent Directors may not be able to persuade the board in all cases because of their lower strength, they should be able to put forth at least the possible courses of action on how to deal with the challenges.

Rapid shifts in technology

While talking about adaptability, one must mention the rapid pace of changes in technology. Blockchain, Artificial intelligence, and the possibility of a sentient AI and stricter data protection laws are going to reshape all industries. The companies are going to be forced to rapidly adapt to the changing paradigms and the reframed goal posts and forceful measures to protect data of their key stakeholders like customers.

Geopolitical risks

The resilience of companies was sorely tested during the pandemic. The recent geopolitical shifts and shifting economic headwinds mean that more is coming ahead. Economic integration means that not just the multinational companies but the local companies are not immune from these risks. The companies can no longer see the geopolitical risks as a distant or remote possibility but their effects on supply chains, logistics, human resources, and the overall marketplace must be accounted for.

Geopolitical decisions like Brexit have impacted more companies than they have realised. The recent changes to the Indian legal system with reference to investment from countries sharing a land border with India is another example of how the risk is closer than imagined. Many companies have redesigned their product chains during this period to cope with the reduced availability of raw materials as well as the supply chain bottlenecks. The role of Independent Directors in such exercises can be most valuable because of their diversified expertise.

Debt Optimization

While debt finance creates financial leverage and increases the returns to shareholders, the level and burdens of debt finance need to be optimised for every business. In recessionary times having a fixed outlay of further debt finance can prove to be a drag on the resources of the company.

Recessionary uncertainties make it even more relevant to rationalise and optimise the debt levels of the company. Unfortunately, under the provisions of the Companies Act, 2013, there is no concept of staggered approval for raising ever-higher amounts of debt. Hence, the Independent Directors must assume the responsibility of ensuring that the business raises debt in a calibrated fashion.

Usually, in recessionary times the companies tend to hold cash which may then be deployed to repay certain existing liabilities. Of course, by its very nature, this is a general statement and may not be true in every industry.

Role for stakeholders

The interest of the stakeholders is required to be protected. Such interests demand enhanced protection along with proper tradeoffs in cases like mergers and acquisitions where the Independent Directors can focus on overall value for all stakeholders rather than just the shareholders. Another special role of the Independent Directors is for handling the competition in the market where the interests of not just the shareholders but the economy as a whole are at stake. In such cases, the Independent Directors must push for the more efficient use of the resources and prevent predatory strategies which may result in wasting the resources of the economy.

Better accountability

The Independent Directors can definitely pursue higher accountability for the businesses they are in, especially on the ESG angles. The Companies are a custodian of the wealth of the society and must account for all the uses of the resources (including the opportunity costs).

The CSR obligations may be discharged better by focusing more upon one of the aspects of the social development and utility of the CSR projects rather than having a wide-based CSR policy.

Statutory Intervention

The present laws do not prescribe the duties of independent directors which are specific and not just anodyne statements meant to embellish the institution of Independent Directors. This aversion to specificity is something which shocks the very conscience of a rational thinker. Further, such duties need to be equally actionable as those of the non-independent directors.

Creating sustainable value

The independent directors are often the cause of a higher enterprise value. Such function becomes even more crucial during times of an economic slowdown when the value is already eroding. The capacity of the Independent Directors must be augmented by putting more tools at their collective disposal. One of the ways in which such trust can be reposed is by permitting the shareholders to directly appoint the Independent Directors rather the process being a Board initiated one and providing more say in the decisions of the Board by mandating their consent for some decisions.

The regulators as well as all the stakeholders need to put both additional levels of trust as well as accountability on the independent directors who appear to be perfectly capable of handling it.
