The Institution of Independent Directors: Does it really Deliver?

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This paper is predicated upon the premise that the institution of independent directors (IDs) need not have come into existence at all if the promoter and executive managements had not unduly enriched themselves at the expense of the minority shareholders, and had instead embraced fair and ethical practices.

1. Introduction

The role and responsibility of independent directors (IDs), which have been under debate for several years, have now come into sharp focus after the failure of many high profile corporations around the world; in India, the Satyam episode was the eye-opener, so to speak. While many brush aside Satyam as a one-off aberration, Satyam is in fact a watershed event for the institution of IDs. What makes the event of Satyam relevant is that it was possible for a huge scam to be perpetrated, and that too over several years, under the very eyes of some of the most reputed and competent persons (four highly successful and renowned academicians, an accomplished retired cabinet secretary of the Union Government, and a world-renowned technological genius) serving on its board as IDs.

If the institution of IDs which is the supreme surveillance body cannot even begin to detect such a huge fraud, what purpose does it serve in protecting the interest of the non-promoter shareholders? If the stranglehold of a majority of the promoters on their companies is so overwhelming that even highly credible, qualified, and educated persons are not willing to
or able to discipline the promoters who appointed them to the board, and tend to trust and provide blind support to the promoters, how then can they collectively act as watchdogs and protect the interests of the non-promoter shareholders they are primarily supposed to serve? This is an inherent paradox of the institution of IDs.

That more scams have not come to light could be due to several reasons—poor surveillance, the absence of more confessions of crime by the promoters, the ineffectiveness of whistle-blowing, and so on. It may not be necessarily because the IDs in other companies have been more diligent and have prevented scams. It would therefore be incorrect to assume that overall the institution of IDs is working well in India. Globally also, the role of IDs is now increasingly being questioned.

2. **Independent directors: The institutional context**

Multiple owners or shareholders of companies who are not in operational control require some mechanism to look after their interests and preempt any expropriation by those in operational control—hired executives or other co-owners. Such a group of people meant to exercise surveillance over the managers and controllers necessarily need to be free from any influence or dependence upon them, and these imperatives led to the evolution of a set of directors on company boards, who were variously referred to as independent, outside, non-executive, non-aligned, and so on. It is of course relevant to note that the job of such directors is not merely surveillance (important as it is); their controlling and monitoring role also continue to exist.

**Rationale for Independent Directors**

The concept of corporate governance (CG) came into existence due to the regulators’ desire to preempt the natural human tendency of the promoters and/or the management for undue enrichment at the expense of the minority shareholders, and to discourage non-compliance with laws and regulations. If almost the entire foundation of CG were to rest on the shoulders of the institution of IDs, it must be robust enough to discharge that
onerous responsibility. But the moot question is whether this institution is strong enough for the job. Regrettably, it seems overly fragile especially in a context like India which is predominantly promoters-controlled. In fact, it may now be playing a negative role by providing a false sense of security to investors and regulators.

It is interesting that although CG and IDs have been publicly debated over the past several years, of the nearly 3,000 listed companies that are governed by Clause 49, only a handful like Infosys, Tata, Godrej, HDFC, Hero Honda, Wipro, M&M and Max continue to be cited even now as role models. The reality is that these cited companies would most probably have had good CG even without Clause 49, because their promoters are people with the right value system, who have passed on those values across their organisations. But this is not true of the vast majority of companies. This debate has to be extended to the entire listed world. Failure to do so will make capital scarcer, hurting the growth of the economy.

Significantly, no strong voices of dissent have been heard from the corporates themselves decrying the ineffectiveness of the system of IDs. Most of them in fact appear to be comfortable with the present state of affairs, even proclaiming that Clause 49 is near perfect, and that no additional regulatory burden should be imposed.

Additionally eminent and respected persons, who are IDs themselves, have written, spoken and debated in defense of the present institution of ID. But they speak from their own personal experiences, and they represent at best a small minority of the listed companies. Interestingly, many of these eminent persons have now started admitting in public that if the promoter of a company and its CEO/CFO are intent on committing a fraud, there is little an ID can do to detect, mitigate, or prevent it. Could it be that much of this defence of the institution of ID in its present format is self-serving?

The promoters themselves also possibly recognise that IDs are a myth but they are happy to go along with the institution in its present format since it offers them an aura of approbation without inflicting any major interference in their usual operations.
Following the Satyam incident, some recommendations were made in the Voluntary Guidelines on Corporate Governance issued by the Ministry of Corporate Affairs (MCA), and in the Naresh Chandra Committee Report on Corporate Governance. Though many of the recommendations are significant steps forward, many of the fundamental deficiencies are yet to be addressed. Moreover, a voluntary code may not be taken very seriously, and any explanations for non-compliance would generally be innocuous and subjective. Regulators, institutional and minority shareholders and other stakeholders therefore need to demand the necessary mandatory changes.

**Defining the role of independent directors**

It would be appropriate in this context to define the institution of IDs especially in the Indian context, which becomes even more relevant in the face of the attempts that are being made to redefine and dilute the role of IDs, in order to include contribution to the development of corporate strategy, and review of the performance of the management in meeting the agreed goals and objectives, and value addition to the company in various other areas through their knowledge. While all these may be relevant in more developed markets with diversified corporate ownership, none of these could be the primary roles of the IDs in India with its predominantly concentrated ownership structures. It should also be recognised that IDs are mandated only for the listed companies. Even the voluntary guidelines of the MCA do not consider it necessary to mandate independent directors for the unlisted public limited companies (approximately eight lakh such companies exist in India), let alone other incorporated entities. This is essentially because only listed companies raise money from the public. The fundamental and primary perceived role of IDs in India therefore is simply the protection of public shareholders through means that would include opposing ideas that are detrimental to their interests, establishing financial controls to ensure that promoters do not enrich themselves through unfair means or excessive remunerations, and so on at the expense of the minority.

It therefore follows that anything else that the IDs do should be seen only as a desirable extra but not at the expense of their primary role of surveillance, and monitoring of the controlling promoters and managements.
The only real meaning of “independent” in this context would be that such persons should be independent of the promoters and the management so that they are able to protect the minority shareholders from the promoters.

This position is also supported by the fact that no one has ever complimented IDs for good business decisions or questioned them for the wrong ones. Even if adding value was an unstated objective, it would only be met partially (if at all) as not many IDs would have the necessary domain knowledge and expertise.

**Appointment of IDs**

If indeed the role of the ID is to protect the minority shareholders from the promoters, prudence would dictate that their appointments be made by someone other than the promoters. The reality and the irony however is that in India, the selection and appointment of IDs is entirely in the hands of the promoters.

Even in the few companies with Nomination Committees, the selection process—barring limited exceptions—is largely influenced by the promoters and management, especially since there is no requirement that such committees should wholly consist of independent directors, or that such meetings should be held in executive sessions without promoters and managements being present. The director selection processes are also very deficient—candidates are initially appointed as additional directors (for which no shareholder approvals are necessary) and are then processed through the next general meeting. No prior approval of the shareholders is required. The problem of appointment of IDs by the promoter could have at least been partly mitigated if some stringent eligibility and entry norms had been prescribed. Sadly, there is not a word on this mentioned in the entire regulation.

**3. Issues related to compliance**

After several extensions, the deadline for compliance (requiring 50% of the board to be composed of IDs) was finally extended in March 2005 to 31 December, 2005. On expiry of the deadline, almost all companies
filed full compliance. On closer scrutiny however, the *modus operandi* was as ingenious as it was simple—hundreds of companies just re-labelled their incumbent directors as independent. The second device was equally innovative—the regulation permitted a reduced one-third of the board to be independent if the board chair was non-executive. In as many as 30% of the companies, promoters or promoters of the promoter companies or even their relatives re-designated themselves as non-executive chairmen to qualify for this well-intended relaxation, thereby reducing the number of independent directors they were otherwise obliged to have. The net result of these actions was an apparently high level of compliance, in letter though not in spirit.

**Does Clause 49 promote board and director independence?**

In addition to these compliance machinations of the corporate, there are the grossly inadequate regulatory provisions with regard to independence of directors and boards—many concessions and compromises were made while framing the mandatory requirements bearing upon director independence (as indeed on many other aspects of good governance). The result is a fairly relaxed regulatory regime, whether in terms of rigorous prescriptions or their effective monitoring for compliance. For instance, *relatives* as defined in the regulations cover only a very few persons. It was (and is) therefore possible for companies to appoint several of their close relatives (who are outside the narrow definition of relatives in the Companies Act) to the board, and they will technically qualify as independent. While anyone related to the promoters is not considered independent, relationships between and among IDs does not carry such a disqualification. Moreover, there are no guidelines on the minimum board size. Many companies have very few directors, and as many as 22% of the companies which reported compliance have just one or two IDs on their boards, while still being compliant with the regulations. For the first two years, no age limit was prescribed for IDs. In 2007, it was found that over 150 young people (some of them barely 18) were on the boards of companies as IDs. It is highly unlikely that someone so young could add value as an ID of a company.
At the other extreme, around 3305 IDs (i.e. 48% of the total number of IDs) were above the age of 60. Significantly, of these 3305 directors, 1541 (22%) were above the age of 70. 233 were past 80, and 7 were older than 90. The 1541 individuals who were 70 years or older, held as many as 2337 ID positions. Their physical and mental fitness can at best be open to speculation.

To make matters worse, there are no norms on educational qualifications/knowledge prescribed. 35% of the ID positions are held by graduates or lesser qualified individuals. Of these, as many as 240 ID positions are held by persons who are not graduates, of which 136 individuals do not possess any college/university education whatsoever. While education by itself cannot be the sole qualifying criterion, it is indisputable that it does expand the knowledge and querying capabilities of an individual.

The limit on the maximum number of ID positions an individual can hold is too high. The Companies Act puts a ceiling of 15 directorships of public companies, making no distinction for listed companies. It is beyond debate that listed companies demand a much greater degree of commitment from an ID, including the attendance of at least four board meetings and several meetings of one or more of the many committees during a year. How many IDs can play an effective role in the listed companies has been a moot question. As of 31 December, 2009, as many as 280 individuals held 5, or more than 5, directorship positions in listed companies, in addition to directorships in several unlisted companies.³

The maximum number of all directorships (listed/unlisted/foreign companies) held by any one individual was 101. Of the 6875 individuals who were IDs, 443 were on the board of 1275 foreign based companies and collectively, were also on the boards of 13285 unlisted companies/organisations. In all, as such, they occupied a total of 26384 directorship positions in 15558 listed/unlisted companies/organisations.

There are also several instances of promoters who are fulltime directors of their own listed companies and at the same time hold ID positions in other listed companies. As of 31 December, 2009, there were as many as 553 such
promoters who collectively held 968 ID positions in other listed companies, and in addition held thousands of ID positions in unlisted companies.

Additionally, for the first two years, there was no guideline prescribing a time limit for the replacement of an ID in the event of a resignation, removal, or death of an existing ID. Neither was there any limit prescribed on the maximum tenure for an ID. As of 31 December, 2009, the tenure of 6,692 (75%) ID positions was more than 3 years; 3,896 (44%) more than 6 years; 2,250 (25%) more than 9 years and 1,680 (19%) more than 12 years. The highest observed tenure of an individual was 54 years.

Relaxed enforcement regime

The regulatory enforcement approaches also do not seem to be stringent, rendering non-compliance by companies not a very serious failure that would invite punitive punishments. While numerical compliance as regards IDs is fully ensured by SEBI at the IPO stage, monitoring appears to weaken post listing. No action has yet been taken against the non-compliant companies, including some of the Public Sector Undertakings who pleaded that the appointment of IDs was not in their jurisdiction. As many as 20 out of the 37 listed PSUs (who have registered with directorsdatabase.com) are non-compliant in the number of IDs.

There are as many as 26 companies who do not have even one ID on their board. The only “action” taken has been to put up the names of all such non-compliant companies on the websites of the stock exchanges; a recent list includes an astounding 1,317 cases.

4. The ID profile of Indian listed corporate sector

As of 31 December, 2009, there were a total of 6,875 individuals who occupied 8,901 ID positions on the boards of 2,461 listed companies. These may be classified into five broad categories as shown in Figure 1.
Home directors

Home directors form the major category comprising those who are known personally to the promoters such as relatives, friends, neighbours, former employees, former teachers etc. The stark reality is that no promoter would ever invite a stranger on to his board (and by the same logic, no person of any merit would accept the directorship of an unfamiliar company). A board position theoretically provides access to company confidential information that a promoter may not feel comfortable sharing with a stranger, fearing misuse.

Even if some of these home directors are qualified and competent, their home connections and sense of loyalty, and not independence, would always take precedence. An analysis of the profiles on www.directorsdatabase.com shows that nearly 70% of all IDs are home members who therefore are natural allies of the promoters and whose independent status is questionable.

Value directors

This is the most visible category of IDs. Value directors are those who provide either knowledge and/or expertise to the company, like lawyers, finance professionals, and technocrats, or retired civil servants who provide networking to the company by opening doors to the government, politicians, and other institutions. Most such persons are also invited to the boards to give a sense of comfort to both the institutional as well as the retail investors.
Admittedly most (if not all) in this category are of high integrity and knowledge. The value they deliver to the company would be huge, which would also benefit the minority shareholders. But this should not be at the expense of the primary role of an ID. They are not independent as almost all such directors are also either personally known to the promoters or have been referred by someone close to them.

With their knowledge and experience, they have the ability to identify the wrongdoings of the promoters. However, such directors would still by and large ignore the same or not contest the issue beyond a point. From past experience, it can be concluded that if some value directors have ever raised their voice in the boardroom, it would probably be because the action in question may adversely impact their personal reputations.

Significantly, most Value Directors are remunerated very well when compared to their past and last earnings. This becomes significant as nearly 48% of the IDs are retired people, who naturally would be quite dependent on the ID remuneration, more so if the remuneration is high. Such IDs would be guided more by their personal economic rationale. There are also cases where an ID’s earnings from a single company are as high as 50% of their total annual income, significantly eroding their independence in dealing with such companies.

An analysis of the profiles on www.directorsdatabase.com shows that about 15% of all IDs fall under the category of value directors.

Following the Satyam scandal, many value directors began to search externally for negative information (if any) about the companies of which they were board members, in order to be able to take preemptive action (by resigning) in case there was anything suspect in the activities of a particular company. Between January 8, 2009 (post-Satyam) and December 31, 2009, as many as 884 individuals holding 946 ID positions (i.e. nearly 15% of the total number of IDs) resigned, and the number is growing by the day. The biggest casualty of this exodus has been competence—the majority of resignations involved value directors, which left behind a disproportionately large number of home directors as IDs.
Celebrity directors

This category comprises people who were mainly invited to become an ID in order to add an aura of respectability and news value to the company, and also to impress the existing and potential retail investors. This category includes film stars, lyricists, sportsmen, defense personnel, fiction writers and the like.

Most people in this category are of high integrity and outstanding credentials. However, a majority of them would have very little to contribute as IDs in the commercial corporate environment. These people may not be known personally to the promoters, but since they do no harm to the company, promoters are comfortable with them.

An analysis of the profiles on www.directorsdatabase.com shows that about 3% of all IDs fall under this category.

Ministers’ directors

These are people on the boards of listed Public Sector Undertakings (PSUs), who are typically appointed by the political high command or by a minister. Most of these people are either politicians who need to be rewarded, or are people who serve bureaucrats who protect the interests of the dominant shareholder—the government—or are individuals that the politicians would like to favour. The main job of such appointees is to carry out the mandate of their respective minister/ministry. Of course, some of them additionally pursue their personal agenda of benefitting from these PSUs. Such persons are clearly not concerned about the minority shareholders.

An analysis of the profiles on www.directorsdatabase.com shows that about 4% of all IDs fall under this category.

Self-centred directors

The directors nominated under a lenders’ or a shareholders’ agreement are treated by the regulations as IDs. In reality, these persons are typically protecting only the interests of their nominating institutions and they become “persons acting in concert” and should not as such be treated as IDs. Their role in the protection of other minority shareholders is negligible.
An analysis of the profiles on www.directorsdatabase.com shows that about 8% of all IDs fall under this category.

It is evident that none of these five categories play their primary role—the protection of the interests of the minority shareholders—essentially because they are invited to the board by the very promoters from whom the minority shareholders are to be protected. Most of them, despite being conscientious and well-meaning, may not even be fully aware of their expected role of minority shareholder protection.

Moreover, as IDs are expected to protect other people’s monies, it should not be expected that they would watch over it with the same diligence and vigilance they would exercise to protect their own. It is also unreasonable to expect IDs to oversee the role and activities of their fellow directors, or to take an adversarial position. Moreover, IDs are invitees—they are guests, and guests who are also being paid. In the Indian culture, guests will always be polite to their hosts, and this further complicates matters. Given this nature of IDs, dissents are naturally rare. And given their relationship with the promoters, the rare dissent would never be made public.

As such, we believe that the entire concept of ID in the manner in which it has been defined and is practised in India is a myth. In order to test this, the following questions need to be asked. Was the ID independent of the promoter at the time of his/her appointment, and does he/she continue to be so? Is he/she competent enough to understand and safeguard the interests of the minority shareholders from undue enrichment by the promoters? The answers in most cases, regrettably will most likely be “no”.

5. **Way forward**

We now review some of the suggestions that have been proposed in order to strengthen the institution of IDs, and then make some recommendations of our own.

It has been suggested that IDs should be elected by the non-promoter shareholders. This is fraught with unimaginable negatives. One could
see all kinds of blackmailers, people propped up by the competition, etc. coming on to the boards and destroying the companies. A suggestion has also been made that the promoters should instead create a panel and the minority shareholders should vote their choice. However, the panel would still be constituted only by the promoters and as such would still include names of insiders.

Another suggestion is that IDs should be appointed by the government or SEBI. This would lead to nepotism, corruption and unnecessary political interference.

Some experts are now exhorting IDs to become more vigilant and ask more and right questions. The reality is they would not, simply because most of them are home directors, and in any case are not competent enough. Only a few of the value directors who are knowledgeable enough, may now ask more questions. But even then, it would be more to safeguard their personal credibility.

It has been suggested that IDs should have access to information other than what is provided to them by the promoters, and they should actively seek the same directly from the functional heads. This is easier said than done; and in any case, the functional heads would be more loyal to their employer (promoter) than to the ID. Moreover, the functional heads could be suitably tutored by the promoters.

Another suggestion that has been put forward is that IDs should meet independently with the functional heads to obtain varied perspectives, which is not viable given the constraints on their time, and the lack of specialised knowledge.

Many believe that what IDs require is formal training. There are already several institutions that offer a wide variety of courses and trainings. However, such training makes little impact.

Many argue that IDs should compulsorily retire after 6 or 9 years as by then familiarity may breed complacency. However, this argument is faulty and assumes that IDs do not connive (by design or negligence) with the promoters in the first 6 or 9 years.
Another suggestion is that companies should be rated for CG. The truth is that CG is very subjective and cannot be measured through check boxes. Credit rating agencies can at best look at some visible aspects of CG like the quality of board members, their company/industry knowledge, the attendance records, quality of agenda items, minutes of the meetings, and other board room practices; but this is all about the letter and not the spirit.

It has been suggested that the quorum of a board meeting should necessarily require the presence of a majority of the IDs, or that for certain agenda items, the presence of all of at least two-thirds of all IDs should be mandated. This is again based on the premise that IDs are truly independent.

Another suggestion demands a budget for the IDs which they can use to hire the services of outside experts like lawyers, accountants, and consultants. However, since the funds would be provided by the company, there could be a conflict of interest. But more fundamentally, would the IDs (who have been appointed by the promoters) be interested in seeking an outside opinion regarding the promoters’ intentions?

Some suggest that the IDs should meet independent of the promoters. However, the low knowledge base of most IDs about the corporate world and laws/regulations would make such meetings unproductive.

It has also been suggested that the audit committee should independently meet with the auditors in order to extract the truth. Other untenable suggestions include—focus on quality not quantity of IDs; include IDs from diverse backgrounds; provide legal immunity to IDs. All these would not help in any way to make the IDs truly independent.

The natural conflict between promoters (whose primary motivation would be to enrich themselves) and the IDs who are supposed to prevent this from happening is at core of the problem.

The concept of independent directors is not viable in the Indian context at this point of time. IDs may make some sense in the US for
example, where companies are widely held and where the rampant undue enrichment of the non-promoter CEOs has to be curtailed. In India, most companies are family-run (nearly 98%); the stranglehold of the promoters on their companies is near-complete. Most listed companies are actually run like proprietary firms. Expecting such families to induct true IDs is merely wishful thinking.

The situation becomes worse when the promoters hold 90% of the stock, as has been the case with most of the new listings in the past 6 years. Small public stakes cannot put any effective pressures on the promoters, and they look at the institution of IDs with even more contempt.

Then there is the mutualisation conflict which is dominant at the corporate level—the positions of owner, chairman, and CEO are vested with the same individual. This then decimates the role of IDs.

Given the ecosystem, most companies have to fight to set up their enterprises, for survival and for achieving growth in as short a time as possible, and their troubles are further compounded by the compulsions of quarterly results. And hence they would arguably use all means to achieve their objectives rather than wait for the big benefit in the longer term that may accrue with good practices.

The mandatory requirement of ID therefore deserves to be scrapped. IDs will always be appointed by the promoters; corporations would neither accept outsiders nor should outsiders be imposed upon them. So the intended benefits of the institution of IDs would always remain a mirage. Neither principle-based nor rule-based regulations will work. Let companies induct IDs if they find it necessary and let investors see value in such IDs. This way, only quality IDs will get appointed, and investors will demand and respect high quality IDs and value such companies differently.

Our conclusion therefore is that the institution of IDs under the present dispensation is not an effective enabler of good CG. It should be the job of the regulators to detect and punish non-compliance and unacceptable corporate behaviour, not the job of the IDs. A bold alternative approach needs to be adopted to achieve the regulatory objectives of higher standards
of governance in corporations. Some suggested initiatives are enumerated below.

The first step would be a comprehensive review of all the regulations, making these meaningful, simpler, and free of loopholes. It is better not to have laws than to have ones which are opaque or which cannot be enforced.

It would be necessary to mandate better corporate disclosures. The requirements on disclosure need to be reviewed with a focus on quality and not quantity, and also to make these meaningful for the investors. Also, severe punishment for non-disclosures and wrong disclosures should be mandated.

Making auditors more accountable is another step. No concessions should be allowed to the auditors; it should be their responsibility to ensure that they have reviewed all the papers themselves and have not depended upon the management’s confirmations. Moreover, auditors should not be appointed by the promoters (who also are in the voting majority at the AGMs). The auditors’ job is to prepare financial statements not for the promoters but for the public shareholders. Auditors for listed companies should be selected (based upon objective criteria) from a panel created by MCA/SEBI; these auditors can then be subjected to greater regulations and oversight. The audit fee should be paid from IEPF/IPF or from a new transaction fee/listing fee.

Errant auditors should be punished severely, and their certificate of practice should be revoked. Also, all audit firms who resign from their clients should be required to submit a detailed report to the regulators explaining in detail the reasons for their resignation.

It would make sense to do away with quarterly results, since this requirement has increased the pressure on the promoters to perform on a quarter on quarter basis. As a result, this requirement has actually become a big deterrent to CG.

The most important move would be to enforce compliance of regulations. Instead of depending upon the IDs, the regulatory agencies
should strengthen their surveillance and enforcement functions (including an Early Warning System) to ensure compliance of all laws and regulations. Alongside, there is a need to develop a system for swift investigation and also swift and adequate punishment to the offenders, which will also act as a deterrent. What is urgently required is compliance, and punishment for non-compliance.

However, we recognise that to scrapping the very institution of ID would be a controversial move, as it has been ostensibly introduced for the protection of minority shareholders. It therefore appears that IDs would stay as a mandatory institution despite its ineffectiveness. The way forward is to strengthen the entire system surrounding the appointment and functioning of IDs.

The caveat, however, is that none of this will in any way significantly improve the institution of IDs or bring about better CG. It may be reiterated that there cannot be real IDs if they are going to be appointed by the owners. Moreover, if quality cannot be mandated, corporates would continue to comply only in letter and would keep finding new loopholes when the present ones are plugged.

Nevertheless, some progress can be made by implementing the following suggestions.

The appointment process of IDs needs to be changed. A Nomination Committee, comprising only of IDs (like in the US), should be made compulsory. The appointment of IDs should be based on merit and other objective criteria. Only persons who can clearly demonstrate that they have enough time should be considered.

Public disclosures should be made on how an ID was found and why is he/she being nominated, along with all his/her past and present relationships of any kind with the company, promoters, major shareholders, and management. The profile of the ID along with all present significant commitments and also the proposed remuneration should be put on the websites of the company and the stock exchanges for public comments for 21 days.
All new IDs should be required to pass a Directors’ Knowledge Test before appointment. There should be a professional institution of directors. Membership should be obtained by passing necessary examinations after a course of instruction at or by reputed/selected business schools/academic centres. The board appointments should be limited to such Certified Directors. All existing IDs could be given a 6-month timeframe to pass the same test. The test should be very extensive and assess the person’s knowledge of finance, Companies Act, SEBI Act/regulations and the like.

No person, including retired people, should be allowed to hold ID positions in more than 3 listed companies. Promoters of listed companies or persons who are fulltime employees anywhere should not be permitted to hold even one ID position. In addition, no person should be allowed to be a member of more than one audit committee of listed companies.

For every agenda item at the board meeting, the management should attach a “Negative Impact Analysis on Minority Shareholders”, proactively stating whether the agenda item has any impact on the rights/interests of the minority shareholders. The IDs should discuss this impact analysis and offer their comments, which should be recorded in writing.

Full details of every single proposed related party transaction should be provided to the IDs, and their approval should be obtained. Similarly, full details of all transactions with any subsidiary company should be disclosed to and approved of by the IDs.

Demutualisation needs to be mandated. The functions of the owner, chairman, and CEO should ideally vest in three different persons, with the chairman being compulsorily an ID, who is appointed in the same manner as described above for an ordinary ID.

The time limit for finding a replacement for an outgoing ID should be set at 60 days at the maximum, and the responsibility for the same should rest with the Nomination Committee.

The uniform 50% requirement needs to be reconsidered. The number of IDs could be related to the percentage of non-promoter holding, as against
50% across all cases. The higher the promoter holding, the higher should be the percentage of IDs.

A new paradigm on board composition is required. We recommend that one-third of the board should comprise promoter-directors, another one-third should comprise value directors appointed by the management (who would not be deemed as IDs), and the remaining one-third should be the real IDs, who are qualified, and have experience in corporate affairs, and who are selected from a pool created by the regulator and who are then subsequently trained and pass the Directors’ Knowledge Test.

ID requirement for PSUs should be dropped, or the process of appointment of IDs should be changed. PSUs already enjoy many exemptions including on minimum public float. They should be exempted from this requirement also; more so because PSUs in any case are subject to additional scrutiny/audit like from CVC, CAG, and the Parliament. Alternatively, the power to induct IDs should be transferred to the Chairmen and the boards of the respective PSUs, which will then allow them to get the IDs both before their IPOs and also find replacements, whenever required, post-listing.

Additionally, the term relatives needs to be expanded, to include several levels of relatives, and include people from the mother’s side as well as from the spouse’s side. If IDs in a company are related to each other, only one of them should be deemed as an ID.

Persons who are nominated under a lenders’ or a shareholders’ agreement should not be treated as IDs. Moreover, the minimum age for IDs should be 35 years, at the least, and the maximum age should be capped at 65 years.

Each company should be required to have a board-level compliance committee comprising both promoters and IDs whose sole mandate is to ensure compliance of all laws and regulations. Members of this committee should be individually liable for negligence or connivance.

All IDs should provide a detailed certificate of independence at the time of appointment, and annually thereafter. This certificate should cover
any and all past and present relationships the ID has/had with the promoters, management, company, and other directors. This certificate should be put up on the website of the company and of the stock exchanges.

A cap on remuneration may not be desirable, and should be decided on a case by case basis. However, the remuneration earned by an ID from any single company should not exceed 15% of his total annual income, in order to reduce his dependence. Moreover, ESOPs and commissions should not be granted to IDs.

Clause 49 presently requires all domestic subsidiary companies of a listed company to also have IDs. This requirement should be extended to foreign unlisted subsidiaries of the Indian listed companies.

Many countries in the world recognise the institution of lobbyists. Several value directors in India are in reality playing that role. It may be worthwhile to recognise this institution which would then allow many people to become professional lobbyists without joining the boards of companies to perform that role.

There is a need to ensure stringent compliance of Clause 49. Non-compliance with regard to Clause 49 needs to be punished. The only effective punishment would be a significant penalty on the promoters/managements in their personal capacities, and in extreme cases, throwing out the promoters/management and bringing in new management. This should also be applied to PSU companies, where the Government is the promoter.

Mandating exit interviews for IDs who resign would enable the regulator to find a way to convert these IDs into whistleblowers of sorts, and identify the ills affecting the companies from which they have resigned.

Institutions would have to shed their passive, inactive roles and take proactive decisions on company agendas. They should also be required to publicly disclose their voting on each resolution annually. Retail investors would gradually give their monies to such institutional investors who are protecting their interests. Greater institutional investors’ involvement would also keep the IDs on their toes. Institutional investors should also play an active role in the appointment of IDs.
An effective whistleblower policy needs to be mandated for each listed company. Anonymous complaints should also be entertained. Only an ID should be appointed in a company to receive such complaints/information.

We also propose that all CG awards should be banned.

6. Conclusion

As long as IDs are appointed by the promoters, independence shall remain a myth. Moreover, quality cannot be mandated and corporates would continue to comply only in letter and would keep finding new loopholes when the present ones are plugged. On the other hand, nominating IDs by an outside body would be counter-productive.

The biggest paradox is that an ID is required to be independent of the very promoter who has appointed him and whose wrongdoings he is supposed to prevent. And yet, the regulations expect the institution of IDs to ensure good CG.

Ultimately, CG is not a matter of regulation. Governance has to be driven by the management and there is no substitute for that. Good behaviour will be valued and respected by the market. Expecting regulations to infuse morality into people is an utopian idea, given the corporate ownership and control scenario in the country.

Notes

1 Corporates initially protested about the non-availability of professionals qualified to become IDs. In response to this, primedirectors.com was created (by the author) which is a free service where professionals can register themselves; listed companies are provided access to the database so that they can select from among the over 19,000 profiles available. However, the response from the corporates has been very poor—only about 300 people have been sourced from this particular website at the time of writing.

2 Following various representations, the minimum age requirement was fixed as 21. As of 31 December, 2009, there were as many as 248 IDs below the age of 35, with 7 being even younger than 25.
This number was 389 as on 31 December, 2006; the public disclosure of multiple directorships through directorsdatabase.com led to many individuals reducing their directorships.

www.directorsdatabase.com profiles the directors on the boards of companies. As of 31 December, 2009, 2,461 out of a total of 2,930 companies (84%) listed at BSE had filed information related to their directors.