NSE

Edited Transcript of the Seminar on

Independent Directors

Issues and Challenges

Mumbai, May 25, 2012

Organised by NSE jointly with SEBI, CFA Institute, NISM and BSE

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Contents

Preface

Good Corporate Governance (CG) is key to the integrity of corporations, financial institutions and markets and central to the health of any economy and its stability. Given the centrality of CG in preserving market integrity, the SEBI has taken a number of initiatives over the years in promoting CG, while the stock exchanges have played a supportive role by monitoring their respective listed companies' compliance with the listing and disclosure standards. It is being increasingly recognized, however, that the passive monitoring of compliance with a set of established standards is not enough. For corporate governance to be effective, there is a need for continuous review and global benchmarking of the CG standards. Further, it is not just the letter but the spirit of compliance that is paramount. Although the 'spirit of compliance' is a somewhat abstract concept, it is given meaning and substance by practices established by some progressive corporates. Wide interactions among industry, practitioners and academics play no mean role in the evolution of CG standards as well as in percolating the 'spirit of compliance'. Against this backdrop, the SEBI has been driving many dialogues and discussions with active participation of stock exchanges and industry.

As part of its supportive role, NSE had earlier brought out a report on "Corporate Governance: an Emerging Scenario" which put together 15 essays by domain experts, practitioners, academics and policy makers. Recently, NSE organized a seminar on **"Independent Directors: Issues and Challenges"**, jointly with SEBI, CFA Institute, National Institute of Securities Markets (NISM) and Bombay Stock Exchange (BSE) in May, 2012. The effectiveness of the institution of Independent Directors (IDs) in raising CG standards and establishing public trust has been an issue of considerable debate. The aim of the seminar was not only to signal the importance that SEBI and exchanges place on the institution of IDs in corporate governance, but also to highlight the possible initiatives that would allow the IDs to play the role expected of them more effectively. The panelists and presenters of the seminar were IDs, investors, academics and industry experts from India and abroad.

The seminar deliberations have been captured in this edited transcript. The executive summary encapsulates the key ideas emerging from the seminar, but is no substitute for the transcript, which provides interesting insights into real life issues and experiences. We believe the transcript would be useful for not only the IDs and potential IDs, but also policy makers, regulators, practitioners, researchers and the investor community at large.

I would like to thank SEBI, the CFA Institute, NISM and BSE for their support in organizing this seminar and making it a success.

Chitra Ramkrishna
Joint Managing Director, NSE

Executive Summary

At the behest of the Securities and Exchange Board of India (SEBI), the National Stock Exchange (NSE) organized a seminar on **"Independent Directors: Issues and Challenges"** jointly with SEBI, CFA Institute, National Institute of Securities Markets (NISM) and Bombay Stock Exchange (BSE) on May 25, 2012.

There were two panel discussions: one on how to make Independent Directors (IDs) more effective and the other on expectations from and delivery by IDs. Three presentations were also made on the subject. The panelists and presenters were IDs, investors, academicians and industry experts from India and abroad. A wide spectrum of stakeholders participated in the seminar as audience.

A. General observations

It was observed that while IDs play a critical part in building people's trust in the market, there is a need for greater clarity on their role. The advisory and the monitoring roles of the IDs were discussed. A broad consensus emerged that the monitoring role of the IDs is relatively more significant, particularly from the viewpoint of protecting the interests of minority shareholders, who have limited voice. Questions however were raised whether the institution of IDs, developed on the basis of the Anglo-Saxon model, would be effective in most countries of the world (including India), where ownership is concentrated and where controlling shareholders have strong influence over functioning of this institution. It was nevertheless observed that in the absence of a better alternative, the institution of IDs is gaining ground the world over, amid attempts in different countries to strengthen this institution. An additional problem that was deliberated is the paucity of competent IDs for the vast number of listed companies in India. This is not only a problem in and of itself, but also a hindrance to some necessary reforms.

It was felt that barring IDs of some well governed companies, effectiveness of other IDs leave a lot to be desired. Although in some notable cases, the experience has been that the IDs have brought in fresh perspectives into the boardrooms and their recommendations have been influential in management decisions, such cases are few and relate largely to the more reputed business groups in India. Such approach must percolate uniformly across India's corporate sector.

It was generally agreed that a process of continuous improvement of this institution is essential to address the challenges facing the ID system, so that the gap between what is expected of the IDs and what they actually deliver is reduced. While international experience could provide a useful guide, all legal and regulatory reforms necessary to make the institution truly independent and effective in India need to reflect the realities of (a) concentrated ownership and (b) paucity of competent IDs. The Companies Bill, 2011, which is before the Parliament, addresses some of the existing issues. It is however recognized that raising corporate governance standards would require going beyond legal and regulatory reforms. Management, institutional investors and media have to play a complementary and/ or facilitating role. In this respect, the significance of some personal traits and dispositions of IDs was also highlighted, which would help them contribute better.

Although some deficiencies still persist, it was observed that corporate governance in India has come a long way.

B. Specific issues and suggestions

I. Role of IDs

- India is enshrining the concept of ID in the proposed company law, which would help clarify the Primary role of IDs on a Board. (Most countries do not provide for the requirement of IDs in their respective company law.)
- The Companies Bill in India proposes that directors should attempt to balance the interests of all stakeholders. There are practical difficulties in interpreting and implementing this.
- Worldwide, IDs play two types of roles: advising to make board decisions more robust (by using their domain expertise) and monitoring. In India, IDs typically focus on advising role and do not give due importance to the monitoring role, although the latter role is of greater significance. IDs need to be cautious of the pitfalls in their advisory role: if their advice results in an unfavorable outcome for the company, their monitoring role could be potentially compromised.
- For their role to be well appreciated, IDs need to equip themselves with adequate domain knowledge about the concerned businesses and their respective risk profiles; else, they may be seen as a hurdle.

II. Challenges facing IDs

- Given that Controlling shareholders in India have a strong influence on the selection of IDs (see below), how can they monitor the controlling shareholders? If they do something which is to the dislike of the controlling shareholders, how can they sustain themselves in the Board?
- In the controlled companies, ownership and access to information remain in the hands of the controlling stockholders which makes it challenging for the IDs to exercise independent judgment.
- The company as well as all its stakeholders may expect IDs to protect their respective interests, which may often be conflicting.
- Many questioned whether IDs possess the information, knowledge, skill and access to resources (such as the ability to hire their own independent experts) to play their role efficiently. Because, to make effective intervention, IDs need to understand the business model of the company and the business realities.

III. IDs' personal dispositions

- The essential attributes of an effective ID can be explained through three Cs: Character, Competence, and Commitment.
- IDs should have sound common sense, fearlessness, and an open mind.
- Mutual trust and respect among the Board members are conducive to efficient functioning of the Board. IDs, like other directors, should strive for the same.
- They need to feel obliged to gain enough information before the Board/committee Meetings.

IV. Nomination and election of IDs

- Controlling shareholders in Asia (including India) effectively control the nomination and election of all Directors on the Board. Minority shareholders need to have greater influence over the Board composition than they do at present. Companies Bill, 2011 provides for the manner of appointment of Independent Directors from a panel notified by the Central Government. Further, the Bill states (as in case of existing Act) that a listed company may have one director elected by small shareholders.
- While in India, IDs are defined as those independent from its promoters, directors and senior management, in Singapore, those independent from only the 'major shareholders' can be appointed as IDs. Major shareholders are defined in Singapore as those having more than 10 percent shareholding.
- One way of giving minority shareholders greater say in the election of Directors is through the process of cumulative voting (proportional representation), which is permitted in Philippines and China. In India, it is allowed under the Companies Act on an optional basis, but is rarely utilized. Is mandating it necessary? There is, however, no empirical evidence to show that the concept of cumulative voting could be a panacea.
- A suggestion was made that IDs' full profile should be made public on stock exchanges' websites and the company should provide justification for why that person should be considered.

V. Database on IDs

- The experience on the use of databank of IDs for the selection of IDs has not been very encouraging because there is still a tendency among companies to choose those whom they already know; nobody wants to get a stranger on Board. This is a fact of life.
- An existing database on IDs in India is used more as a tool to find availability of somebody that the management / promoters already know. In Singapore, the Institute of Directors has a data bank of IDs for almost 2 years; but this is found

to be serving at best as an enabler to access a bigger base of Directors and not as a substitute for the circle of known contacts.

- There is nothing wrong in people going to their circle of contacts to select IDs, provided their selection is based on transparent benchmarks.
- The concept of a defined pool from which IDs can be exclusively selected did not find favor, because it is amenable to manipulation.

VI. Compensation for IDs

- In the U.S., compensation for IDs includes stock awards and stock options. For most companies, about half of the compensation received by IDs comprises stock awards or stock options. Some Indian companies also offer stock options to IDs in addition to sitting fees. The appropriateness of such incentives is debatable. Companies Bill expressly prohibits granting of stock options to IDs.

VII. Limits on Term and Directorship of IDs

- Some IDs sit on several Boards and have often been referred to as 'Busy Directors'; it is a much debated issue in Asia as to how effective they are.
- Paucity of competent IDs in India has complicated matters; for example, in the proposed Companies Bill the number of public companies in which a person can hold directorship is as high as 10. Further, IDs can hold office in any given Board for a maximum period of two consecutive terms of five years each; they can even be eligible for reappointment after the expiration of three years of ceasing to become IDs.
- In Malaysia, the new CG blueprint recommends that the maximum number of Directorships is 5 and the Director should seek approval of the Board of these 5 companies before accepting new appointments. A proposal to include this in their listing rules is currently being discussed.

VIII. Quorum

- Currently in India, the quorum can be attained even without IDs and the meetings can go on; the need for the presence of majority of IDs to constitute a quorum was highlighted.
- SEBI may come out with such a requirement, keeping in view the provisions of the Companies Act, if it feels that it has sufficient leeway to do that.

IX. Liability of IDs

- In India, the law and the courts have been gravitating to the position that IDs cannot be held liable for something that they could not have had an influence on. The Companies Bill, 2011 seeks to provide some relief to IDs in this regard.

- A case was also made against blanket protection for IDs, because there is a general complaint that IDs are not diligent enough.
- In some jurisdictions, such as Singapore, the exchange has begun to reprimand, name and shame the errant IDs. There have also been cases where criminal actions have been taken; but they are rare.
- A case was made for IDs to have their dissent notes recorded appropriately in the minutes of the board meetings.

X. Removal of IDs

- In most of the jurisdictions, an ID can be removed with simple majority. The Companies Act requires that if directors are removed before expiry of their respective terms, they have a right to be heard in the meetings.
- There should be more stringent rules to ensure that Independent Directors are not removed before the end of their terms without sufficient reasons. In Philippines, for example, the listing rules require two-thirds majority to remove a Director.

XI. Resignation of IDs

- Resignations of the independent directors are generally shown to be on the ground of medical or personal reasons and rarely on the ground that the company is involved in a malpractice. A case was made for IDs to owe an explanation to the shareholders (who elected them in the first place) as to why they were quitting.

XII. Enforcement

- There is significant scope for improving the enforcement of corporate governance norms, including those relating to IDs.
- It has been a challenge for PSUs to appoint requisite number of IDs on the Board.
- Effective ways for enforcing Corporate Governance provisions need to be analyzed and identified.

XIII. Role of other stakeholders

- The management should be forthcoming in providing any document or information that the IDs ask for.
- Institutional investors have been playing a complementary role and there is scope for this role to be strengthened.
- Media attention to companies' governance is drawn only when there is a big scam or governance failure, because they make attractive headlines. The media needs to also highlight the achievements of competent Boards.

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A. Welcome Remarks

– Chitra Ramkrishna, Joint Managing Director, NSE

Honourable Chief Guest, Shri Rajeev Kumar Agarwal (Whole-Time Member, SEBI), Smt. Usha Narayanan, distinguished panellists, ladies and gentlemen, a very good morning to all of you. I welcome each and every one of you who has taken time out this morning to be part of this seminar on "Independent Directors: Issues and Challenges." We have among us today many Independent Directors, CEOs, CFOs, Company Secretaries, representatives from the academia, and of course, from the exchanges, and the regulatory staff members. Clearly, such a wide spectrum of stakeholders coming together on a Friday morning is evidence of the increasing emphasis and importance that is being attached to corporate governance in India, as well as the world over. Having said that, let me emphasise that this seminar would not have been possible had it not been for the direction and thrust of the SEBI in this regard. Putting together a policy discussion such as this has been one of the major thrust areas of SEBI's multipronged efforts towards improving integrity and governance standards in the market.

An additional point to note is that getting the exchanges to collaborate in this effort is clear evidence of the complementary role that the regulators and the exchanges play in effecting all the corporate governance standards and practices in any market. While the SEBI sets the listing and disclosure standards, the exchanges are really responsible for the day-to-day monitoring of the corporates' compliance with these standards, and therefore, in some sense, constitute the arm for implementing the norms necessary for preserving market integrity. So, it is against this backdrop that we all congregate here this morning to have a lively discussion, sharing experiences on the subject of Independent Directors. We are going to have two sessions: the first one centres around how to make Independent Directors (IDs) more effective, and the second one focuses on the expectations from IDs and their actual delivery against these expectations.

Questions have been repeatedly asked as to whether IDs are truly independent, especially in a situation where corporate ownership is highly concentrated and there is a predominance of family-owned businesses. Besides, there may be other factors that affect the effectiveness of IDs. For example, do IDs get enough information prior to meetings? Does the management keep them adequately informed? Is there clarity about what they are expected to do in terms of participation in the Boards? Is there an adequate accountability framework? Do they have a facilitation framework and the capacity to discharge these duties? What has been the experience in India and other markets? I am sure the morning's discussion will throw light on many of these areas. Since IDs are critical to corporate governance, it is a matter of concern for all of us here. Needless to say, since the exchanges are in charge of monitoring compliance with Clause 49, which many of you in this room are familiar with, the outcome of these kinds of discussions would help us do our jobs better.

On a final note, I would like to add that no matter what we do in areas such as this, it is an ever-evolving framework; after all, it is really not the words or the rules, but the spirit of compliance that brings effectiveness in several critical governance situations. However, the debate must go on, because only then can we hope that we will reduce the chances of accidents as well as their impact on market integrity, over time. In closing, let me once again thank the SEBI for the guidance and direction that they have provided in putting together this seminar. I would also like to acknowledge the support of our other partners: the CFA Institute, the NISM, and the Bombay Stock Exchange. On behalf of the NSE and the other organisers, once again, I welcome all of you to this morning's deliberations, and I hope that we all have a very productive forenoon.

B. Keynote Address

– Rajeev Kumar Agarwal, Whole-Time Member, SEBI

Ladies and gentlemen, a very good morning. It is a matter of immense pleasure for me to interact with a gathering as enlightened as this. Friends, since the evolution of SEBI in the early 90s when India started liberalizing its economy, we have come a long way as far as the market infrastructure is concerned. Many crucial developments have taken place in the market, such as screen-based trading, complete dematerialization of shares, T+2 settlement system instead of the ad-hoc settlement system that existed in the early 90s, the world class clearing and settlement system, and disclosure-based IPO regime. Still, our record, as far as the corporate governance is concerned, is not all that laudable. Let me admit this: there are still issues relating to the governance of the corporates.

Friends, if we really want to mobilise savings into the capital market and to develop our capital markets, it is necessary to generate trust. Trust is the most crucial factor that encourages the savers to divert their savings into the capital market. Any amount of effort to improve the market infrastructure would be futile if trust is not effectively generated. If the corporations are not managed properly, we shall face very stiff hurdles as far as the mobilisation of the funds is concerned.

The next five-year plan targets a savings of USD 1000 billion into the infrastructure sector alone. How can we meet such targets unless we are able to mobilise our savings into the capital market? Therefore, we will have to generate trust by displaying high standards of corporate governance to the investors, and assuring them that their interests are being protected. It is here, where the corporate governance becomes very crucial; this is not to say that India has not moved in this direction, nor that the efforts made in the last 20 years have been insignificant. Imagine a situation where a large number of corporates or the majority of corporates were family managed; this used to be the situation in India. We have moved from a situation where most of the corporates were family managed to a situation where quite a number of the corporates are being professionally managed. But still, as I said, there are some issues, and this change is an ongoing process. No amount of effort will be adequate in this direction. We have to continuously work on this and see that things keep on improving. Real success would be when the investors start trusting the management and begin to put their savings into the capital market instead of investing in unproductive investments.

Friends, a corporation cannot be managed properly unless the Board is independent. The independence of the Board is the most crucial factor, which is where the role of the Independent Directors comes into play. As such, an Independent Director is like any other Director, and is duty-bound to protect the interests of the company as a whole. Still the Independent Director has a special place. Because being independent, an ID is in a position to exercise independent judgement on issues that may be related to competing interests. When faced with issues where the interests of the management or the promoters are in conflict with those of the minority shareholders, an Independent Director is best placed to take a judgement. Therefore, this institution needs to be strengthened.

The Independent Director's role is particularly important in the areas of remuneration and related party transactions. I am not saying that related party transactions per se are questionable; they are not. Maybe most of such transactions are in the interest of the company, but still, some of these transactions may involve a conflict of interest. Therefore, Independent Directors have to exercise special care while looking into related party transactions.

Another thing I would want to say is that the interests of the company and the interests of the minority shareholders need not necessarily be at divergence. Normally, I would say, the interests of the company should converge with the interests of the shareholders, including the minority shareholders. It is only when some personal elements come into play that the interests of the company may diverge from those of the minority shareholders. Therefore, certain related party transactions may become questionable, because there may be some personal interests in them. This is where the Independent Directors have to exercise their independence.

As far as the qualities of an Independent Director are concerned, I would say that an Independent Director should have sound common sense, fearlessness, and an open mind. He should not be very rigid about things because he has to understand the realities of the business and the business models as well. He should understand the fact that ultimately, the business is being run by the operating Directors, who understand the business model. So, his intervention should be well informed and he should also be accountable for his decisions. If he does interfere, his decision will also be subject to scrutiny. Therefore, it is advisable for the Independent Directors to gain sufficient knowledge about the business domain of the company.

It is also necessary for them to understand the business model of the company; only then would their intervention be well appreciated, and their contributions will become genuine. Otherwise, there may be complaints from the management that the Independent Directors are unnecessarily interfering in the business of the company, making it difficult for them to run the business. This kind of situation or this kind of deadlock should not come about. The Independent Directors should also appreciate the problems of the management. It would, therefore, be necessary for them to be well informed before the Board Meetings that they have to attend. They are fully empowered to request for any documents or any information from the management. It would be advisable for them to gain enough information before going to the Board Meetings; if they do so, their intervention will be very well informed and productive. They have to exercise some supervisory oversight over the statutory compliances which are to be made by the company because a situation should not arise where no alerts are generated and the company finally gets into a big trouble.

Friends, I will not take much time of yours. Before I close my remarks, I would like to highlight the co-operation between SEBI and OECD. In December, we had a very good policy dialogue in the SEBI Bhavan, which involved a large number of participants. The Indian corporate governance framework is mostly aligned with the six principles enunciated by the OECD. So friends, I wish a big success to this conference, and I am very sure that fruitful discussions will take place and there will be many takeaways from this conference.

Thank you very much.

Session I

C. Presentation I: The Evolving Role of IDs

- Afra Afsharipour

D. Presentation II: Search for True Independence

- Lee Kha Loon

E. Panel Discussion I: How can IDs be made more effective?

Panellists: Shailesh Haribhakti
Mak Yuen Teen
Nawshir Mirza
Amit Tandon

Moderator: Umakanth Varottil

C. Presentation I: The Evolving Role of IDs

– Afra Afsharipour, Professor, University of California, Davis

My goal is to begin this morning's discussion about the evolving role of Independent Directors (IDs). I would like to accomplish a couple of things in this short presentation—first, to speak about the role of IDs; and second, to provide you with some data on the ID model from the United States.

The Role of IDs

Legislation and regulation envision two broad roles for IDs: (i) an advisory role, as the brain trust, consultant, or strategic advisor to management and/or the controlling shareholder; and (ii) a monitoring role. In the case of a controlled entity, IDs can act as monitors of the controlling shareholders on behalf of the minority shareholders, and in the case of non-controlled companies, IDs can act as monitors of the management on behalf of the shareholders.

While these two roles are both envisioned, there are questions as to whether IDs can perform both roles. Scholars continue to explore the challenges for the ID model. Can IDs act as effective monitors? Are IDs truly independent of the management and/or the controlling shareholders? How does one define independence? A checklist approach towards defining independence may not capture the high level of independence that we expect from IDs. There are also issues with respect to the nomination of IDs at controlled companies—these issues could arise from either a lack of transparency in the nomination process or the controlling stockholders' control over the nomination and election process.

Many have also questioned whether IDs possess the information, knowledge, skills, and resources required to act as both advisors and monitors. In some jurisdictions, there are issues regarding how to attract appropriate IDs. Companies need IDs with the professional competency, skills, and expertise to exercise quality corporate governance.

Particularly with respect to the monitoring role, there are challenges for IDs serving on the Boards of controlled companies. In such entities, ownership, power, and access to information remain in the hands of the controlling stockholders, making it challenging for the IDs to exercise independent judgement. Moreover, the IDs sometimes perceive themselves to be serving more as advisors to the controlling stockholders than as their monitors. The IDs may also not have access to incentives or resources—such as the ability to hire their own independent experts—in order to effectively monitor the controlling stockholders. The IDs may not have the skills to combat potential governance problems. In fact, in a recent study, IDs noted the lack of sufficient training programs and resources, and expressed concern about whether such deficits undermined their monitoring role.

The ID's monitoring role also brings up some thorny issues regarding director liability. To what extent do we expect IDs to monitor the day-to-day activities of the management, and if they fail to catch problems at the firm, what amount of liability do we intend to impose on the IDs at the firm? The issue of liability is quite an important one to consider if we want to attract strong, qualified, and experienced people to Boards.

IDs: The U.S. Scenario

I would now like to turn to some data and information from the United States. Publicly-listed companies in the U.S. are subject both to federal rules—as promulgated through listing standards and the Securities and Exchange Commission (SEC) regulations—as well as to the rules of the state in which they are incorporated.

Definition of Independence

According to the NYSE rules, to qualify as "independent," the board must affirmatively determine that the director has no material relationship with the company. Similarly, the NASDAQ rules define an Independent Director as a person other than an officer or employee of the company or its subsidiaries, or any other individual having a relationship that, in the opinion of the company's board, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. Both the NYSE and the NASDAQ rules provide categories of directors who are not considered independent. The SEC's regulations do not directly define director independence, but they do require identification of the members of the three major committees (the nominating committee, the audit committee, and the compensation committee) that are not considered independent.

While the listing rules lay out independence standards that are similar to those found in India, the director independence standards under state law are much more contextual, and come from judicial decisions. For example, the courts focus on economic ties and whether the directors were under the "dominion and control" of a fellow director or senior executive, and have even reviewed a wider array of personal and professional relationships to determine independence.

Percentage of IDs

Under the NYSE and the NASDAQ listing rules, Boards must have a majority of IDs, who must be disclosed in an annual proxy statement. There is, however, an exemption for controlled companies, i.e., companies in which more than 50% of the voting power is held by an individual, a group, or another company. For example, Facebook, which recently went public in the U.S., specifically noted in its registration statement that they plan to take advantage of this controlled-company exception, and that they will also take advantage of the exemption from the requirement to have a nominating committee.

In terms of director independence, data for 2011 gathered by The Conference Board shows that across industries, companies in the U.S. reported that IDs constituted more than 80% of their Board membership, as compared to about 54% for Indian companies (based on The India Board Report 2011).

Meetings of IDs

The rules of the stock exchanges require IDs to participate in regularly scheduled meetings at which only IDs are present.

Nomination, Election, and Removal of IDs

According to the rules of the stock exchanges, companies must have a fully independent Nominating/Corporate Governance Committee, which, among other things, would be responsible for identifying qualified Board members consistent with the criteria approved by the Board, and for recommending or selecting director nominees. Controlled companies, however, are exempted from this requirement.

The election of directors in the U.S. is governed by the corporate law of the state in which the company is incorporated. Under Delaware law (the primary jurisdiction in which the majority of publicly-listed U.S. companies are incorporated), the default rule is that directors are elected annually by plurality vote.

The standards for director removal also come from state corporate law. Under Delaware's default rule, any director may be removed, with or without cause, by the holders of a majority of the shares, who are entitled to vote at an election of directors. With respect to removal, the Delaware statute does not differentiate between controlled and non-controlled companies. The U.S. regulatory requirements impose significant public disclosure obligations if a director is removed, or if he/she resigns from the Board.

Director Compensation

The size of director compensation in the U.S. tracks the size of the company based on revenues and assets. Compensation for IDs is not just composed of cash, but also includes other forms of compensation such as stock awards and stock options. For most companies, about half of the compensation received by IDs is composed of stock awards or options. Most companies also pay additional board fees to IDs who serve as the Board Chairperson or lead director, as well as to IDs who serve as committee chairs or committee members.

D. Presentation II: Search for True Independence

– Lee Kha Loon, Head, Asia Pacific Standards and Financial Market Integrity, CFA Institute, Hong Kong

Board composition and independence are fundamental issues in corporate governance, especially in Asia. The concentrated ownership structures in Asia increase the importance of independent non-executive directors on corporate boards. In Asia, companies commonly have controlling shareholders, who have the ability to control the nomination and election of directors to the Board. The search for true independence depends on the understanding of the following key issues: determining the board composition and the effectiveness in maintaining independence when conflicts of interest arise; defining independence and the criteria for determining independence; setting the term limits for long service independent directors; limiting the number of directorships one can hold; and defining the processes for informing the public when a director resigns.

Board Composition

The number of independent non-executive directors (INEDs) on Asian boards is comparatively less than in companies in the U.S., Australia, Canada, and the U.K. The average number of INEDs required on the Board differs widely across jurisdictions. The minimum number of Independent Directors (ID) required is at least three in Hong Kong, whereas it is one-third of the total Board membership in Malaysia, India, and Singapore. In India, where the executive chairperson is not independent, the Independent Directors have to constitute at least half of the Board. Japan did not introduce the concept of INEDs until last year, and they just require one ID. The CFA Institute recently conducted a study in Hong Kong, and found out that about 77% of the main board companies had Boards composed of one-third or more INEDs; however, only 9.3% main board companies had a majority of INEDs in the Board. The study also found that although two-thirds of the main board companies complied with the new CG code to separate the roles of the Chairperson and the CEO, only 1.7 % of the companies had an INED as Chairperson in Hong Kong. The entire report "Board Governance: How Independent are Boards in Hong Kong Main Board Companies?" is available on the CFA Institute's Website.

Definition of Independence

The definitions of independence are generally in terms of negative attributes, which, if present, would deem a director non-independent. A comprehensive definition would require that a non-executive director should not:

- Be a current or past employee of the company or its subsidiaries;
- Be a substantial shareholder, or be connected to or represent a substantial shareholder;

- Represent other interest groups that could exert significant influence (suppliers, customers, etc.);
- Be an employee/partner of a professional firm that has a current or past business relationship with the company/subsidiaries or related parties;
- Participate in the company's share options or performance-related pay schemes, or receive financial assistance from the company/subsidiaries or related parties;
- Receive an income from the company other than the director's fees;
- Have conflicting cross-directorships;
- Serve as an Independent Director for more than a specified length of time; and
- Be over a certain age (Hermes suggests 70 years as the upper age limit for IDs).

Many of these requirements are incorporated in the listing rules and the corporate governance codes throughout Asia. In most jurisdictions, if a person is related to the management by birth or marriage, or to the major shareholder, he/she is not considered independent.

In India, there is a moratorium of three years if an ID has been a partner in an audit firm that is related to the company, or if he/she has been a past employee. India permits the award of share options to Independent Directors in addition to the director's fees. The appropriateness of such incentives is debatable.

Board Committees

Most of the listing rules require an Audit Committee as shown in the table below. The need for a Remuneration Committee and a Nomination Committee is also increasing with the revamp of the CG codes in Asia. Board Committees play a critical role, and INEDs are often required to chair these committees.

Board Committees: Regulations In Asia

	Hong Kong	**India**	**Philippines**	**Singapore**
Audit Committee	Yes	Yes (2/3 INEDS and independent chairman)	Yes	Yes
Remuneration Committee	Comply or Disclose*	Non-mandatory requirement under the Code	Non-mandatory requirement under the Code	Comply or Disclose*
Nomination Committee	Recommended under the Code	No	Yes	Comply or Disclose*

* Companies need to comply with the guidelines given in the Code of Corporate Governance, or disclose and explain in the annual report why they have not complied.

The audit committee is often required to play the role of a watchdog, especially when a situation involving a conflict of interests arises (such as related party transactions); the committee is also expected to oversee the effectiveness of internal control. There have been several cases in Asia recently, where the securities regulator took action against INEDs for acts of negligence. In the case of Transmile in Malaysia, two INEDs were jailed for one year and fined for failure to oversee the reporting of financial results. Transmile overstated their sales and profits in their quarterly results in 2006 and 2007. Another case involved Centro Properties and Centro Properties Trust (REITS) in Australia, where the INEDs were held responsible for the misclassification of a short-term debt of USD 2 billion. The classification had an impact on how the investors viewed the financial strength of the companies, as they could not roll over their loans in the banks during the financial crisis in 2008. In Hong Kong, the Listing Committee reviewed and took disciplinary action against 36 INEDs between 2007 and 2011, mostly for the breach of the listing rules pertaining to financial reporting, continuous disclosures requirements, and transactions requiring shareholder approval.

Nomination and Election of Directors

In Asia, the controlling shareholders can effectively control the nomination and election of all the directors, including the INEDs. How can the process of election and nomination of directors be further enhanced to give minority shareholders more influence? Any changes should take into consideration the "one share, one vote" principle. The introduction of cumulative voting, which is permitted in the Philippines and China, may provide alternatives to the director election process.

Term Limits, Directorship Limits, Resignation, and Removal of INEDs

Setting a limit on the number of directorships an individual can hold is a much-debated issue in Asia. Some INEDS sit on various boards, and have often been referred to as "busy directors." In Malaysia, the new CG blueprint recommends that the maximum number of directorships is five, and that the director should seek the approval of the Boards of these five companies before accepting new appointments. It is currently under discussion for inclusion in the Listing Rules. In Singapore, no number has been set on the number of directorships, but a director is expected to have a 75% attendance rate. The Nomination Committee has been vested with the power to decide whether an INED is serving on too many Boards before he/she is appointed.

There should also be adequate rules to ensure that directors are not easily removed before their term is up. In most jurisdictions, an INED can be removed with a simple majority, but in the Philippines, the Listing Rules require a two-thirds majority to remove a director.

E. Panel Discussion I: How can IDs be made more effective?

Panellists: Shailesh Haribhakti, Chairman, BDO Consulting Pvt. Ltd.
Mak Yuen Teen, Associate Professor, NUS Business School, Singapore
Nawshir Mirza, Independent Director
Amit Tandon, MD, Institutional Investor Advisory Services

Moderator: Umakanth Varottil, National University of Singapore

Moderator: Welcome to this panel discussion where we have a stellar array of panellists who will share their experiences. When Afra and Kha Loon were making their presentations, it occurred to me that we are dealing with an area that gives rise to more questions than answers, and I am glad that I am only asking the questions rather than answering some of them in today's panel discussion.

Given what we have seen so far, there has certainly been what we call a "transplant effect", i.e., the concept of Independent Directors that arose in the United States a few years ago, has been transplanted in different countries around the world. This occurred due to several reasons including the Enron scandal, and the consequent introduction of the Sarbanes-Oxley Act. Although we also adopted it in the late 90s in India, one thing that still remains a bit of a mystery is how it applies to each specific context, especially in the context of India. This is what we really need to think about, and it applies to other countries in Asia as well. This is really the context in which we will look at Independent Directors in this panel discussion. We also have expertise from Singapore; Professor Mak Yuen Teen is on our panel. So we will get to exchange some ideas from Singapore as well, and then determine how we can make this institution of Independent Directors effective.

Without further ado, let me start off the panel discussion by addressing my first question to Mr. Haribhakti. We saw a number of slides in the last hour or so, that dealt with developments in various jurisdictions, primarily in the U.S., as well as in some Asian countries. Everybody seems to be trying to figure out the best potion or concoction for this concept of Independent Directors. However, do we believe that there could be some kind of convergence as to what the concept of the Independent Director should be in different countries, or is it going to be a case of "trial and error," whereby every country attempts to find the best mix of what does or does not work?

Shailesh Haribhakti: From what I saw in the presentations, it became very clear to me that convergence has happened to some degree. There is no question that the world has begun to value Independent Directors, and more than 50% of the Board in almost every jurisdiction is independent. I can't think of a single Board represented in this whole audience where a company would necessarily want to go below the 50% limit of Independent Directors. So, to that extent, I think convergence is happening. In India, we have a very strong group of practising Company Secretaries. Many of them are present in this room, and they make sure that these hygiene factors—whether Directors are Independent, whether there is a conflict somewhere, and so on—are completely up to scratch. So, we don't need to worry about these hygiene factors anymore. What we need to worry about now is how one can create the atmospherics that will enable the Independent Directors to actually perform the roles that the society, the management, the public at large, the government, and everybody want them to fulfil. I think this should become the new focus of research, of discussion and deliberation at seminars such as this one. Because if we don't have those atmospherics, then all these criteria for selection, rotation, voting—all of this will be meaningless.

And so, today, I would like to present a notion that I have begun to refer to as "open source governance." What I see is three very distinct trends. First, the world is becoming a C2C one, because we have figured out how to relate to one another as human beings in a far superior manner than ever before. All the barriers to relating to one another that used to exist are falling apart.

Second, if we are in a world where it is possible through C2C interactions to create products, services, and value to a scale that is suited to our needs, then we need a very special way of governance, because it is not ownership that is going to be influential. Access and the ability to value the interdependence and still be independent are going to determine whether true value will actually be created.

Third, we are witnessing situations where business models suddenly fall apart. Take the case of Blackberry. All of us were swearing by the Blackberry three years ago. Today, any of our children would tell us that we belong to an old generation. It is all about the iPhone today; social networking driven interfaces have become the modern way to communicate. And the business model of a company such as RIM suddenly fell off the cliff; even large manufacturers of mobile phones have completely changed their business models. Thus, there can be huge disruptive technologies coming in and changing the way we work, and that is why it becomes so important to create the right atmospheres.

And what do I mean by that? There are three very basic fundamentals that ought to be in place. First, there should be an environment of trust and respect. If you cannot trust and respect somebody who is sitting at the table with you, you are never going to be able to deliver your best. So, trust is very crucial.

Second, sustainable value creation is possible only if you place yourself in the path of accountability. If the management of a company does not believe in this, then it will not manage risk of the right quality. The one takeaway from the slides was that not too many companies have risk management committees. In fact, that is the most crucial committee as I see it. At least, the role of that committee is the most crucial one that is needed today for governance to actually function.

And, third, what we can conceptualise is that all of us possess soft power. We have the ability to influence. We know that the basic nature of human beings is a desire to be honest. We know that there are certain things that people will not accept or tolerate. And if we can somehow bring this soft power to the work that we do within the Board, then we will have the right outcomes—responding in time to changes in the business model; making sure that succession exists; ensuring that the triple bottom-line is taken care of; and making sure that sustainability is actually established for the end products.

So, I would propose that we should start thinking about this kind of open source governance, where there should be no barriers to the management wanting to be fully transparent. There should be no barriers to Directors wanting to source value from anywhere—external, internal, management, cross checking, research, whatever they need. And there should be no barrier to people going out and making sure that the accountability that should be established is actually done, in practice. There should be whistle blower protection. There should be policies to make sure that things that are intolerable do not get done. And the outcome should be visible.

Perhaps the most important thing is to create an atmosphere of respect for others in the Board. As I see it, the role of any Chairman is in creating exactly that, by not permitting cross talk, by making sure that people communicate with each other respectfully, and by making sure that the real issues are confronted. If that does not happen, all these great things that we talked about—the number of Independent Directors and all of that—would be meaningless. So I would say that the focus should shift to what happens within the Boardroom, and to the interactions among the Board members.

Moderator: The open source ideas add an interesting technological twist to corporate governance, which I believe ultimately enhances transparency, and hence seems important. Moving to an issue that has more to do with facts on the ground, one question that keeps cropping up is: Do we have a surplus of Independent Directors or a paucity of Independent Directors? That is, we may have all these rules, but do we have enough people with the required competence and the will to satisfy their roles?

Shailesh Haribhakti: My honest answer to that question is that we don't. People simply want to be on a Board, without realising their responsibility, or the trust that they need to generate, or the training that they really require to fulfil their responsibility. I think people are simply obsessed with being on a Board, as opposed to wanting to contribute. If that paradigm does not shift, and if there are thousands of companies in some jurisdictions—like I saw in one of the slides earlier—how many of the Directors of those companies can discharge their duty efficiently? For example, how many can get a succession plan accepted? How many of those guys can respond to a broken business model being revamped? These are the key questions, and if you apply these tests, we will find that there is a paucity of good Independent Directors.

Moderator: Effectively, the substance is more important than the form. That is probably the takeaway from Mr. Haribhakti's responses. We now move on to Prof. Mak Yuen Teen. The Singapore experience is similar to the situation in India to a large extent, because both have controlled companies with the government as well as family shareholders having significant shareholding. Given this, I would like to take up one of the issues that Prof. Afsharipour raised. If we look at the U.S. context, the message seems to clearly be: If you have a controlled company like Facebook or Google, we don't care whether you have Independent Directors or not. However, we don't really think this approach works. On the other hand, in Asian jurisdictions, we have a substantial part of our companies following the controlled company model, but we still seem to be relying heavily on the concept of independence. Is there some kind of disjoint here, or do we still believe that we should continue to pursue the path that we have been taking all along?

Mak Yuen Teen: I think there is a disjoint. Perhaps the thinking in the U.S. is that in a situation where the controlling shareholders hold more than 50%, their interests are probably largely aligned with the interests of the company. That may be why the U.S. has taken that position. But then, what about the public shareholders in a public company, who may own more than 40%? Their interests are also pretty important. And we know many situations where the interests of the controlling shareholders are not aligned with the interests of the company or the interests of the minority shareholders. In Singapore, it took us many years of reforms, and it is only in the most recent round of reforms that we finally adopted the concept of independence from "major shareholders" (the term is defined as those having more than 10% shareholding), whereas the U.S. essentially still uses the concept of independence from the management, and maybe business relationships. In Singapore, we operated on the same concept of independence from the management for many years, despite an intense debate that such a concept was not appropriate in Singapore because of the concentration of shareholding, and that we do need independence from major shareholders as well. Finally, this concept was adopted, but it was based on the notion of 10% shareholding. So, I think there is a disjoint in how the concept of independence is perceived in the U.S. and in Singapore. I can see why the U.S. continues to think the way it does, but I don't agree with that line of thinking.

Moderator: To get a little bit more into the practical issues with controlled firms, we heard questions regarding the nomination committee. How do you appoint an Independent Director? Is the appointment done by the controlling shareholders, who we call promoters in India? They have a significant role in determining who the Independent Directors should be. What are some of the methods that can address this question of appointment and removal in a controlled company?

Mak Yuen Teen: I think the concept of a nominating committee started in the U.S. and the U.K., and other markets sort of adopted this concept. Actually, I am not sure that it really works. I am not convinced that the way nominating committees are put together in companies really works. Because at the end of the day, who actually appoints people on the nominating committee in the first place? Basically, it is the controlling shareholders themselves. Moreover, one of the very important responsibilities of the nominating committee is to recommend the reappointment of Directors, of course. In a way, you are recommending your own reappointment because you are on the nominating committee. And you are supposed to be assessing the Independence of Directors on the nominating committee. When you are doing that, well, you are actually assessing your own independence!

Sweden has an interesting model. They have a nominating committee, which is a shareholder-led nominating committee that is not made up entirely of Board members. In the Swedish model, they essentially say how many people can be from the Board and how many people cannot be associated with the controlling shareholders. So there are people on the committee who are actually appointed in the General Meeting of the shareholders, and are not members of the Board. I think the whole idea is to try to make the nominating committee and the nomination process more independent in companies where you have controlling shareholders. However, the nominating committee concept is also undermined sometimes, because in many countries, the law allows shareholders to propose Directors directly. So, the shareholders can actually circumvent the entire process involving the nominating committee.

In Singapore, for example, if somebody owns 10% or more shares of the company, he can call a meeting and propose to nominate his candidates on the Board. The nominating committee can express an opinion about the suitability of these candidates; however, according to the law, even if the nominating committee says no, the shareholders cannot be stopped from appointing Directors. And of course, there are also situations where even if the nominating committee feels that a Director, including an Independent Director, is doing a great job, the shareholder or the controlling shareholder can call a meeting and use his voting rights to remove the Independent Director. Therefore, while the concept of a nominating committee is nice in theory, I think it does not operate in the way we think it ought to operate.

I would like to note another point in this context. In the work that I have done, I find that in about three-quarters of the companies in Singapore that have a nominating committee, the committees meet once a year or do not meet at all; they are very inactive, they don't really do all that much.

Moderator: That leads us to the ultimate option, which is what we call cumulative voting or proportional representation, where the minority shareholders also get a right to have direct representation of their nominees on the Board as Independent Directors. Of course, as Mr. Lee Kha Loon said, this option is not utilised in most countries. In India, we do have an option under the Companies Act, where the company can provide for proportional representation in the election of directors (in the Articles of Association). However, I am not aware of any listed company that has actually exercised this option. So, do we need to take it to the next level, and start considering whether to make this provision mandatory, if at all we think of an Independent Director as someone whose role includes the representation of the minority.

Mak Yuen Teen: I think there are a number of options available, and different countries have chosen different options. Some countries have provided for cumulative voting. In reality, it is rare for companies to have cumulative voting.

There are other ways of ensuring that the IDs represent the interests of the minority shareholders. The recent OECD report on related party transactions talks about the experiences in a number of countries related to the process for appointing and electing Independent Directors. The report talks about Italy and Israel, for example, where only minority shareholders have the opportunity to nominate and vote for at least some of the Independent Directors. I don't know the exact rule, but it does say that for the election of certain Independent Directors, only minority shareholders can vote. In other words, controlling shareholders can't vote. This is a bit like related party transaction voting in which the interested party cannot vote.

On the issue of the election of Independent Directors, I have written commentaries stating that it is essentially a super interested party transaction. Who you get as Independent Directors is critical, because they end up sitting on audit committees, reviewing interested party transactions, and so on. They play a critical role, and to me, the selection of IDs is an important IPT (Interested Party Transaction) or RPT (Related

Party Transaction); therefore, we now ought to think about whether we should allow only minority shareholders to vote. Some people, of course, would say that that is not fair: Why should major shareholders not have the right to vote for these Directors? But if you think about it, is it fair for a shareholder who owns, let's say, 5% to be able to choose the whole Board? When you vote for Directors individually, based on an ordinary resolution, you win every time as long as you have 51% of the shares. And in practice, you don't even need to have 51%. Is this really fair? I feel we need to think out of the box a little in this kind of situation—the controlling shareholder type of situation. We cannot just copy what is in the developed markets, copy the concept of a nominating committee, copy the election and the removal of Directors, and apply them to our context, because I don't think they work.

Moderator: In short, while it is good to have nomination committees, they are not the complete and final answer.

Moving on to Mr. Mirza, we would certainly like to tap into your experience as an Independent Director on the Board of several companies. I have one specific question: What do you perceive as your role on the Boards of these companies? We have the dichotomy of the role of the independent directors: Is it an advisory role, or is it a monitoring role? And even when we think of monitors, we usually talk about auditors: Are they watchdogs or bloodhounds? I don't think we have to go so far as to attribute the same thing to an Independent Director, but how do you see your role when you are on the Boards of these companies?

Nawshir Mirza: Umakanth, your first question is about my experience as an Independent Director. By the way, my experience has not been in *many* companies—only in a few, selected companies, as many as I could manage. In my experience, the first problem occurs on account of high enthusiasm on the part of prospective Board members to get on to Boards, as Shailesh had mentioned. So, I think such enthusiasm requires to be toned down now.

Before I elaborate on my experience, let me digress a little. We have all these conferences that discuss governance within a capitalist framework system. Indeed, those who organise these conferences are the temples of capitalism: stock exchanges, the SEBI, and so on. But we don't invite a single capitalist to these conferences. We only invite all the *little* priests of the system: Independent Directors, Company Secretaries, and so on. Where are all those Agarwals, Lalajis, and Chettiars? Where are *those* people in this room? Because if you listened to the speakers, *they* are the ones who form the obstacle to all these wondrous things that companies should do. These are the families that have promoted these companies. So why don't we get these families into this room to participate in this discussion? If you don't invite them, we are only preaching to the converted. We started this conference at a certain point, and ultimately, we will go back to the same point, and come to these conferences *ad nauseam*. The same thing is regurgitated again and again. To a certain extent it becomes a waste of everyone's time. I have been rude to my hosts right at the beginning of this conference; but note that there is an advantage in being rude because you can be a little more effective as an Independent Director. If you are a nice guy, I don't think you can be very effective.

Coming now to your question, Umakanth, on what has been my experience. I think it has been unfair on our part to beat up only the families that own businesses; the government's performance as a controlling shareholder has been just as bad, but has not been equally highlighted. You saw what happened in Coal India—after 2 decades, when some Independent Directors in a government company finally stirred a little, they were smacked down by a decree. And the SEBI hasn't had the ability yet to enforce the requirement of Independent Directors in totality on the Government of India companies, or it is just about beginning to succeed. So, my experience has been this: if you have a good controlling shareholder, actually, you perhaps don't need Independent Directors. Also, if you have good Independent Directors in some companies, it is because those are the kind of companies that good Independent Directors choose to join. And if you have got nasty controlling shareholders, they get all the wrong sorts of Independent Directors who don't come to the Board meetings anyway; even if the poor guys do turn up for the meetings, what would they do when they are smacked down by a decree?

So, that has been my general experience. We are within a capitalist framework. No country has yet been able to conceive of anything *else* that is going to succeed; no one has. You have, of course, the option of smashing that framework. But smashing that framework would mean that we would no longer be ruled by this bunch of people like what happened during the French Revolution, or we would have a completely different system like when America's founding fathers introduced the Universal Adult Franchise.

What happened then, Umakanth, was in the context of political democracy. There was democracy even before all of these revolutions. They had a Parliament in England. But who could vote for elections into that Parliament, and who could become members of that Parliament? It was only the people who could contribute to the Sovereign, to the King. So, if I was a land owner and I paid land revenue, or if I gave the King soldiers to fight his wars, I had a right to vote to decide who should represent me in the Parliament. There was no right for the average person.

It took the French and the American revolutions to finally change that system of democracy, and to say that democracy is not only for those who contribute, but for all those who are affected by governance. And in a corporate world, who are the people that are affected by a corporation's behaviour? The answer is: the stakeholders.

We keep nibbling at the edges of this thing: Who should the Independent Director be independent of? Should he be independent of the management, as in the U.S.? Or should he be independent of the controlling shareholder, particularly in the context of the Asian family owned companies? Or should he be independent of all stakeholders, so that he can balance the interest of the stakeholders, which is something that is proposed in the Companies Bill? Perhaps no country in the world has gone as far as the Companies Bill in this regard, and I think they have introduced something that is not even at a conceptual stage yet anywhere else. And they expect Company Directors to start balancing the interest of all stakeholders, even when the concepts of how this will ever be done within a capitalist framework have not yet been discussed or thought through by all the academics here! Umakanth, I don't know if I have answered your question; I may have gone all over the place.

Moderator: I would probably draw you back! Your observations were very useful, and they pretty much determine the context in which we are discussing corporate governance. However, to be more specific, there are a number of stakeholders. The promoter is a stakeholder; there are minority shareholders; and then, there may be creditors, employees, and so on. Of course, the Companies Bill is only now going to tell us who the Independent Director's constituency should be. But given the current circumstances, who do you have in mind when you act as an Independent Director? Can you think of everyone? Can you put one interest over the other? Is that fair at all?

Nawshir Mirza: I don't know what will finally come out, but the draft Companies Bill refers to "stakeholders." I don't think they have gone to the extent of defining them; but they have sometimes mentioned some stakeholders and not mentioned others. If the draft is finally passed as it stands today, even the taxman would be a stakeholder! So the Independent Directors of Vodafone could be sued for what they did—withholding taxes—when they paid Hutchison, because they did not protect the interests of a very important stakeholder in this company! Similarly, if I am on the Board of a company that persistently makes large profits, obviously, the controlling shareholder would be delighted. But a vendor may think that this company is making a lot of profit by squeezing him to near death, which is, I think, what all companies do with their vendors. "The company should give me a better profit margin," the vendor will argue. A customer of a shoe company may say, "Why should I pay USD 100 for these shoes, when these guys are making 20% profit after tax? They should sell their shoes cheaper. And you, Independent Director, should have changed the pricing of the shoes." So where does it all end? As I said to you, although there has been no discussion about this conceptual issue of balancing all the stakeholders' interests, our Companies Bill has already trotted it out with good intentions, but without sufficient thought.

Moderator: I think, fortunately, at least under the current Company Law, Directors owe their duty only to the company, and it is only the company that can sue. So I think these conceptual discussions are required before a new legislative development takes place.

Let me move on to one particular stakeholder—the investor community. We see that with the evolution of proxy advisory firms that were hitherto non-existent in the Indian context, it seems that proxy advisors are representing the minority investor community. Mr. Tandon, as a proxy advisory firm, what do you have in mind when you look at Independent Directors, their appointment, their role, and so on?

Amit Tandon: There is a fundamental difference between the role of the Board as seen in the U.S. and Western Europe versus what we see in Asia. One has to remember that in the U.S., apart from the occasional Facebook and

Google, most of the companies are run by professional managers. So, why do we have so much focus on the Board? So much literature is focused on the Board, because the Board is the mechanism through which the dialogue between the company and the shareholders takes place. So the shareholders appoint the Board and say, "You are the people who will now be running the company; you are going to be deciding whether products should be sold for USD 100 or USD 80; you are going to be deciding the strategy, and so on." As against this general scenario, in most of Asia, and certainly in India, there is already a set of controlling shareholders, with shareholdings as low as 15 or 20%, who are able to direct the way the company moves and think about the strategy, the investments, and so on. So, the role of the IDs is to focus primarily on protecting the interests of the minority shareholders. However, when we speak to people who have been appointed on Boards, and ask them what their role is, we get a sense that for most of them, it is not so much about looking after the minority shareholders; rather, they see their role as that of an informal advisor to the promoter family. So, that is one part of the issue: What is the role the IDs visualise for themselves?

Our concerns at the moment are relatively straight forward, namely, the number of Boards people are on, and the amount of time they have spent on the Board. If some people have been on the Board for 15 years or 17 years, they can continue on the Board by all means, but then, we wouldn't consider them independent. So, it would be much better to say that these are non-IDs, rather than IDs. So, it becomes a bit of a classification issue. Further, as I see it, once you have been on a Board for 17–18 years, there is a high degree of familiarity, which means it is very difficult for you to come up with fresh ideas or new thoughts. (There are of course exceptions.) So, if you are seeking new thoughts, new contributions, then at some stage, you would need to draw the line. In our wisdom, at some stage, we decided that it is three terms of three years each.

This decision also takes into account the complaints made by the companies saying that it is difficult to find IDs. I have a slightly different view on this, which I will now articulate. When promoter families look at appointing IDs, I see them drawing two Venn diagrams. One includes people whom they know, and the other one includes the people who they think will be able to contribute but are also pliable. So when you put these two diagrams together, the intersecting set becomes relatively small, which is why while selecting IDs, we have a list that is relatively smaller than what one would expect in most cases. So, this is one of the things that we have started focusing on.

Independence may be a state of mind; but the key question is: What is the role that IDs are expected to play? Speaking to investors—more to foreign investors rather than to Indian investors—the prevalent view seems to be that it is very rare to find a person who can play both roles—monitoring and advisory. You would have one set of people on the Board who would play a monitoring role, and another set who would play an advisory role; for the same person to wear both hats on the Board is going to be difficult. So, our role at this stage is to put together all these learnings and speak with the Boards. Unfortunately, we have not had a dialogue with the so-called "Guptas and Agarwals" to be able to conclusively determine what they expect from IDs, but we certainly did speak to the investors and the IDs.

One last point: While speaking to investors, the majority view appered to be that we should experiment with the concept of cumulative voting. They felt that promoter directors with small shareholdings are able to have complete influence on the composition of the Board; since cumulative voting will give minority shareholders some influence over the Board composition, at least at this stage, it seems to be a welcome step. At this point, one does not know what the outcome will be once it is introduced; but more and more people feel it would be a welcome step.

Moderator: I'd want to follow up on a couple of points—the tenure of directors, and the pool from which we get these IDs. Now the Companies Bill seems to make a lot of very involved suggestions on these issues. Any thoughts on the provisions of the Companies Bill, as far as IDs are concerned?

Amit Tandon: Well, at least the Companies Bill recognises that there are going to be IDs; so that is good. So far, the concept of ID has been mentioned only in Clause 49 of the Listing Guidelines. Since the Bill has gone through many alterations, I am not sure what the final proposal on the table is. As regards this whole concept of having a pool from which people are going to be selected, I don't think it is a good idea, because my own sense is that once you have a pool and people start to get selected from it, companies would have a good excuse for doing or not doing things. They can turn around and say, "The IDs were selected from a pool created by the Ministry of Corporate Affairs.

What can we do if these IDs failed to bring out something of importance, which they should have brought out? Please don't turn to us." So, I am not in favour of such a pool of people from which IDs are to be selected.

Moderator: Coming back to the two IDs on the panel here, one of the key issues that crops up is the liability of the ID, the legal issues. One can plod through the legalese, but what is the perception of IDs as far as liability is concerned? I would request Professor Mak to follow up with his Singapore experience because we know that this is a hotly debated issue in Singapore as well.

Shailesh Haribhakti: Before I answer this specific question, can I make a few points about the nominating committee and the pool idea that Amit talked about? I think as opposed to a pool, if you could have access to a database that talks about an individual director's actual experience and his/her track record in terms of actually delivering outcomes and delivering specific value, then there could be a nominating committee consisting of IDs selected from that database. I had mooted this idea 15 years ago in an article in *The Chartered Accountant*, but it did not find much favour in the case of the selection of auditors in terms of track records and so on. However, in the case of IDs, I think this is an idea whose time has arrived. So I thought I would put it before this panel.

On the issue of liability, I think it has finally been recognised, at least in India, that you cannot hold a person liable for something that he or she could not have had an influence on. This is now becoming clear, which is a very positive move in terms of limiting the liability of IDs, because otherwise, it was an absolutely open, very dangerous situation. This morning, I was walking with Mr. C. S. Lodha. Many of you might know that in 2002, he resigned in one stroke from all the Boards he was on, because a company that he was on the Board of warned him that there was a raid on their premises, and some of the members of the raiding party might visit his premises. The minute he heard this news, he got off all the Boards that he was on. This is the stark reality even today. Just by being an ID, you do not know what exactly is happening in the day-to-day affairs of the company. So, you cannot be held responsible for the things that you have absolutely no influence on. That logic, I think, is being brought into the law. The courts have also been reasonable about this aspect, but there can also be very nasty situations. For example, we have a very obscure law, which seemingly protects small depositors who had put unsecured deposits in companies. That law has become absolutely macabre in the way that it operates. If you are an ID or independent Chairperson, and somebody has not been repaid his or her deposits, then action can be taken against you, regardless of whether you had resigned from the Board many years ago, or whether or not you had anything to do with accepting or utilising those deposits. So, we have had some very strange situations. The direction of thinking *of late*, I think, is positive.

Nawshir Mirza: I agree with Shailesh on his views about protecting IDs from matters of which they were unaware, and of which they could not be aware despite the diligence expected of them. I think that, broadly, is the legal test for holding people liable. Until now, the experience generally has been that the IDs have got into trouble over things that don't fall into this definition—a cheque issued by the company bounced, or the provident fund was not paid on time, or something like that. So, they have to be protected against all this. However, I am also not in favour of any kind of blanket protection, because as it is, the general complaint seems to be that many IDs are not diligent enough. And if they are protected regardless of what they do, then with such blanket protection, they will become even less effective in their Boards. So, I am not in favour of that; but we should not have situations where IDs are held liable on petty issues, with the authorities going after them.

Moderator: I think there have been many developments on this front in Singapore that I read about in the press regularly, including in Professor Mak's commentaries. So Professor Mak, would you like to offer any takeaways from Singapore, including the recent case, where a stock exchange went after an ID?

Mak Yuen Teen: See, the duties and the liabilities of the Director have always existed, but the enforcement has changed. Until recently, there was no enforcement action against IDs. There were cases where the ID simply resigned just before something went wrong. This is a common occurrence; there is no accountability. I think, now, we are seeing changes; some administrative sanctions are being used by the exchanges. The Singapore Exchange, for example, has started to reprimand, name, and shame the errant IDs in some cases. Initially, when the exchange was doing that, they were targeting only the executive directors. I complained against that. I asked, "Why is it that IDs are not held accountable in certain cases?" I agree that they cannot be held accountable in all cases, but in certain cases, they must also be held accountable. Otherwise, you get people who think they can sit on Boards without having to do their job. We have had a couple of cases recently in Singapore, where criminal action was taken against IDs. One case involved Airocean; there was basically non-disclosure and a misleading announcement. It had to do with the senior management of this company, who was investigated for corruption. While the media was speculating that the CEO was being investigated, the company issued a statement refuting this, stating that, "He is assisting in the investigation, and he is not being investigated." This turned out to be a false announcement. One ID was jailed for four months, and the other ID was fined and disqualified. The allegation against the ID who was jailed for four months was that he, being a lawyer, was active in drafting the misleading statement, and that he had visited the CEO when he was in jail. Therefore, he knew about the matter. This was an extreme case.

The other case that we had recently, which is still going on, involves a company called China Sky. This is an interesting case because the Singapore Exchange reprimanded the whole Board. It started with a query from the exchange to the company about certain transactions, including certain related party transactions. The company had failed to disclose a serious conflict of interest. It emerged that the person who was party to the related party transaction was the Chairman of the Audit Committee. His firm—an accounting firm—was doing the books and the internal audit, preparing the accounts, and so on, and they disguised and hid the related party transaction. The Board allowed a statement to be issued that none of the directors had any business relationships. If we look at this case, we will all agree that some action should be taken. That particular ID has now been arrested and charged, and is apparently being investigated by the Commercial Affairs Department. The problem sometimes is that when directors look at such cases, they say, "Oh, director liabilities are getting very onerous." However, these are very extreme cases and if you exercise your due care and diligence, avoid conflict of interests, and so on, you are not going to be hauled up.

Moderator: I think we have a lot to take away from this discussion. We may have about 10 minutes for questions from the audience.

Q and A

Q: I would like to thank the panel for a very insightful discussion. I am Namit Arora, from Standard Chartered Private Equity. Just one quick question. We would be interested in knowing the panel's views on the Board composition at Berkshire Hathaway—specifically in the context where David had to leave Berkshire Hathaway—and at Facebook, in view of the recent Instagram acquisition that was presented to the Board.

Moderator: May I request Afra to comment on this?

Afra Afsharipour: Both of these companies are controlled entities, where the controlling stockholder holds more than 50% of the voting stock of the corporation. In the U.S., the regulators have decided that such companies need not have a majority independent Board. The problems for these entities and their Boards are going to arise when they are sued; and they always do get sued. At that point, state corporate law will apply, meaning that the state court judges and courts will be reviewing the actions of the Board and the controlling stockholder. While the regulations arising under the NYSE, the Nasdaq, and the SEC rules are not that stringent on controlled companies, the state courts are much more stringent. The Delaware courts are, in fact, extremely powerful in controlling related party transactions, in quashing the types of activities where boards have not been involved and the controlling stockholder has directed and abused his position. What usually happens, and what may happen in the Facebook context, is that the Delaware court judges may scrutinise the controlling stockholder—like Zuckerberg—rather than the federal regulator or the exchanges.

Moderator: Thank you very much. Any further questions from the audience?

Q: This comment is for Mr. Haribhakti. You referred to building up a database of IDs. I can tell you that my good friend, Mr. Prithvi Haldea, has already built up such a database of IDs, known as Prime Database.

Shailesh Haribhakti: I am fully aware of his database. The idea that does not sit well with all of us is that you have a pre-determined panel from which you can select individuals. If you have an open database, which identifies the track record of the Director and also talks about that person's qualifications—like Prithvi's database does—you are really giving valuable insights about the ID. It is not a mandatory thing that somebody has to select a Director from this database. It is an enabling panel, which is a very positive thing, and that is why he has received tremendous support from the regulators, the Government of India, and everybody else that matters.

Forgive my cynicism. If I want to appoint someone as a Director—a nice, convenient individual who is not on the database—no one can stop me from getting him registered overnight on the database and appointing him the next day.

Q: I would like to know your views on professionals, lawyers, CAs, and Company Secretaries being appointed as IDs, while the firms where they are partners or associates are giving advisory or transactional assignments to the organisation where they are IDs. Do you think that constitutes a material pecuniary relationship? Although the view of the Companies Bill is a little different on this, given the present context of the statute, what would your views be? And, may I direct one question to Prof. Afra? What would your view be on the role and responsibility, as well as liability of the IDs at the time of the meltdown that happened in the U.S.? I am asking for a general perspective.

Afra Afsharipour: What should be the role of the IDs and their liabilities? Unfortunately, in the cases that we have had so far, because our corporate law in the U.S. tends to be relatively management – and director-centric from a common law standpoint, none of those directors have been found liable. Part of the reason is that while we have a fairly robust doctrine on the monitoring responsibility of directors, we don't actually have much of a robust doctrine on their actual liability when they fail to monitor. So, under the U.S. law, the failure to monitor would essentially have to be an act in bad faith in order to find the Directors financially liable. And so, there has not been much exploration yet into the liability of IDs during the financial meltdown, but there certainly is an enormous amount of controversy about this in the U.S. currently.

Q: Would someone like to speak on the role and responsibility of the IDs in the Satyam case?

Nawshir Mirza: No, this will be an endless session then. So I will not get into that, but I will just answer the question that you had asked in the beginning: Should IDs, who are professionals, provide advice in their professional capacity to the company? I think that IDs, by definition, have to be independent. I shall give you an example from my experience. I joined the Board of a company and chaired its audit committee. In the first meeting, the auditors raised an issue that our investment in a Chinese subsidiary that had been set up two or three years earlier was impaired. The CEO of the company, who was present, and who obviously needed to deal with this impairment issue, turned to one of my colleagues on the committee and said, "Mr. X, you remember, it was your idea that we set up this Chinese company." That man, Mr. X, was rendered speechless. The purpose of the audit committee is to protect the auditor; if he makes a proper recommendation and the management disagrees, the purpose of the committee is to make sure that the management jolly well does what the auditor is suggesting. But here was a member of the committee whose ability to contribute was impaired because it was his advice that had resulted in this outcome. This leads to the question: Should Directors give advice? Shortly after the capitalist system received severe body blows with Enron and other scandals, *The Economist* (you cannot think of a more capitalist magazine than *The Economist*) wrote an editorial in which it was said that there were enough people to give advice and that IDs should not have any advisory roles, as that would impair their objectivity. So, I think—and even *The Economist* held this view—that there should be no advising for IDs, only monitoring responsibilities.

Q: I am John Lim, from Singapore. I just want to make two quick comments. The first is about this data bank, which I think is a very interesting idea. I just want to share that in Singapore, the Institute of Directors has had a data bank of IDs for almost 2 years now. The experience has not been very encouraging, because companies still want to look for Directors from among the people that they already know, and that is a fact of life. We are pushing for two things at the moment. First, we want to get companies to disclose more, and improve the process they undertake when they appoint IDs. Secondly, we see nothing wrong in people going to their circle of contacts to select people, provided their selection is based on disclosed, transparent benchmarks. We always say that this database should serve as an enabler for you to access a bigger base of Directors and not act as a substitute for your narrow, old boys' network.

The second comment I wanted to make was about the U.S. controlled companies being given a waiver on the appointment of IDs. Personally, I am not in favour of this, being a firm believer in the corporate governance ecosystem. But at the same time, we cannot have a situation where, in a capitalist society characterised by mobile capital and all-round competition, you can inject a system that overrides the rights of the people who provide the money, and yet expect that there would be no flight of capital. You might protect the minority shareholders; but if I have paid for 51% control, I am not going to be happy if you get a lot of regulations imposed on me. This would make it inflexible for me. If somebody else is prepared to be more flexible, that is where my money is going to go.

Prithvi Haldea: Since my database is being quoted, let me inform you that I created my database in 2005, primarily because of corporate India's hue and cry that there were not enough Independent Directors. The database now has as many as 19,000 professionals enrolled. What has been the usage? Hardly any company wants them, because no promoter wants a stranger, however qualified he may be, on his Board. So, the database is mainly being used only for one purpose currently: "Oh, Mr. so-and-so is now available. I know him, or I know someone who knows him well, so I can hopefully get him on my Board."

Moderator: Unfortunately, due to constraints of time, I am compelled to bring the curtains down on such a lively discussion. Thank you very much, panellists, organisers, and members of the audience.

Session II

F. Presentation III: IDs, Management, and Investors: Expectations vs. Delivery

- Mak Yuen Teen

G. Panel Discussion II: IDs, Management, and Investors: Expectations vs. Delivery

Panellists: John Lim Kok Min

Shailesh Haribhakti

Navneet Munot

Bala Subramanian

Moderator: Prithvi Haldea

F. Presentation III: IDs, Management, and Investors: Expectations vs. Delivery

– Mak Yuen Teen, Associate Professor, NUS Business School, Singapore

I have been asked to talk about what IDs expect from the management, and what the investors expect from the IDs, and also to assess their delivery against these expectations. In some sense, you may call the difference between the expectations and delivery the "expectations gap." What is the nature of this gap, and how does one bridge it?

Let me start with what investors expect from IDs. This is a serious subject. Let me make it a bit light. Many of you may have watched *The Avengers* and *Captain America*. What some investors expect of IDs is for them to be like Captain America: courageous, noble people, who only think of the wellbeing of others and not about themselves, and so on. They could really be expected to do almost the impossible. So, the expectations of some investors from IDs are very high.

What do IDs think of themselves? Many of them perceive themselves as Superman because they sit on many Boards, and they can rush at the speed of a bullet from one meeting to another. However, the problem is that when something goes wrong, these busy IDs quite often resign from the Board citing other commitments, personal reasons, and so on. They become like Superman being confronted by kryptonite.

Investors, on the other hand, sometimes get IDs who only carry the title of an ID, but are actually there to help the management. In some of the cases that we have seen in Singapore, the IDs were totally aligned with the controlling shareholders and management. Such IDs behave in a manner that is totally contrary to what their public face suggests can be expected of them. They are like Two-Face in Batman. Thus, there is a big gap between the expectations and the delivery: while some investors have unrealistic expectations of IDs (expecting them to be like Captain America) and some IDs think they are like Superman, their actual delivery falls far short of the expectations.

What are the essential attributes of a good ID? These attributes can be explained through three Cs: Character, Competence, and Commitment. The first C stands for Character: IDs need to have integrity, the courage (like Captain America) to ask challenging questions, and professionalism, which means that they will not take on something when they know that they can't do the job. Competence means possessing the skills and experience relevant to the Board and the company. There are IDs who may be very independent on paper, but are totally incompetent. Commitment refers to the ability to commit sufficient time to the company and to the Board. I see these three Cs as essential attributes of a good ID.

I have come across IDs who are very good, but are in a dysfunctional Board. To me, a good ID needs a good Board to be effective. What makes a good Board? Clearly, the Board needs to have sufficient power, and it needs to be clear about its roles. Besides, there are important Board processes and practices, such as the selection of Directors, Board renewal and session planning, induction, professional development, decision making, and so on, that affect the effectiveness of a Board and that the Board needs to focus on. A good Board should have a good enough number of IDs; but over and above that, there should be certain personal attributes (mix of competencies, commitment, and diversity of viewpoints) among the Directors on the Board.

In terms of addressing the expectations gap for IDs, here are some possibilities:

(i) *Clarification of the duties of IDs*: All Directors have the duty to act in the interests of the company, which is a general duty. I think the question to clarify is related to their secondary duty, which is to safeguard the interests of the minority shareholders and stakeholders.

(ii) *Appointment and removal of IDs*: We have already discussed the recruitment of IDs from external sources or from some register of Directors; John Lim just talked about the Singapore Institute of Directors, which has such a register. However, the experience in different countries is that nobody really taps into these registers. So, this is a challenge. Besides, whether we should think about changing the composition of the nominating committees to include non-Board members and minority shareholders' nominees—like in the Swedish model—is another question.

On the matter of cumulative voting, while some countries allow it, only a few companies in those countries practise it. Most countries have provisions that allow minority shareholders holding a certain percentage of shares to nominate Directors on the Board. Israel and Italy have made some changes in terms of the election of at least one of the Independent Directors: controlling shareholders cannot vote. Another possibility is whether the election and the removal of IDs should be subject to higher thresholds of support by shareholders, including minority shareholders. So, some of these developments are actually departures from the way we usually view the issues of appointment and removal of IDs.

(iii) *Remuneration of IDs*: On the subject of the remuneration of IDs (the "carrot"), I think there needs to be more transparency; moreover, IDs need to be remunerated reasonably. The point is that if you expect people to commit their time, they won't do things for free; after all, they are not Captain America. But you also can't pay them too much, because if you do so, they will not leave the Board. Having said that, they should also not be joining the Board just for the fees.

(iv) *Enforcement of Directors' Duties (the "stick")*: We talked about the "carrot" (remuneration of IDs); there also needs to be a "stick" (the enforcement of Directors' duties). Those IDs who breach their duties and fail to act honestly ought to be subject to appropriate enforcement actions. There should be different types of enforcement action depending on the nature of the breach. Many markets have developed a range of sanctions over the years, which include criminal, civil, and administrative sanctions (such as reprimands, disqualification, blacklisting of Directors, and so on).

(v) *Stricter rules on becoming and remaining IDs*: Should there be more stringent "fit and proper" criteria for becoming an ID? Should we have stricter definitions of independence, and should training and professional development be made mandatory for IDs? Malaysia, for example, has been more progressive than other countries in making it compulsory for Directors to attend training sessions and continuing professional development programs. Having said that, I think there are some Directors who are un-trainable; they would never improve, regardless of how many courses they attend.

The other issue is related to limits on the tenure: Should there be a limit on the number of years that a person can continue to serve as an Independent Director, and should there be some limits on the number of directorships per individual?

Let me now move to the issue of the Board and the management. A good Board needs a good and supportive management to be truly effective. In many cases, I have received complaints from the management that the Directors of the Board are trying to micromanage things. I think there needs to be a mutual relationship of trust and respect between the management and the Directors of the Board. There must be a "challenge function" for the Board; in other words, the management needs to understand that the Board can challenge the management, and ask the management questions. Sometimes, the management can be very defensive and not receptive; then, it can be very difficult. When the management provides the Board with relevant information on a timely basis, the Board can be more effective.

G. Panel Discussion II: IDs, Management, and Investors: Expectations vs. Delivery

Panellists: John Lim Kok Min, Chairman, Gas Supply Pte Ltd, Singapore
Shailesh Haribhakti, Chairman, BDO Consulting Pvt. Ltd.
Navneet Munot, Chief Investment Officer, SBI Mutual Fund
Bala Subramanian, Adjunct Professor, IIMA and IIMB

Moderator: Prithvi Haldea, MD, Prime Database

Moderator: I would like to start with some opening remarks, which are mainly based on my research and my interactions with hundreds of corporates.

But, first things first. The title of this session includes "Expectations and Delivery," and it would be good for all of us to at least converge on the answer to the fundamental question: What is the fundamental role of independent directors? If we don't, we will all be going astray. Only when we converge can we put the right expectations and figure out if they have delivered what was expected of them.

So, let me start. I will make it very simple and talk mainly from the Indian perspective, where—in almost all cases—the promoters and the management are composed of the same set of individuals.

Consider this typical scenario in India: I promote a company, grow it to a reasonable size, and maybe even get some VC and PE investors to help me with my growth capital. I then grow further, and make the company worthy of an IPO. I raise money from the public, in most cases, 10%, 15%, and 20% of capital. In the case of government companies, it could be as low as 5%. Investors put in money because they like the way that I built the company, and they have faith in my competence to grow it. Before the IPO, I constitute a Board of Directors comprising people that are well known to me and who I trust will help me in running my company.

Now at the time of the IPO, the regulator walks in and says that half of my Board should be composed of Independent Directors. The question that I keep on asking is whether this is because the regulator believes that I will not be able to run the company as well as I used to before, just because I have some public money now. Or is it because the regulator feels that the public should have a better management that will only come from outside through IDs? It is neither of these, because the regulator's job is not to ensure the better management of a company. It is not the regulator's mandate to ensure that the companies perform or do well; had it been so, the regulator would have some prescribed age, qualifications, experience, and so on for becoming an ID. And logically, all unlisted companies should also have IDs. In reality, the regulator believes that because I now have public shareholders who are voiceless and disintegrated, there is the likelihood that I may short-change them and unduly enrich myself. Hence, the regulator wants IDs sitting on my Board to prevent this.

So, according to me, the only role of the IDs, as a regulatory mechanism, is to protect the interest of the minority shareholders. Why do we then have so much confusion about the role of IDs? While some purists maintain that an ID has the same responsibility as any other Director, many incumbent IDs, while shirking away from this main role, have piled additional responsibilities on themselves. All the additional responsibilities and value additions can only be a bonus role, but not at the expense of their primary role.

Clearly, if the company wanted value from these people, it could hire them as experts, advisors, consultants, employees, or whatever. What is the need to bring them on board as Independent Directors? The role of the IDs should be focused only on protecting the interests of the minority shareholders, because the regulator believes that there is a possibility of the promoter short-changing the public shareholders. After all, the only thing that changes when a company gets listed is that it acquires public shareholders.

So, if the protection of the interests of the minority shareholders is really the fundamental role of IDs, what has been achieved so far on that front? As far as I can see: almost nothing. What we found from our database when we were building the profiles of our IDs is that out of 9000 Independent Directors of listed companies in India, nearly 70% of them are what I call "home directors": your classmates, colleagues, club partners, neighbours, and relatives. Note that since the definition of "relatives" in India has been brought down from 74 to only 22 relatives, there are many relatives that one can actually appoint on the Board and still call "independent." According to me, these home directors do not even recognise their role—forget about understanding it—because they are there only for numerical compliance. There is not a single word in the law about what qualifications or experience

IDs should have, or any training they have to go through, or any reporting they have to do to the public or to the regulators.

Now comes the biggest irony: these home directors, as well as all other IDs, are appointed by the very person(s) whose misdeeds (in a sense) the IDs are supposed to prevent. The very word "independent" means that the IDs should ideally be independent of the management. And to top all of this, these invited guests—the IDs—are also paid by the promoter. And if the IDs are retired people—about 50% of them are—they better keep their mouths shut, lest they be shown the door.

When the regulators first said that 50% of the board should be composed of Independent Directors, what did the companies do? Many simply converted the designation of some of their existing Directors, who had been on the board for several years, to Independent Director. Also, in many cases, we found that the Executive Chairperson became a Non-Executive Chairperson. Although he was the promoter, he began to call himself the Non-Executive Chairperson and stopped drawing money from the company, so that the requirement for IDs became only one-third of the Board size, instead of half.

If the role of the IDs is really the protection of the minority shareholders from the misdeeds of the promoters, who is appointing them? Ironically, it is the promoter himself who appoints IDs. Look at it from the promoter's perspective. I am a promoter. How can I let a stranger into my own home? I will not get a stranger on board. I have to have a certain comfort level, not only because I don't want opposition of any kind that will hurt my personal interests, but also because he might leak out information to others or be detrimental to the company.

The very word "independent" means that the person should be independent of the management and the promoters. But these are invited guests, and very significantly, these are also guests who are paid. How can you expect them to speak against me, their appointer? I do concede that there are—what I call—value directors sitting on the Boards, who bring strategy, who bring knowledge about law, finance, etc. But have they really played the role of protecting the minority shareholders? That is a pertinent question, because in all the companies with high profile shareholders, I found all kinds of unfair mergers and acquisitions, preferential issues to promoters, and a lot of anti-minority shareholders activities, leave alone illegal activities such as insider trading, siphoning of funds, and so on. Have they brought any of this to the notice of the regulator or the public?

I have not heard of a single case where an ID has resigned saying that the company is involved in malpractice. The reason for resignation is almost always poor health or preoccupation. Has the regulator ever gone to any of these IDs who resigned? Three thousand of them resigned after the Satyam scam because the question of personal reputation came up. They started believing that they did not have enough knowledge about the company, that they attended only four meetings in a year, and if there were a scam tomorrow, it would put their entire life's reputation at stake. Therefore, we witnessed large-scale resignations taking place—mainly of value directors—in the last three years.

Ultimately, why do we place so much importance on IDs? Let us look at public sector undertakings (PSUs), which constitute 30% of our market capitalisation. Before the IPO, they were being run by the government, the way the government wanted to run them. Since they were to be divested, they had to be listed; but before they were listed, the SEBI wanted 50% of the Board to be independent. I know of at least three cases where the IPOs were delayed significantly because the concerned minister for that PSU could not make up his mind about whom to appoint as IDs. Finally, the IDs came on to the Board and the company went public. Since the government still owns 90–95%, the government continues to run it the way it wants to. What role can we expect from Independent Directors of such PSUs, who in any case are at the mercy of the government? And worse, many PSUs are non-compliant on the appointment of IDs post listing, and no action has been or can be taken against them. The situation is not vastly different when it comes to the private sector; simply replace the government with families where the promoters would run the company the way they have been running the company prior to their IPOs.

Forget about quality; even in terms of numerical compliance, the ID requirement is insisted upon only at the time of the IPO, which is a farce. Post the listing, when some IDs move out or die, ID vacancies are not filled for months and years. No regulatory action is taken against such companies. In any case, what action is feasible? So in effect, the regulator is saying that you ran the company well before the IPO, but just for the duration of the IPO you should have IDs, and after that you can once again manage without them. So, in effect, is the regulator not misguiding the IPO investors?

The IDs are a regulatory response to the crash in investors' confidence. When the regulators want the IDs to prevent frauds and malpractices, to look after the minority shareholders, and so on, the investors' expectations are also raised accordingly. But in reality, these people are the least equipped to do all this. I think that the way the institution has been designed and implemented only gives a false sense of security to the shareholders, which is now rapidly getting eroded, especially after the Satyam scam. People have now stopped trusting the Boards. I would not look at the Board of Directors of a company to get the confidence to invest in that company. I would rather look at other factors.

And finally, how can we expect corporates to be an island of virtue in an ocean of corruption? We are expecting all these high standards to be maintained by corporates, when, right from starting a business to growing it, you know that you have to adopt a lot of malpractices. In today's environment, the winner is the one who breaks laws, and the race to grow is so rapid that you keep breaking laws, knowing that you will not be caught. If you do get caught, you will not be punished. And if you are punished, you will be out on bail soon, and you can continue like this for your lifetime.

Finally, corporate governance or ethics cannot be an afterthought nor can it be made mandatory. It is either in your DNA or not; if it is, then you do not require IDs. And if it is not in your DNA, IDs can be of no help; IDs are not the solution.

Unless the regulator imposes IDs on companies, which is not a good way out, and which the promoters will oppose in any case, independence will always be a myth, because if the promoter or the management is going to appoint the Independent Directors, there can never be independence.

We should rather have simpler laws, enforce those laws, and punish people swiftly to create deterrents, and have better disclosures and better monitoring, instead of depending on this mythical institution of IDs. The sooner we abolish this institution, the better it will be for everyone.

I will now be very happy to listen to divergent views, if any, on this subject. John, can we have your remarks?

John Lim Kok Min: The most important role of the Board is to add value to the company and the shareholders, and to grow the company successfully. That is why in many cases, companies that are successful seldom have any complaints about corporate governance, even though their corporate governance is less than satisfactory—because they have met the expectations of the investors. The role of the Board in the company is to grow the company and add value. What is the purpose of the investor putting money into the company? His expectation is that if the money is put there, it will grow and accrue, so that his total shareholder returns—both from dividends as well as capital appreciation—will justify his decision of investing his money there. I think that's the most important part, and given the purpose that I just defined, the role of the board is basically to do what they can in order to grow their company; but of course, we live in a world with rules and regulations, and societal expectations, and therefore, we are supposed to do this within legislation. At the expense of seeming somewhat impolite, I have to SAy that I am somewhat at variance with the moderator's definition of the role of an Independent Director. I subscribe to what was mentioned earlier about the role of the Board: the Board of Directors' primary role is to act in the best interests of the company, but the Independent Director, by virtue of his position, has a secondary role in certain circumstances, which is to ensure that the interests of the minority shareholders are not compromised.

In terms of expectation and delivery, my answer is a categorical one: there is, in fact, a wide gap between investor expectations and delivery by the Boards as a whole, not only by Independent Directors. I think this is mainly the outcome of over-expectation and underperformance. Investors put in some money there; maybe they are small shareholders, but they sometimes also expect to have the rights of the major shareholder. They want an equal say; they want their views to be heard. I think in the real world, this does not happen. If you have only 0.0001% of the ownership, you are not going to get the rights or the airtime of somebody who has got maybe 50–60%.

What do investors expect of the Boards, and by implication, of the Independent Directors also? They expect that the Board is competent and honest, and that the Directors—especially the Independent Directors—have the courage to challenge the management, raise questions, and reject proposals that are not in the best interests of the company. Also, they expect these Directors to be accountable for their actions; they expect these Directors to be fair at all times. They expect a lot of things. But unfortunately, the reality is that the performance of Independent Directors today in most companies, while varying from company to company, is not commensurate with the over-expectations of the investors. We have not talked about the expectations of regulators; we are only talking about the investors and the Board. But there are expectations from the regulators, which is why when you list a company on an exchange, the exchange will expect certain things, which they believe will protect all shareholders, especially the minority shareholders, in the case of what is called a controlled company.

There is a wide disparity between investor expectations and the delivery of most Independent Directors, and I think we should be focusing on how we should close this gap. There are various steps that can be taken; but I think our first step is to recognise the situation as it exists today.

Moderator: What you have just stated is also mentioned in the previous presentation—the primary role of an ID is to grow the company, and the protection of minority shareholder interest is more of a secondary role. I do not agree. It is also good to hear that IDs should be courageous, that they should be bold. But the key question, Professor Bala, is that given the appointment process, how do you think we can ever achieve this?

Bala Subramanian: Let me also say that my view on the institution of Independent Directors is at variance with the moderator's view. I know that democracy, for example, is not the best form of governance. It has major weaknesses built into it; but at the same time, we cannot afford to give up democracy until we find a better alternative. I believe the case of Independent Directors as instruments of good governance is similar to this. Maybe the institution of Independent Directors is not best suited to countries like India where ownership is concentrated; indeed, almost every country other than the U.S., and the U.K. to a lesser extent, have concentrated ownership, and hence, IDs may not be the best solution. But what is the alternative? Thus, until we find a better alternative, we must adhere to this. The iconic American CEO, Jack Welch Jr., is quoted as telling his business heads, "If you can't mend it, end it" in the context of his stated objective of achieving number one or two status globally in their respective businesses. I think the institution of Independent Directors can still be mended to better serve its stated objectives; if it can't, we should find something else that can do so.

I also want to mention that bad news is always sensational news, and that is what the media is generally after, with due respect to some of our colleagues from the media who are present here today. If the media repeatedly publishes the virtues of Boards, nobody is going to read them, because like good air and water, and all such things, these are taken for granted. We look at governance in companies only when there is a big scam or a failure in governance; until then it is taken as a given. Pure air is taken for granted; but if there is pollution, then that makes news. What I want to say, Citing Shakespeare, is that the good that men do is often buried with them (Mark Antony at the funeral of Julius Caesar). I think that the good deeds of the Independent Directors tend to get buried, not in their graves, but in the criticism that we have of the very institution. There are plenty of good things that Independent Directors do, but they don't make good news, they don't make good copy, and so you don't hear about them. It is only the bad news that makes it to the headlines, and we tend to paint the whole system as rotten and dispensable based on such incidents that are reported.

Professor Mak talked about the three Cs earlier on; I have a different combination of three Cs. The board's role, I think, is to Contribute, to Counsel, to Control. Let us admit that every single Director on the Board is not going to have all these traits or these skill sets in equal measure. There will be some people who can contribute more with their domain knowledge. There may be others who have vast experience and are be able to counsel: "What you want to do is good but this is not the way to go about it." The third element is control, which involves making sure that wealth is not only created in the company, but also transmitted through a pipeline to the ultimate beneficiaries, who are the shareholders. This pipeline is a treacherous one, with scope for various forms of leakage—tunnelling, siphoning, diversion, and so on. But these things do happen, and sometimes, I find it very amusing that we tend to accept that it is the right of the controlling shareholders to tunnel something out because they have put the money in and come out with an idea; therefore, if there are some private benefits, it is their entitlement. I don't think this is right. If they have put in 60% of the equity, certainly let them have 60% of the profits and the cash that the company makes. Why should anyone accept that they have the right to anything more?

Another question that is invariably asked is: How can you bite the hand that feeds you? Your own friends appoint you, and then you go and argue against them, and disagree with them. I think there is a fundamental flaw in this. If you think back to the point that was made earlier, the character of the individual is very important. The personality is important. I have known people who have been Directors on company Boards; they would not qualify under the checkbox-ticked qualification criteria, but they have been fiercely independent. They will go and share a drink afterwards, they will enjoy a dinner with the promoters, but when it comes to judging a particular subject for discussion, they will apply their mind and say, “This is what I think. I can be overruled; the majority can do something else.” But if they feel strongly about the matter, they will also request the Board to note their dissent in the minutes so that everybody knows when/if it becomes a subject of litigation. At least a judge will look at them a little more sympathetically, and if the others are sentenced to 20 years in prison, maybe they will possibly get only a year in jail, or something like that. So, I think we need to consider this as well.

I would want to quote an example from history to make my point here. Thomas Becket was appointed Archbishop of Canterbury by King Henry II. The king had always had problems with the church. He wanted to appoint a good friend as the Archbishop, which is why he appointed Thomas Becket. Once he took the job, Becket started singing the same tune as his predecessors. The King was naturally upset and asked him why he was doing this to him, despite being his friend. Becket is reported to have said that although they were friends, when speaking as the Archbishop of Canterbury, he could not agree with some of the King’s decisions. I would recommend the example of Thomas Becket as one that all Independent Directors should follow. But a word of caution: eventually Becket had to pay with his life; he was killed by the King. I don’t know how many Independent Directors would be willing to go that far—not to the extent of paying with their life, but at least fighting hard for what they feel is correct.

I would only say that there is a lot to be said in favour of the system of independent or non-aligned directors. In fact, I never understood the provisions in the U.S., where if you are a controlled company, the institution of IDs does not apply. I would have thought that in a controlled company, this should apply in a more vehement way than otherwise. If we adopt the U.S. rule, all the listed public sector undertakings, for example, would qualify as controlled companies and they would have no Independent Directors to safeguard the interests of the minority shareholders. The point is that in such cases, the Independent Directors are doing something and the big brother (i.e., the controlling shareholder) is trying to thwart their efforts. This is not a good thing. It is coming out in the open, and I think that is due to the institution of Independent Directors. If Independent Directors did not exist, perhaps even what is happening in Coal India and other companies may not have come out in the open.

Moderator: There are a couple of things I would like to respond to. It was said that IDs do a lot of good work, which rarely gets publicised. By the same logic, when they do bad work, that is also not made known to the world quite often. So IDs come in and go out without anybody in the world knowing what they have done for the company, and when they resign, they are not even obliged to explain why they are resigning. Should we not have detailed disclosures about the reasons for resignation at the very least? I have not heard of a dissent noted, for example, in any Board meeting. Ultimately, the minutes are prepared in a manner that indicates that everything was approved unanimously. Maybe if we encourage the practice of dissent notes and the practice of directors explaining to the regulators or the shareholders why they have resigned, there will be greater confidence in such individuals. At least, they stood up for the cause of the company and the minority shareholders. I agree that there are several directors who deliver a lot of value. But my question is: Do they deliver value when it comes to protecting minority shareholders' interest? I don't want to get into a debate on that at this point. Professor Bala, your response?

Bala Subramanian: I just saw my notes and realised that I missed one important point. While we do want the institution of Independent Directors to exist, the question is: How can we systemically enable the institution of IDs to work? We have not enabled them. My recommendation for a long time has been the following: Let the law be amended to say that a majority of Independent Directors should also be present to constitute a quorum, when you are deciding on a quorum for a meeting. Otherwise, what is the point in saying that it is a very valuable thing to have Independent Directors when none of them are present in a meeting, and the remaining (non-independent) directors meet and pass resolutions that affect the whole company. Also, there may be certain key matters—related party transaction, and so on—where I think the approval of a majority of Independent Directors should be obtained before those things are allowed to happen. Instead of merely calling them bad eggs that are useless to society, I think we should try and see whether we can systemically enable the system to work better.

Moderator: That brings us back to the appointment process; but I will come back to that later. Navneet, you manage people's money. I will give you a small example, and would then like your response on this issue. There is the case of an IPO, where the promoter merged an unlisted company that was fully owned by him into the company that was going for an IPO, and did the valuation of the unlisted company at INR 10,000 crore. Therefore, the promoter acquired the shares of this IPO company (worth INR 10,000 crore) through the swap, free of cost. I did not hear any voice of protest either from any fund manager or from the IDs of that company, which comprised a galaxy of people. This is not an isolated case. I read every prospectus and this has been happening in many cases. As a fund manager, how do you look at Independent Directors? What kind of faith do you put in them?

Navneet Munot: Right now, shareholder activism is very new. In fact, I read about this new term, "shareholders spring," along the lines of the "Arab spring" or the "Jasmine revolution." Recently, the CEOs of Aviva and AstraZeneca were toppled. Shareholders have made noises and cut the bonuses at Citibank, UBS, Barclays, and Credit Suisse. I am not sure if something of this extreme nature will happen in India in the near future, but I think we are moving in that direction. Globally, it has begun to be driven by the regulators and the government, where they want the shareholders to play a larger role. So far, not only in India but globally as well, investors have been largely indifferent.

One reason for this indifference is that there is no incentive really to influence the management—if the investors are not happy with the management, the better thing is to just go and sell their stock or not apply in their IPO. The other reason is that investors may not have the skill sets and resources required to engage with the management in a manner that really increases the value. Another major issue is whether investors have the levers of control. I have voted negatively in several resolutions, but they were still passed.

In India, I think we have just copied the whole governance framework from the Cadbury report and the Sarbanes-Oxley Act, which include the broader framework for making the management accountable to the shareholders. In India, the greater role of independent directors should be to take care of the interests of minority shareholders. Someone mentioned the family-owned companies or "Lala" companies earlier. If you take the top 500 companies, I would classify 463 of them as family-owned companies. One Lala who owns more than 26% in almost 60–70 cases is the Government of India. Look at the oil marketing companies; look at what is happening in Coal India; look at some other PSU companies. The Lala could also be some multinational company—by and large, they are perhaps better than the others. You can't generalise governance failure across all these Lala companies. But the market is a great leveller. If you look at the last 10 years, the companies with more than 76% promoter ownership have underperformed in the market by a big margin. They are the worst performers.

To me, the role of IDs in the Indian context has more to do with making the majority shareholder accountable to the minority shareholder, because the latter have a very limited voice. We have just started making noise. Some people like Amit have started this proxy advisory. Now, we are working on this collectively. So far, we have been able to influence some of the managements, and I think the trend of institutional activism is going to catch on. Companies arrange meetings of the CEOs with us, and they take us to the plant. I have never seen any company saying, "Meet my Independent Directors to understand my value system." Independent Directors should play a bigger role in a corporate value system; they need to define and uphold the same. Such a value system is more important than the corporate goals of profitability, efficiency, or wealth creation alone. Such a value system incorporates moral values, honesty, integrity, positions on environment, governance, social issues, and so on.

In the Indian context, the whole framework has been weak, because the enforcement has been quite weak. You file something against Clause 49, and the enforcement will take seven years or so. The same holds when you file any lawsuit against a government company. I have been following this whole TCI vs. Coal India issue very keenly. Let us see what comes out of it. I am not very optimistic that TCI will really gain, but at least it will have an influence. So, in India, it should be seen from that context. I hope that we, the shareholders, get a lot more access to Independent Directors, and try to understand their value system.

Also, I think, analysts—whether a sales side analyst or a buy side analyst—should focus a lot more on corporate governance issues, although that is not something that may be present in their regular DNA. But thanks to the regulator, the mutual funds have been asked to have a voting policy, and put it on their Websites. The regulators have also asked the mutual funds to put the decision of the voting committee on every single vote that they give. Some of these things will create more awareness, and help to improve corporate governance.

Moderator: Shailesh, I will let you have the last word on this. How do you look at fund managers like Navneet and people like Amit Tandon; do you see them as competition to Independent Directors? Do you feel your role is being usurped by these institutions?

Shailesh Haribhakti: Well, Prithvi is a very dear friend of mine. I have to make that disclosure first. The second disclosure is that I have spent 5,000 hours of my life sitting in boardrooms, sitting in committees, and sitting in organisations, playing the role, however defined, of a Director. After having made all my disclosures upfront, I will now express my views. Now what I would like to share with you are 10 instances that made me feel there was a contribution or a value addition that happened because Independent Directors were present on the Board. Then I'll leave it to you all to judge whether this institution has the potential to deliver any value or whether we should leave it completely to the fund managers, or institutional investors, or proxy companies. So here goes, just 10 instances.

Moderator: Since we are running short of time, I think 2–3 instances of the best kind should suffice.

Shailesh Haribhakti: That's fine; I'll go by what the moderator says, and give you the two best instances.

The best that I can think of is when the news about derivatives was broken to corporate India three years ago. All of us were completely taken by surprise that exotic derivatives—which had very little to do with the underlying model of the company—were, on many occasions in a very unauthorised manner, actually contracted, and the losses hit, and they hit big. This particular company whose audit committee I was chairing suffered a loss of INR 100 crore on exotic derivatives. So what was the first thing that we—the Independent Directors—proposed, which the management accepted? We proposed that even though there is no occasion for disclosure, let us make an immediate comprehensive disclosure of what went wrong, and what action the company was planning to take in order to ensure that the situation does not destroy the company's value. So, here are the lessons: we wanted sustainability, we wanted to make sure that the truth was told, and told immediately. We took responsibility. A committee to correct the whole derivatives mess was set up comprising only Independent Directors, who were given full access to the bankers, to the executives in the company, and to whoever was responsible for contracting these derivatives. The final outcome was that this particular company today, as a very small or medium company, is the darling of the investors. In a falling market, it has been a singular example of one that has outperformed the market. The seeds for this were sown when we wanted to be transparent; we wanted to make sure that the integrity of the whole process was kept in full public view and we wanted to be accountable. It is so important that these fundamental principles are established, and when a big situation like this happens, the Directors, particularly the Independent Directors, have the courage to make sure that this kind of approach is taken. Nothing could distract us from the objective of cleaning this mess up.

Moving to my second example. There is this company that is absolutely high performing; it is the biggest company in the space that it operates in. It ran up a very significant quantum of debt, while the business model was still marvellous and still fantastic. The very important outcome that had to be delivered very quickly was to cut down the debt. Again, what happened was that the Independent Directors were requested to step up to the front and take the tough decision to actually sell off very important components of the company, and to make sure that the debt gets cut down. The Board set a target that the debt must come down to X ratio in a 12-month framework. It was the remit of a committee of Independent Directors to make sure that this happened, so that the majority would not influence the decision by saying, "We love this business, so this won't be sold. Sell everything else." In fact, many of you can now recognise the company, because all this is public information. The dearest part was the first to go in order to create a visible impact, and to make sure that the necessary things that needed to be done were actually done. I can give you hundreds of such examples where it was only because of the presence and the active participation of the Independent Directors that the outcomes had been very positive. We cannot just brush aside IDs as an institution that is not visibly protective of the minority. The IDs do protect minority interests; there are occasions where we have stopped preferential issues, where we have re-priced ESOPs, where we have done all sorts of things to make sure that there is fairness in the whole proposition.

Moderator: What I had said is obviously not true for all the companies and all IDs. I was talking of the majority of the companies. There are of course some companies that are exceptions to the rule such as Infosys, Hero Honda, and maybe 10 other such companies that you will continue to hear about, where good people like you, professionals who understand the business, who are committed to it, deliver a lot of value; but such people are a hopeless minority, I must say.

Here I would like to suggest that people like you—professional Directors—be paid handsomely by the companies for the value you deliver, instead of just INR 20,000 as sitting fees or a small share of the profits. But the question remains as to whether the IDs in the majority of the companies have performed their role, which is basically what the regulators want them to do—not to look after the company per se, but to look at the new element, i.e., the public shareholders. That was the point I was making.

Anyway, I still did not get an answer from you on the nomination process. I would like to have your views also on that, Professor Bala.

Bala Subramanian: Following from what Shailesh said just now, I think I would categorise independence into two parts, to put it simply. One is invited independence; the other is imposed independence. I think the institution of Independent Directors works very well where it is invited for the value it brings to the Board and the company. On the other hand, if it is imposed by the SEBI, the NSE, or the BSE saying, "You must have two-thirds and one-thirds," and all that, the chances are that it is unlikely to work. Whether you can convert imposed independence into invited independence also depends on the Independent Directors. At the end of the day, the promoters should also see that these guys—I am saying "guys," mainly because, there are not too many women in the boards today—can bring in some value. Which promoter does not want value from whatever source it comes?

Coming to the nomination process, I don't think that going to pools makes any sense at all. If you don't like the nomination committee as it is currently conceived, it is the job of the Board to appoint the IDs. I can also tell you that in a concentrated ownership situation like in India, to have an independent nomination committee without the involvement of the promoter in order to even suggest which Directors should be inducted would be dysfunctional. So, you would need to take them on board. But the decision should ultimately be that of the Independent Directors as to who should come on board.

Now that we have talked about getting people on board, I would like to add a few words about getting people out of the Board. We have been talking about terminating the services of IDs. Many separations of Independent Directors happen because of fear and not necessarily due to non-performance, because many of them are brought in on the basis of their excellent track record. I would suggest one regulatory change that we need to make. The Directors are appointed by the shareholders; but when they resign, to whom do they address the resignation letter—to either the Board or the Chairman, right? Don't the IDs owe an explanation to the shareholders about why they are quitting? I think we should ask the Independent Directors or any Director who is resigning from the Board before his/her term, to make a statement giving the reasons for resignation, either personally in front of the shareholders at a meeting or at least in a letter to the shareholders. I completely agree that reasons such as wanting to pursue other personal interests and all that should not be acceptable. They should have a checklist of things that should be avoided: medical reasons, producing wrong medical certificates, and so on. But let them at least come out with some broad indications as to why they are resigning. I think they owe it not only to themselves but also to the shareholders, particularly the outside shareholders.

Moderator: John, before I come to you for your take on the nomination process, let me state that in India we have a system wherein a person who is appointed by the Board as a Director is first called Additional Director. Then this appointment is ratified by the shareholders at the next AGM through a majority voting, which could be six or even nine months later. This means that a person is actually on the Board as a Director even without the shareholders' ratification. I don't know how it works in your territory.

One of the changes that I have been proposing is to have a requirement where you have to put out a detailed profile of the proposed Independent Director on the Website of the stock exchanges, or make the information public in some other way, and then invite public comments. The company should also give full justifications as to why that person is being considered, and very importantly, the promoter should disclose under oath how and when he/she met this person, the basis for inviting the person, and so on. John, would you like to throw some light on this?

John Lim Kok Min: Even in our jurisdiction—Singapore, Malaysia—it is the same. The board can appoint a new Director in between AGMs, but at the first AGM after the appointment, he must be ratified by the shareholders. So this system exists in other jurisdictions as well. I think there has been too much emphasis on independence. Independence, after all, is just a question of defining the situation where the potential Director or the Director does not have any relationships (with the management) that will actually prevent him from making objective decisions in the best interests of the company. It doesn't in any way say that somebody who is independent by definition will in fact be a competent Director. I think we have not focused sufficient attention on the competence of the Director. As Professor Bala said, for you to act and grow the company, you must be competent, you must have a certain amount of experience, and so on. We have a saying in Singapore that if you have a Board of very independent but non-competent Directors, they will become independently incompetent, and that Board cannot succeed.

Basically, I also believe in a balanced corporate governance ecosystem; but for that to work, it would require the holistic efforts of all the stakeholders, including the media. The media is a very important component of a balanced corporate governance ecosystem, because it goes hand in hand with disclosure and transparency. You have gatekeepers, auditors, and so forth, but it requires the holistic efforts of investors, particularly the institutional investors, the other Board Directors, the media, and the regulators, who all play a crucial part. I believe that if there is sufficient transparency, things will improve because Directors are concerned about personal integrity and reputation. During the nomination process, if full disclosure is required in terms of how the company went through the nomination process, what the requirements of the company were in terms of collective Board skills benchmarked against the challenges facing the company, what collective board skills the company currently has and what the new Director will in fact bring to the company, and so on, I think the quality of the Directors will improve. I do not believe that Directors who are incompetent, who are not properly qualified, will enjoy having their nomination constantly challenged by investors and shareholders.

I find what has been happening in recent years to be quite encouraging. As Professor Mak said earlier, the roles and responsibilities of the Directors have not changed much, but the expectations have certainly increased. I see shareholders coming to AGMs, asking a lot of questions, and challenging the Boards. The members of Boards, particularly Independent Directors, must now be prepared to be there to answer the questions and to be accountable for their actions. I think I still see a future for this institution, but the nomination process has to focus on competency and greater disclosure. All the stakeholders should play the role of highlighting good as well as bad, so that the good is not always buried.

Navneet Munot: To a large extent, I agree with Shailesh that we should not be too self-critical. We are looking at only those cases where there have been failures. I think institutional activism is on the rise and I see a great future. I think the SEBI has been ahead of other jurisdictions in Asia and other parts of the world on several aspects. Also, look at the collapse of the banking system in 2008–2010. Considering the way that the RBI has worked, and the way the entire banking and financial services have been evolving in India, there is little reason for us to be too self-critical. Just look at what has happened in the West, particularly over the last four years. I am, relatively speaking, far more optimistic about India.

Moderator: Let us end today's debate on this optimistic note. We have time for just one question from the audience.

Q and A

Q: Sir, what I have is not a question but a comment, or rather, a point of view. We have been talking too much about minority shareholders' interest, as if nobody is concerned about the independence of the Independent Directors, and as if that is not considered at all by the corporate world. In my personal experience—I have also spoken to my colleagues in various large-sized companies—the governance process and the role of Independent Directors and value addition have increased considerably. But is there anybody who is evaluating the progress we have made since the time when we were at zero level? We criticise those managements where the value addition is not happening, particularly in promoter-dominant companies. Our experience is that in such companies, irrespective of whatever regulations and types of tests we put in for the selection of Independent Directors, the performance is unlikely to improve. This is happening across the world, and it will continue to happen in India as well. The fact that should be recognised is there has been progress in the corporate sector, particularly in those corporates that are pertinent in the context of the Indian economy. Thank you.

H. Closing Remarks

– Usha Narayanan, Executive Director, SEBI

I don't want to stand between all of you and lunch, but I have a duty to perform and I shall keep my remarks short and sweet. First of all, I can definitely assure Mr. Mirza that when we talked about what the Independent Directors expect from the management, we definitely wanted the management to be here. Probably because it is the results season now, the attendance of the management is less than what was expected. But in the next conference, we will definitely have some promoters also on the panel.

There were various speakers and several points were made; I will pick up just few of these points and then outline what our view is. Mr. Lee Kha Koon talked about the reasons for the resignation of IDs. I am glad to inform you that SEBI is proposing to mandate disclosure for the reasons for resignation. The quality of the details that should go into it is a matter for analysts to suggest. Probably the number of resignations so far was too few until now, and you need a good sample size to even analyse what the reasons for resignation are, and to conclude on the basis of the same.

At the same time, Professor Bala said that IDs should not be allowed to quote medical reasons or other personal reasons as the reason for their resignation; but what if a person was genuinely not well? So we can't simply say that you can't quote illness as a reason, but we can always analyse and see whether many people just quote personal reasons, medical grounds, and things like that. While doing analysis on this issue, the events that surrounded the resignation of the person from the company should also be taken into account. Probably, some learnings from this will help us to improve the kind of disclosures that need to go into the system.

The panellist spoke about the risk management system, which already exists as part of the mandate to the audit committee. But today, risk management is understood to include only financial risk management and nothing beyond that; probably, it was a mistake to group it under the audit committee's duties and responsibilities. There is more to risk than just financial risk. So the suggestion that we should have a risk management committee in addition to the audit committees is something that is worth thinking about.

A lot of discussion went on about whether the model of corporate governance that we have is effective in a controlled company kind of situation. Do we need this institution of IDs at all? As Professor Bala said, we can't just junk this institution, at least not in India, because it has after all been mandated only for the last 5 or 6 years. We need to study the effectiveness of this institution over a longer period to really come to a conclusion as to whether to junk it or improve upon it.

Somebody made a remark about stakeholders versus shareholders. I just wanted to share one detail that I read in one of the academic papers, when one of the small banks in England— was being taken over by a Greek bank. The CEO was against this takeover, and he went and complained to the takeover panel saying this was not in the interests of the depositors of the British bank, because there was a large number of London depositors who had money in the Greek bank, and he was of the view if they were allowed to take over, it would be a disaster. The takeover panel put its hands up, saying that they could not stop the Greek bank since it had met all the parameters laid down in the regulations. Subsequently, the CEO went ahead and recommended the takeover to the shareholders. When somebody questioned why he recommended the takeover, when he had been vociferously voting against it initially, he said his duty lay in protecting the interests of the shareholders; and as far as the shareholders who were exiting were concerned, this was the best offer. "So I cannot but recommend the takeover," is what he had to say. But ultimately, the question arises as to what happens to the deposit holders in that company. Who is going to look after their interests? Is it not the duty of the Directors? I am glad to say that for a banking company in India, the Directors' duties and responsibilities go beyond the shareholders, and encompasses the deposit holders as well. So is the Independent Director's role restricted to protecting and promoting the interests of only the shareholders, or the whole universe of stakeholders? How it plays out when the new Bill comes in will be interesting to see.

Mr. Mak Teen talked about the three Cs—Character, Competence, and Commitment—of Independent Directors. I started my career in banking. When we started learning how to do a project appraisal, one of the things that we were told is that when the promoter comes to you, you should assert three Cs, i.e., Character, Capacity, and Capital. Character is common in these two contexts; competence and capacity are one and the same thing. When it comes to commitment, it is not only commitment to time but also commitment to capital. So, in a manner of speaking, the qualities that we expect of an Independent Director are almost aligned with those expected of a Promoter-Director. So I do not know how to differentiate between the characteristics of IDs and the other Directors, because the same qualities are expected of all the Directors. That is why we say the Independent Director's role is as important, if not more important, than that of the Promoter-Director. In a manner of speaking, we can say that the Independent Director is also equally responsible, except in day-to-day management.

Some people talked about the panel of Directors, and why the SEBI should not have them. I don't think the regulator gets into this anywhere in the world. In fact, even when the MCA mooted it as part of the Companies Bill, we had our own reservations about it. As someone pointed out, I can get myself included in the panel by putting in an application; then, I will coolly come and say that I was selected from your panel, and so I do not have to disclose my personal or other interests to the Board.

Now, who can or cannot be a Director? How can the SEBI prohibit someone who is a Director in one petroleum company from being a Director in another, and so on? When we go down as a regulator to specify these things, we could be accused of micromanagement. So we have only put out a broad spectrum of requirements—that you need to have a diversified Board in terms of age, education, and experience—without specifying the finer details of those requirements.

As regards the Companies Bill's provisions on the inclusion of Independent Directors, we have our own reservations. If we have to change anything that is included in the Companies Act, then it becomes a long-drawn process, and because it is a dynamic world, you may have to make changes frequently. Rather than have it as part of the Companies Act, it should be part of a set of rules or listing agreement. Then, we would have the flexibility of amending these rules from time to time, as required. But the Bill is already on the Table; let us wait and see.

Further, somebody made a remark about the need for a majority of IDs to be present in order to constitute a quorum. Mr. Lee Kha Koon and his colleagues had come to meet me yesterday. Incidentally, in our informal discussion, I had raised the same question. Currently, even without Independent Directors, the quorum can be attained and the meeting can go on. How far we have the power to mandate such things given the provisions of the Companies Act is something that we are examining. And probably, we may come out with such a provision if we feel that we have sufficient leeway to do so.

Another point is about Related Party Transactions (RPT). The review of RPTs is part of the audit committee's duties and responsibilities. But when it comes to audit committees, it comes as a *fait accompli*. So one of the things that we are looking into is whether we should ask the RPTs to be pre-screened by the audit committee before it is put up for a vote. We have made a recommendation to this effect, and hence, the Companies Bill also includes the requirement that RPTs should be voted on by the shareholders, and that too only by Independent shareholders. But I don't know how many of the RPTs really go to the shareholders for voting. Most of the investment decisions are within the power of the Board. It may or may not go to the shareholders at all for voting.

We have brought about certain other changes like the declaration of voting results by the category of the investors. In the recent budget, the Government of India had announced the introduction of e-voting. The infrastructure facility has been put in place by the two depositories after consultations with us, and it has been tested. It is being used by some companies today on a voluntary basis. We envisage that, at least to start with, it will be made mandatory for some companies in the near future.

We also had certain proposals in mind about the term, the number of directorships, etc.; but we didn't take them forward because the Companies Bill contains provisions for them. It may not be appropriate to introduce such provisions at this stage.

What are the takeaways from this meeting? One is about cumulative voting. We need to examine the jurisdictions where they have cumulative voting. How far it is practicable or feasible, and whether we can implement this, needs to be evaluated.

Last but not the least, Mr. Haribhakti talked about his experiences related to instances of positive intervention by the IDs. I feel there is a lot of value in sharing experiences not only of instances where we have added value, but also of instances where we have failed as Independent Directors. Someone from the Institute of Directors or the CFA Institute should take the initiative and talk to the Independent Directors and list out such instances, maybe masking out the names. This will give a lot of value addition to first-time Independent Directors; even for other Independent Directors, it will have lessons on how to react in a particular situation, and how to add value to the company. It will be a great learning experience. So, somebody should definitely take this lead and bring out a book on it.

Thank you very much. I really appreciate the efforts of NSE, BSE, and NISM in bringing together this conference, and we hope for continued co-operation from all of them.

Thank you.

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May prosperity always bloom

NSE

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