

# Independent Directors: Increased Responsibilities



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The collapse of global financial services firm Lehman Brothers in 2008 was not only a wake-up call for the global financial system but it also put the role of independent directors in spotlight—who are not related to the management. Out of the nine independent directors on the Board of the financial services behemoth, only two had experience of the financial services industry. With the ability to question management limited, the Board of Directors was not able to correctly assess the risks attendant to the business model. The collapse of Lehman Brothers stressed the need globally for the revamping of existential corporate governance structures, especially the role of independent directors as watchdogs to ensure smooth functioning of corporates in adherence with strict policy protocols. Many countries were quick to bring in sterner legislations and create a regulatory architecture to fend of future crises.

## Indian Answer

India answered to the global challenge by amending the existing legislation in this regard. In order to ensure compliance with corporate laws and bring in increased transparency and compliance in the functioning of companies, the Government of India replaced the Companies Act 1956 with the Companies Act 2013. The amended legislation was hailed as a watershed reform in corporate independence as it placed greater emphasis on the performance of independent directors as overseers of company affairs and created a viable corporate ecosystem where independent captains would play a key role in steering the company ship in choppy global economic waters. Moving away from the traditional role of independent directors being mere rubber stamps in the board room, the Companies Act 2013 has empowered them to protect interests of shareholders and ensure enhanced functional stability of the company. In the wake of several white-collar scams which rocked the country, the mandatory appointment of independent directors to several board-level committees is seen as a key government initiative to ensure greater probity in corporate matters which is very essential for ensuring the confidence of various stakeholders

Sub-section 6 of Section 149 of the Act defines an Independent Director as a director other than a managing director, a whole-time director or a nominee director. The Companies Act 2013 has clearly laid down guidelines regarding the appointment of independent directors. The concerned person should have integrity with the prerequisites of expertise and experience to watch over company proceedings. The potential independent director should not be a past or present management of the company, its holding, subsidiary or associate company nor should he be related to the management or directors in the company, its holding, subsidiary or associate company. There should be no past or present pecuniary relationship between the independent director and the company, its holding, subsidiary or associate company, or their management or directors, in the two immediately preceding financial years or the current financial year. All directors, independent or full-time, will be declared as wilful defaulters in violation of Article 19(1) (g) of the Constitution if they wilfully default on a loan.

## Dual Role

The independent directors have a dual role to play in the functioning of the company. As an independent director, he is a conscience keeper with the principal role that the affairs of the corporate are being managed in a manner which is fair to all stakeholders. . The IDs thus work with a broader interest and are true guardians of corporate principles. Secondly, ID brings in the desired skills and subject expertise into the boardroom as management may or may not have the required expertise. Thus the IDs make a qualitative difference in the board room. From both the angles, the role of IDs is assuming increasing significance as the days go by. They possess the competencies to bring in fresh governance protocols to company workings and deploy new-age knowledge tools to enhance the productivity and earning capacities of the organization.

## PSU Experience

A majority of public sector units (PSU) in India are not in conformance with listed rules governing the appointment of independent directors on company boards. With around 200 posts of independent directors lying vacant in PSUs, serious questions have been raised on their decision-making procedures and fraud-detection capabilities. Early detection and prevention of financial scams forms the crux of appointing independent directors. It is largely believed that half of listed PSU boards should have independent directors who are free of management control, perform the role of administrators of shareholders' interests and are empowered to employ an effective check and balance mechanism on company policies.

The appointment of independent directors in PSUs, especially in state-run banks whose loan books are bloated with huge non-performing assets, in the process depleting their capital adequacies, is seen as a potent requirement to ensure transparency in the loan disbursement process. Many large-scale government PSUs are plagued by arbitrary processes of tendering, doling out contracts and payments. A lack of supervisory mechanism to oversee the different aspects of awarding works to external agencies is the breeding ground for lack of accountability, corruption and favoritism. It is here that an independent supervising agent in the form of independent directors who are free of fear and favor from the control of management can ensure that contracts and other work is awarded in line with laid-down principles of accountability and zero tolerance of corruption and graft. The government should set an example ensuring that its affairs are in order and an independent overseeing mechanism is in place to check the working of PSUs.

#### **Private Sector**

The role of an independent director assumes paramount importance in a private sector set-up where the interests of minority shareholders need to be protected. It is generally observed that corporate boardrooms of listed companies comprise of a larger number of non-executive (independent) directors as compared to non-executive (full-time) directors. Private corporate entities have a higher degree of compliance with SEBI guidelines prescribing the appointment of independent directors. Private sector players provide a greater degree of freedom and functional bandwidth to independent directors to carry out their duties in a judicious and non-partisan manner. Independent directors in private sector boardrooms chair key organizational committees such as audit, compensation, governance and nomination. They are also responsible for setting valuation parameters for the issuance of shares and investments.

Conflict management forms a key resolution area of their tasks as they facilitate the smooth working environment by ensuring good working relationships between workmen and the management. They are instrumental in carrying out mergers & acquisition activities for the management. They are also the harbingers of innovation processes for the company ushering in new R&D techniques and production tools. Independent directors in the private sector, as compared to their peers in the public sector, are subject to higher standards of integrity and strength of character. It is absolutely pertinent that they remain resolute in carrying their duties and not succumb to fear and pressure from any quarter.

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#### **Family-run Business Scenario**

The corporate landscape of India is dotted with the large-scale presence of family-run enterprises. With a patriarchal set-up where operational control passes from one generation to another, these family-held units are averse to appointing external qualified professionals as directors. These entities are characterized by concentration of ownership in the hands of few related individuals and little or low independence and decision-making power for the board of directors. With critical decision processes circulating between various family members who are appointed as directors at various levels of hierarchy, the scope for the appointment of independent directors largely remains unexplored or unwelcome. However, given the unidimensional sectoral experience of management in these units, their capability to face diverse local and global multi-sectoral economic challenges is limited. It is in this context that experienced, qualified professionals appointed as independent directors can bring a fresh perspective to policy decisions with their domain knowledge and unbiased style of functioning. They can prove to be key facilitators in elevating the company as a prime domain player from its family-run existence and ensure fair-play in the decision making process along with providing a fillip to the asset-building exercise.

#### **Facilitators for Future Growth**

India is rapidly rising as an industrial powerhouse among the Emerging Markets (EM) economies. A rise in disposable incomes, a young population under the age of 35 with huge purchasing power and changing trends in consumer demand and preferences have the potential to propel the Indian economy on an upward trajectory. Corporate organizations in India will have to gear up to face the challenges of a changing global economic order where emphasis will remain on innovation, technical challenges and best management practices. It is in this context that independent directors can act as facilitators to bring a paradigm shift in operational structures of corporates by enhancing productivity, optimum resource utilization and scalability in an unbiased and non-conformist manner. Far from being localized agents of change in closeted management functions in conventional corporate environments, independent directors will need to take on a more broad-based, diversified and global outlook to position the country as the focal point of world industrial and economic activity.

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