

# Increasing Challenges for Independent Directors: The Great Leap Forward



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A lot has been written, said and agonized about the new responsibilities and liabilities of Independent Directors (IDs) in India as a result of the companies Act 2013

As with most institutions in India – the institution of the ID is being challenged to make the aspirational leap from its present regressive practices to, not just progressive, but cutting edge practices; and with raised legal consequences for not doing so. But as with most things in India, only when we are forcibly dislodged from our present positions of comfort and pushed into the deep end, do we make the great leap forward!

The new law mandates independent directors who, as the old joke goes, usually open their mouths only to pop a cashew nut in, to “offer independent judgement on issues of strategy, performance and key appointments, and taking an objective view of the performance and evaluation of the board (hitherto, typically the private preserve of promoter chairmen, who decide who comes on the board, what topics they discuss and often what they will decide.) “Independent Directors are additionally required to satisfy themselves on the integrity of financial information, to balance the conflicting interest of all shareholders .... the companies act 2006 has also imposed on independent directors the duty to promote the success of the company, its employees the shareholders, the community, and for protection of the environment..... it remains to be seen whether a company’s inability to continue profitably will be deemed as a failure of the company and hence, a breach of the directors duties.”<sup>1</sup>

This is quite a tall order. However the law is clear that we need to start the journey towards the great leap forward. In this article, let us explore the challenges of doing so and how to deal with them. There are two ways to do this – one is for each individual ID to learn a few more “tricks of the trade” to become more effective individually; and the second is for the entire collective or institution of IDs to become structurally stronger so that all members of it are better enabled to discharge their new duties better. My push would be for the second. As with most institutions, the method of making them fundamentally stronger requires them to have the right people, the right processes, the right issues, the right dynamics and the right incentives.

Let me reflect on some of these in this article.

The right people and the right incentives are a big challenge and an inter related one. After the new law came into force, lawyers have gone into overdrive (and perhaps legitimately so) to expound on all possible reasons why independent directors can now get into serious legal trouble even though they may have acted in good faith. This has spooked many people who have decided to stop being IDs.

There are however a large number of “undecided” even positively predisposed current and potential IDs, who are absorbing all the discourse and asking themselves “just how dangerous is it” and “what’s in it for me / why should I do it”. The trouble is that no one is putting out answers to these questions. However if the institution of IDs is to deliver on its expanded duties, now clearly prescribed by law, it does require the best available talent, drawn from diverse fields of experience and with the required levels of capability. It cannot do that with training below par talent. In fact ID training is of questionable value because the role of an ID is to make judgement calls. The training that is typically done is only around the rituals of governance which any smart and experienced professional can pick up ‘on-the-job’ easily. Learning how to make board-member judgement calls and to learn how to supervise but not supplant management, is learnt through apprenticeship. That’s why quality of ID talent is so critical – each generation passes the baton on through board room experience. If we don’t keep the quality high then the impact will be felt for many generations to come!

How do we attract good proven, diverse talent? Advocacy is needed to do that, perhaps sponsored by SEBI and MOCA and concerned investor organizations. The first task of the advocacy is to answer the question. “Why should anyone become an ID”? No job is worthwhile and no institution strong without ‘purpose’. So we need to propagate a meaningful purpose. To me the purpose to propagate is “making the business environment in the country cleaner and better”. We all have to do our bit as citizens and it is ‘jury duty’ that everyone who can do must do. If India Inc is to seek foreign capital, it needs to claim good governance. And that means all the senior beneficiaries of India Inc must work at it – that’s what good corporate citizenry is about.

We need to create a citizens’ army of good corporate governors and those who are qualified to, must serve time. Another motivating reason to put forward is that being an ID provides a rare ring side view of business and enormous learning about business – a different kind of learning than that of performing an executive function. It also provides for life after 60, where you can use your considerable knowledge and wisdom to ‘give back to society’. Additionally, being an ID is incredible learning,

and the closest to industry connect for very talented academics.

As an ID, you are learning for free- from the company management, from your peers and from other service providers and the joy (and the rub off and pay off in other spheres of professional activity) is huge. Also when you become an independent director you meet and work with, in a generally non hierarchical atmosphere, people you may have otherwise never come into contact with and you are far richer for all these experiences. Testimonials from experienced directors would help bolster the case to persuade good people to want to become IDs.

What of the inordinate liability? The Indian state is periodically prone to doing stupid things but it is not utterly whimsical in its behaviour. We need to have enough faith that in our country the legal system will not needlessly come after people in a manner where they cannot defend themselves. In most of our life experiences, the state has not behaved so. The mindset and focus should be on enabling directors to build evidence in boardrooms through agenda and minutes to demonstrate that there has been enough duty of care exercised. Risks exist everywhere. A fraud in the company and the CEO's head rolls. A questionable licensing deal for a public good done by one competitor and the rest of the players' top teams are hauled over the coals. Let us look at training boards and managements to manage governance regulation risk, – and keep the faith that if you have done no wrong, there is not a big chance that you will be in prison. Driving a car is dangerous too. The laws on manslaughter and murder and rash and negligent driving are draconian, if we read them. But many of us believe that if we are prudent, we will drive for 50 years and not end up in jail. And many IDs have had rewarding periods as IDs and stayed out of trouble.

The enhanced legal liability is actually a call to the board system and to IDs to do their jobs better without fear or favour. Lets take minutes of meetings. Mostly, what passes for minutes, even in the companies famed for great governance is embarrassing. It is a tacit agreement that board members seem to have, that nothing of what transpired in the room should be revealed, no dissent should be captured. Why? Most minutes talk of what management told the board and little else. If this is the choice boards and IDs make on minutes, then how will they ever be able to protect themselves in troubled situations and prove that they did indeed perform their duty of care? The challenge before IDs is to do their duty of care and be able to demonstrate the same through process and documentation that they have done so created, best practices shared. Templates for this need to be created, best practices shared. Who will do all this advocacy for talent, sensible discussion on risk and ways to demonstrate that they have been diligent? Required urgently: a classy body called Indian Institute of Corporate Governance which is an independent not for profit body promoted by MOCA, SEBI, the top 100 listed companies in India, larger investor protection entities,

and run by a professional management reporting to a professional board. Successful models of this exist already exist in India, and we know it can be made to work.

Attracting great talent also needs decent levels of remuneration. The law is far more generous in its remuneration limits for directors compensation than companies are. Investor activist groups, who object to ID remuneration must realize that quality directors, like quality management, come at a price. There hasn't been a systematic salary survey of Independent Directors (other than scrappy articles in newspapers or what individual 'celebrity' IDs earn) linking remuneration of IDs to profit of company, governance complexity index, work load and business complexity index. There are enough HR and talent consulting firms many of whom have a board practice, who can do this and must, in order to influence practice. To begin with they have to develop these constructs like governance complexity etc. and socialise them

A movement to get good people into the fold as IDs cannot come from ID training programs as I have discussed earlier. In fact all 'training' 'knowledge dissemination' and 'best practices dissemination should be done continuously in boardrooms, on the job. Every board should voluntarily have one collective knowledge session every quarter (like the better Auditors do to educate audit committees) on various aspects of the IDs job from how to conduct CEO evaluation to how to have excellent board composition to strategy challenging processes etc. Consulting firms claiming to have board practices must lead the way, for a fee of course. The cost of good governance needs to be an expense item that we start tracking and putting out in the public domain and in accounts. The P&L should contain a visible item 'cost of governance' and % of revenue spent on it.

What are the other challenges we face in strengthening the institution of independent directors? Two big ones are worthy of mention. One is promoter centric companies and our unwillingness in India to challenge the divine all-powerful rights of promoters, despite the significant public shareholding in their companies. And the second is the low will of IDs to exercise their rights.

The weakening of the ID institution starts with clubby boards or promoter appointed or management appointed "independent" directors. This aspect never gets discussed adequately. The new laws increase the risk of sins of omission and commission and the response is to villify the law. What we should be doing instead is using it to ensure that crony and clubby IDs are not appointed by nominations committee, given the risk attached to the whole board in the event of not doing its legally prescribed job well enough.

The second and related challenge to effective functioning of the institution of IDs is the IDs themselves. It is not surprising the amount of impediments IDs say that management / promoter chairmen/ CEOs put in the way of their functioning well. If IDs are appointed as

“independent” by these same people, there is obviously an impaired ability for them to function. However now there are so many provisions in the law and the listing agreement to empower IDs – and they should use it to perform their duty well. IDs today who say they have been prevented from doing their jobs are in effect saying “we don’t want to exercise our rights and risk getting kicked off this board”. In fact the new law now asks for reasons why someone is resigning so it makes sacking an ID that much harder. In this environment for IDs to get a sensible set of board processes implemented is not hard. The roadblock is perhaps the will to get it done. In today’s environment, the penalties may be high (which everyone discusses) but the empowerment by law and regulation is also high (not discussed at all). Now, by law, IDs have the majority or chairmanship in most committees and even on boards. The challenge is to use the power to effectively do their jobs. An Indian promoter CEO/MD is never or rarely evaluated by the board, and many remuneration committees do not have CEO and key management personnel evaluation as part of their process before approving pay increases. Its not due to lack of skills to do so, but lack of will it’s a cultural thing.

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It’s the same for strategy especially M&A, and performance monitoring. Nothing stops or has stopped the board from doing it before, except fear of promoter power or lack of larger purpose or mission.

The IDs job is not to mentor, cheer, coach, support or provide management consultancy or be the promoter appointed watch dog.

It is to supervise, ratify, approve, direct value creation and preservation and compliance with laws and ethics. A whole different lexicon. The challenge is for us to rise to the occasion and grab the opportunity that the law has given us and not complain or spook ourselves about how the new law will fill the jails with unsuspecting ID – lambs being led to the slaughter.

This is our country, lets change it for the better. As more people retire, fit and healthy at 60, there is more good but ‘idle’ talent floating around. Let management be young and boards be ‘old’ and even 60 years olds today have seen enough of technology and liberalization in their career span of the last 15 years to not be considered irrelevant.

Indian boards are still very promoter or power CEO centric. There are very, very few truly widely held and board governed companies where there is no management active shareholder who the board know hows go. Now, with all the new developments, the playing field is level today. IDs can and must seize the moment and strengthen and set new practices for the institution of IDs to perform far more effectively than ever before. It’s time to get rid of the overhang of issues and impediments of yesterday, and make efforts to build a strong ID institution for the future. WHY should anyone bother? Because its our ‘give back’ to our country, because its valuable and enriching learning and networking and because it’s a lot of fun too, and because it needs to be done.

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<sup>1</sup> Nishit Desai.com, New Directions, By Shinoj Koshy et al