

THE INSTITUTION OF INDEPENDENT DIRECTORS : SOME THOUGHTS

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Conceptually, nobody can deny the importance of independent directors for corporate governance. The Irani Committee recommendations have unwittingly lent some poignancy to the debate on independent directors. Whether independent directors should be half the number of the Board as mandated by SEBI or one-third its number as recommended by the Irani Committee seems to have caught the popular imagination. However, what seems to have been missed in this debate is the importance of independent directors and whether the nascent institution of independent directors is to be given a short shrift in the name of the emerging competition in Corporate India.

CORPORATE GOVERNANCE – A CASE OF FORM OVER SUBSTANCE

Corporate Governance as a way of business life is yet to take roots in this country. It is unfortunate that corporate governance regulation has taken on a strict form without any commensurate conviction on the part of the corporate leadership in this country. This unfortunate trend has resulted in the corporate governance regulations being followed as a mere ritual. Added to this, are the newfound competitive challenges which the corporate leadership is made wily nilly to face. In this state of flux, there is always a temptation to proclaim that entrepreneurs know best what is good for their companies. Independent directors neither have the time nor the inclination to appreciate the nuts and bolts of business to provide effective stewardship for corporate business. Independent directors are boardroom intruders to be tolerated for the sake of compliance with corporate governance regulation. Whether one would want to admit or not, this seems to be the reality. Nobody should be blamed for this. The Regulator is absolutely justified in framing strict corporate governance

regulations with a well-justified emphasis on the mechanism of independent directors. As of today, corporate leadership is also justified in not seeing any tangible business benefits in complying with corporate governance regulation in letter and spirit. Then, what is the real problem? The real problem to my mind is the apathy of major institutional investors in this country towards the view that good corporate governance practices would result in long term wealth creation. The major institutional investors in this country do not seem to exhibit the sensitivity expected of them as investors of public funds by demanding corporate transparency and accountability; they are also to a large extent driven by a speculative mindset to maximize profits on the stock markets even today speculation and insider trading seem to thrive. Unless this changes, independent directors would not be taken seriously for what they are really worth and independent directors would continue to be what largely they are today-independent by definition but not really independent in practice.

INDEPENDENT DIRECTORS – AS HARBINGERS OF SOFT POWER

This can change only if major institutional investors as investors of public funds do business by enthroning the highest principles of public accountability and transparency. To that extent, the Regulators should step-in and do a credible reality check on such investors. Once the major institutional investors are reined in, Corporate India would automatically be questioned by them on the standard of corporate governance actually practiced by respective companies. This in turn would have a multiplier effect on the market capitalization of companies. Once this happens Corporate Leadership would sit up and take notice. Corporate governance and the concomitant independent directors would no longer be boardroom

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intrusions but be harbingers of soft power and corporate wealth.

It is true that independent directors in Corporate India are by and large renowned retirees living in the past and carrying on with the present. This would soon change if companies were to seek out the best of independent directors in their prime, as a business need. Independent directors endowed with a rich mind and an independent disposition can bring out a much-needed transformation in boardrooms – Board meetings can become very effective strategy sessions rather than a meeting where form supersedes substance.

Corporate India is at a strategic inflexion point in this regard. Future competition is going to be based not only on hard factors of business but mainly on soft factors like corporate credibility and governance standards. That's where the independent directors come-in. Corporate India would do well to adopt a stiffer prescription on independent directors as a wise preparation for a challenging but a rewarding future.

INDEPENDENT DIRECTORS–AS BULWARKS AGAINST CORPORATE FRAUDS

Corporate frauds and scams greatly erode corporate wealth. Corporate India as a whole should have a vested interest in preventing and minimizing corporate frauds and scams. One of the effective tools for preventing and minimizing corporate frauds is to reinforce the institution of audit. One of the surest ways of reinforcing the institution of audit is through an effective oversight provided by audit committees. Independent directors on audit committees provide one of the best ways of reinforcing both internal audit and annual statutory audit. Thus, independent directors who are truly independent can be an effective bulwark against corporate frauds and scams. However, it should be quickly added here that independence alone without the necessary competence could hardly make for a good independent director. If Corporate India is serious about raising the bar on governance standards, it should appoint very competent independent directors after a thorough search, even a global search, if necessary. This brings us to the next question of appropriate remuneration for competent independent directors. The popular saying goes, “when you offer peanuts you get monkeys”. This is also true unfortunately when it comes to selecting independent directors. Unless an attractive

remuneration is paid, it is axiomatic to say that the best persons would not come forward to join the ranks of independent directors. It is again erroneous to say that attractiveness of remuneration would erode the independence of independent directors. It may happen in the short term. But if many large companies offer attractive remuneration for independent directors as a norm, competent independent directors being not a large number would be sought after by companies, without the need to stick to one company because of the attractiveness of the remuneration. Hence the question of compromising on one's independence does not arise for such competent independent directors.

In the prevailing era where the Indian economy is slowly but surely integrating with the global economy, the first hundred companies in India cannot ignore the need for globalize and global reach. It is true that business families today own quite a few of first hundred companies in India predominantly. It is not an exaggeration to say that such companies would have to grow at an exponential rate in order to acquire a global size and reach. For an exponential growth rate for such companies the capital requirements would be beyond the reach of the controlling families. Such companies would have to access necessarily both domestic and global capital markets for their capital needs. This can be done well only if the governance standards are quite high with very competent independent directors providing the much needed re-assurance of the same.

PROTECTING INDEPENDENT DIRECTORS

It is often said that being an independent director in India is like going in a raft with holes all over in the middle of the Atlantic Ocean. To my mind, this statement is not totally untrue. In case, the institution of independent directors is to be properly supported and nurtured, persons of high stature and calibre first should not have the psychological fear of the unknown before they decide to become an independent director of a Company. Providing statutory protection to independent directors is neither here nor there. This brings us to the question of how independent directors could be meaningfully protected from unknown pitfalls ? The revised clause 49 of the Listing Agreement with the Stock Exchanges while talking of the role of the Audit Committee mentions about the Audit Committee reviewing reports on legal

compliance. Taking a cue from this, companies could engage the services of reputed law firms to undertake independent legal due diligence exercise covering all legal and regulatory matters on a six monthly basis and the same could be reviewed by the Audit Committee. Once this is done, independent directors on the basis of expert legal due diligence having been conducted on the company on a regular basis, could claim immunity from prosecution, should it unfortunately happen. The famous statement of Law by the eminent jurist Buckley J in *Re : Duomatic Ltd., (1969) 1 All E.R. 161* is worth quoting here to reinforce the legal point that a director would be deemed to be acting reasonably in a matter when he seeks expert legal advice in that connection. This is what Buckley said : “In my judgment a director of a company dealing with a matter of this kind who does not seek any legal advice at all but elects to deal with the matter himself without a proper exploration of the considerations which contribute, or ought to contribute, to a decision

as to what should be done on the company’s behalf, cannot be said to act reasonably”.

If the Audit Committee were to initiate an expert independent due diligence on the company at regular intervals as the Audit Committee may think fit, non whole time directors especially independent directors can derive quite a bit of legal comfort from such an exercise. Companies would do well to recognize the strategic importance of such an exercise and to initiate the necessary processes in this regard.

CONCLUSION

It can be said that the sea bubbles scandal led to the great invention of the limited liability company. The corporate frauds of the twenty first century have resulted in the discovery of the institution of independent directors. For India to become an important economic power in the years to come, it is not wise to fritter away this discovery.