INDEPENDENT DIRECTORS – GATEKEEPERS OF CORPORATE GOVERNANCE

V BALAKRISHNAN*

In recent times, corporate India has witnessed a lot of discussion on the desirability and effectiveness of the role of independent directors. The recent enactment of regulations such as Clause 49 of the listing agreement with stock exchanges have enhanced the depth of the debate on the issue.

Traditionally, many of the Indian companies were owner managed and run as family concerns. The need for independent directors on the board was not felt as the performance expectations and interests of the owners and those of the investors appeared to be aligned. There was no battle of "me"(the owner) against "them" (the investor). However, this is not the case now. The reforms of 1991 opened India to the external world. The Indian markets and businesses are now clearly aligned with the global markets. Globalization is forcing companies to adopt global best practices in the area of corporate governance and requires them to clearly put a structure in place which will differentiate between private interests and public benefit. The corporate scandals in the developed countries brought in laser focus on governance issues. Corporate governance is no more a topic of mere debate, but one of the pre-requisites for any credible corporation. The ownership level of the corporation is no more a guiding factor to decide on the need for independent directors. An external view and oversight is considered necessary and an independent board conveys that comfort to the market.

A board that is independent of management can strengthen the effectiveness of the oversight function. This principle has been adopted in many of the corporate governance legislations introduced around the world. The rules seek to ensure the independence of directors and emphasize the need of such directors to be assertive about exercising their oversight authority in corporate decision-making. The role of independent directors have moved from a mere statutory requirement to one of an institution vested with crucial powers and responsibilities including enhanced oversight of the company's functioning, challenging managements as appropriate and helping shape the regulatory and other policies on the manner in which corporations are run. In short, independent directors have substantive responsibilities as the "investors' advocate" with emphasis on independent thinking, learned debate and objective focus on the needs and interests of the investing community. Many corporations have also appointed a lead independent director.

Independent directors have a very critical oversight function to discharge. The oversight function is very important in areas such as corporate governance, independent audits, director nominations, executive compensation and related party transactions. The independent directors are involved in overseeing the work of companies from the inside. This is in contrast to auditors and other external regulators who have an outsider's view of the company.

Regulatory regimes can never be as effective as active and inquisitive independent directors. Directors with their inside view can monitor new developments and troubleshoot problems when they arise. Independent directors should also ensure that they understand the operations of the company completely. They should have the ability to reconcile long term objectives and short term goals. Directors should also ensure that sufficient time is devoted to their duties as board members. It is very important that independent directors should not accept memberships on too many boards as they may not have sufficient time to effectively discharge their responsibilities. It should be remembered that the job of an independent director is not for the inattentive. It requires time, commitment and dedication. An informed and engaged board of directors can work towards protecting shareholder interests in an effective manner.

* *Company Secretary and Senior Vice President - Finance, Infosys Technologies Ltd.*

The independent directors can provide guidance for management's decisions and ensure a focus on the investors' interest over those of the management. The powers of independent directors are not merely persuasive. Statute bestows upon them the power of the vote which is much more effective than mere persuasive power of words. Independent directors are under no compulsion to vote in favour of management's positions merely because such approaches are convenient or because they lead to the path of least resistance. Wherever deviations are present, independent directors can and should ensure that boardroom activities are realigned for the larger interests of the stakeholders. Independent directors have a large role to play in the shaping of the board's agenda and decisions. They are in a position to direct the board's attention to matters which require detailed analysis and review. Independent directors can ensure that the tone and tenor of the board's discussions and decisions are in conformity with the stewardship function of the board and management. Board room discussion should be backed by data and decision should be taken after objective evaluation. Tough questions need to be asked to management and the independent directors should ensure that the answers are unambiguous and truthful. Independent directors need to stand up to management if necessary. They should never be a rubber stamp. They should review all information on the proposals provided to them and analyze the data to determine how the proposals can affect the interest of shareholders. They should also clinically analyze management's proposals to determine if there are any conflicts of interest between management, the company and its stakeholders. Independent directors should also conduct periodic executive sessions without management being present so that they can discuss and debate issues in an open and frank manner.

Corporate governance will continue to be the primary responsibility of independent directors. The actions of directors should be in conformity with their responsibility as true stewards of corporate accountability. The responsibility needs to be discharged without undue interference from the CEO or other members of management. Companies, management and directors should realize that compliance is not a check-the-box exercise. The spirit and not just the letter of the law should be followed. The actions of the independent directors should demonstrate ethics, integrity, honesty, and transparency.

Executive compensation is another area where leadership of independent directors is sought. While deciding on executive compensation, independent directors should discharge their fiduciary duty of dealing with shareholder funds. The focus should be on long-term performance. Performance measures should not be limited to profits and EPS, but should go beyond these and place emphasis on management excellence.

Independent directors can play a very important part in the area of compliance. They should play a watchdog role in the compliance area. Some boards have appointed a chief compliance officer to work under the independent directors. The chief compliance officer will have exclusive focus on compliance controls and procedures. Independent directors should also adopt code of ethics and require all key employees in the company to adhere to the same. Independent directors should also facilitate confidential and anonymous channels for employees to submit complaints about questionable practices in the company. These whistleblower hotlines are a very effective compliance tool as the independent directors are able to act in a proactive manner. Independent directors should also liaise with regulators and provide inputs on compliance challenges and emerging compliance issues. Early stage identification and tackling of potential issues will help everyone in adhering to the law and prevent such issues from becoming significant problems.

Rules and regulations alone cannot ensure that corporations are clean and honest. There should be an atmosphere of ethical conduct and a proper mind set to do the right thing. The independent directors have a great responsibility to create, preserve, and strengthen the ethical and moral fabric of the corporation.

In closing, independent directors should serve as independent watchdogs serving the interests of shareholders. Shareholders rely on independent directors to protect their interests, address conflicts of interest and to ensure that shareholders' wealth and the business is managed properly by management. However, the increased emphasis on the watchdog role of independent directors should not dilute their primary role of providing strategic guidance. The board should not be diluted into an operating committee interfering with day to day management decisions. A fine balance has to be arrived at between the oversight role of independent directors and the operational freedom of executive management.