INDEPENDENT DIRECTORS

Catalysts to Strong Corporate Governance

By Pavan Kumar Vijay
Founder – Corporate Professionals Group
**EVOLUTION OF THE CONCEPT OF INDEPENDENT DIRECTORS**

1990: Beginning of British Corporate Governance movement by Cadbury Committee Report.

1996: Constitution of Indian Industry (CII) task force on Corporate Governance which extensively debated the issue of Independent Directors.

1999: Constitution of the Kumar Manglam Birla Committee by SEBI to raise standards of Corporate Governance in India.

2000: Addition of Clause 49 on Corporate Governance in the listing agreement providing for mandatory appointment of Independent Directors.

2002: Naresh Chandra Committee and Narayan Murthy Committee by SEBI made further suggestions on the definition of Independent Directors.

2005: The J.J. Irani committee report constituted by MCA recommended the appointment of Independent Directors in unlisted companies.

2013: Companies Act, 2013 gave legislative stamp to the recommendations of the J.J. Irani Committee report.
IN INDIA, CORPORATE GOVERNANCE IS AN AGE OLD CONCEPT
Rig Veda ... 1500-1200 BC
Commitment to well-being and progress of all stakeholders is our age old mantra
“सत्यं वद धर्मं चर”
Satyam Vada Dharmam Chara

- Taittariya Upanishad
“Forever speak the truth and follow the dharma”
Truth: Disclosure of Actual State of Affairs (Transparency in operations and transactions)
Dharma : “Dharma is for the stability of society, the maintenance of social order and the general well-being and progress of humankind.”

- Karna Parva of the Mahabharata. Verse-58 in Chapter 69
GOVERNANCE CONCEPT IN ‘RAMAYANA’

To provide “the maximum happiness for the maximum number of people for the maximum period, based on the principles of Dharma – righteousness and moral values.”

- Ayodhya Kand
OBJECTIVE BEHIND THE CONCEPT OF INDEPENDENT DIRECTORS

1. Independent functioning of the Board

2. To protect the interest of minority Shareholders & other stakeholders of the Company

3. Independent monitoring of the company’s performance

4. To enhance the quality of Corporate Governance
COMPOSITION OF BOARD

Board of Directors

Promoter Directors

Controlled Decision Making

Lack of Independence

“Poor” Corporate Governance

Over-looking the interest of Minority Shareholders

Undue Advantage to Promoters

WHAT VACUUM THEY WANTED TO FULFILL?
STAKEHOLDERS EXPECTATIONS FROM INDEPENDENT DIRECTORS
Shareholders are not the only Stakeholders in Corporate Governance
STAKEHOLDERS’ STAKE IN CORPORATE GOVERNANCE VALUE CHAIN

- **Investors**: 1/3rd Investment
- **Lenders**: 2/3rd Investment
- **Customers**: 100% Earnings
- **Suppliers**: ½ of Working Capital
- **Employees**: 100% Value Generation
- **Government**: Basic Infrastructure & Facilities
- **Regulator**: Dispute Resolution

**2:1 Debt – Equity Ratio**

**2:1 Current Ratio**
STAKEHOLDERS IN VALUE CHAIN

ROLE OF STAKEHOLDERS

SUPPLIERS
- Supply Funds, Materials and Services

HUMAN RESOURCE
- Value Addition and Management of Resources
- Give Opportunity to Co. to Satisfy their Needs

CUSTOMERS
- Give Opportunity to Co. to Satisfy their Needs

EXPECTATIONS OF STAKEHOLDERS

PUBLIC
- Biological, Economic and Cultural Environment

PUBLIC EXPECTS PARTNERSHIP FOR SUSTAINABLE DEVELOPMENT
Enhanced Trust and Confidence of all Stakeholders
<table>
<thead>
<tr>
<th>Stakeholders</th>
<th>Expectations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investors/shareholders</td>
<td>IDs are expected to be independent from the management and act as trustees of shareholders.</td>
</tr>
<tr>
<td>Regulators</td>
<td>that the independent directors must institutionalize compliance with applicable laws/regulations, ensure timely &amp; complete disclosures and bring red-flags to the notice of Regulator</td>
</tr>
<tr>
<td>Board of Directors</td>
<td>that they should add value to the board discussions and act objectively in evaluation of various proposals.</td>
</tr>
<tr>
<td>Employees</td>
<td>that the independent directors should ensure that employees are treated as stakeholders in the decision making process.</td>
</tr>
<tr>
<td>Banks and Financial Institutions</td>
<td>It is expected that IDs must ensure that there is a timely and accurate flow of information to them.</td>
</tr>
<tr>
<td>Society</td>
<td>considering society as a stakeholder, the independent director should ensure that the company conducts its business responsibility taking due care of environment &amp; natural resources.</td>
</tr>
</tbody>
</table>
WHETHER THE INSTITUTION OF INDEPENDENT DIRECTORS ACHIEVED THE PURPOSE OR NOT?
WHETHER THE PURPOSE HAS BEEN ACHIEVED OR NOT?

Ingredients of Independent Directors

Independent + Expert + Devotion of Time = Effective Corporate Governance

BUT

• Those who are expert, have no time
• Those who have time, are not expert.
REALITY OF INDEPENDENCE

**Independent Directors**

- *Disinterested Director*
- *Uninterested Director*
## REALITY - APPOINTMENT OF INDEPENDENT DIRECTOR

### Compliance in Spirit

- **Disinterested Director**
  - Expert in a particular discipline.
  - Knowledge about the companies business.
  - Precedence to knowledge over names.
  - Capability to dissent.
  - Provides independent assessment of business decisions.
  - Informed decisions.

### Compliance in Letter

- **Uninterested Director**
  - Uninterested towards Company but Interested towards his own.
  - Not concerned with the Company’s business.
  - Precedence to name over knowledge.
  - Acts as per the whims of the management.
  - Silent observer at the meeting.
  - Decision on selective basis.
CONTROVERSIES SURROUNDING INDEPENDENT DIRECTORS

- **Satyam Computer Services Limited**: The Independent Directors completely failed to identify the huge financial irregularities in the Company.

- **IL & FS Ltd**: The Independent Directors are under lens on account of willful neglect and failure to stall or raise questions on the decisions of the Company.

- **Tata-Mistry Clash**: Mr. Nusli Wadia (Former Independent Director of Tata Group) was removed from the board by Tata's apparently for presenting an opinion contrary to the views of majority shareholders. After this dispute, the ease with which IDs can be removed as per the whims of the promoters, came into limelight.
CONTROVERSIES SURROUNDING INDEPENDENT DIRECTORS

- **Nagarjuna Finance Ltd.:** Arrest warrants were issued by the Andhra Pradesh govt. against the independent Directors of the company namely Mr. Nimesh Kampani, Mr. A.P. Kurian & Minoo Shroff for breach of trust in the alleged involvement of repayment of public deposits taken by the Company.

- **Fortis Healthcare Ltd.:** 4 independent directors were removed from the board of Fortis healthcare at the request of investors for not satisfactorily exercising their fiduciary duties towards the shareholders after alleged news of siphoning of funds by the Singh Brothers without the approval of Board.
PROCESS FOR APPOINTMENT OF AN INDEPENDENT DIRECTOR
Eligibility check as required under law (Inc. no. of maximum directorships)

Evaluation of desired candidate by Nomination committee.

Taking consent of the proposed director and initial disclosures.

Approval of appointment in the board meeting and necessary filings with the authorities.

Issuance of formal letter of appointment including terms & conditions.

Approval of shareholders by way of an ordinary resolution.

APPOINTMENT PROCESS
COMPOSITION OF BOARD

The Board shall have Atleast one Women Independent Director

Board of Directors

- Executive Chairperson/Non-Executive Promoter Chairperson
  - Atleast half should be Independent

- Non-Executive Chairperson
  - Atleast 1/3 should be Independent
DISCLOSURES AT THE TIME OF APPOINTMENT

Disclosure of Interest
In any other entity by way of shareholding or directorship along with the list of relatives.

Disclosure of Disqualification
Certificate of eligibility to be appointed as Director.

Disclosure of Independence
Certificate of eligibility to be appointed as Independent Director.

Disclosure under Insider Trading
Details of any shareholding in the Company.
CONTINUOUS AND EVENT BASED DISCLOSURES

- Disclosure of Interest: Any change in the interest in other entities.
- Compliance with Code of Conduct: Compliance Certificate with the code of conduct prescribed for Board of Directors and Senior Management.
- Disclosure of Disqualification: Eligibility Certificate to act as Director.
- Disclosure of Independence: Certificate of eligibility to be appointed as Independent Director.
SITTING FEES: for attending Board/Committee meetings shall not exceed Rs. 1,00,000/- per meeting.

Also IDs shall be entitled to reimbursement of expenses.

PAYMENT OF COMMISSION
Upto 1% of net profits.

Above 1%, special resolution is required.

Remuneration can be paid either by way of a monthly payment or a specified percentage.

IDs shall not be entitled to any stock options.

The company shall undertake Directors and Officers insurance for all the IDs.

The government is considering a proposal to limit the remuneration for independent directors upto 20% of his total income.
An ID may hold office for a term up to 5 consecutive years; For re-appointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report; shall not hold office for more than 2 consecutive terms (cooling period of 3 years for re-appointment); Independent Director shall not be liable to retire by rotation; and The re-appointment shall be on the basis of performance evaluation.

A person can be director in maximum 20 companies out of which maximum 10 can be public companies. With effect from April 01, 2019, a person shall not be a director in more than 8 listed entities. A person who is serving as a whole-time or managing director in any listed entity, shall not serve as an independent director in more than 3 listed entities.
An ID may resign from his office by giving notice in writing to the Board and thereafter notify the MCA/Stock exchanges giving detailed reasons of resignation along with a confirmation that there is no material reasons other than those provided.

The director who has resigned shall be liable even after his resignation for the offences/defaults, if any, occurred during his tenure.

An independent director may be removed before the expiry of his first term by passing a ordinary resolution. In case of removal in second term, special resolution shall be required.

An ID who resigns or is removed from the Board shall be replaced by a new ID within 3 months from the date of such resignation or removal.
At least 1 separate meeting of IDs in a year;
All IDs to strive to attend such meeting;
In the said meeting IDs shall:

- Review the performance of Non-ID’s and Board as whole;
- Review the performance of chairman of the company;
- Assess the quality, quantity and timeliness of flow of information b/w the Co. management and Board.

1. Whether ID should require to share the decisions taken in their meeting with the Board?
   Act is silent on the same, therefore, ID can decide on their own.

2. Whether Minutes of Separate Meeting need to be confirmed by the Board?
LIABILITIES OF INDEPENDENT DIRECTORS
Under the Companies Act, 2013, Directors are responsible under various provisions of the Companies Act, 2013 as officer in default;

An Independent Director can be treated as an officer in default only when he is aware of such contravention or where such contravention took place with his knowledge, consent or connivance;

Following acts shall be considered as deemed consent:
1. Participating in proceedings of Board or Committee without objecting on any matter;
2. Failure to object to any matter in the draft minutes of a meeting in which he didn’t participate;
Directors are also criminally liable in case of misleading statement in prospectus, failure to repay deposits or misrepresentation in statements filed with Authorities.

Apart from Companies Act, 2013, criminal liability also arises under Negotiable Instrument Act, Prevention of Money Laundering Act etc.

It is important to understand that failure to exercise duties carefully can subject ID to cases of criminal breach of trust by the shareholders.
JUDICIAL PRONOUNCEMENTS

IN RE: JAIPRAKASH ASSOCIATES LTD:
The Independent Directors along with the promoters were restrained from transferring, alienating or otherwise dealing with, or disposing of, any property and assets belonging to them in order to safeguard the interest of stakeholders.

IN RE: ZYLOG SYSTEM LTD.-
SEBI issued show cause notice of all the directors including IDs for non-payment of dividend after declaration.

IN RE: PYRAMID SAIMARA THEATRE LTD.-
SEBI restrained three independent directors to act as independent directors for two years on account of failure to prevent false and misleading statements.

IN RE: PUNJAB NATIONAL BANK LTD.
The NCLT freezed the assets of the independent directors of the company on account of failure by Nirav Modi and Mehul Choksi.
RESPONSIBILITIES & FUNCTIONS OF INDEPENDENT DIRECTORS

- **Responsibilities & Functions of Independent Director**
  - Acts both as a safeguard and a source of competitive advantage;
  - Help in bringing independent judgement on issues like strategy, key appointments, etc.;
  - Bring an objective view in performance evaluation of board & management;
  - Strive to attend all meetings of the members, Board of Directors and committees;
  - Determine appropriate levels of remuneration for ED’s, KMP & senior management;
  - Report concerns about unethical behavior, actual or suspended fraud or violation of company’s code of conduct or ethics policy; and
  - Calling for additional information where the accounts show less than the actual picture.
DUTIES OF INDEPENDENT DIRECTORS IN A MEETING

Duty as the Chairman of a Committee of Board

To finalize the agenda items which are ought to be discussed in the meeting and invite other members to give comments on draft minutes.

To be present at the General Meetings to answer to the queries of the shareholders.

Duty as the Member of a Committee of Board

To ensure that the statutory terms of reference are duly looked into by each committee.

To effectively contribute towards his role in committee.
CORE AREAS TO LOOK INTO
CORE AREAS THAT NEEDS YOUR ATTENTION

- Maximum time of ID’s is consumed in Board/Committee meetings. It is necessary that Board processes are effectively followed;
- Should recommend setting-up of Board/Committee calendar for the entire year to ensure full attendance;
- Should contribute in finalization of agenda of meetings, make sure that important issues are discussed in the meetings;
- Ensure that adequate agenda papers are circulated before the meeting;
- Seek information/MIS on various agenda items for adequate preparations;
- Willing to question the management to various issues related to the company; and
- Ensure that minutes reflects the true proceedings of meetings.
Promoters route funds in their companies through a structure of related party transactions ("RPT"); Need and importance of each RPT should be evaluated and then approved; Arm’s length pricing needs to be thoroughly examined; Always useful to check comparable quotes for RPT; and Threshold limits should be fixed for undertaking RPT.

Detection and prevention of fraud is assuming significant importance; ID shall ensure effective internal financial controls are implemented and regularly; evaluated by Third Party; Strong and independent Internal Audit team; and Deficiencies identified by Internal Audit Report are adequate addressed.
For Independent Directors:
- ID should be careful in discussing matters with Third Party specifically confidential information about the company or any of its group companies; and
- Not to trade in the shares of the Company or its listed subsidiaries without pre-clearance from the Compliance Officer.

For the Company:
- Timely disclosures are made on purchase of shares;
- Cases related to Insider Trading should be dealt with rigorously; and
- Effective safeguard are built to prevent mis-use of UPSI.

Insider Trading:

Vigil Mechanism:
- To ensure that the board has formulated a vigil mechanism for directors and employees to report genuine concerns.
- To ensure employees can report their genuine concerns without any fear
- Adequate protection is provided to whistle-blowers
Risk Management:

- Effective risk management policy is framed adopted;
- Risk are mapped and necessary precaution against them are adopted
- Regularly monitor implementation of policy.

Investor Grievance:

- Adequate mechanism to address the grievances of the shareholders
- Grievance are addressed in a time-bound manner
- Serious allegations related to fraud/siphoning should be thoroughly investigated
In wake of ILFS saga, it is important to continuously working of subsidiary & associate companies;
Minutes of Board meeting of group companies should be adequately looked into;
Utilization of loans and investment by Companies in group companies should be regularly evaluated;
Quarterly review of financial performance; and
Requirement of having too many subsidiaries/associates companies should also be questioned.
Review the performance of non-independent directors:

- Subject of Evaluation i.e. who is to be evaluated;
- Process of Evaluation including laying down of objectives and criteria to be adopted for evaluation of different persons;
- Feedback to the persons being evaluated;
- Action Plan based on the results of the evaluation process;
- Frequency of Board Evaluation;
- Responsibility of Board Evaluation and
- Review of the entire evaluation process periodically.
HOW TO STRENGTHEN THE BOARD PROCESS
The Secretarial Standard Board of ICSI is in the process of introducing a new initiative of **Structured Agendas** to be adopted by the Corporate Houses in India.

The concept of Structured Agenda aims at **standardization of diverse practices** with respect to preparation of Notice, Agenda, ATR, MIS and Minutes. This will eventually lead to quality and informed decision making essential for attaining the objectives of the company.

The **standard structure** will ensure **quality and adequacy of information**, ease of reading, ease of comprehension, Presentation of volume in a manner that vital information is highlighted, Depicting real financial health of the company and **automatic compliance with legal compliances**.
THANK YOU

CS PAVAN KUMAR VIJAY

Founder - Corporate Professionals Group
Chairman Core Group on Vision New ICSI 2022 &
Chairman, Secretarial Standards Board
Past President, ICSI,
E : pkvijay@indiacp.com
M : +91 9810032568