

INDEPENDENT DIRECTORS, KEY TO GOOD GOVERNANCE

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Abstract *The collapse of high profile large corporations such as Satyam, Enron etc. while performing the governance practices has raised many issues regarding good governance mechanism. The independent directors are one of the important mechanisms for the good governance practices in an organisation. In India two-third of the companies are family owned and therefore presence of independent directors on the board is very important to protect the rights of minority investors and other stakeholders. Independent directors with independent thoughts and action may lead to a constructive value addition for the firm. The present paper discusses the importance of independent directors on the board. The paper also shows a glimpse of the current picture of corporate structure and corporate governance in India. Though the role of independent director is most important to detect and prevent the unethical practices still it fails to perform their roles in many cases. This paper identifies and explains the drivers on reasons, why independent directors still fail to perform their fiduciary roles in many cases. Finally the article concludes based on the functioning of the independent directors and challenges for having an implementable code of conduct for them. The diverse opinion of the corporate experts, government bodies, and industry apex bodies is the need of the hour to make one that is easy to implement.*

Keywords *Independent Directors, Corporate- Governance, Stake Holders*

WHY INDEPENDENT DIRECTORS NEEDED ON THE BOARD

Economic crisis (2008) in America has raised many questions about the governance practices of the various corporate companies. World financial crisis and public pressure on private companies in specific areas were brought in critical aspects in corporate governance practices in most part of the world.

Increase in white collar crime suggests that even highly qualified representative may not provide assurance for good governance as they tend to trust and provide blind support to the promoters. Presence of independent directors on the board of the company plays vital role for the good corporate governance. It plays the very significant role in various corporate decision-making of the board like executive remuneration, audit function, merger-acquisition, succession planning, etc. All the listed companies need independent directors as corporate governance compliances.

In India more than 60 percent of the listed companies are promoter-driven companies; so it becomes more crucial to understand how they find independent director. Is it based on individual connects and judgments or based on nomination process and thoroughly analysis? Are they appointed for the specific purpose or only for the sake of governance formalities, merely to abide by the law in words but not in its true spirits?

The notion of independent director is to have truly independent persons of independent mind with required skills, experience, and knowledge who can challenge the actions/ decisions that are against the benefits of minority investors and other stakeholders.

PICTURE OF INDIAN CORPORATE

India is the country where the industries include lots of small and medium scale enterprises, listed/ unlisted limited liabilities companies, and global companies so it is difficult to have the common laws of corporate governance that can be applicable to all the firms. In India Clause 49 is applicable to the all the listed companies as a listing agreement while government provides additional voluntary compliance guidelines that can be followed by any corporate company. If any entity can not comply with the governance guidelines then they need to explain where/ why they are not complied and give the explanations for the same to the stakeholders.

In India, Ministry of Corporate Affairs (MCA) administers the basic acts i.e. Company Acts and other professional bodies like Institutes of Chartered Accountant, Institute of Cost Accountant, Company Secretary Acts, Limited Liabilities Partnership Act etc. Initially it was the department of the company affairs but after the series of corporate fraud in India and also in the overall world, it has come in light and has taken several initiatives to monitor the governance practices in company. Initially it was focusing on the structure of the company; now it realized the importance of corporate world. That is the reason now we have separate

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Ministry of Corporate Affairs which makes/ changes/ erases the required laws, rules and codes for the corporate.

In India promoters or promoter groups possess the large share holding and most of the management decisions are dominated by promoters. Therefore, the truly independent director should be independent from the promoters but in India more than 70 percent independent directors are appointed by the promoters and most of them are home directors. That is why the appointment of independent directors is very critical in India. Prime database on stats of independent director in India suggests that in India there are 6443 independent directors holding the positions on the board out of which 2213 belong to listed companies. Study shows that only 2.5 % women hold the position of independent directors. Statistical data reveal the few interesting observations like 198 directors are not even graduates, 3500 are graduates, and 245 are below the age of 35 and 18 are below 25 including 18 years. SEBI doesn't specify any qualification or experience to become independent directors on the board.

Listed companies are raising the funds from the public money so they must have independent director to protect the rights of minority investors and other stakeholders. Recently parliamentary standing committee has submitted the bill. It states that 2 percent of profit should be kept for the corporate social responsibilities and it would be applicable to the companies which meet certain criteria in terms of specific turnover, assets or profit for first three year etc. The notion of CSR is old in India but the law is new for the India corporate. Companies which generate the revenues from the community need to understand their ethic responsibilities to preserve and protect the community in term of CSR. CSR is not a charity but it is more than that because it creates positive brand image in mind of the stakeholders. So it is a win-win situation for all. If any company wants to exist in the market it has to earn the right existing in market and then it earns for the stakeholders.

WHO ARE INDEPENDENT DIRECTORS?

As mandated by Clause 49 (Section 2/45), the independent director of a company is a non-executive director who does not have any material relationships or transactions with the company, its promoters, senior management, holding company, subsidiaries, and associated companies. He may receive the remuneration of directors. He should not be directly or indirectly linked with companies as partner, supplier, vendor, or customer of the company. At the same time he should not have a substantial share holding of the company.

Higgs states that independent director is considered as independent when the board determines that the directors is independent in character and judgment and there are

no relationships or circumstances which could affect or appear to affect the director's judgment. Greater number of independent directors on board will result in improved firm performance (Padmini and Vasanthi, 2011) while powerful executive directors i.e. duality roles, promoter executive or executive being only the board manager would not have a detrimental effect on performance (John and Jackling, 2009). Sarkar and Sarkar (2009) concluded that the multiple directorship by independent directors is positively correlated to the firm performance but multiple directorship by inside directors is negatively correlated to the firm performance. Carter and Colin (2004) estimated that the time to be devoted by any outside director for a company varies from about 80 hours for a stable and satisfactory company situation and industry complexity to 320 hours for a challenging company situation and industry complexity where the board plays the role of pilot. Apart from the above Agrawal and Knoeber (1996) have found that greater proportions of outside directors has a negative impact on the performance of the firm i.e. high proportion outside directors may result in lower financial performance. Bhagat and Black (2002) had also found negative correlation among proportion of outside directors and corporate performance.

IMPORTANCE OF PRESENCE OF INDEPENDENT DIRECTORS ON THE BOARD

The role of board is to maximize the total value for the investors, customers, employees, government, society, and other stakeholders, for a company has to earn the revenues that is more than the expectations of the owners i.e. shareholders, then and then it can satisfy the need of other stakeholders. It is also known as the above average return i.e. returns more than the investors expected risk / return.

Role of independent directors is of two folds i.e. as a strategic advisor to the corporate and at the same time protecting the rights of minority shareholders and other stakeholders. As a strategic advisor he must have sufficient skills, experience, and knowledge to accelerate the growth of the company. He must have some academic experience so at least they can read and understand the financial terms and transactions. Shareholders should be assured that they are getting the best possible people to run their company.

They should provide the products and services more than the expectations of the customers i.e. worth more than the customer pays for it and provide the opportunities to the employee to be more productive in their job. The ultimate responsibilities of the independent directors are to monitor the company's business affairs and governance compliance with the laws, shareholder agreements, governing documents, and articles of the incorporation.

Independent directors play very important role while selecting, compensating, overseeing, and planning for the succession of the CEO. Failure in corporate governance is not only the issue of government or companies but it is really the issue of the public morality.

WHY THE INDEPENDENT DIRECTORS FAILS TO PERFORM THEIR ROLES?

There might be number of arguments for the role of independent directors at time of any financial fraud by a company. In most of the cases it is found that presence of independent directors fails to assure the roles given to them. Should we totally rely on independent directors for the good governance or laws, government ministry, regulatory body, industry apex body also need to do something. Following could be the probable reasons why independent directors fail to perform their roles and responsibilities.

- Independent directors may have limited roles in company affairs or may take limited interests in it.
- They may not be sufficient qualified to understand the financial terms and transactions.
- Enough time have not been given to discover anything from the report.
- They hold too many positions on different boards.
- They get handsome remuneration from the promoter so they may oversee the real picture.
- For a large corporate, independent directors may not be the primary or sufficient tool for insuring good governance.
- Legal standards may not be sufficient and powerful to prosecute the unethical governance practices.

ATTRIBUTES OF INDEPENDENT DIRECTORS

Though we may not have clearly attributed picture of independent directors, from the experience and suggestions from the corporate experts, government ministry initiatives, and apex bodies of the industry, the following attributes are expected in an independent directors.

- Willingness to devote the time in responsible manner to create the value for stakeholders.
- Commitment and dedication to the county and society as whole.
- They must continue to act like independent directors of independent mind. The decisions should not be taken like a de-facto employee of the company i.e. culprit in hands of promoter.

- Their role should not be limited to prevention, detection and reporting of the frauds/ wrong doings but also need to add value for the stakeholders.
- Must have ability to ask the hard questions and challenge the decisions of promoters when needed
- Ability to listen patiently, contribute valuable inputs, awareness of the industry, and available when needed.
- Creating, protecting, and sustaining the company's strategic vision.
- They should be constructive challengers. Instead of merely detecting the error and mistakes they must suggest appropriate solutions for the problems.
- Ensure the right balance among the individual, social, economic, and environmental interests.

CHALLENGES IN CODING ATTRIBUTES FOR INDEPENDENT DIRECTORS

Value creation involves vision, risk taking and complex trade-offs among a variety of different participants in the business enterprises of the firm. In order to maximize value, one should not only satisfy with the company values but ensure the support of all corporate stakeholders. The independent directors can play a crucial role in function through its vision and strategic leadership. A board may face following challenges while deciding the codes for the independent directors.

- Who will appoint the independent directors and what procedure needs to be followed for the same?
- How to ensure coordination between independent directors?
- Tenure of independent directors.
- Whether independent directors to be paid remuneration.
- Can any law prescribe attributes of ID?
- What is to be paid to whom (especially executive directors) and who is appointed to senior positions on what basis?
- Governance practices are beyond the rule of law.
- Difficult to have clearly articulated law because of wide spectrum of industry (large, small, global companies)
- Independent directors may be independent according the laws and the listing agreements but may not be independent in terms of thoughts and actions.
- Too much pressure on them can shrink the pull of ID for a board.
- Person of integrity will not sacrifice their pride, dignities, and reputation for the focus to being on some board i.e. that is not the attraction for them to become independent director.

CONCLUSION

Existing provisions are outdated. So the government has to come out with higher standards of corporate governance and need to prosecute the wrong doer i.e. people with the set of greed, who do not follow the ethics/ governance practices and misuse the money of investors. We need a powerful process to prosecute and punish them as it happened with Rajat Gupta in US. We also have the Stayam case for financial fraud but it is still pending for the final judgment.

Establishment of higher standards needs the collaborations, participations, and helping supports from the corporate and government. Ministry of corporate affairs has to work and participate with listed public limited companies to develop a successful model of corporate governance where businesses are based on the societal needs and professional to be less greedy. Business needs to live in harmony with society and environment and create win-win situations for their stakeholders.

Government can only provide an environment where good governance practices can take place. We also need to ensure that the investors should become the activist as Warrant Buffet used to say about Microsoft, 'Though Bill Gates is my closed friend and also I am having a good relationship with him, still I have not invested a single dollar in it because I don't understand the business of Microsoft.'

In the various corporate governance activities the government has to ensure the open and transparent reporting of self-compliance governance practices instead of becoming mere watchdog for the same.

The effectiveness of the board requires appropriate compositions of board members in terms of demographics, skills, expertise, experience, value system etc. Diversity in board safeguards against single minded group thinking. Independent directors should meet without promoter/management once in a year. They should not depend on the promoter on any reference. An Indian institution has to come in raw and make world class institutions that should provide the source of qualified moral scholar to the corporate.

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