

INDEPENDENT DIRECTORS

The concept of “independent directors” is new to India. It was first brought to India by the 1999 Kumar Mangalam Birla committee on corporate governance. Three years later, the Naresh Chandra committee gave governance more thought. Finally, in 2004 the Narayana Murthy Committee affected changes to Clause 49 of the listing agreement.

As it stands today, the existing company law has no mention of independent directors. The very purpose behind appointing independent directors is to put checks and balances on each and every activity of the company and bring independence, impartiality and wide experience; but independent directors cannot be expected to magically prevent scams from happening in a company.

It has been decided in Central Government vs. Sterling Holiday Resorts (India) Ltd. and Ors. that “the Board of directors should be strengthened by appointing independent directors.”

Clause 49 of SEBI’s listing agreement mandated the appointment of independent directors on the board of directors. Clause I, sub clause (ii) of annexure-1 of Clause 49 mandates that “where the chairman of the board is a non-executive director, at least 1/3rd of the board should comprise of independent directors and, in case the chairman of the board is an executive director, at least ½ of the board should comprise of independent directors”. However, there is no provision for their selection process or independence. There is also ambiguity in law about the qualifications of an independent director in the present company bill. At present we need laws which precisely define the roles, qualifications, functions, duties and responsibilities of an independent director.

The Companies Act does not have a definition of ‘independent directors’, though the definition of independent director as given in the recently-amended Clause 49 of listing agreement is an inclusive definition, which lays down who can be independent directors. Clause 49 of the listing agreements defines independent directors as follows:

“For the purpose of this clause the expression ‘independent directors’ means directors who apart from receiving director’s remuneration, do not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in judgment of the board may affect independence of judgment of the directors.”

An independent director is expected to act as a watchdog of the board and to protect the interests of shareholders. However, since they are handpicked by the promoters themselves, the directors are usually friends of the promoters rather than watch-dogs of the board. Though an independent director is paid by the company, it must be borne in mind that the company is not only owned by its promoters, but all shareholders, so they are supposed to represent the interests of the minority shareholders. There are circumstances where independent directors are not independent, which broadly includes:-

1. their selection procedure
2. no age limit
3. no specific qualification required
4. no right to interfere in the day-to-day operations
5. no time-limit for replacement of an independent director

Independent directors are still the only hope of instilling discipline in the murky world of corporate finance, provided their independence is not being compromised. If they are not independent, then their appointment in a company will be meaningless. This position deserves to be corrected by empowering SEBI and the Indian government.

Independent directors, with their rich experience, are a very powerful part of a company; they play a vital role in securing the interests of shareholders as well as being expected to give inputs for the benefit of management. To secure the independence of an independent director, there is a need to break the nexus between the independent directors and promoters who sponsor them. To do so, the nomination of an independent director must be made by SEBI and the government.