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Role of Independent Directors in Corporate Governance

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ABSTRACT

For an extensive period of time Independent Directors have been considered as an important pillar of Corporate Governance in the Companies. Their primary function is to bring an independent and unbiased perspective to the board in order to manage the interests of the shareholder and the management of the company. This research article focuses on the concept of the independent directors, its evolution and its significance and relevance in the contemporary legal corporate structure. This article also focuses on the concept of the corporate governance, its origin, and the meaning that it has acquired in today's time. With a focus on the roles and responsibilities of the independent directors per se and their involvement in ensuring that the corporate functions prudently and runs its business legitimately while conforming to the rules and regulations that govern its working.

Keywords*: Independent Directors, Corporate Governance, Supervision, Independence, Companies Act 2013.*

I. INTRODUCTION

Companies involve a wide range of individuals, including shareholders, stakeholders, creditors, managers, directors, auditors, and so on. When these individuals have strong interests in the company, the company's main goal is to maximize profits, and top management will be responsible for ensuring that this happens so that everyone who has an interest in the company is satisfied. A major part of corporate governance is that it offers the structure for managing, directing, controlling, and administering businesses. "Corporate governance involves a set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined" (OECD, 2015). The four pillars of corporate governance are disclosure, accountability, integrity, and transparency. It is accurate to state that a firm that upholds a high degree of transparency will have the confidence of its stakeholders, shareholders, and creditors, all of which are beneficial to the business over the long term.

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One of the most important components of a nation's corporate governance standards is an independent board of directors for publicly traded corporations. In corporate governance, board independence has grown so important that it is practically required. Because of this, recent governance reform has placed a greater emphasis on independent directors' accountability and ability to promote higher governance standards.[2] By serving as a liaison between the majority and minority shareholders, as well as between the proprietor and the owner of the business, independent directors can lower agency costs between these parties and ensure that the company's decisions align with the interests of its investors. Knowing the impact of independent directors on corporate governance is crucial, and corporate governance would benefit much if we can prioritize the independent directors' functional role. It is important to first comprehend how independent directors operate in order to talk about their function in sound corporate governance.

(A) Who are Independent Directors?

The International Finance Corporation (IFC)[3] states that an independent director must to meet a set of basic standards. It stipulates that only those who have not worked for the corporation or any of its affiliated companies for the five years prior to the appointment date may be considered for such positions. Additionally, they must to be unaffiliated with any business that the firm relies on as a consultant, advisor, major supplier, or customer. In an ideal world, independent directors wouldn't work as executives for a different company where any of the executives sit on the board of directors or be related to someone who works or has worked as an executive officer for the company for the previous five years.

Similar directions for the nomination of IDs have also been released by the Securities and Exchange Board (SEBI) in India. According to SEBI[4], "independent directors" are non-executive directors who, aside from receiving the director's compensation, have no significant financial ties to the company, its promoter, its directors, senior management, or any other alliances that might compromise their independence. They cannot be connected to the company's promoters, executives, or those who held managerial roles at the board or a level below it over the previous three fiscal years.

The Companies Act of 2013 places a strong emphasis on independent directors under section

[2] Donald C. Clarke, *Setting the record straight: Three concepts of the Independent director*, SSRN Electronic Journal (2006).
[3] IFC indicative independent director definition, https://www.ifc.org/content/dam/ifc/doc/2023/IFC-Indicative-Independent-Director-Definition-062719.pdf (last visited Jul 28, 2024).
[4] SECURITIES AND EXCHANGE BOARD OF INDIA (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015.

149(4), which states that every publicly traded company must have at least one-third of its total number of directors serve as independent directors. However, this provision does not directly address the CEO duality, which is the most frequently occurring issue in corporate governance.[5]

II. Corporate governance in India

The term "protection for minority shareholders" was frequently used to refer to corporate governance, which is a different topic. Even those who are aware of the concept of corporate governance frequently confuse American theory with current practice. A Few Basic Meanings of Corporate Governance "The ways in which lenders to corporations ensure that they will receive a return on their investment are the subject of corporate governance."[6] At first, shareholder authority over management served as the cornerstone of corporate governance. There were not many shareholders, but those who did exist were near enough to the board of directors to have some influence. Indeed, it is still the case in a number of smaller, closely held businesses throughout the globe. However, there are a few of sizable businesses with sizable shareholder bases (Reliance Industries Ltd, for example).

The "Companies Act 2013" mandates that independent directors be appointed to all listed public companies. Section 149(6) discusses what constitutes an independent director. As per section 149(7), each independent director is expected to declare their independence as needed. Section 149 (8) specifies the rule of conduct for independent directors and professional behaviour. The selection process for independent directors is outlined in Section 150(1). An Independent Director may be reappointed under section 149 (10), although his term of office is limited to five years. given that such an independent director may not occupy the post for more than two terms in a row and may be reappointed as an independent director after an interval of three years after the job's termination.

III. The necessity of corporate governance

1. Investors who invest in any firm won't even be able to get a decent night's sleep unless they learn that the company has sound corporate governance and that it has all the information they need. The company will be able to draw in investors from all around the world with excellent corporate governance.

[5] The Companies Act, 2013, $ 149(4), No. 18, Acts of Parliament, 2013 (India), available at https://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf.
[6] Andrei Shleifer & Robert W. Vishny, A Survey of Corporate Governance, 52 J. Fin. 737 (1997).

2. Upholding openness is a fundamental tenet of corporate governance. The more openness the organization maintains in its financial and auditing processes, the fewer malpractices, frauds, and other misdeeds will occur.
3. The two main components of corporate governance are accountability and transparency. It will be simple for the business to instill confidence and expectations in stakeholders if it can keep those essential components in place. Because senior management will be acting with good intentions, corporate governance will lower the company's risk.

IV. Independent directors and corporate governance

In the company's board of directors, a director's duties include guiding management's decisions to optimize shareholder wealth and ensuring that the interests of shareholders are protected. A crucial element in the independent and objective performance of the board that underpins the achievement of these goals is the makeup of the board. However, the analysis of the literature showed that the overwhelming shareholding of promoters, inadequate openness and disclosure in board procedures, and other factors make the board of directors unable to safeguard the interests of the shareholders. Independent members should make up the makeup of the board to guarantee smooth and appropriate operation of the board. Additional evidence indicates that board independence and Company performance is correlated in that an independent board with superior Corporate transparency policies raise investors' interest in the firm enhanced company reputation, thus augmenting improved interest of stakeholders in the Corporation.

The concept and intent of corporate governance are still uncontested, and this is especially true when considering the function of independent directors. In general, the IDs fit within the corporate governance framework. Their appointment is to guarantee an efficient and well-rounded board. It is indisputable that the board of directors (BoDs) is the most important tool for ensuring corporate governance compliance, and its oversight is crucial. By actively criticizing the formulation of policy choices and initiatives, the IDs support the board. Furthermore, they guarantee responsibility by closely examining the management's performance. Their independence enables individuals to do these activities more quickly since it prevents them from having any affiliations that can skew their judgment. [7]

Ensuring corporate governance may draw significant cash for business operations and that all business transactions are equitable and transparent to all parties involved, which in turn draws

[7] Manu Sharma, Role of Independent Directors in Corporate Governance, 16 SUPREMO AMICUS 198 (2020)

investors and guarantees that the firm has a strong board of directors. The board's independence is essential to ensure that it performs its duties with objectivity and keeps management responsible to the corporation. The custom in many legal systems suggests that having independent directors is a solution to that.

The existence of sizable family-owned companies has created grave risks to accountability and transparency, leading to harsh criticism of the Indian corporate sector's history of lax corporate governance compliance. Historically, family members have held a significant stake in the majority of these businesses and have not felt motivated to provide the independent directors with enough information. The independent directors found it difficult to maintain accountability and openness, particularly since they attended relatively few annual meetings that were primarily ceremonial in nature.

Because of this, independent directors in huge corporate structures—many of which were conglomerates with a wide range of assets and interests—were unable to properly understand the matters before the board or to be held accountable. This may be compared to the more effective western businesses, where independent directors are seen as partners in the management team and as the company's "outside guardians,"[8] whose duty it is to ensure that the management never loses sight of producing value for the shareholders.

V. TATA SONS CASE

The decision to depose Mr. Cyrus Mistry as chairman of Tata Sons has provoked controversy and put the Tata family's reputation for moral leadership in India Inc. in jeopardy. The independent directors on the board of IHCL (Indian Hotels Company Limited) have all endorsed Mr. Mistry. Due to the collaborative responsibility of boards, Mr. Mistry and the independent directors have equal liability for any mismanagement. According to Mr. Cyrus, legacy problems and hotspots are the root source of all crises. What circumstances led the independent directors of Tata Chemicals and IHCL to back Mr. Mistry? Are they able to obtain the truth? The greatest corporate governance standards were incorporated in the corporate structure of the Tata Group, which was led by Mr. J. R. D. Tata for about 50 years and by Mr. Ratan Tata for more than 20 years. Mr. Mistry deliberately disrupted this long-standing corporate structure by designating himself as the only Tata Sons representation on the boards of Tata operating entities. It's important to remember that when their employment expires, all Tata employees are required to swiftly resign from any Tata corporations in which they serve

[8] See Jitendra Singh, Mike Useem & Harbir Singh, Corporate Governance in India: Is an Independent Director a Guardian or a Burden, Feb. 2007.

as non-executive directors under the Governance Guidelines Framework, which Mr. Mistry himself created in 2015.

Thus, in accordance with his own directives, Mr. Mistry ought to have quit from every other board of directors as soon as he resigned from his position as Executive Chairman of Tata Sons. However, he has chosen not to do so, blatantly violating the Governance Guidelines Framework.

(A) Satyam Fiasco

The largest accounting fraud in corporate India history, B. Ramalinga Raju admitted to a Rs. 7,000 crore balance sheet fraud eight years ago. He had kept the information hidden from the board, staff, and auditors of the IT company for several years. The fraud was dubbed India's Enron, a reference to the American energy company that failed due to a massive accounting scandal. It exposed several concerning facts regarding the shortcomings of the nation's corporate governance regulations. Satyam, the fourth-largest company in the country with high-profile clients and the recipient of multiple corporate awards, including the coveted Golden Peacock Award for global excellence in corporate accounting, has become embroiled in the largest scam in the country just months after being named India's IT jewel.

It has shocked business circles in India and hurt the company's standing among investors. A number of shortcomings in corporate governance processes were highlighted by the hoax, including unethical behaviour, dishonest accounting, the questionable function of auditors, an incompetent board, the lack of independent directors, and the inability to disclose shares that were pledged.

VI. CONCLUSION

In the broad scheme of things, independent directors may be necessary to achieve the goals of corporate governance. Given that India's economy is expanding and that businesses are receiving previously unheard-of levels of funding from both domestic and foreign sources, this is all the more alluring. As the Indian business sector grows, there is an increasing expectation that it would follow stricter corporate governance guidelines in a transparent manner for its shareholders. They owe their investors a fiduciary obligation, which cannot be waived by just proving there has been no fraud or bad faith. Rather, affirmative action is required in such a partnership**.**

The study found that a board's ability to increase firm efficiency increases with its level of independence. Because they really represent the interests of all investors, even minor owners, and have no actual stake in the firm, they aid in the smooth operation of the corporation.

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