Crafting the role of independent Directors: Opportunities and Challenges under the new Companies Act, 2013

Report Submitted by

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Contents

Abstract 4
1. Introduction 5
2. Independent directors and Corporate Governance (CG) 8
3. Regulatory environment 12
4. Data and analysis 18
4.1 Data 18
4.2 Analysis of the Interview 20
i. Pre-Boarding preparation 21
ii. On Boarding (At the time of joining) & engagement 21
iii. Voice of the independent director 22
6. Discussion 28
6.1 Insights from interview 28
6.2 Enhancing the role of IDs 30
i. Confidence, Credibility, and Contribution 30
ii. Independence and Obligation: 31
iii. Development of Critical Skills 31
iv. Expectations from the Company's 33
v. Policy consideration 34
7. Conclusion 36
Reference 38
Annexures 41
Annexure 1: 41
Annexure 2 42

Abstract

Independent directors play an important role in ensuring good corporate governance in companies. However, in recent years multiple questions have been raised about their effectiveness in monitoring and supervising management. The spate of corporate scandals and the massive resignations of independent directors have further raised concerns.

This study critically examines independent directors' roles, responsibilities, and duties. The paper identifies and elaborates on the critical challenges Independent Directors face while executing their roles, duties and responsibilities. The report also makes specific policy recommendations to enhance their function.

1. Introduction

Several corporate scandals in the recent past, including that of Enron WorldCom, Satyam IL&FS, YES Bank, and others, have questioned the role of the Board and, more significantly, the role of independent directors in corporate governance. What is more worrisome is that a mechanism for ensuring good governance, ie. Independent directors (IDs) are under pressure and are facing several challenges today. A recent article in the popular press indicated that 316 independent directors exited from companies during the financial year 2019,[1] which "*reflects a growing trust deficit in India Inc, and the threat of liability prevents"* many capable individuals from accepting board positions. More importantly, it is not only the liability but the reputational risk they must face in case of fraud or other misdemeanours perpetuated by the management. A growing concern is that IDs may be held responsible for operational matters that are not part of their duties, which may ultimately result in the breakdown of the governance mechanism.

The institution of the corporate Board (hereafter referred to as the Board) is founded on the basis that a group of trustworthy people should look after the interests of the shareholders and a broader stakeholder community. Traditionally, boards consisted of promoters, executives, representatives of interest groups (such as lenders and institutional investors), and a few others who were not connected financially to the company. Having executives on the Board created conflicts resulting in agency problems. One way to alleviate this problem was to appoint independent directors who were not associated with the business's day-to-day operations and could influence and monitor the managers.

In many countries, independent directors are mandated by law as part of good governance. In the USA, requiring independent directors was attributed to i) the need for better monitoring of management, ii) increasing the reliability of the firm's decision-making, and iii) the shift towards stakeholder focus (Gordon, 2007). Gordon (2007) also reported an increase in the IDs in the Board from 5% to 75% between 1950 and 2005 in the USA. The rules related to IDs in the US were further strengthened by tightening the appointment criteria, increasing the liability, particularly those related to violation of fiduciary duties, introducing the concept of a lead director and developing the idea of committees such as audit committees, nomination committee, etc. (Gordon, 2007). Independent directors' role broadly includes improving

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[1] https://economictimes.indiatimes.com/news/company/corporate-trends/more-independent-directors-take-the-exit-fearing-legal-scrutiny/articleshow/69883746.cms accessed 22/1/191

corporate credibility, governance standards, and the company's risk management. They are expected to bring accountability to the board process and take an unbiased view of the decisions. The growing importance of their roles cannot be underestimated, mainly when there is a need to protect minority shareholders. In recent years, however, IDs as a mechanism of good governance have been under attack worldwide, and their effectiveness is being questioned (Balasubramanian, 2019, Mohanty and Mishra, 2018).

In the Indian context, the Companies Act 2013 and Clause 49 of the listing agreement mandate independent directors (IDs) for companies. The Companies Act 2013 (hereinafter "Act") has brought in some significant reforms in corporate governance concerning the Board and the independent directors. In the Act, the sections related to the role, duties, liabilities, and removal of directors are well articulated. The role and responsibilities of the IDs are mainly laid down in Sections 149, 177, 178 and 135. The "Code for Independent Directors", given in the Schedule IV of the Act, elaborates the guidelines for professional conduct, their role and functions and duties in an elaborate manner. IDs are expected to bring independent judgment and value addition to the decision-making process, evaluate the performance of the Board and the management, and safeguard the interest of the minority shareholders and all stakeholders. Such an explicit recognition of the role of independent directors is central to strengthening the corporate governance in the listed companies. While the Code of conduct has articulated its duties and responsibilities, several questions have been raised regarding its effective implementation.

Sceptics believe that the "independent directors cannot play their role effectively in raising the quality of corporate governance on the ground and that it was unrealistic to expect them to protect the interest of minority shareholders. The argument stems from the fact that companies in India have concentrated ownership. Companies in India, including listed companies, have concentrated ownerships, where the majority of shares are being held or indirectly controlled by one large group of shareholders (Indian Family, Government, and Foreign Investor), which we can term as controlling shareholders. Thus, these majority shareholders operate, manage, and control the companies.

Further, the controlling shareholders (because of their shareholding) exercise great power, including appointing board members and IDs (Varottil, U, 2010). Although domestic institutional investors and the public have an ownership stake, their involvement in management is limited. Public shareholding percentages are less, and they are dispersed. Even collectively, they would not be able to influence or change the decisions of the majority shareholders.

The majority shareholders directly or indirectly control the company's management and operations. Therefore, it become necessary for the regulators to intervene and ensure that the companies have people on the Board to protect the interest of the minority shareholder and other stakeholders.

A more balanced view would be the positive role the directors can play within the organisations in creating systems and processes that better strengthen their oversight and fiduciary roles. With the concentrated ownership in Indian companies, there is a need for a deeper understanding of how IDs can be effective on boards.

Given the above discourse, this study contributes to the literature by examining whether the provisions of Schedule IV and the Act provide a framework for strengthening the role of independent directors. Secondly, understand the mechanisms available for organisations and the directors to enhance the spirit of the Act and, thereby, corporate governance in organisations.

This research addresses the following questions:

- What are the existing theories, literature and benefits of having IDs on Board?
- What are the roles, responsibilities, and duties of independent directors' (IDs), as envisaged in the Act?
- Do the provisions of Schedule IV of the Act provide a framework for strengthening the role of independent directors? Do the IDs face any challenges?
- Are there mechanisms available for organisations and directors to strengthen the spirit of the Act and, thereby, good corporate governance in an organisation? Are there any best practices that can be adopted?
- What policy recommendations can be made to strengthen the role of IDs?

To answer the above questions, we use a mixed-design approach to address the research questions. We first review the existing literature globally and in the Indian context. We use secondary analysis based on the annual report and other published material on the implications of Schedule IV and the Act. We conduct in-depth interviews to understand and identify the challenges faced by the IDs. The interviews are also meant to identify best practices adopted by some companies that can be followed to perform the role better.

The rest of the report is organised as follows. In section 2, we discuss the regulatory provisions of the Companies Act 2013, with a specific focus on independent directors. In section 3, we discuss the role of IDs in corporate governance. In Section 4, we discuss the

challenges in the Indian context. The following section discusses the data and methodology. In Section 6, we analyse the interviews and discuss the challenges. In the last section, we conclude.

2. Independent directors and Corporate Governance (CG)

Today businesses are complex and large, requiring huge capital, eliciting the need for managerial expertise and supervision. This meant the appointment of professional managers to manage and operate businesses. The shift from a traditional owner-run business to manager-run organisations with lesser and lesser involvement of shareholders (for day-to-day operations) tends to create agency problems (Fama and Jensen, 1983).

The agency problem arises due to managerial goal incongruence with that of the shareholders. Adam Smith (1976) identified the agency problem as one where the managers "managing other people's money" cannot be expected to take care of the resources the same way if it is their own money. The agency problem is quite accentuated when there is dispersed ownership (with millions of shareholders), and no individual or group can influence the company's affairs. The conflict of interest between the managers and the shareholders assumes several forms, such as managers pursuing unprofitable ventures, and paying themselves high remuneration, thereby incurring agency costs. In this context, the concept of the Board of Directors evolved.

The Board of directors in a company are appointed by the shareholders and is entrusted with the task of monitoring the managers and, in a larger sense overseeing the organisation. The Board has a fiduciary responsibility to act in the best interest of the shareholders and the company. While board-level governance is an interesting proposition, the moot question is what would be the composition of the Board of directors. Traditionally, the Board consisted of the company's senior executives and representatives from specific stakeholders. The executives on the Board can make decisions as they are involved in the company's day-to-day affairs. However, this may result in an inherent bias or conflicts in decision-making that may impair their judgment. Moreover, the rent-seeking behaviour of the executives may be detrimental to the interest of the shareholders and the company. Therefore, there was a need seen for independent directors on the Board.

ID's bring in outside perspective and have no material financial relationships that may impair their judgement on matters relating to the company and its shareholders. These directors can challenge management, including the CEO. The best example of the strength of independent directors is that of Apple, where the Board sacked the then CEO, Steve Jobs, despite being the

promoter of Apple. Having IDs is not just a requirement of law. IDs are expected to provide leadership and strategic guidance, objective judgement independent of management and exercise control (monitor) over the company while remaining accountable to the shareholders at all times. Beyond the fiduciary duty, the Board's role can broadly be divided into the following aspects: i. Strategy formulation and performance monitoring ii. Have an oversight on risk management and Internal control iii. Improve transparency and disclosure iv. Protect the interest of the minority shareholders and v. Others, including establishing a value framework.

There are several benefits of appointing IDs. Prior research has found that IDs are suitable for the company as they have significant experience and expertise that will positively impact the firm's performance and valuation (Duchin et al., 2010). Studies have also found that the composition of the Board and independent directors also affect shareholders' wealth (Daily and Dalton, 1992; Beasley, 1996). However, personal attributes such as a degree or professional experience of independent directors had no association with the performance of the business (Grace et al. 1995). Singh and Delios (2017) find that firms with more independent directors on the Board will follow growth strategies in domestic and international markets. Choi, Park and Yoo (2007) examine the valuation impact of outside independent directors in Korea. The researchers found that independent directors positively affect valuation; however, it also depended on the board composition and the nature of the markets in which it operated. A study by Dah et al. (2012) finds that IDs affected the firm value positively after the Sarbanes Oxley Act of 2002. In the Indian context, an earlier study showed that IDs had a positive effect on financial variables such as return on equity and return on assets (Dadhich and Arora, 2019)

Studies have been undertaken to understand the existence of independent directors and firms' financial statement manipulation (earnings management). Chen Cheng and Wag (2015), show that ID's have a monitoring effect on earnings management, provided the cost of information acquisition is lower. Researchers have also examined the benefits of independent directors in committees such as the audit and nomination committees (Cyert et al., 1997; Shivdasani and Yermack, 1999; Latham, 1999; Carcello and Neal, 2000). Patelli & Prencipe (2007) examined independent directors and organisational transparency. Using data from 175 Italian non-financial listed firms, the researchers examine the role of IDs in transparency (as measured through the disclosure index) in the presence of dominant shareholders. The authors find independent directors' have a positive effect on disclosures and in mitigating agency

costs. Studies by Petra (2007) and Ferreira et al. (2011) find a positive relationship between the quality of accounting and transparency and the proportion of independent directors.
In the Indian context, firm performance is positively correlated to multiple directorships of independent directors in contrast to the existing western literature (Sarkar and Sarkar, 2009). A study by Dadhich and Arora (2019) showed that IDs positively affected financial variables such as return on equity and return on assets. Theoretically, there are several benefits of having independent directors, but empirically, there is no significant evidence to explain their role in directors' compensation, CEO turnover or adding value to shareholders and performance in some cases (Adams et al. 2010, Crespí-Cladera and Pascual-Fuster 2014)

An obstacle in appointing competent IDs is the threat of a lawsuit, reputational risk, and other liabilities the position may bring about. Directors' liability is regulated under the Companies Act, SEBI regulation and other statutes. These laws set out specific requirements for corporate governance and impose penalties for violations. Generally, corporate rules set out the duties and responsibilities of directors and provide a framework for holding directors. A study by Brochet and Srinivasan (2014), in the US class action suit context, shows that about 11% of the IDs are named as defendants, mainly if they are part of the audit committee. The reputational risk is so high that they may lose out on other directorial positions they hold (Srinivasan S (2005); Fich and Shivdasani, 2007).

So far, the discussion revolved around ownership structures such as in the USA and UK, characterised by dispersed shareholding, with a no-known promoter or family holding, and the block holders are usually institutional investors. In the Indian context, and for that matter, in most parts of the world (other than the USA and UK and a handful of other countries), ownership is concentrated, and business groups or family ownerships are highly prevalent. The concentration of ownership in India can be classified into (i) Indian Promoter ownership,
(ii) Government or state ownership and (iii) Foreign ownership, ie. A subsidiary of a multinational company. In all these cases, power is concentrated in the hands of a few, which brings in governance challenges as to how independent directors are selected and how they function on boards. Bebchuk and Hamdani (2017) argue that how IDs are appointed in practice significantly weakens their oversight responsibilities and may toe the line of controlling shareholders. Transporting independent directors as a once size fits all mechanism for better governance without understanding the institutional and corporate structure may be futile.

Concentrated ownership leads to a different kind of agency problem termed a principal-principal governance problem. The principal-principal problem arises between the controlling and minority shareholders (Dharwadkar et al., 2000). Young et al. (2008) state that the governance problem in emerging economies causing grave concern results from "*concentrated ownership, extensive family ownership and control, business group structures, and weak legal protection of minority shareholders. Such principal–principal conflicts alter the dynamics of the corporate governance process and, in turn, require remedies different from those that deal with the principal-agent problem."*

In the absence of good governance mechanisms, including poor legal enforcement, inadequate protection of the minority shareholders, and very few external deterrents (threat of takeover), the problem between the controlling shareholders and the minority shareholders will result in the expropriation of the minority shareholders by the majority shareholders (La Porta et al., 2000; Morck et al., 2005; Young et al., 2008).

Such expropriation or entrenchment by controlling families results in tunnelling through related party transactions (purchasing supplies and materials at above-market prices or selling products and services at below-market prices), giving loans and other resources at less than the market rate and engaging in strategies that is beneficial to the family or for self-interest (Khanna and Rivkin, 2001; Chang and Hong, 2000, Bertrand and Mullainathan (2002). Using a novel data set from China, where board disclosure of board dissent is mandated, Ma and Khanna (2015) find that independent directors generally support management as they feel obliged to be appointed to the Board. They dissent only when they quit the board position or when the Chair who appointed them quits. This also indicates that there are Board dynamics involved. Where the controlling shareholders have enough voting rights, they not only influence and control the Board but also get any outcomes approved through the general shareholder meetings, even if the Board fails to support them. Similar challenges exist when the controlling shareholder is government; the IDs are expected to follow the government's dictates in many areas (e.g., declaring dividends or subsidising the prices) even if they are publicly listed companies. Similar issues may persist when the controlling owners are foreign entities. A suitable governance mechanism must be in place to prevent such expropriation and the onus envisaged by the regulators lies with the independent directors. In all such cases, extrapolating to India, a governance mechanism suited to the USA & UK where the legal and

other factors are different may produce different and suboptimal results. Minority shareholders do not have much voting power as they do not have enough controlling shares, nor are there robust systems such as class action suits through which they can discipline the dominant shareholder.

To conclude, IDs have a crucial role in good corporate governance. In a company where the Board is represented by the executive or family directors, IDs genuinely represent the interest of minority shareholders and other stakeholders.

3. Regulatory environment

This section briefly discusses the regulatory background of IDs in India. Indian listed companies must comply with the requirements specified in the Companies Act, 2013 and SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015. The Companies Act of 1956 did not define or specify the appointment of independent directors. Though the IDs were part of the Board, their role and importance were first recognised by the Irani Committee in their company reforms. The report observed that IDs bring objectivity and independence to the board process and protect the minority shareholders (J J Irani Committee Report, 2005). The concept of IDs was introduced in the Act of 2013. The Act of 2013 has several sections that deal with the appointment of IDs, minimum number of IDs, tenure, re- appointment and cooling off period between re-appointment, Code for independent directors, duties and liability of independent directors. SEBI regulation mandated the appointment of ID for listed companies much earlier.

Appointment of IDs

As per Section 149 (4) of the Companies Act 2013, every listed public company shall have at least one-third of the total number of directors as independent directors. Unlisted public companies need to appoint a minimum of two independent directors if they satisfy the following criteria: (i) they have a paid-up share capital of Rs. 10 crores or more, or (b) having a turnover of Rs. 100 crore rupees or more; or (c) have a total outstanding loans, debentures and deposits exceeding fifty crore rupees.

Section 149(6) defines an independent director as a "director who does not hold any material or pecuniary relationship with the company or its promoters, its directors, its holding or subsidiary companies." Additional provisions for independent directors are similar to the SEBI regulation and are included in Annexure 1. The independent director holds office for a

term of up to five consecutive years. They can be re-appointed by passing a special resolution, but no independent director can hold office for more than two consecutive terms. The provisions for the retirement of directors by rotation do not apply to independent directors. The Code for independent directors is given in Annexure 2

The Securities and Exchange Board of India issued SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. Here, under Sec. 16 (1)(b) "independent director" is defined as a non-executive director other than a nominee director of the listed entity:

(i) who, in the opinion of the Board of directors, is a person of integrity and possesses relevant expertise and experience;

(ii) who is or was not a promoter of the listed entity or its holding, subsidiary or associate company [2][or member of the promoter group of the listed entity];

(iii) who is not related to promoters or directors in the listed entity, its holding, subsidiary or associate company];

(iv) who, apart from receiving the director's remuneration, has or had no material pecuniary relationship with the listed entity, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

(v) none of whose relatives has or had pecuniary relationship or transaction with the listed entity, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. Or more of its gross turnover or total income or fifty lakh rupees or a such higher amount as may be prescribed from time to time, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(vi) *who, neither himself nor whose relative*(s) —

(A) holds or has held the position of key managerial personnel or is or has been an employee of the listed entity or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

(B) is or has been an employee or proprietor or a partner in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of —

(1) a firm of auditors or company secretaries in practice or cost auditors of the listed entity or its holding, subsidiary or associate company; or

[2] Inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1.10.2018.

(2) any legal or consulting firm that has or had any transaction with the listed entity, its holding, subsidiary or associate company amounting to ten per cent or more of the gross turnover of such firm;

(C) holds together with his relatives two per cent or more of the total voting power of the listed entity; or

(D)is a chief executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent or more of its receipts or corpus from the listed entity, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent or more of the total voting power of the listed entity;

(E) is a material supplier, service provider or customer or a lessor or lessee of the listed entity;

(vii) who is not less than 21 years of age

(viii) who is not a non-independent director of another company on the Board of which any non-independent director of the listed entity is an independent director

The above definition is quite exhaustive and includes the recent amendments. People appointed as IDs must not have any material financial or monetary interest or receive any incentive that may compromise their independence. Though the law does define the term independent director, what truly makes one independent is the "*independence of thought,"* which is the ability to evaluate situations and objectively take a decision. This implies that a person making a decision is not influenced by the consequences of its impact on oneself, positively or negatively, i.e. it is not based on self-interest.

The shareholders appoint all directors, including IDs. They can be appointed for five years initially and another five years for a second term. Further, new rules notified on 22 October 2019 require independent directors to pass a test to demonstrate their knowledge and proficiency in certain areas for board-level functioning. They need to score certain minimum marks on the test to qualify. There are some exceptions available to this rule.

Independent directors are also mandated in certain board committees. The Act requires at least three directors on the audit committee with a majority of independent directors. In the SEBI (LODR) Regulations, at least two-thirds of the members must be IDs, with the Chairperson as an independent director. The committee members must be financially literate, and at least one should be an accounting or financial management expert. To have a transparent, independent, unbiased approach of the company towards its social responsibility, the Companies Act requires at least one independent director to form part of the CSR committee (Sec 135 of the Act).

We briefly discuss the regulatory requirement on (i) Duties related to independent directors, (ii) Liability of independent directors & (iii) Remuneration for Independent directors

The Companies Act also mandated that listed companies or every public company with a paid-up capital of Rs. 100 crore or more or a turnover of Rs 300 crore or more to have one woman director.

Duties of the IDs

Unlike the earlier Companies Act, of 1956, the new Act explicitly states the duties and responsibilities of the directors, including independent directors. Section 166 of the Act specifies that a company director shall abide by the Articles of Association of the company. Further the, they shall act in good faith to promote the objectives of the company. Other provisions of the section state that a director shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment. They shall be not involve in a situation in which he may have a direct or indirect interest that conflicts. Further, a director shall not assign his office to another.

All directors, including independent directors, must act in good faith and in the best interest of the company, its shareholder's employees, the community and the environment. i.e. directors of a company have a fiduciary duty irrespective of the type of directorship. Fiduciary duty has been interpreted by courts and academicians to include: Duty of care, duty of loyalty and disclosure or candour (Black,2001). The duty of care would mean to attend meetings and be aware of any decisions being taken and its impact. They should have a questioning mind and seek expert advice wherever required. Directors must read and understand the financial statements, must be familiar with the business and the industry. The duty of loyalty is to act in the best interest of the company rather than their own personal interest. Here the interested directors must leave the decision making to other directors.

An uniform fiduciary duty has been challenged on several grounds. Gelter and Helleringer (2015), argue that directors have to take into account several stakeholders and sometimes conflicting ones. The differences can arises because of the constituency they represent when they are appointed. For example when directors are government appointees. They are supposed to act in the best interest of the company, but they also are bound by the influence exerted by the appointer.

Schedule IV of the Companies Act (see Annexure 1) gives the duties of the IDs.
The general responsibilities include updating skills and knowledge, attending, and conducting meetings, ensuring their concerns are recorded correctly in the minutes and reporting any fraud or other unethical practices in the company. The duties include proper deliberations of items related to related party transactions as well. In recent years the Boards duties have become more complicated. Businesses today are complex arising form globalisation, technological advancement, and new age issues such as cyber security risk etc. Further, a fundamental shift in value creation is coming not from tangible assets but from human resource, innovation and customer centricity has made the directors role even more difficult. In such a situation the scope of directors duties has expanded and many IDs are also seeking more clarity on how to carry out their duties. Being on Board is no longer a luxury and IDs have to spend more time and effort in fulfilling their duties.

Liability of IDs

The general principle is that all directors are collectively liable, unlike shareholders with limited liability. Directors are exposed to several liabilities due to the breach of their fiduciary duty and other duties specified in the Companies Act. For example, liabilities can arise when "materially false statements" are made, or knowingly material facts are omitted in any return, financial statements, prospectus, or other documents. The Act imposes unlimited personal liability for fraud. Directors are also treated as "officers in default" and are subject to fines or other actions by both SEBI and the stock exchange. Directors' liabilities can be either civil liability or, in some cases, criminal liability, resulting in monetary fines and even imprisonment. IDs are also subject to the same provisions as any other director on the Board. However, recognising their limited access to information or involvement in day-to-day operations, the Act limits the liability of IDs to only those "*acts of omission or commission by a company which had occurred with his knowledge, attributable through board processes, and with his consent or connivance or where he had not acted diligently*. (Section 149 (12))" IDs are not held liable for their decisions under the safe harbour protection of the "business judgement rule."
Many other laws hold directors directly liable under their respective regulations (e.g., cheque bouncing under the Negotiable instruments Act), and there is no safe harbour clause. As a result, IDs may face financial fines and reputational harm from violations which may not be because of them. Section 177 (1) of the Act casts responsibility on the independent directors

to review auditors' independency, approve related party transactions, etc. IDs would have to be vigilant else there would be liability under the said provisions as well.

A recent amendment, The Companies (Amendment) Act, 2019 that came into effect on July 31, 2019 has brought some additional changes to the liabilities of directors including IDs. The amended Section 212. provides that in case of an investigation by the Serious Fraud Investigation Office, any director, key managerial personnel, other officer of the company or any other person or entity who has taken an undue advantage, whether in form of any asset, property or cash or in any other manner, the Central Government may file an application before the Tribunal or appropriate orders with regard to disgorgement of such asset, property or cash and also for holding such director, key managerial personnel, other officer or any other person liable personally without any limitation of liability. Now the scope of Section 212 has been widened and has attempted to include any person that would also include IDs under the purview of this provision.

Remuneration of Independent directors

Over the last decade the role and responsibilities of directors have significantly increased, while the number of meeting may still be the same, the average time spent by the directors going through the agenda and additional responsibilities such as internal controls, risk management and regulatory compliances increased the time spent. The Act provides for the following remuneration.

IDs cab be paid a sitting fee subject to a maximum of Rs 100,000 per meeting attended. Sitting fees can also be paid for subcommittees. IDs and other directors who are not Managing directors, a commission of up to 1% of the net profits of the company can be paid if there is a managing director/whole-time director and up to 3% of the net profit if there is no managing director subject to other conditions/approvals (second proviso to Section 197(1) of the Act. Bank and public sector directors cannot be paid commission. IDs cannot be compensated with stock options.

A survey large companies show that sitting fees ranged from Rupees twenty five thousand to a lack of rupees including fees paid for attending sub-committee meetings. Some companies did not pay sitting fee, but paid profit linked remuneration /commission as permitted under the Act. Are the remuneration provided to IDS including the sitting fees adequate, given the work and time spent on the agenda items. In the US, IDs are paid remuneration based on the

responsibilities. A audit committee chair and a lead director are paid additional remuneration (Is there a need for periodic revision at least to take care of inflation? If so, how can that be determined?

To conclude, the Companies Act 2013 and SEBI regulations have taken steps to strengthen governance regulation related to independent directors. However, is that adequate? Are there any emerging best practices that take place within the organisations and are not known and can have better impact than regulations ? In the next we section we seek the answer to these questions

4. Data and analysis

4.1 Data

In this research, we use a semi-structured approach to interviews, to understand the challenges faced by IDs, and to discuss not only the what of the questions but also placed importance to explanations and solutions to deal with some of the issues. The respondents contacted held independent director positions in various listed companies. A total of fifty Independent Directors were contacted, and thirty-nine interviews were finally completed. A questionnaire was developed after reviewing existing literature on Board role and governance. We also discussed the questions with academia and industry professionals with experience in this area. We ran a few pilot tests, and after few iterations with academia and industry professionals to refine the questions. Detailed notes were taken during the interviews. To avoid low fidelity, we also recorded the interviews wherever permitted. Each interview was comprehensive and took about ninety minutes to two hours. The interviews were later transcribed to ensure no data was lost. The questionnaire, notes and recordings were used for preparing the analysis. Each of the questions were summarised into different topics based on the original design. Open ended questions and additional information was summarised towards the end.

Secondary data for the research was collected from two sources. The larger data on directors was collected from the CMIE Prowess database. Additional data was collected from the NSE Infobase database. The directors interviewed came from more than one industry and are summarised in Table 1. Some of the board members held more than one board position; hence, the number is more than 39.

Table 1: Industry in which the Independent Directors served

Sectors	Number
Banks	4
Financial Institutions (Insurance, Mutual Funds, Asset Management, market infrastructure intermediary)	14
Infrastructure	2
Services (Retail, Logistics, Garments, HR etc.)	3
IT/ITES	8
Manufacturing (Chemicals, Electronics, Foods)	16
Consumer products (Health and hygiene, Accessories etc.)	4
Total	51

Source: *Hand-collected data from NSE Infobase and other sources*

Of the sample, 43% of the IDs had less than three years of experience. The challenges faced by young IDs will help us understand the challenges better. The summary of experiences is given in Table 2

Table 2: Summary Years of Experience as IDs

Years of Experience	No. of Directors
Less than 3	17
4-10	12
Above ten years	10

Source: Hand-collected data from NSE Infobase and other sources

Of the sample, around 25% were women directors. The gender distribution is given in Table 3

Table 3: Gender of IDs

Gender	Number
Male	31
Female	8
Total	39

Source: Data sample

We collected additional remuneration and sitting fee data from 462 large non-financial companies in BSE. Data was collected for the year 2018-2019. We find that some companies do not pay sitting fees but pay remuneration (commission) only. In contrast, some companies do not pay any remuneration but pay only sitting fees. Summary statistics are given in Table 4 below. Sitting fees may include all fees, including those for sub-committees.

Table 4: Details of Sitting fees and commission

	Sitting Fees	Remuneration/ Commission
Minimum	No fees /10000*	No Remuneration**
Maximum	Rs. 36 lakhs	Rs. 3.15 crore

Source: NSE Infobase

*Lowest amount paid NIL ** Reasons also will include no profits made.

4.2 Analysis of the Interview

The questions ranged from their basic experience, the number of boards they served, their challenges, and suggestions for crafting their role better. Initial questions particularly with more experienced IDs also related to the changing nature of their roles. The structured questionnaire and interviews had thirty-six questions. Some answers lead to more questions, both clarificatory and elaboration.

The questions captured the following:

(i) Pre-Boarding preparation

(ii) On-boarding (at the time of joining)

(iii) Voice of the Independent director & continuous engagement

(iv) Others including challenges.

(v) Suggestions for enhancing the role of independent directors.

Analysis

Initial questions were related to the changing role of the Board over the last decade. The response included factors such as globalisation, changes in technology, more regulatory compliance, related party transactions, oversight of risks, slow but steady rise of shareholder activism in India and the failure of companies has led to greater responsibilities over time.

Some IDs mentioned that, some of their colleagues were focused on short term perspectives, and did not think long term. The respondents stated that their duties were defined (in the Companies Act, 2013), and companies also expected more. Their role in the committees such as audit Committee and others ensured more accountability and engagement with the company. Their role has changed from a mere spectator or a reviewer to more strategic and monitoring role. Further, they are now required to move beyond the shareholders to a larger stakeholder context, including Corporate Social Responsibility (CSR).

i. Pre-Boarding preparation

IDs identified how they were selected for the positions. Primarily these were through
(i) recommendations by someone in their network, (ii) some association /engagement with the company earlier, (iii). they were selected from the director's database (iv). Government search panel and recommendation (v) others. Some IDs were interviewed for the role and had reference checks before joining. Most IDs of public sector enterprise board/Bank ID position was mainly contacted through controlling shareholders.

The considerations for joining the Board were industry familiarity, a perception that they would be able to add value to the discussion, and the prestige associated with the position. Due diligence was an essential part of accepting the role of ID. Some directors familiar with the company (due to the prior association) readily accepted the appointment. Most other directors did their due diligence before joining the Board. Some of the elements they examined were i. existing regulatory violations, including SEBI notices and data from the stock exchange ii. The integrity of the promoters iii. Cultural fit iv. Prior knowledge of the promoter v. meeting with other board members vi. Information from other companies in the industry vii. Speaking to the directors who quit

ii. On Boarding (At the time of joining) & engagement

Though IDs became familiar with the company after they joined, it was still necessary for the company to conduct an induction program for these directors. An induction program is helpful as it gives more detailed information about the company, which otherwise would take a long time to collate. This program will help create an understanding of the business and its markets; it builds a link with the organisation and its people.

From the interviews, we found that 40% of the IDs did not have any formal induction or did not attend one. Large companies conducted induction programs (60% of the IDs underwent an introduction program). The induction program involves a set of reading material, financial statements, a visit to the factory, or the site locations. The company also makes a presentation to disseminate information related to business, its market & industry environment, and the processes followed within the company on internal control. For State-owned enterprises, the Department of Public Enterprises sends the IDs for training to prestigious institutes. The company's CEO, CFO, and some senior executives spent some time with the IDs.

In some organisations, IDs were also trained periodically on various aspects of business, such as finance, cybersecurity, risk management, and compliance. IDs can better understand the implications of certain transactions and would be able to monitor the company better with additional training. Presentations were made to the directors when there was a change in law or other significant aspects related to the industry. A few IDs stated that companies did not favour training due to its high cost.

To summarise: There is a need to have a formal induction program by the companies as a best practice. It will also be helpful to have a continuous professional development program.

iii. Voice of the independent director

The following summarises the interview on board meetings and IDs role. Independent directors interviewed had attended all the meetings. In case they were not physically present, they participated through video conferencing. Though video conferencing is acceptable by law, there were technical issues and challenges (such as getting disconnected, being unable to hear, lacking a microphone, etc.); hence physical presence was better. A calendar of meetings was usually prepared and informed to all directors.

The Companies Act specifies procedures related to the conduct of meetings, including the notice period. Usually, companies don't violate these rules and send the agenda before the due date. Some companies have given electronic devices to the directors, and all documents are uploaded onto the same. IDs claimed that seven days is an adequate notice period for preparation. Though, sometimes companies sent the agenda papers only three days before the meeting, not giving enough time for preparation. IDs also stated that what was not on the agenda and intentionally left out was a cause for concern. Sometimes unpublished price- sensitive information, related party transactions, and others were tabled only at the meeting.

On being asked about the readability of the documents and the information provided, the directors stated the following:

- The documents prepared were clear and comprehensive. In case of doubt, they would seek more information from the company.
- Sometimes there was information overload. Each agenda item could go up to 60 or more pages making it difficult to go through in seven days.
- Often, urgent and most important things are taken up first that needs a little more deliberation (which is a good practice).
- Some IDs felt that important information might be hidden; therefore, they needed to dig out the same.
- Management also anticipates the questions that might come up at the meeting, and answers to these questions were prepared and sent as a presentation. This saves time, and quality time is spent on more relevant parts of the agenda.
- Most IDs mentioned that they were comfortable with the proceedings in the meeting. They brought in their expertise while discussing matters.
- Many IDs stated that strategy-related topics were usually discussed in a separate meeting for 2 or 3 days, which included management presentations to the Board. This practice was absent in a few companies. The Board also spent time discussing future direction. IDs have a vital role to play in strategy formulation. Questioning key assumptions, projections, outlooks, and risks will help get better clarity. Implementation of the strategy is left to the management. IDs stated that operational matters (project-based industry or banking industry) were also included in some board meetings as they directly impacted compliance and performance and were thus unavoidable. IDs faced a few dilemmas. For example, where does the Board draw a line on Strategic matters? How far can they get involved with operations?
- An Independent Director on the Board of a large organisation shared that different Board meetings had a different focus depending on the time of the year and in alignment with milestones such as Appraisals, Results etc.
- Some IDs experienced discomfort when the information was not fully available. They stated that it "wa*s like a time bomb waiting to burst. You never know when the same decision could lead to a big disaster. You are not seeing the big picture*."[3]

[3] Statements in Italics are quotes from the interviews.

- A few IDs felt that not enough was being discussed about the future, and only the past was analysed. Though most IDs acknowledged their role as supervisory, for a few, it included mentoring senior management.

IDs were also part of the CSR committee, audit committee, and other committees & hence, they relied on the other members to go in-depth and give the necessary information.

Are Independent directors being heard at the meeting? How do they contribute during the deliberations? What are the challenges?

One of the critical challenges for IDs was contributing to the board meeting, particularly during a discussion when there were conflicting views vis-à-vis the controlling shareholders. Bebchuk and Hamdani (2017) articulate that how IDs are selected, elected, and retained by the controlling shareholders will affect how the IDs react in the meetings. They posit that the IDs may side with the controlling shareholders in case of conflict and thus may not be able to protect the interest of the minority shareholders.

Board decisions are collective decisions. They are unanimous and are explained and resolved if any concerns exist. The biggest challenge in the board meeting is for controlling shareholder-driven companies (both private and public sector undertakings). In such cases, decision-making is highly influenced by what the promoter /controlling shareholder decides. -
- A few IDs observed that in India, the boards are mainly driven by the controlling shareholders and hence difficult to dissent. Some IDs also thought the company had done a favour by appointing them independent directors and felt they "have some obligation to the controlling shareholders."

- "*Nowadays, board members are very receptive, including the promoters. The idea is not to manage the Board, but to ensure they can perform their roles better."* IDs believed that the meetings were conducted very professionally and issues were deliberated upon. Dissenting was rare, though a few unresolved problems exist.

- Dissent can also be recorded in the minutes specifically. For example, one ID stated, "in ca*se of an acquisition, the dissent was recorded with his name (later, the decision proved to be correct when the approving authority did not permit the merger)."*

- On a few occasions, the management felt that ID's who dissent create an obstacle. When the administration had a different perspective, it was difficult to debate the issue.

-One of the IDs mentioned that they did not get the answer unless they asked the right and pointed question, and on a few occasions management tended to avoid giving an accurate picture.

-Management tended to overstate the opportunity and sometimes understate the risks in the new project/acquisitions. Asking the right questions helps get clarity.

-After the meeting, minutes are prepared and circulated. Some IDs mentioned that the *"Minutes are recorded in a faceless way. We cannot make out who said what and who agreed or disagreed. In 90% of cases, there is no voting and recording of a specific person's dissent. Five years later, if someone reads the minutes, you cannot determine who agreed and dissented*." Though specific deliberations are not recorded, the final decision is recorded.

- One common theme emerged: the independent directors found it more comfortable to take up contentious matters one-on-one with the Chairman rather than raising queries during the board meeting. They felt this was a more effective way to deal with conflicts. The Chairman has a very important role to play on how the meetings were conducted, how decisions were made, and encouraging and ensuring the involvement of all Directors. IDs stated that the *Chairman's role is critical as they created an environment of transparency where all the board members were encouraged to speak and contribute to the discussion*. Theoretically, all directors are equal, but because of experience or other factors, some may feel more important than others. Some IDs indicated that younger IDs are bogged down by dominant colleagues whenever there is a difference of opinion.

A few IDs requested independent assessments and additional data for decision-making.

-Issues in the public sector undertaking are different, where government appointees have no constraint on dissent, but they must tow the line of the government. In some cases, where a bureaucrat is the Chairperson, and a person junior to them is on the Board, there may be an issue due to the chain of command.

-In most cases, IDs did not meet or discuss before the meeting without executive members.

Continuous Engagement:

- IDs met a few management team members depending on the need. While a few others met and interacted with senior management if they wanted more information or data.
- Some IDs reported interacting directly with other managers, while many did not.

- In one of the companies, there was a mentorship program wherein the board members mentored some senior leaders.
- Some IDs went the extra mile to get more information about the company and get themselves updated. In contrast, others occupied elsewhere or had their own /businesses and found it difficult to do beyond the minimum.
- IDs had difficulty managing both their job as well as a board position and were not able to do justice to the role\
- Some companies had special sessions for ID's related to the macroeconomic scenario and other aspects.
- Most boards held strategy meets where management presented the company strategy to IDs. When the strategy and plans are presented, they evaluate whether it is in the shareholder's interest and endorse accordingly.
- Independent Directors restrict their role to oversight, carefully drawing the line and not getting involved in operations.

Others:

Some of the other aspects of their roles are discussed next:

- Financial statement, Frauds & Controls

"*The audit committee is the most important as they thoroughly scrutinise the organisation's financials. Further, they also get to see the auditor's presentation and the management representation on any questions or qualifications raised by the auditor.*" One major lacuna faced by IDs was understanding the financial statement from a manipulation perspective. Most IDs felt that this was the weakest aspect of their board role. The standard view was that they depended highly on the audit committee for their input. Most directors also meet with auditors without the executive management being present.

- Certain IDs mentioned that "*they have to have trust the CEO, and the auditor of the company and depend on their integrity*" and that "*finding any manipulation or even fraud would be difficult*." Greater responsibility must be placed on the audit committee as they monitor the internal controls and risk management.
- IDs of public sector companies mentioned that *"Liability aspects are not very important for a PSU board member because of three levels of check that happen. There is an internal audit,*

statutory audit, the CAG Audit (Comptroller and Auditor General), and the parliamentary committee. So there are multiple levels of checks and balances."

They pointed out that *"it is almost impossible to know everything about the company. You must be confident that the company is following the law in letter and spirit. You must reassure yourself based on the systems and processes they follow, the people managing it, and their reputation*."

-IDs were aware of the laws related to the Companies Act and SEBI rules. In case necessary, they also sought inputs from the Company Secretary.

Remuneration of Independent Directors

One of the contentious issues was board remuneration. There was a wide variation in responses regarding whether the compensation was adequate and could be increased without any conflict of interest.

-Some IDS felt that the sitting fees were sufficient if the amount received was one lakh per meeting, while others thought that the sitting fees (in the absence of other remuneration) were quite inadequate for the kind of effort and risk taken.

-Companies that paid higher remuneration also expected a lot from the IDs. Banks and PSU paid relatively less with no commission component. "*Public Sector Remuneration is very low. Even if they double, it will make no difference. People take up the role for prestige. A standard format or prescription cannot be applied to every company."*

-Many Independent directors expressed that remuneration should not be just the time or effort but must be compensated for the risk. Some said that mandatory limits should not be applied and companies should make provisions for paying some commission at least. Some IDs felt that the concept of 'adequate' remuneration is purely subjective based on your estimation of the work you put in. This is not a full-time role, and independent directors have to decide how much time to devote to the role vis-a-vis the responsibility.

-Most IDs were apprehensive about risks, particularly reputation risks. *Howsoever transparent and well-meaning the organisation may be, ultimately, management handles the operations. If there is mismanagement, board members may not be informed about this*. The more significant challenge was the reputation risk when the company indulges in fraud, and "*they get questioned on how they failed to prevent the occurrence."* These situations are very

challenging for Independent Directors. *You need to be clear on what sort of company's Board you may want to be associated with.*

Understanding the business's financials was difficult in case the IDs did not have a finance background. The audit committee has information about the audit, internal controls, risk management, related party transactions, etc. For this reason, the IDs rely heavily on the audit committee and the auditors to ensure the accuracy of financial information. The CEO's integrity and trust in the top management are a general necessity for IDs to function confidently. Many IDs indicated: *trust is very essential in an relationship. We need to have confidence, that the management is transparent.*

In the next section, we discuss and summarise the findings.

6. Discussion

In the earlier section, we examined specific challenges faced by the IDs, from their invitation to join the Board until their cessation. How the IDs overcame these challenges are discussed next, followed by suggestions for best practices.

6.1 Insights from interview

The IDs took the following steps before joining the company. Some of these are practical insights for the new IDs. [4]

- *KYC: Knowing the company you are joining, Understanding the industry they operate in, and reading all news about the company and the industry are basic requirements before joining.*
- *Meeting with board members and the company's senior leaders is essential while considering the invitation.*
- *Due Diligence: For regulatory violations, one must go through various reports and the SEBI website. In particular, review the latest financial statements, audit reports, credit ratings, news reports, regulators' actions, etc*
- *Do a background check of the management.*
- *One needs to be mindful that Indian family-run businesses have their style of functioning and have a lot of influence on the Board. In comparison, those owned by the government*

[4] Statements in Italics are quotes from the interviews

will have "governmental pressure or influence" for certain decisions. In multinational corporations, the parent company's standards on ethics and other compliance-based requirement are high, and the local companies have to adhere to the global policies of the head office.

- *Independent directors should have expertise and qualification in some functional area and business experience. Experience working at a senior level (CEO, CFO) or as an entrepreneur helps get a rounded view of the business. Domain expertise is an advantage.*

IDs gave the following advice for continuous engagement with the company and their role

- *Keep up-to-date information about the company; talk to experts if IDs cannot fully understand the business. Duty of care includes reading the agenda, attending meetings and getting explanations from functional directors and senior management. Knowing the company apart from ID's operational area of expertise is essential.*
- *The IDs need not feel obligated to the company or the promoters for their appointment.*
- *There are always softer signals when there is smoke first, and IDs must be vigilant and identify them There should be no hesitation in raising the red flag if something is wrong.*
- *The role of the Board is supervisory, and IDs should not interfere in day-to-day matters. Management needs to be given the space to operate. Management role is different from that of the Board. The Board must not interfere with deployment or strategy execution. They can review results and outputs and ask questions. IDs need to guide the management in the right direction to avoid issues in the future.*
- *IDs must also be well prepared for the meeting. Agenda papers must be studied well before the meeting. (Some IDs did not find time, and usually glanced through the papers enroute to the meeting)*
- *IDs must upskill themselves – both generic and industry-specific insights. (what is changing now and will change in the future). Focus on and understand the company's business, environment, competition, consumers, customers, technology, and up-to-date knowledge of relevant laws /rules and regulations*
- *Plan a mid-quarter audit meeting to review everything related to the closure of the financial result, e.g. general audits, processes, and compliances.*
- *Training or information-sharing sessions are essential. If directors find it challenging to give time separately, the same should be woven into the Board meeting schedule.*

- *If there are issues, IDs must insist on noting their dissent in the minutes along with their name. If problems are not resolved or addressed, the IDs may resign from the Board. Some IDs mentioned that for key issues, a matrix is created to record the names of the members and whether they agreed or dissented*
- *IDs stated that they considered whether "the remuneration proposed is reasonable for the size and type of the company. Excessive remuneration outside the industry range may not always be free from expectations of unequivocal support to the management or controllers. One must review the offered compensation as a proportion of the total income from all sources.*
- *Insist on Directors & Officer's liability insurance.*
- *IDs should avoid accepting directorships in companies that compete with each other in the material lines of their business.*[5] *Such directorships will always invite conflicts of interest situations that are best avoided.*
- *The board evaluation process must be strengthened.*

6.2 Enhancing the role of IDs

The Act elucidates the Code of conduct, the roles, responsibilities, and duties of IDs in Schedule IV. Mere prescriptive and externally driven regulatory interventions may not improve the Board's oversight function. A one-size-fit approach, following other countries' regulations, may turn out to be futile. Conflict of interest may hinder the effective working of the IDs. The role of IDs can be enhanced in several ways. This paper makes the following suggestions based on the interviews, prior literature and best practices,

i. Confidence, Credibility, and Contribution.

- Theoretically, all directors are equal, but because of experience or other factors, some are given more importance than others. IDs must not be intimidated by a few other (dominant) board members. In all such cases, "being polite and yet firm" is a trait that new directors must develop consciously.
- Wherever the Chairman of the Board and the managing director (CEO) positions are handled by the same person, it would be prudent to appoint a lead director.

[5] Recently, Reserve Bank of India has updated its "fit and proper" criteria for independent directors on public sector banks (Directions dated 2 August 2019), which prohibit such directorships any way

- Management decides on what they want to share with the Board. IDs need to read the document carefully and ask relevant questions for further information. Remain connected with the larger community around them to pick up the softer signals.
- The IDs should regularly meet separately without the CEO at least a few times a year. According to the governance expert Ram Charan et al (2013), the growing practice of executive sessions in which the independent directors meet alone is "the single most important innovation in governance to date."
- Updating and upskilling are essential to know the latest developments that will help contribute better.

ii. Independence and Obligation:

- Maintaining one's independence is of utmost importance. IDs should not think the company has done them a favour by appointing them. They are on the Board because of their experience and functional expertise. IDs play a vital role in governance, and they must perform their function without fear or favour and in the best interest of the shareholders, specifically the minority shareholders and other stakeholders.
- Though most IDs may meet the definition of independence specified in the law, they must also be in true spirit. Independence is a state of mind.
- IDs must never ask for or accept perquisites or facilities from the company, which is not part of the members' approved package. Avoid even unwittingly getting obligated to the management or controlling shareholders. There will be times when mutual support may be expected, even if one's conscience militates against it.
- The courage of conviction, i.e., being able to state your point of view and take a stand or dissent without worrying about losing position/money.
- IDs must give sufficient time for doing justice to the position. The company must also send the agenda on time.

iii. Development of Critical Skills:

- Industry Knowledge: IDs need to develop a familiarity with the industry. This will help in the understanding of the business, its supply chain, macro factors that affect the business, and the way of functioning

- Develop an understanding of law and governance. Understand the roles and responsibilities as given in the Act.
- An important aspect is to oversee the strategy of the business and talent. Though some companies make presentations, it is often one-way and voluminous. It should be part of continuous engagement (though not at an execution level). Focussing more on the future will enhance and improve the decision-making process, such as where to invest or grow the business. A few companies had off-site meetings and sessions for the Board to better understand the strategy and other issues.
- IDs can also seek advice from experts to improve the quality of decision-making.
- Eye for detail: Ability to check what's given, cross-check information, get into the depth of any issue coming up in the agenda on their own, and, if needed, contact the required person in the company for additional information.
- Communications: They should have strong communication skills
- Judgement - ability to assess competency, ability to spot matters that would require taking expert advice, ability to balance the interest of all stakeholders, demonstrate scepticism in the face of optimism of management (and at times of other directors),
- Generic Skills: Willingness to learn and genuine interest in the company's affairs.
- Cognitive skills: e.g., being able to absorb the proceeding in a meeting, asking the right questions, wearing a multi-disciplinary hat and being strategic in thought, processing information very quickly at a high level, and seeing the big picture in a limited time.
- Interpersonal skills: Ability to work in a team by providing complementary skills. Work with others towards a common objective.
- Accuracy of financial data and frauds:
    - IDs need to meet with internal and external auditors regularly, review internal audit reports and ask internal auditors to explain fraud detection control measures taken by the company. This meeting must not include the executive management.
    - Confirm that the auditors are satisfied with the statements and don't have any concerns beyond what is already shared and recorded.
    - Insist on granular data on related party transactions, segment reporting, major changes in investments, receivables, borrowings, or other key data.
    - Insist on zero tolerance regarding employees involved in fraud, bribery (giving or taking), tax evasion, and compliance failures. There are always signals which go unheeded/unnoticed when frauds are committed.

- Compare data with competitors or others in the industry, and check for positives and negatives, i.e. showing extraordinary growth or profitability that is not in line with industry or losses. These suggestions may not be adequate when frauds are perpetrated with the auditors, as in the case of Satyam.
- It also helps if the Board in general and IDs in particular actively create and insist corporate culture that gives priority to ethical standards,

iv. Expectations from the Company's

- The company must organise an induction program for the new ID, and every independent director should go through the same.
- Periodic training is essential primarily for those related to regulation, new technology, risk management, or related to the business or industry that helps better understand the business.
- The company must take adequate Directors' & Officers' liability insurance.
- Appoint IDs through an independent process, ideally through the nomination committee.
- Enhancement of sitting fees based on the time and effort spent and increased limit. (Some companies have a commission, but not all companies have high enough profits to be shared with the IDs. IDs in PSU should also be given the same benefits as in the private sector for taking the role of Independent Director.
-
- Send the agenda and other papers on time and share information promptly.
- One of the respondents shared that management anticipates the questions that may come up in the meeting for various items on the agenda and prepares a presentation answering these questions beforehand so that more focus may be brought on the most relevant items during the meeting.
- Independent Directors may need support to go through the large volume of information shared with them – running into hundreds of pages for a meeting. A resource who can distil the information and update them on the salient points could be helpful.
- Arrange visits to the company factory or other facilities and get to know the management team better.
- Some of the suggestions to enhance the role of the IDs require a lot of transparency and support from the company. When the CEO and the management have transparent and

upfront communication about difficult situations or other sensitive matters, it instils confidence and credibility in IDs

v. Policy consideration:

This report suggests several policy recommendations. There seems to be a shortage of IDs; hence, companies are approaching the same set of people again. Companies must adopt a more professional, independent, and transparent approach to appointing independent directors, preferably through the nomination committee. Companies need to align their strategic priorities to skills required in the board room with that of the IDs. The recent initiative on the data bank for IDs seems to be a good start.[6]

Appointment of Independent Directors:

The biggest challenge is in the process of appointment and the way it is administered. IDs are identified by the promoter/controlling shareholder, and their continuation on the Board also depends on them. As explained earlier, IDs in such cases may not want conflict with the controlling shareholder in any decision-making process. IDs oversight, in some sense, gets diluted, and their ability to protect the minority shareholders will be undermined in case of conflicts. It is suggested that certain IDs are appointed and terminated only by minority shareholders. A representative director should also be part of the audit committee. Bechuk and Hamdani (2017) have proposed a similar arrangement when controlling shareholders exist, which, according to them, will help monitor and avoid "self-dealing" transactions by the controlling shareholders. The researchers have given several examples of countries where such directors have been inducted to the Board or appointed by the minority shareholders. The authors also opine that the idea for such an appointment is not to disrupt the strategic decision-making process but to prevent the controlling shareholders' rent-seeking behaviour. The other alternative suggested is that IDs should be elected by majority non-controlling shareholders voting in person or through proxy or electronic voting along with the controlling shareholders (Bebchuck and Hamdani, 2017). These measures would hopefully minimise the chances of controlling shareholders getting any sympathising IDs. Here, we must be cognisant that controlling shareholders can still get resolutions passed in the general meeting by virtue of their majority shareholding.

[6] www. www.independentdirectorsdatabank.in.

A major cause of concern for IDs is a liability. IDs are not part of the day-to-day management, so expecting them to take responsibility for management acts is unfair. In a recent case, the honourable court did not consider the IDs position in an organisation when examining the case of dishonour of cheques.[7] The fact that IDs can be indicted for an offence involving dishonour of cheques, which is a managerial act over which they have no control, can be a challenging,

Generally, in case of fraud, it is established that when a person is found guilty, they forfeit the income and other wealth amassed from fraudulent transactions, i.e. 'disgorgement' of assets. This principle applies to senior management and directors too. However, the applicability of such provisions to IDs seems to cast more onerous duties than before. While the exception to the rule given in the Act comes in much later, IDs would have to go through an investigation process.

It is suggested that the liability of the IDs is limited and does not extend to acts that are beyond their control. They should be held responsible in respect of such acts of omission or commission which had occurred with their knowledge and was part of the Board process and with their consent.

Remuneration: The sitting fees seem disproportionately low for the risk and efforts put in by many IDS. Although a few companies reward their IDs well, not all companies are in that league. Though some companies pay remuneration (commission), the amount itself may not be enough, and the sitting fees at Rs. 1 lakh, the maximum amount, is still too little for the efforts. The regulator must revise the maximum limit for sitting fees

The law recently proposed that IDs must complete an assessment (except for those who are exempt) to take up the ID position. None of the IDs interviewed recommended an exam. They felt it would be a negative force and deter people from joining the boards. Instead, they suggested that IDs be asked to take a refresher course that would lead to certification. This way, both quality and up-to-date knowledge may be ensured. We recommend mandating continued professional training or education for some minimum hours every year, which can be identified/approved by regulators rather than an entrance exam.

[7] https://indiacorplaw.in/2019/02/actions-independent-directors-dishonour-cheques.html

In the case of IDs' appointment in a public sector undertaking both in the central and the state, an independent and transparent process should be followed. Several listed undertakings do not come under specific provisions of SEBI. SEBI should play a more vigilant role for PSUs as much as it plays in the private sector.

7. Conclusion

The primary objective of this study was to understand the role of independent directors as a mechanism of good corporate governance. The paper also addressed the challenges faced by the IDs in executing their role. This paper addressed the following questions: What are the current roles, responsibilities, and duties of independent directors (IDs) and contrast the new role of the independent directors as envisaged in the Act? Do the IDs face any challenges? How can the IDs improve their function and contribution? iv. What policy recommendations can be made to strengthen the effectiveness of IDs?

We use a mixed-design approach to address the research question. A review of the existing literature was undertaken to understand the importance of IDs. We conducted 39 in-depth interviews with independent directors and others connected to the Board to understand the challenges and get their opinion on how they can enhance their roles.

IDs can play a crucial role, from being there for mere compliance to influencers and implementers of good corporate governance. Prior research has shown the positive effect of IDs on performance, including financial parameters such as return on assets and return on equity. IDs are expected to protect the interest of the minority shareholders and the overall interest of the company. The recent scandals in India and the rest of the world have triggered the debate on the effectiveness of IDs as a governance mechanism. The problem is further accentuated when there are controlling shareholders. IDs are generally appointed/appointed with consultation of the controlling shareholder. This creates a perception that the IDs have to support the controlling shareholder for all decisions, even if they are detrimental to the company or the minority shareholders of the company. This method of appointment weakens the governance role of IDs.

Based on the interviews, the directors identified several impediments to the effective performance of their role. The first one is the liability that is imposed on them. IDs felt that their liability is very high, even when they do not control of day to day management. An induction program was missing in many companies. Frauds, related party transactions, and

lack of transparency were also caused for concern. A few IDs felt the remuneration was inadequate, particularly the sitting fees.

Based on the interviews and discussions, the paper suggested a few voluntary guidelines for companies to adopt. An orientation program for the directors at the beginning of their tenure. Continuous professional education program as decided by the company, including a finance program for directors with no finance background. Adequate Directors and Officers' insurance must be taken in line with the liability borne by the IDs

One of the primary causes of concern for an ID is a liability. Independent directors' liability should be different from that of full-time directors since their access to information is limited. The law makes no distinction between full-time and IDs. It is unreasonable to expect outside directors to have the same information and understanding of the company's affairs as inside directors. The liability should be aligned with what was known and presented in the board meeting rather than an omnibus responsibility. Specific matters for which outside directors may be held responsible may be listed in the Code of conduct so that the liability of outside directors is limited to those items with a safe harbour clause.

The biggest challenge is in the process of appointment and the way it is administered. We suggest that a certain percentage of IDs are appointed and terminated only by the minority shareholders. Such representative director should also be part of the audit committee. Getting independent directors on the Board is only one part of the equation; the other is ensuring their voice is heard and heeded on all essential matters. This can likely be achieved by modifying the quorum requirement to provide at least one-half of all the independent directors at the meetings, prescribing support of at least one-half of independent directors for certain critical resolutions, and so on. The sitting fees seem disproportionate to the risk being taken and the efforts put in by many IDS. The regulator must revise the maximum limit for sitting fees.

The research study has a few limitations. The study of IDs was limited to a small sample of 39 IDs most of them from large companies. It may be possible that these companies had good practices in place and this was captured in the interviews. The questions were also limited to certain aspects of their role and responsibilities and a few areas may have been missed out in case they did not want to answer the same or such an issue did not exist in their companies.

This paper has put forth several suggestions to strengthen the role of IDs. We hope they go a long way in improving the overall governance of Indian companies.

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Annexures

Annexure 1:
Provisions related to Independent directors under the Companies Act 2013

Sec. 149(4) - Every listed public company shall have at least one-third of the total number of directors as independent directors and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies.

Explanation.—For the purposes of this sub-section, any fraction contained in such one-third number shall be rounded off as one.

Sec. 149(6) – An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director—

(a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

(b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;

(ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

(c) who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

(d) none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(e) who, neither himself nor any of his relatives—

(i) holds or has held the position of key managerial personnel or is or has been an employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

(ii) is or has been an employee or proprietor or a partner in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of

(A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

(B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;

(iii) holds together with his relatives two per cent. or more of the total voting power of the company; or

(iv) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or

(f) who possesses such other qualifications as may be prescribed.

Explanation.—For the purposes of this section, —nominee director means a director nominated by any financial institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any Government, or any other person to represent its interests.

Sec. 149(7) - Every independent director shall at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director, give a declaration that he meets the criteria of independence as provided in sub-section (6).

Annexure 2

Schedule IV of the Companies Act, 2013.

CODE FOR INDEPENDENT DIRECTORS

The Code is a guide to professional conduct for independent directors. Adherence to these standards by independent directors and fulfilment of their responsibilities in a professional and faithful manner will promote confidence of the investment community, particularly minority shareholders, regulators and companies in the institution of independent directors.

I.Guidelines of professional conduct:

An independent director shall:

(1) uphold ethical standards of integrity and probity;

(2) act objectively and constructively while exercising his duties;

(3) exercise his responsibilities in a *bona fide* manner in the interest of the company;

(4) devote sufficient time and attention to his professional obligations for informed and balanced decision making;

(5) not allow any extraneous considerations that will vitiate his exercise of objective independent judgment in the paramount interest of the company as a whole, while concurring in or dissenting from the collective judgment of the Board in its decision making;

(6) not abuse his position to the detriment of the company or its shareholders or for
the purpose of gaining direct or indirect personal advantage or advantage for any associated person;
(7) refrain from any action that would lead to loss of his independence;
(8) where circumstances arise which make an independent director lose his independence, the independent director must immediately inform the Board accordingly;
(9) assist the company in implementing the best corporate governance practices.

II. Role and functions:

The independent directors shall:
(1) help in bringing an independent judgment to bear on the Board's deliberations especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct;
(2) bring an objective view in the evaluation of the performance of Board and management;
(3) scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance;
(4) satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible;
(5) safeguard the interests of all stakeholders, particularly the minority shareholders;
(6) balance the conflicting interest of the stakeholders;
(7) determine appropriate levels of remuneration of executive directors, key managerial personnel and senior management and have a prime role in appointing and where necessary recommend removal of executive directors, key managerial personnel and senior management;
(8) moderate and arbitrate in the interest of the company as a whole, in situations of conflict between management and shareholder's interest.

III. Duties :

The independent directors shall—
(1) undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company;
(2) seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company;
(3) strive to attend all meetings of the Board of Directors and of the Board committees of which he is a member;
(4) participate constructively and actively in the committees of the Board in which they are chairpersons or members;
(5) strive to attend the general meetings of the company;
(6) where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the minutes of the Board meeting;

(7) keep themselves well informed about the company and the external environment in which it operates;
(8) not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board;
(9) pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company;
(10) ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use;
(11) report concerns about unethical behaviour, actual or suspected fraud or violation of the company's Code of conduct or ethics policy;
(12) acting within his authority, assist in protecting the legitimate interests of the company, shareholders and its employees;
(13) not disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law.