ROLE OF INDEPENDENT DIRECTORS

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Introduction

With the explosion of scandals pertaining to Corporates due to mismanagement and fraud in recent years, the regulators all over the world have been implementing a series of policies aimed at improving corporate governance and ensuring that companies follow ethical and normative rules of business. Thus, as a part of this initiative, the companies are required to nominate a certain percentage of their board to persons who are not affiliated to the company. These are the so-called independent directors who sit on the boards of companies in a purely professional manner without having a hand in the day to day running or other activities of the company.

In India, the gravity of Independent Directors was recognized with the introduction of corporate governance. The Companies Act, 1956 does not directly talk about IDs, however, Clause 49 of the Listing Agreement which is applicable on all listed companies mandates the appointment of ID's on the Board. A need has been felt to update the Act and make it globally compliant and more meaningful in the context of investor protection and customer interest. The need for IDs aroused due to the need of a strong framework of corporate governance in the functioning of the company. There was a growing importance of their role and responsibility. Thus, the Companies Act 2013 came into picture, which defined and clearly enumerated the role of IDs and their qualification and appointment in the board of the company and their importance in good corporate governance in the company. Also, the new Act specifies their duties and liabilities, making them a substantial part of the company.

An Overview

According to SEBI[1], the expression "independent director" refers to a non-executive director of a company who apart from receiving the director's remuneration, does not have any material pecuniary relationships or transaction with the company, its promoters, directors, senior management, holding company or its subsidiaries and associates, which may impact his/her independence. An ID is vested with a variety of roles, duties and liabilities for good corporate governance. He helps a company to protect the interest of minority shareholders and ensure that the board does not favour any particular set of shareholders or stakeholders.

The role they play in a company broadly includes improving corporate credibility, governance standards, and the risk management of the company. The whole and sole purpose behind introducing the concept of ID is to take unbiased decisions and to checks various decisions taken by the management and majority stakeholders. An ID brings the accountability and credibility to the board process. These IDs are the trustees of good corporate governance.

Statutory Position

The Companies Act, 1956 do not specifically give the definition of the ID. However one can find parameters mentioned in the Clause 49 of the listing agreement which is applicable to all listed companies in order to recognize a director as an ID. According to this clause ID's are those who apart from receiving director's remuneration do not have any material pecuniary relationships or transactions with the company, promoters, senior management, holding company or subsidiary or associates which affect their independence. Moreover he is not related to promoters or persons occupying management positions at the board level or at one level below the board and has not been an executive of the company in the immediately preceding three financial years. Apart from this he will be disqualified if he is not less than 21 years of age or holds 2% or more block of voting shares or shares or if he is a partner or executive of any statutory audit firm or the internal audit firm or the legal firm(s) and consulting firm(s) that have a material association with the company. All provisions of clause 49 are mandatory to be followed by every listed company.

[1] "Definition of the independent director," SEBI — Amendments to Clause 49 of the Listing agreement, 31 October 2003

According to NASDAQ "Independent director" means a person other than an executive officer or employee of the company or any other individual having a relationship which, in the opinion of the issuer's board of directors would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.[2]

Clause 49(II) of the Listing Agreement provides that in case the Chairman of the Company is non executive director, one-third of the Board must comprise of Independent Directors. However, if the chairman is an executive director, half of the board must comprise of Independent Directors. He is any non-executive directors who possess relevant expertise and integrity and in no way is related to the company. According to this clause, no person can be an independent director of more than seven listed companies. If a person is serving as a whole time director in any listed company, then he shall not be the independent director of more than three listed companies.

The Companies Act, 2013 has adopted many of the provisions of clause 49 of the listing agreement and has defined the term 'Independent Director' u/s 2(47) which says that Independent Director means an Independent Director as referred to in sub-section (5) of section 149. As per sub-section 6 of Section 149 of the Act, ID means a director other than a managing director or 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) 1.) Who is or was not a promoter of the company,
   2.) Who is not related to promoters or directors in the company.
c) Who has or had no pecuniary relationship with the company
d) None of whose relative has or had pecuniary relationship or transaction with the company.
e) Who, neither himself nor any of his relative---
   i. Holds or has held the position of a key managerial personnel
   ii. Is or has been an employee or proprietor or a partner, in any of the three preceeding financial years.
   iii. Holds together with his relative two per cent or more of the total voting power of the company; or

[2] NASDAQ Rule 4200 a(15)

iv. Is a Chief Executive or director, of any non-profit organization, or who possesses such other qualifications as may be prescribed.

Role and Duties of Independent Directors

The role of an independent director is considered to be of great significance. Schedule IV of the Act lays down certain critical functions like safeguarding the interest of all stakeholders particularly the minority holders, harmonizing the conflicting interest of the stakeholders, analyzing the performance of management, mediating in situations like conflict between management and the shareholder's interest. It also lays down certain duties like keeping themselves updated about the company and the external environment in which they operates, not disclosing the confidential information of the company unless approved by the Board or required by law. They actively participate in the committees of the board in which they are chairpersons or members, and undertaking appropriate injunctions and refreshing their knowledge, skills and familiarity with the company, regularly attending the General Meeting of the company and many others. The familiarization programmes has been introduced whereby the directors would be familiarized with their role, functions in the company. Also, the details of business functioning would be elaborated.

Clause 49 provides that the ID of a Company shall hold a meeting where only independent directors are present and no other member or director. The objective of this meeting is to analyse the performance of the other directors and to assess the quality and quantity of information flow between the Company and the Board for effective functioning. However, the 2013 Act requires them to meet at least once a year to evaluate the performance of the chairperson of the company. This would immensely aid in ensuring smooth and proper functioning of the BOD of the Company.

The 2013 Act restricts and limits the liability of IDs to the matters which are directly relatable to them. Section 149 (12) limits the liability of an ID "only in respect of 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". Therefore, he cannot be held responsible for those matters which are out of the purview of their knowledge.

Independent Directors also plays a major role in fraud prevention and detection. With the recent exposure of high-profile cases of fraud in India, IDs are taking direct interest in reviewing the fraud risk management framework put in place by their organizations to mitigate the risk of fraud.

Conclusion

Independent Directors bring in the much needed professional expertise since they are individuals with wide experience in running companies as well as the fact that they sit on the Boards of other companies which means that they are abreast of the latest happenings. There has been a move by the regulators in many countries to ensure that independent directors do not have conflicts of interest and these have been codified into rules governing how many companies they can associate themselves with and the sectors and industries that they represent. The 2013 Act has conferred greater empowerment upon IDs to ensure that the management & affairs of a company is being run fairly and smoothly. But, at the same time, greater accountability has also been placed upon them. They now have a better say in the management of the company, which thereby immensely strengthen the corporate governance.