INDEPENDENT DIRECTORS AND MASS RESIGNATION

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Introduction

Board members have a fiduciary duty to the company's shareholders because one of their roles is to convey shareholders' interests to management. Members of the board monitor management's operations and work to keep the company in business. Any act of commission or omission by a director is subject to liability. They ought to maintain their reputation. While independent directors may engage in passive monitoring, if they are informed of a decision where there is a larger chance that negligence will be detected, they may choose to quit board rather than face the repercussions. In such cases, the resignation of a director may have an impact on the governance of the company.

Although there have been a variety of improvements in corporate governance, the adoption of Clause 49 of the Stock Exchange Listing Agreement by SEBI in 2000 is an important step taken to encourage independent directors to be involved in functionality of the company.[1] Clause 49 specifies the need for independent directors to serve as a board member in a firm; (ii) provides a definition of independence (albeit with modifications throughout time); and (iii) outlines the specific responsibilities and liabilities of independent directors.[2]

After two significant scandals, we make speculations on the relationship seen between resignation of board members and business management. In 2009, Corporate India observed numerous independent directors stepped down from being the board member of the company. This segment of the paper aims to briefly chronicle these incidents and discusses some probable ramifications of the widespread resignations.

Literature Review

For observers, the reasons behind directors' resignations are an enigma. It could be the outcome

[1] S.N. Ananthasubramanian, New Obligations on PSBs, HINDU BUSINESS LINE, Jan. 13, 2006, available at http://www.blonnet.com/2006/01/13/stories/2006011302040500.htm.
[2] Clause 49, Article I(A)(1) Explanation(i) of the Listing Agreement available at: http://www.bseindia.com/ downloads/Listagree.zip [hereinafter "Listing Agreement"].

of a disagreement, an ego clash, a time crunch, or the desire to put oneself above potential consequences of an action. Resignations of directors may be an indication that a company's governance is failing. According to research, clustering resignation and earnings management have a negative relationship, meaning that when directors step down from the board, the firm's propensity to manipulate results lowers.

In the literature that is now accessible, there are two primary reasons given for directors resigning: Jumping ship is at the discretion of the directors[3] and Cleaning house is the discretion of board to clear out the bad directors[4]. Directors' resignations point to a possible governance issue for the company in either scenario. There shouldn't be more than one resignation if it is something unique for a particular person. However, more than one director is likely to step down if it is to disassociate themselves from the results of a bad choice because the downsides would apply to all of them to a certain extent.

Antecedents to Director Resignations

Independent directors are not as effective as regulators may believe according to research[5]. Analysis of certain survey data[6] has revealed that independent directors would choose to step down from their position than speak up. Those who decide to speak up are often pressurised by the senior authority to step down. A study[7] on these independent directors have revealed that poor future performance increases the chance of quitting. They look at the resignation explanations given by directors. Weak, vague, or unverifiable justifications are typically indicative of recent and upcoming subpar performance. Such resignations or reasons cause the market to react negatively, which lowers forecast adjustments.

The reason for such resignation can be to save reputation, disassociate themselves from a fraud that can be discovered in foreseen future, earnings that are misreported, no compliance and/or incautious decisions. Media reports have often highlighted that independent directors can stepdown when specific matters are revealed or are talked over. Thus, it's possible that the

[3] Semadeni M, Cannella A, Fraser D, Lee D. 2008. Fight or flight: managing stigma in executive careers. Strategic Management Journal 29: 557–567.
[4] Arthaud-Day M, Certo S, Dalton C, Dalton D. 2006. A changing of the guard: executive and director turnover following corporate financial restatements. Academy of Management Journal 49: 1119–1136.
[5] Mace, M. L. (1971). Directors: Myth and reality
[6] Mace, M. L. (1971). Directors: Myth and reality
[7] Bar-Hava, K., & Segal, D. (2010). Do outside directors tell the truth, the whole truth, and nothing but the truth when they resign? Available at SSRN 1547852.

resignation of the independent directors is a result of recently discovered earnings management. It's probable that independent directors resigned out of fear rather than in protest. The difference between the two is that they give up when they think that their efforts to manage their earnings are coming to light and there is a chance that they may be caught doing so. [8]

The directors decided to leave because the effects of the poor decisions made by the companies were starting to be seen. This could be the case for a variety of reasons. Independent directors quit as soon as they learnt of such decisions since they might not have been as cautious when such decisions were taken. Independent directors may endorse such activities if it permits them to continue serving on the board, but if something goes wrong, they will strive to retract themselves from it.

As a result, when independent directors leave a company's board of directors, it conveys a distinct message to the public, especially to international investors. The company might find it challenging to obtain resources from the outside environment, which could hurt the company's success in the future. Additionally, it would be challenging for the company to appoint new independent directors to cover the seats left vacant by departing directors. A company of this type, as well as its management and board, are therefore under enormous pressure to adhere to corporate governance principles, restore their damaged reputations, and send the necessary message to the public. The management of this company can anticipate reduced earnings in the upcoming year due to this pressure.

This could imply that the new directors are much more inclined to curb in earnings management when these directors are substituted as a result of their resignation and the firm's efforts to appoint new directors. This finding may also be explained by the fact that directors who are overworked and feel they cannot provide sufficient value are more likely to leave the board, whereas those who believe they can contribute value are more likely to join, and their value is reflected in the real earning management parameter the following year.

Mass Resignation in light of scandals

B. Ramalinga Raju, who is the founder and ex chairperson of Satyam Computer Services, confessed of committing a fraud in the accounts of Satyam on the 7th of January 2009. Indian government officials have penalised the involved individuals forRs. 14,000 crore (roughly

[8] Dewally, M., & Peck, S. W. (2010). Upheaval in the boardroom: Outside director public resignations, motivations, and consequences. Journal of Corporate Finance, 16(1), 38–52.

US$3 billion according to prevailing currency fluctuations).[9] "India's Enron"[10] widely regarded as the greatest scam in the to ever be witnessed. Raju's claimed misdeeds involved the falsification of approximations for revenue $1 billion US dollars on the balance sheet of Satyam's account. [11]

Raju (managing director and chief financial officer) in addition to Price Waterhouse Coopers auditors, were all detained by Indian law enforcement agencies after Raju made his confession[12]. State of Andhra Pradesh accused Raju and others for charges of criminal breach of trust and conspiracy, deceit, falsification, forgery[13]. Distinct interrogations were started by the Ministry of Company Affairs, Securities & Exchange Board of India (SEBI), the Government of India amongst others.[14]

Satyam's independent directors, which comprised of a professor at Harvard Business School, the erstwhile Indian School of Business' dean, and an erstwhile secretary of Indian cabinet, seem to have been noticeably missing from those instantly accused and locked up in affiliation with the scandal. Nevertheless, in December 2008 and at the beginning of 2009t, his gold-plated group might have stepped down or change by the Government of India. [15]

With no need to dread, Satyam's independent directors have endured significant reputational damage and intense community scrutiny for their inability to acknowledge such a serious and persistent scam as well as the consensus sanction of the contentious but later on deserted transaction data to procure two businesses managed by the promoters of Satyam.[16] The harm to their reputations and the considerable possibility that they could still be held accountable caused thousands of other independent directors in India great anxiety. Many independent

[9] S. Tibken, Satyam Scandal Shocks IT Sector, Wall Street Journal, Jan. 8, 2009, available at http://online.wsj.com/article/SB123135583835961599.html
[10] V.S. Khanna, Corporate Governance in India: Past, Present & Future?, 1 Jindal Global Law Review 171 (2009).
[11] G. Anand, How Satyam was Saved, Wall Street Journal, Apr. 14, 2009, available at http://online.wsj.com/article/SB123960834835313077.html
[12] R. Guha and J. S. Kumar, Satyam's Raju Brothers Jailed, Wall Street Journal, Jan. 10, 2009, available at http://online.wsj.com/article/SB123157680420571007.html
[13] V. Umakanth, A Cautionary Tale Of The Transplant Effect On Indian Corporate Governance, 21(1) Nat. L. Sch. Ind. Rev. 1, 33 (2009)
[14] C.R. Sukumar, Rs 4,739 Cr More Fraud In Satyam: CBI, LIVEMINT, Nov. 25, 2009, Available At Http://Www.Livemint.Com/2009/11/25001310/Rs4739-Cr-More-Fraud-In- Satya.Html
[15] Three Satyam Directors Resign, More may Quit, LIVEMINT, Dec. 29, 2008, available at http://www.livemint.com/2008/12/29144505/Three-Satyam-directors-resign.html
[16] Satyam's Independent Directors had Raised Concerns over the Deal, HINDU BUSINESS LINE, Dec. 19, 2008, available at http://www.thehindubusinessline.com/2008/12/19/ stories/2008121951600400.htm

directors were concerned in the wake of Satyam because they believed—correctly or incorrectly— they could be accountable for the terrible deeds of an inconsiderate promoter that were executed without independent directors' being notified.[17]

In 2009, the experience of Nimesh Kampani, foremost investment bankers, of india exacerbated the anxieties of independent Indian directors. From 1998 until 1999, Kampani, the founder of the JM enterprises, worked on the board of Nagarjuna Finance as an independent director.[18] In 2001-2002, the bpard of Nagarjuna got accused under the provisions mentioned in Andhra Pradesh Protection of Creditors Act for defaulting in refund of Rs. 100 crore to depositors. [19]Interestingly, besides the initial promoter and another director's arrest , the Government of India also charged and arrested Kampani, who had previously already resigned from the board way before the accusations were being made public. Kampani avoided arrest and imprisonment for nine months by staying in Dubai until a judge suspended the proceedings against him in October 2009.[20]

While many have viewed Satyam as a "one-off" freckle on India's corporate governance, and the Nimesh Kampani occurrence could have been more politically driven, the incidents in Hyderabad later in 2008 and 2009 had a huge effect on directors at firms of India. Independent directors were Concerned of being imprisoned, subject to liability, damaged reputations for doings perpetrated without their awareness by promoters, a large number of independent board members initiated to step down. [21]

In fact, since the date of Raju's confession, around 935 independent directors of Indian corporations resigned, with 619 withdrawals classed as resignations. According to news reports quoting the same information, there were approximately 300 departures by the end of May, indicating that the pace of departure remained relatively constant throughout the year.[22] These

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[17] Why Independent Directors are Quitting in Droves, REDIFF NEWS, Apr. 27, 2009, available at http://www.rediff.com/money/2009/apr/27why-independent-directors-are- quitting-in-droves.htm

[18] C.R. Sukumar and B. Kalesh, Kampani Surprised at Nagarjuna Probe, LIVEMINT, Dec. 23, 2008, available at http://www.livemint.com/2008/12/22234706/Kampani-surprised- at-Nagarjuna.htm.

[19] Govt to Probe Nagarjuna Finance Fraud On 'Top Priority' Basis, LIVEMINT, Jan. 5, 2009, available at http://www.livemint.com/2009/01/05181016/Govt-to-probe-Nagarjuna- Financ.html.

[20] C.R. Sukumar, Kampani Gets Relief from Andhra Court, LIVEMINT, Oct. 15, 2009, available at http://www.livemint.com/2009/10/15010515/Kampani-gets-relief-from- Andhr.html

[21] Reputation at Stake? 340 Independent Directors Quit in 2009, BUSINESS STANDARD, May 14, 2009, available at http://www.business-standard.com/india/news/reputation-at- stake-340-independent-directors-quit-in-2009/08/06/61615

[22] the Directors Database Chronological Cessation Index, available at http://www.directorsdatabase.com/t_ceased_ind.asp

mass resignations underscore an important issue for India's business sector: the functions of independent directors in Indian corporations and the liability concerns associated with them are poorly understood.

Findings and Implications of Independent directors

The Confederation of Indian Task Force advises to legislators that indepdent directors should not be tried for the case of 'non complaince' without a prima facie case can be formed proving that the independent directors were accountable on the behalf of the business. In a similar vein, a bill of private members that propose revisions to the Firms Act proposed by the Chamber of Indian Merchant in February 2009 excludes independent directors from liability for the actions/ errors on behalf of the companies). The reform specifies the detention warrants for independent directors won't be authorised without the approval of District Court judge, who should avail a chance to the independent director to be listened before granting approval. [23] The exemptions given are for lawsthe independent director was "actively engaged in or accountable for" violating / executed with his expressed consent, or he was responsible of gross scam/deliberate carelessness.

Watch dog or strategic advisor?

Independent directors thought themselves to be strategic advisors to promoters and management. However, Independent directors need to be on constant look out while working for a controlled company. Independent directors cannot voice their opinion to management to prevent any poor decisions. Directors and advisors of the firm have collectively observed that the role of these independent directors is of a 'seasoned advisor' who could use his expertise in aiding to advise the management for development or directional purpose in addition to scenarios of conflict. Independent directors cannot be expected to work as watch dogs in a working environment wherein there is always a high and unclear possibility for major reputational damage and severe, criminal liability with no clarity on the laws to safeguard themselves. These directors must be given an opportunity to use the information supplied to them by current management of the company to maximum limit. It is very challenging and

[23] R.K. Luthra, Retaining talent on company boards, ECONOMIC TIMES, Apr. 29, 2009, available at http://economictimes.indiatimes.com/Opinion/Editorial/Retaining-talent-on-company-boards/articleshow/4461613.cms

draining to rely on any type of data or information without a substantial legal protection while working as watchdogs. [24]

Director liability

There is significant unclarity for the roles, responsibilities, obligations and challenges of independent directors in the controlled companies. Independent directors are always fearful about every action as it is constantly subject to imprisonment for violating regulations in practise by the management team or for committing fraud.

There are multiple researches which portray that independent directors have once already been issued arrest warrants pertaining to claims like 'nuisance value'. This has had an effect on directors to resign and has demotivated individuals with great potential to join the board of the firm. Management should consider providing the newly joined independent directors with certain guidelines to kick start their journey in good faith and this may bring in some clarity for the quality of work and conduct expected.

Provision of principles that make an effort to duplicate some 'fudiciary duties' taken from Delaware law will leave less room for hiccups. These provisions will act as a guideline to courts as it will offer more flexibility and directors with little assurance which can safeguard them from possibility of imprisonment. [25] Reports have shown that over 500 firms have applied for Directors and Officers insurance in 2009 to address the concern of risks pertaining to provision of services amongst themselves. This insurance is a medium to limit the liabilities that directors can be subjected to. [26]

Compensation of directors

Post the famous Satyam and Nimesh Kampani scandal, the independent directors felt the compensation offered to them are insufficient, provided being constantly subjected to 'nuisance' risk arrest for actions made by corporate beyond the independent director's control

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[24] V. Umakanth, A Cautionary Tale of the Transplant Effect on Indian Corporate Governance, 21(1) Nat. L. Sch. Ind. Rev. 1, 33 (2009).

[25] S.J. Mathew, Hostile Takeovers in India: New Prospects, Challenges, and Regulatory Opportunities, 3 Colum. Bus. L. Rev. 800, 843 (2007)

[26] S. Mody, Companies take cover for CEO fraud, TIMES OF INDIA, March 4, 2009, available at http://timesofindia.indiatimes.com/biz/india-business/Companies-take-cover- for-CEO-fraud/articleshow/4220513.cms

and authority. Corporations are making an effort to actively adopting D&O insurance to eliminate the burden off these directors and taking appropriate measures by considering and altering compensation to make lives of these directors a little easier.

Signalling effect of resignation

The stepping down of independent directors conveys a powerful message to the market indicating that there has been conflict between the prevailing board members. However, there is no guarantee on the effectiveness of this signal. Resignation in case of the scandals mentioned are prime examples of how the financial press attack any resignation, build up a story and spiral into the detailed reasoning for the resignation. The resignation of independent director can be considered as powerful function of watchdog as it can threaten the promoters into considering the opinions of independent directors which can prevent the promoters to function on their self-interests.

Changes after Satyam and Nimesh Kampani

Promoters have actively considered opinions of independent directors post-Satyam and Nimesh Kampani. Independent directors are volunteering asking question in board meetings and taking significant efforts to comprehend business decisions and functionality. Post-Satyam and Nimesh Kampani, it has been observed that Board discussions are now of long duration, talked about with more data and in depth. These changes come hand in hand with more discomfort to be watchdogs as independent directors still feel they don't have the required protection or expected compensation.

Conclusion

In the aftermath of the Satyam and Nimesh Kampani scandals, politicians of india may have a comparable opportunity to alter the stance of corporate governance. This formidable authority should be used to understand the general applicability of legislation certainly that will persist for generations.

In conclusion, there is sufficient material to provide meaningful insight into independent directors, but there are also a number of concerns that require more examination. Clustered resignations may communicate to the external market that the company in question has poor governance. Therefore, it may have an effect on a company's accessibility to material (such as cash and human capital) on the external market and its market value. Firms have the constant

pressure to act in a certain way that will re-establish their governance image in order to prevent such damage. In terms of monitoring, companies benefit from these resignations. A far-fetched explanation could be that these directors departed because they fought for reduced manipulation and were partially successful. When their influence was exhausted, they resigned. Their departure may have also served as a cautionary signal to the auditors, who would not have allowed for any estimation flexibility. In addition, resignations bring the company into the media spotlight; hence, companies engage in conservative tactics to make this time event-free. The market would be able to comprehend that director resignations just before to and around the release of bad news by the media do not relieve them of monitoring failures. Therefore, whereas the research suggests that directors quit due to bad corporate governance, we are able to demonstrate that the resignation of independent directors can also lead to beneficial changes in corporate governance and less manipulation in earnings management.