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# INDEPENDENT DIRECTORS IN INDIA: WATCHDOGS OR DECORATIVE POSITION? A CRITICAL CORPORATE GOVERNANCE ANALYSIS IN THE INDIAN CONTEXT

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Sneha Jain, BALLB (Hons.), Jagran Lakecity University, Bhopal.  
CS Executive Student

## ABSTRACT

Independent Directors occupy a central place in the contemporary framework of corporate governance in India. Conceived as neutral professionals capable of balancing managerial power, supervising promoter conduct, protecting minority shareholders, and strengthening transparency, they were statutorily embedded through the Companies Act, 2013 and reinforced under the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015. Their role, however, remains contested. Repeated corporate collapses, governance failures, and boardroom controversies have generated a recurring concern: whether Independent Directors are effective institutional watchdogs or merely decorative appointments intended to satisfy compliance mandates.

This paper critically examines the legal architecture governing Independent Directors in India, including appointment, qualifications, duties, liabilities, committee participation, and accountability mechanisms. It also analyses major corporate governance failures such as Satyam, IL&FS, DHFL, and other recent episodes to assess whether Independent Directors meaningfully discharged their fiduciary obligations. The paper argues that while the institution of Independent Directors remains indispensable in theory, structural realities such as promoter dominance, informational asymmetry, social proximity in board appointments, and limited enforcement frequently dilute their effectiveness.

The paper concludes that Independent Directors in India are neither wholly ornamental nor consistently vigilant. Their effectiveness depends upon board culture, regulatory enforcement, professional competence, and the genuine independence of their appointment process. Stronger reforms are therefore necessary to transform them from symbolic figures into substantive guardians of governance.

**Keywords:** Independent Directors, Corporate Governance, Companies Act 2013, SEBI LODR, Board Independence, Minority Shareholders, Promoter Control.

## **I. Introduction:**

Corporate governance represents the system through which corporations are directed, managed, and controlled. It seeks to ensure that corporate power is exercised responsibly, transparently, and in the interests of shareholders and stakeholders alike. In modern companies, separation between ownership and management often creates agency problems, where managers may act in self-interest rather than in the interests of investors. To address this imbalance, the institution of Independent Directors emerged globally as an internal monitoring mechanism.

In India, the need for board independence became particularly acute because many listed companies continue to operate under concentrated promoter ownership. In such companies, management control often overlaps with ownership control, increasing the risk of related-party transactions, tunnelling of assets, preferential decision-making, and suppression of minority shareholder interests. Independent Directors were introduced to provide objective judgment and institutional restraint.

The Companies Act, 2013 granted statutory recognition to Independent Directors, while SEBI's governance framework strengthened their presence in listed entities. Yet, despite these reforms, major corporate scandals have raised doubts regarding their actual efficacy. Many boards containing eminent Independent Directors failed to detect fraud, challenge questionable transactions, or prevent governance collapse.

This gives rise to the central inquiry of this paper: **Are Independent Directors in India effective watchdogs of corporate governance, or have they become decorative positions created to satisfy legal formalities?**

## **II. Historical Evolution of Independent Directors in India:**

Prior to liberalisation, Indian company law did not recognise Independent Directors as a separate class. Under the Companies Act, 1956, boards were largely composed of executive directors, promoter nominees, family members, and lender representatives. Governance standards were weak, and shareholder activism was limited.

The first structured move toward board independence came through the **Kumar Mangalam Birla Committee Report (1999)** constituted by SEBI. The Committee recommended

mandatory inclusion of independent non-executive directors on boards of listed companies. These recommendations were incorporated into **Clause 49 of the Listing Agreement**, which became India's first formal governance code.

The **Narayana Murthy Committee (2003)** further strengthened the framework by recommending improvements in audit committees, disclosures, related-party oversight, and board accountability.

The decisive legislative step occurred with the enactment of the **Companies Act, 2013**, which for the first time codified the concept, eligibility criteria, duties, and liabilities of Independent Directors under Section 149. Subsequently, SEBI operationalised these principles through the **SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015** ("LODR Regulations").

Thus, Independent Directors in India evolved from a stock exchange compliance concept into a statutory governance institution.

### **III. Statutory Framework Governing Independent Directors:**

#### **A. Companies Act, 2013**

##### **1. Section 149(4)**

Every listed public company must have at least one-third of the total number of directors as Independent Directors. Certain prescribed unlisted public companies are also required to appoint them.

##### **2. Section 149(6)**

A person can qualify as an Independent Director only if he or she:

- is a person of integrity and possesses relevant expertise and experience;
- is not a promoter of the company or its holding, subsidiary, or associate company;
- is not related to promoters or directors;
- has no material pecuniary relationship with the company; and

- satisfies additional independence conditions.

### **3. Section 149(10) and (11)**

An Independent Director may hold office for a term of up to five consecutive years and is eligible for one further term by special resolution. Thereafter, a cooling-off period applies.

### **4. Section 149(12)**

Liability of Independent Directors is restricted to acts of omission or commission occurring with their knowledge attributable through board processes, with their consent or connivance, or where they failed to act diligently.

## **B. Schedule IV – Code for Independent Directors**

Schedule IV lays down professional conduct and duties, including:

- safeguarding interests of all stakeholders, especially minority shareholders;
- bringing objective judgment to board deliberations;
- scrutinising management performance;
- satisfying themselves regarding integrity of financial information;
- moderating conflicts between management and shareholders.

## **C. SEBI LODR Regulations, 2015<sup>1</sup>**

For listed entities, SEBI requires Independent Directors to play an active role in governance committees, particularly:

- Audit Committee
- Nomination and Remuneration Committee
- Stakeholders Relationship Committee

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<sup>1</sup> SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

- Risk Management functions (where applicable)

SEBI has also tightened rules relating to resignation disclosures, related-party transactions, board diversity, and appointment approvals.

#### **IV. Intended Role of Independent Directors: The Watchdog Theory**

Independent Directors are expected to function as internal constitutional checks within the corporate structure. Their “watchdog” role may be understood in the following dimensions:

##### **A. Monitoring Management**

They are expected to supervise executive management and question business decisions involving risk, compliance, ethics, or conflicts.

##### **B. Protecting Minority Shareholders**

In promoter-driven companies, Independent Directors act as a balancing force to ensure that controlling shareholders do not misuse corporate resources.

##### **C. Ensuring Financial Integrity**

As members of audit committees, they review accounts, internal controls, auditor independence, and red flags.

##### **D. Overseeing Related Party Transactions**

Independent approval is critical where transactions involve promoters or group entities.

##### **E. Ethical Governance**

Their presence signals that the company is governed not merely by insiders but also by neutral professionals.

If effectively functioning, Independent Directors can significantly improve investor confidence and market discipline.

## **V. Why the “Decorative Position” Critique Persists:**

Despite the ideal framework, criticism of Independent Directors in India remains widespread.

### **A. Appointment by Promoters**

In many companies, Independent Directors are nominated by promoter-controlled boards. This creates an inherent conflict: those who appoint them are often those whom they are expected to monitor.

### **B. Social and Professional Networks**

Appointments may favour retired bureaucrats, former regulators, friendly professionals, or socially connected persons rather than truly independent dissenting voices.

### **C. Information Dependence**

Independent Directors depend heavily on management for board papers, financial data, presentations, and agenda framing. Without independent information channels, their oversight is weakened.

### **D. Passive Board Culture**

Many boards function through consensus rather than challenge. Directors may avoid confrontation to preserve relationships.

### **E. Multiple Directorships**

Some individuals serve on numerous boards simultaneously, reducing time and attention available for each company.

### **F. Risk Without Power**

Independent Directors face reputational and legal consequences after scandals, but may lack real authority beforehand. This discourages capable professionals from accepting such positions.

Hence, critics argue that many Independent Directors are “independent in law but dependent

in practice.”

## **VI. Case Studies from India:**

### **A. Satyam Computer Services Scandal (2009)<sup>2</sup>**

The Satyam fraud remains one of India’s most significant governance failures. Despite a board containing eminent personalities, massive accounting manipulation continued undetected for years. The board also approved the controversial Maytas acquisition involving promoter-linked interests shortly before collapse.

The scandal exposed that board prestige cannot substitute for actual vigilance.

### **B. IL&FS Crisis**

(Union of India v. Infrastructure Leasing & Financial Services Ltd. & Ors., Company Petition proceedings before NCLT Mumbai Bench (2018 onwards). Infrastructure Leasing & Financial Services collapsed under enormous debt burdens and governance deficiencies. Questions were raised regarding board oversight, risk supervision, and financial monitoring.

### **C. DHFL Governance Breakdown**

(Reserve Bank of India v. Dewan Housing Finance Corporation Ltd. (DHFL), Corporate Insolvency Resolution Process before NCLT Mumbai.) . Dewan Housing Finance Corporation became associated with allegations of diversion of funds and governance irregularities. Independent board supervision again came under scrutiny.

### **D. Yes Bank Governance Concerns**

Although not solely an Independent Director failure, concerns regarding risk governance and concentration of authority demonstrated the need for stronger board independence.

These examples reveal that statutory presence alone does not guarantee substantive independence.

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<sup>2</sup> SEBI v. B. Ramalinga Raju & Ors., Adjudication / regulatory proceedings relating to Satyam Computer Services Ltd.

**VII. Judicial Position on Liability of Independent Directors:**

Indian courts have increasingly recognised that Independent Directors should not be mechanically prosecuted merely because of board designation. The liability of Independent Directors has been a significant issue in Indian corporate jurisprudence. Since Independent Directors are entrusted with oversight functions rather than day-to-day management, courts have repeatedly examined the extent to which they can be held responsible for corporate misconduct. The judicial approach in India has generally attempted to strike a balance between two competing concerns: first, ensuring accountability of directors where negligence or complicity exists; and second, protecting honest and non-executive Independent Directors from unnecessary prosecution merely because of their position on the board.

The statutory basis for this principle is found in Section 149(12) of the Companies Act, 2013, which provides that an Independent Director shall be held liable only in respect of acts of omission or commission by a company which occurred with his or her knowledge, attributable through board processes, and with consent, connivance, or failure to act diligently. This provision recognises that Independent Directors are not involved in daily operations and therefore should not be treated in the same manner as executive management.

The judiciary has also recognised the practical role of Independent Directors in corporate governance. Courts have noted that these directors are appointed to provide expertise and independent judgment, not to supervise every operational act personally. Therefore, unless board records, committee minutes, or documentary evidence show knowledge of wrongful conduct, liability should not be casually imposed.

However, judicial protection is not absolute. Where Independent Directors ignore clear warning signs, approve fraudulent transactions, or fail to exercise reasonable diligence, courts and regulators may hold them accountable. If board papers disclose irregularities and directors remain silent, the defence of passive status may not succeed. The law expects Independent Directors to ask questions, review documents carefully, attend meetings regularly, and record dissent where necessary.

In cases involving financial misstatements or governance failures, courts may examine whether the Independent Director was part of the Audit Committee, Risk Committee, or any board committee responsible for reviewing internal controls. Membership of such committees may

increase expectations of diligence. If red flags were obvious and no inquiry was made, liability may arise from failure to act diligently rather than direct participation.

The judicial trend therefore reflects a middle path. Courts do not support blanket prosecution of Independent Directors merely because they sit on the board. At the same time, courts do not permit the title of “independent” to become a shield for negligence or wilful blindness. The standard applied is one of knowledge, participation, consent, connivance, and diligence.

This balanced position is important for India’s corporate sector. Excessive liability may discourage qualified professionals, retired judges, regulators, accountants, and experts from accepting Independent Director positions. On the other hand, complete immunity would weaken board accountability and damage investor confidence.

Therefore, the present judicial approach seeks to preserve the institution of Independent Directors by protecting genuine professionals while penalising those who misuse the position or fail in their duties. In conclusion, Indian courts increasingly recognise that Independent Directors are neither ceremonial figures nor universal scapegoats. Their liability depends on facts, evidence, board processes, and whether they discharged their responsibilities with honesty, care, and reasonable diligence.

#### **A. Pooja Ravinder Devid Asani v. State of Maharashtra<sup>3</sup>**

The Supreme Court held that non-executive directors cannot be implicated without specific allegations showing responsibility for the wrongful conduct.

#### **B. Sunil Bharti Mittal v. CBI<sup>4</sup>**

The Court emphasised that criminal liability cannot arise solely from holding office; there must be active role or legal basis for attribution. The Supreme Court of India observed that criminal liability of directors cannot be presumed solely because of their office. There must be specific allegations showing active role, consent, or criminal intent. Though the case did not deal exclusively with Independent Directors, the reasoning has influenced later cases concerning non-executive and independent board members. The judgment clarified that vicarious liability

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<sup>3</sup> Pooja Ravinder Devidasani v. State of Maharashtra & Anr., (2014) 16 SCC 1: AIR 2015 SC 675.

<sup>4</sup> Sunil Bharti Mittal v. Central Bureau of Investigation, (2015) 4 SCC 609: AIR 2015 SC 923.

in criminal law must arise from clear statutory basis or direct involvement, not from mere designation.

### **C. Maksud Saiyed v. State of Gujarat (2008)<sup>5</sup>**

The Supreme Court of India held that directors cannot automatically be prosecuted unless the complaint specifically states how and in what manner they were responsible for conduct of business. General allegations against all directors were considered insufficient. This principle is particularly important for Independent Directors, who often face inclusion in complaints without evidence of participation.

### **D. Statutory Protection under Section 149(12)**

This provision balances accountability with fairness by requiring knowledge, connivance, or lack of diligence before imposing liability.

Such jurisprudence is crucial to attract competent professionals to board positions.

## **VIII. Recent Reforms and Regulatory Developments:**

Regulators have attempted to strengthen the institution through multiple reforms:

### **A. Independent Director Databank**

The Ministry of Corporate Affairs introduced an online databank of eligible persons and proficiency requirements.

### **B. Enhanced Resignation Disclosures**

Where an Independent Director resigns, listed companies must disclose detailed reasons, reducing silent exits before scandals.

### **C. Shareholder Approval Reforms**

SEBI proposed stronger public shareholder participation in appointment and removal

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<sup>5</sup> Maksud Saiyed v. State of Gujarat, (2008) 5 SCC 668 (SC).

processes.

#### **D. Stricter Related Party Transaction Oversight**

Independent scrutiny of promoter-linked transactions has increased.

These reforms indicate recognition that legal presence must be supplemented by functional independence.

#### **IX. Comparative Perspective:**

In jurisdictions such as the United States and United Kingdom, Independent Directors operate in relatively dispersed ownership markets with stronger institutional investor activism and litigation pressure.

India's challenge is distinct because many listed companies are promoter-controlled. Therefore, imported governance models require local adaptation. Independence in India must mean independence not merely from management, but from controlling shareholders as well.

#### **X. Are Independent Directors in India Watchdogs or Decorative Positions?**

The answer is nuanced.

##### **They are Watchdogs when:**

- the board culture encourages questioning;
- promoters respect institutional governance;
- directors are competent and courageous;
- information is transparent;
- regulators enforce accountability.

##### **They become Decorative when:**

- appointments are relationship-based;

- management controls information flow;
- dissent is discouraged;
- board meetings merely ratify pre-decided outcomes;
- directors prioritise prestige over responsibility.

Therefore, Independent Directors are not inherently ineffective. Their success depends upon the governance ecosystem surrounding them.

## **XI. Reform Recommendations:**

To make Independent Directors genuinely effective in India, the following reforms are desirable:

### **1. Independent Appointment Mechanism**

Greater involvement of minority shareholders and nomination committees independent of promoters.

### **2. Direct Access to Information**

Right to interact with auditors, compliance officers, and internal audit teams without management filtering.

### **3. Professional Training**

Continuous education in finance, cybersecurity, ESG, insolvency, and sectoral risk.

### **4. Performance Evaluation**

Transparent disclosure of attendance, committee participation, and contribution quality.

### **5. Safe Harbour Protection**

Protection from frivolous proceedings where directors acted honestly and diligently.

## **6. Rational Compensation**

Adequate remuneration to attract serious talent without compromising independence.

## **7. Cap on Over boarding**

Limit excessive board memberships.

## **XII. Conclusion:**

Independent Directors in India remain one of the most important instruments of corporate governance. They are necessary because concentrated ownership structures create heightened risks of abuse, opacity, and minority oppression. However, necessity alone does not ensure effectiveness.

The experience of Indian corporate scandals demonstrates that many Independent Directors have failed to act as vigilant monitors. Yet it would be incorrect to dismiss the institution as merely ornamental. In several companies, Independent Directors have challenged promoters, demanded disclosures, opposed unfair transactions, and strengthened governance.

Accordingly, Independent Directors in India are neither purely watchdogs nor purely decorative positions. They are potentially powerful guardians whose effectiveness is often undermined by flawed incentives and structural dependence.

The future of Indian corporate governance depends not on abandoning the model, but on making independence real rather than nominal.

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