UNLEASHING THE WATCHDOGS: EVALUATION OF INDEPENDENT DIRECTORS IN INDIA'S CORPORATE GOVERNANCE ECOSYSTEM

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ABSTRACT

The presence of an independent directors in India's corporate governance ecosystem is a step towards ensuring transparency and accountability. However, the implementation of the system has several loopholes. This paper evaluates the current legislative framework for independent directors in India while taking into account judicial pronouncements. It also critically analyzes the regime and compares the progress with that of the UK and the US. The paper provides recommendations to improve the system, including prioritizing the appointment of independent directors with relevant expertise and experience, ensuring that the proposed independent director fulfills pre-determined criteria, providing sufficient information and resources to independent directors, defining and communicating their roles and responsibilities, and providing ongoing training and development opportunities.

Keywords: Accountability, Corporate governance, Expertise, Fairness, Independent Directors, Liability, Transparency.

Introduction

Corporate governance refers to the rules and practices governing a company's management and direction. It is critical for long-term sustainability and success and involves interactions among shareholders, Board of Directors, management, and other stakeholders. The role of the Board of Directors in ensuring transparency, accountability, and ethical behavior has increased in recent times. Independent directors, who are non-executive directors without any ties to the company's management or promoter group, play a critical role in protecting the interests of stakeholders. In India, regulatory authorities and investors have recognized the importance of independent directors in promoting corporate governance. However, the efficacy of independent directors in contributing to corporate governance is a debated upon issue, and this research aims to conduct an in-depth evaluation of their role in India's corporate governance ecosystem as laid down by the ***"Companies Act, 2013"***, and the ***"Securities and Exchange Board of India (SEBI) Regulations, 2015"***.

Research Question

Considering the aforementioned quandary, the research question to be dealt with in the present study is as follows:

How effective are independent directors in India's existing corporate governance ecosystem and what measures can be taken to enhance their role in promoting transparency, accountability, and ethical behaviour in companies?

Review of Literature

In order to analyse the current state of research related to the role of independent directors in maintaining corporate governance in India, it is important to review existing literature on the subject.

Journal Articles/Publications

Saravanan, Thenmozhi and Sasidharan (2022)[1] evaluate the role of independent directors in ensuring effective corporate governance and the effect of such effectiveness on adding value

[1] Palanisamy Saravanan, Muthuveerappan Thenmozhi, Aghila Sasidharan, *Are independent directors enhancing value in the post mandate period?: Empirical evidence from India*, 22 J. PUB. AFF. 1, 1-9 (2021).

to firm business. The authors do so to analyse what effect legislative instruments mandating independent directors' appointment within Boards of Directors of companies create. The authors find that such mandate has only led to an enhancement in such efficacy, which has in turn added value to business of companies.

Vijay (2014)[2], Bhattacharya (2016)[3], Sahoo and Dwibedi (2019)[4] and Maheshwari (2020)[5] attempt to analyze the efficacy of corporate governance measures in light of the introduction of SEBI Regulations and provisions under the Companies Act of 2013, to find that the appointment of independent directors, if done in compliance with the said legal instruments, leads to more efficacy within the corporate governance mechanisms of the company.

Pareek and Pasumarti (2021)[6], while performing a comparative analysis between India, UK and the USA to determine the position of an independent director within the corporate governance mechanisms in the companies of each country, find that although the compliance with regulations mandating appointment of independent directors has increased in India, the percentage of independent directors in Indian companies is significantly less than that in US and UK companies, thus creating a cause of concern for policy-makers, academicians, legal professionals and corporates alike. A similar approach is taken by **Kishore (2017)**[7] while comparing the Indian legal framework with that of the UK.

Committee Report(s)/Policy Paper(s)

The **Kumar Mangalam Birla Committee (2000)[8]** recommended including independent directors as watchdogs of corporate governance. They suggested mandating an audit committee to have three independent directors, with at least one with financial and accounting expertise.

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[2] Geetika Vijay, Corporate Governance under the Companies Act, 2013: A more Responsive System of Governance, 4 IND. J. APP. RES. (2014).
[3] ASHISH K. BHATTACHARYA, CORPORATE GOVERNANCE IN INDIA: CHANGE AND CONTINUITY (Oxford University Press 2016).
[4] Deepali Rani Sahoo, Dr. Sukanta Kumar Dwibedi, An Analytical Study Relating to the Role of an Independent Director in the Globalised Era: A Detailed Study, 10(1) ASIAN J. MGMT. 72, 72-78 (2019).
[5] Vikas Maheshwari, Role of Independent Director in Corporate Governance, 6(7) EPRA INT'L J. MULTIDISCIP. RES. 203, 203-211 (2020).
[6] Sanjay Pareek, Prof. Dr. Srinivas Subbarao Pasumarti, Independent Directors in India, UK and USA: An International Study, 25(3) ANN. R.S.C.B 9091, 9103-9105 (2021).
[7] Kamal Kishore, Independent Directors and Corporate Governance: A Comparative Study of Indian and UK Provisions, 16(1) I.U.P. J. CORP. GOV. (2017).
[8] KUMAR MANGALAM BIRLA COMMITTEE, REPORT OF THE KUMAR MANGALAM BIRLA COMMITTEE ON CORPORATE GOVERNANCE (Securities Exchange Board of India 2000).

The **Naresh Chandra Committee (2002)**[9] and the **Narayan Murthy Committee (2003)**[10] also recognized the importance of independent directors in corporate governance. These committees were some of the first to highlight the significance of independent directors in ensuring transparency, accountability, and ethical behavior in Indian companies.

The **Uday Kotak Committee (2017)**[11] was requested to provide with recommendations pertaining to certain factors concerning corporate governance, including ensuring independence of independent directors and their active involvement in a company's affairs. The committee recommended modifications with respect to the eligibility criteria for appointing independent directors.

Analysis

Legal Framework in India

According to **Section 149 of the Companies Act**[12] and the **2015 SEBI (Listing Obligations and Disclosure Requirements) Regulations**[13], a person whom a company appoints as an independent director must adhere strictly to the relevant provisions. The regulations mandate that independent directors cannot have any connections with the promoters or directors of the listed entity (or its holding, associated company or a subsidiary). They should not have held a key managerial position in these in the past three financial years. Additionally, independent directors and their relatives are barred from holding 2% or greater of the company's total voting power.

The new amendment of the LODR Regulations, effective from 1st April 2022, has further amended the definition and requirements to allow independent directors to strengthen their part in protecting the interests of shareholders.[14]

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[9] NARESH CHANDRA COMMITTEE, REPORT OF THE CII TASK FORCE ON CORPORATE GOVERNANCE (Ministry of Corporate Affairs 2002).
[10] SHRI N R NARAYANA MURTHY COMMITTEE, REPORT OF THE SEBI COMMITTEE OF CORPORATE GOVERNANCE (Securities Exchange Board of India 2003).
[11] UDAY KOTAK COMMITTEE, REPORT OF THE COMMITTEE ON CORPORATE GOVERNANCE (Securities Exchange Board of India 2017).
[12] Companies Act, 2013, §149, No. 18, Acts of Parliament, 2013 (India).
[13] SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Securities and Exchange Board of India, No. SEBI/LAD-NRO/GN/2015-16/013, 2015 (India).
[14] SEBI (Listing Obligations and Disclosure Requirements) (Sixth Amendment) Regulations, 2022, Securities and Exchange Board of India, No. SEBI/LAD-NRO/GN/2022/103, 2022 (India).

Following are some key changes related to independent directors in listed companies[15]:

- Independent directors and their relatives must not have had any financial relationships with the company, promoters, or directors in the past three years, except for directorial remuneration.

- Relatives of independent directors cannot hold securities or have debts towards the company or its subsidiaries in the present or previous three fiscal years.

- A special resolution of shareholders with at least three times as many votes in favor as against is required for the appointing, reappointing or removing independent directors.

- The NRC must disclose how the proposed independent director meets predetermined criteria, and its composition must consist of 75% independent directors.

The Companies Act's Schedule IV includes the professional code of conduct that an independent director should follow.[16] Additionally, the LODR Regulations outline the different responsibilities that independent directors have with respect to the company and its shareholders.

After appointment, independent directors must declare their independence at board meetings, per the Companies Act. Private companies and unlisted public companies not meeting the criteria in Section 149 of the Companies Act do not have to appoint independent directors. Section 149, in conjunction with Regulation 17 of the LODR Regulations, mandates the following for a listed company[17]:

- The Board of Directors mandatorily needs to have both executive as well as non-executive directors. At least one has to be female.

- At least half of the directors must be non-executive.

- In case of a non-executive chairman, a minimum of 33% directors have to be

[15] *Ibid,* cl. 3.
[16] Companies Act, 2013, Schedule IV, No. 18, Acts of Parliament, 2013 (India).
[17] *supra* note 13, at Reg. 17.

independent.

- If not, then at least ½ of the directors need to be independent. This requirement also applies if there is a non-executive chairman who has a connection to the promoter.

Instances and Judicial Pronouncements

Considering the standing of independent directors as the guardians of corporate governance, it is important to note the various instances that occurred in India, along with judicial pronouncements wherein such nature of independent directors has been highlighted, in light of their duties and liabilities.

- The ***Satyam scandal*** occurred in 2009 in India. Ramalinga Raju, the Founder Chairman of Satyam Computer Services, admitted to cause inflation of the company's assets and earnings over several years, resulting in a decline in investor trust and a stock market downturn. Raju and other executives were arrested and imprisoned, and Tech Mahindra later acquired the company. The scandal prompted regulatory reforms and increased oversight of corporate governance in India, especially the duties and liabilities of independent directors.[18]

- Regarding the liability of independent directors, SEBI clarified in ***In re, Inter Global Finance Ltd.***[19] that independent directors have the same liabilities as other directors under the 2015 LODR Regulations. Similarly, the NCLAT in ***Shailesh Chawla*** also gave a ruling that was consistent with SEBI's position.[20]

- However, the Supreme Court has taken a more liberal approach to the role of independent directors. In ***Sunil Bharti Mittal***, the Court held that directors may only be held accountable for wrongdoing if there is adequate proof of their active involvement and criminal intention or if the applicable law explicitly imposes liability on them.[21]

- The Court also acknowledged in ***Chintalapati Srinivasa Raju*** that independent directors cannot be implicated for all forms of conduct within the business of a

[18] Madan Bhasin, Corporate Accounting Scandal at Satyam: A Case Study of India's Enron, 1(12) EUR. J. B & SOC. SCI. 25, 25-47 (2013).
[19] Inter Globe Finance Ltd., *In re,* 2021 SCC OnLine SEBI 121
[20] Shailesh Chawla v. Vinod Kumar Mahajan, 2020 OnLine NCLAT 657.
[21] Sunil Bharti Mittal v. CBI, AIR 2015 SC 923.

company.[22] This approach was reiterated by the Bombay High Court in ***Satvinder Jeet Singh Sodhi***, where the Court held that unless a non-executive director was involved in the business of the company, they cannot be held responsible for dishonor of cheque by the enterprise.[23]

Critical and Comparative Analysis

India has progressed significantly in recent years, as far as corporate governance is concerned, with the introduction of various regulations and amendments aimed at enhancing transparency, accountability and shareholder protection. There are still certain areas where the corporate governance ecosystem of the country can improve.

Firstly, the selection process for independent directors lacks transparency, and there is a lack of diversity in their selection.[24] Many of them get appointed on the basis of their relationship with the company's promoters or management, rather than their qualifications and experience.[25]

Secondly, there is a lack of training and awareness among independent directors, which hampers their effectiveness in performing their duties.[26] Many independent directors do not clearly understand their roles and responsibilities and are unable to provide effective oversight and guidance.[27]

Thirdly, non-enforcement and regulation of independent directors' duties and responsibilities is a significant issue.[28] Independent directors may be unable to act independently and, in the company's, best interests due to pressure from management or promoters.[29]

Fourthly, the remuneration for independent directors is often inadequate, which can cause a

[22] Chintalapati Srinivasa Raju v. SEBI, 2018 (7) SCC 443.
[23] Satvinder Singh Sodhi and Ors. v. State of Maharashtra, MANU/MH/2364/2022.
[24] Supriti Mishra, Do Independent Directors Improve Firm Performance? Evidence from India, GLO. B. REV. 1, 1-19 (2020).
[25] *Ibid.*
[26] Pranav Mittal, The Role of Independent Directors in Corporate Governance, 4 NUJS L. REV. 285, 285-299 (2011).
[27] S. Lakshmi Naaraayanan, Kasper Meisner Nielsen, Does personal liability deter individuals from serving as independent directors? 140(2) J. FIN. ECO. 621, 621-643 (2021).
[28] Andrea Melis, Luigi Rombi, Country-, firm-, and director-level risk and responsibilities and independent director compensation, 29(3) CORP. GOV. INT'L REV. 222, 222-251 (2021).
[29] Amrinder Khosa, Independent directors and firm value of group-affiliated firms, 25(2) INT'L J. ACC. & INFO. MGM'T 217, 217-236 (2017).

conflict of interest.[30] Many independent directors may be tempted to act in the management or promoters' best interests, rather than the company's stakeholders', to secure future appointments or gain other benefits.[31]

Finally, a lack of transparency in the process for evaluation of independent directors is an issue. Many companies do not disclose the criteria used for evaluating independent directors, making it difficult to assess their performance objectively.[32]

Moreover, there is still a long way to go for India to improve in terms of its corporate governance ecosystem, so as to meet the US and UK standards.

In the ***World Bank's 2022 Ease of Doing Business report***, India ranks 63rd globally, up from 77th in 2018.[33] However, in terms of corporate governance, India ranks lower, in Group 2, which has a score between 60-80 out of 100. In comparison, the UK and the US both fall in Group 1, which has a score above 80 out of 100.[34]

While India's efforts to improve corporate governance are commendable, there is still a long way to go to match the standards of the UK and the USA. It is essential that Indian companies continue to strive towards better governance practices to enhance their competitiveness on the global stage.

Conclusion and Recommendations

In conclusion, the amended LODR Regulations have strengthened the role of independent directors in India by introducing strict guidelines for their appointment, responsibilities, and conduct. These changes aim to enhance transparency, accountability, and corporate governance while protecting the interests of shareholders. India's efforts to prioritize the role of independent directors are commendable, although there is still room for improvement. It is noteworthy that India falls behind the UK and the USA in terms of the strength of independent directors.

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[30] SANJIV AGARWAL, GUIDE FOR INDEPENDENT DIRECTORS: COMPANY LAW, SEBI GUIDELINES, CORPORATE GOVERNANCE (Bloomsbury 2021).
[31] ARINDAM DAS, CORPORATE GOVERNANCE IN INDIA (Routledge 2019).
[32] UDAY KOTAK COMMITTEE, *supra* at note 11.
[33] Ease of doing business: Govt working on to reduce compliance issues, says official. THE ECONOMIC TIMES, https://economictimes.indiatimes.com/news/economy/policy/ease-of-doing-business-govt-working-on-to-reduce-compliance-issues-says-official/articleshow/92705974.cms?from=mdr (last visited Mar 14, 2023)
[34] SAHA, WORLD CORPORATE GOVERNANCE INDEX (2022).

To overcome the same, the following recommendations should be taken into consideration:

- To achieve effective oversight and decision-making in a company, the appointment of independent directors with relevant expertise and experience is crucial.
- The Nomination and Remuneration Committee (NRC) should ensure that the proposed independent director meets predetermined criteria and disclose how the criteria are met. Independent directors should be given sufficient resources and information to carry out their duties effectively.
- It is essential to clearly define and communicate the role and responsibilities of independent directors.
- Companies should also offer ongoing training and development opportunities to enhance independent directors' comprehension of the company's business affairs and the industry in which it operates.

By following these recommendations, companies can ensure that they have an effective and competent board of directors, which is essential for strengthening corporate governance and working in the stakeholders' interests.

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