

“Independent” or “I’m dependent” Directors?

by M. Damodaran

The disquieting number and variety of scandals in the corporate world have shaken the trust of ordinary men and women in the institution of the joint stock company as a vehicle of economic growth. The frightening frequency with which skeletons have tumbled out of corporate cupboards in different jurisdictions has led to lawmakers and regulators sitting up and taking notice of the emergent need to put structural and systemic solutions in place. Increasing transparency and disclosures that are complete, correct and contemporaneous have been identified as, at best, a partial response to the problem on hand. Regulatory interventions have become more in-depth, intrusive, and inquisitive. The costs of compliance have consequently increased, leading mid-sized and small-sized corporates to address existential issues.

Yet another development, at least as significant, in the last decade has been the increased faith placed in the institution of the independent director. When the concept of independent directors in corporate boardrooms originally surfaced, the predictable response was to fill these slots with persons with whom the management and the promoters had a very high comfort level, on account of belonging to the same social or economic circle. These independent directors, more often than not, saw their role on boards as one of making up the numbers in order to get the arithmetic of board composition compliant with regulations. This translated to passive presence in boardrooms and an unwillingness to engage with management, leave alone challenge management positions on proposals or policies. With the compensation of independent directors set at ridiculously low levels, professionals with reasonably high income streams saw board positions as a waste of valuable time.

Independent Directors, as an entity, should have made their presence felt with reasonable numbers in position in India with the inclusion of Clause 49 in the listing agreement. Prior thereto, some company managements and promoters saw value in inducting persons with diverse experience as board members but they were too few to make a serious systemic impact. Following the regulatory stipulation in Clause 49, companies reached out to persons who were seen as “safe” additions to the Board. Experience, merit, diversity and such other considerations did not inform the process of selection of potential independent directors. This was only to be expected having regard to the fact that in most Indian companies, private or public, the promoters held the majority shares and voting rights, and there was hardly any possibility of any of their proposals being questioned or even commented on, leave alone being opposed by “carefully selected” independent directors subscribing to the philosophy of peaceful coexistence with managements and promoters.

The induction of new members on boards was also a casual affair with a brief phone call or a short email serving the purpose of induction. The newcomers came into the boardrooms with no briefing whatsoever and, on occasions, not even a nodding acquaintance with the domain, the sector or the company. There was also the principle of mutuality with close friends serving as independent directors on each others’ boards. Regulatory compliance, in effect, meant ticking the box of having the right numbers in place without any thought being given to the possibility that value would be added by outside directors. Past reputations,

often not relevant to the company's requirement, saw the practice of several grey eminences invited to join boards so that companies could have bragging rights on the quality of individuals on their boards. The expressions "flower vase" directors, once used in the United Kingdom to describe such directors, would have fitted the Indian situation admirably.

The situation has undergone a significant change with the coming into force of the Companies Act, 2013. The extraordinary range and variety of responsibilities heaped on independent directors has made the institution of independent directors very vital to the objective of promoting stakeholder democracy. No longer is it a question of getting the numbers right in the composition of the board. The reality today is that the independent directors are burdened with a number of functions, some of which seem to be inconsistent with their part-time non-executive status. While it is easy to brush aside, in seminars and symposia, the over-prescriptive arrangements of the statute, the inescapable fact is that they have to be complied with. The requirements spelt out include an engagement letter setting out the rights and responsibilities of the independent directors and the expectations from her as a board member. Post the inclusion in a Board there is an induction process to familiarise the newcomer with the domain, the sector and the company. This would ordinarily lead to a director being better informed, than in the past, when she attends the first and subsequent meetings of the board.

The real problem from the governance perspective is less about uninformed directors and more about directors unwilling to honestly grapple with issues and address alternatives. Given the shareholding pattern, many independent directors are beholden to the management for getting them into corporate boards and choose to hold themselves back in order not to be seen as biting the hand that feeds them. With independence being defined in terms of the absence of material or pecuniary relationships, in the context of an inability to define independence as a state of mind, independent thought does not surface often enough in boardrooms.

Just as companies are expected to undertake due diligence in order to select the right persons for inclusion as members of the board, potential directors should also evaluate the companies to the boards of which they have been invited. Careful and discerning potential directors should scrupulously avoid companies that have a patchy regulatory track record and a board which has members of questionable repute or integrity. Discovering that one does not belong, after having agreed to join the board, is unfair both to the individual and to the company.

Having joined the board, the independent director must be constructive not combative and assertive without being aggressive. She must consciously seek to work on the information asymmetry that she is bound to suffer from on account of her non-executive part-time role. And while the duties and functions are many and varied, the true test of having measured up to expectations is to be, and to be seen to be, an active proponent and practitioner of stakeholder democracy.