

Corporate Governance and Board of Directors

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I. INTRODUCTION

“More and more of the decision-making in public corporations is in the hands of independent directors. And that’s only going to work if those independent directors have the information that they need.”¹

The role of Independent directors in synchronising the interests of various parties and evaluating their performance can be barely be disregarded, in today’s system of corporate governance in India.

As per the Companies Act, 2013, an Independent Director is a director other than managing director, whole time director or nominee director. In the opinion of the Board, he is a person of integrity and possesses relevant expertise and experience.²

II. HISTORICAL ORIGINS

The use of a body of representatives for improving governance can be traced back to the political institutions and medieval guilds in the late middle Ages in Western Europe.³ Some of these guilds developed into regulated companies, such as the British company of Merchant Adventurers which had a governor and an elected board of assistants taking care of the company governance.⁴

India - Genesis and Evolution

India witnessed a dramatic development in the field of corporate governance in the 1990s.⁵ The Kumar Mangalam Birla Committee report proposed a new clause 49, being applicable to all the listed companies of a certain size, containing norms for corporate governance.⁶ Traces of several concepts that emerged in the U.S. and U.K. such as an independent board and audit committee could be seen in this report.⁷

¹ Wayne Guay, Independent Researcher and Expert at Wharton University of Pennsylvania, Lecture on *Can Independent Directors Remain Independent*, <http://knowledge.wharton.upenn.edu/article/how-independent-directors-bridge-the-information-gap/> (Jun 16, 2015)

² Section 149(6) and 2(47), *Companies Act*, 2013

³ F. A. Gevurtz, *The European Origins and the Spread of the Corporate Board of Directors*, *Stetson Law Review*, 33 (2004), P. 946

⁴ *Ibid* (note 23), P. 945

⁵ N. Balasubramanian, Bernard S. Black & Vikramaditya Khanna, *Firm-Level Corporate Governance in Emerging Markets: A Case Study of India*, available at <http://ssrn.com/abstract=992529>; Afra Afsharipour, *Corporate Governance Convergence: Lessons from the Indian Experience*, 29 *NW. J. INT’L L. & BUS.* 335 (2009), P. 5-6

⁶ Securities and Exchange Board of India, *Report of the Kumar Mangalam Birla Committee on Corporate Governance* (Feb. 2000), available at <http://www.sebi.gov.in/commreport/corpgov.html>

⁷ *Ibid*, ¶¶ 6.9 and 9.4

Inspired by the Sarbanes Oxley Act which emanated due to Enron, WorldCom and other government scandals in the U.S., SEBI appointed the Narayan Murthy Committee that suggested reforms in the Clause 49, which came into effect on 1 April, 2005.⁸

India's Enron

The case of *Venture Global Engineering v. Satyam Computer Services Ltd. and Anr.*⁹, RamalingaRaju, who was sentenced to seven years in jail, was the chairman of Satyam Computer Services who committed financial fraud to the tune of Rs. 7000 crore. After the scandal, the Confederation of Indian Industries set up a task force to suggest reforms and the National Association of Software and Services Companies established a corporate governance and ethics committee headed by Narayana Murthy. The report of the latter addressed reforms relating to audit committees, shareholder rights, and whistle-blower policy.¹⁰

In December 2009, drawing upon the findings of the CII Task Force and the ICSI report as well as suggestions from various other stakeholders, India's Ministry of Corporate Affairs,²⁵⁹ issued Corporate Governance Voluntary Guidelines 2009.¹¹

III. LEGISLATIVE FRAMEWORK IN INDIA

Companies Act, 2013 And Companies (Appointment And Qualification Of Directors) Rules, 2014

The provisions that substantially deal with independent directors are as follows:

- **Mandatory requirements of appointment**

As per S. 149(4) states that every listed company should have at least one-third of the total number of directors as independent directors and the Public Companies having paid up share capital of ten crore rupees or more or the Public Companies having turnover of one hundred crore rupees or more or the Public Companies which have in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees shall have at least two directors as Independent Directors.¹²

- **Qualifications**

An Independent Director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical

⁸ Securities and Exchange Board of India, SEBI/CFD/DIL/CG/1/2004/12/10 (Oct. 29, 2004), available at <http://www.sebi.gov.in/circulars/2004/cfdciro104.pdf>.

⁹ *Venture Global Engineering v. Satyam Computer Services Ltd. and Anr*, AIR 2010 SC 3371

¹⁰ Naveen Srivastav, *Satyam Fiasco: Corporate Governance Failure and Lessons Therefrom*, Researchgate, P. 32, January 2010, The IUP Journal of Corporate Governance, Vol. IX, No. 4, 2010

¹¹ *Corporate Governance Voluntary Guidelines*, 2009, Ministry of Corporate Affairs, Government of India, 24 December 2009; http://www.mca.gov.in/Ministry/latestnews/CG_Voluntary_Guidelines_2009_24dec2009.pdf

¹² Section 149(4), *Companies Act 2013* r/w Rule 4, *Companies (Appointment and Qualification of Directors) Rules, 2014*

operations or other disciplines related to the company's business.¹³

- **Manner of Selection and Appointment**

Subject to the provisions of Section 149(6), an independent director may may be selected from a data bank containing names, addresses and qualifications of persons who are eligible and willing to act as independent directors, maintained by any body, institute or association, as may be notified by the Central Government, having expertise in creation and maintenance of such data bank and put on their website for the use by the company making the appointment of such directors.¹⁴

- **Code of Conduct**

The Code of Conduct mainly lays down the standards for the following:

- A. Guidelines for professional conduct
 - B. Roles and functions of the independent directors
 - C. Duties
 - D. Manner of appointment and removal
 - E. Meetings
 - F. Performance evaluation mechanism
- II. Creation and Maintenance of databank

The Rules provide for the maintenance of databank of persons offering to become independent directors by anybody, institute or association which has been authorised by the government in this behalf.¹⁵ An application has to be made by the person desirous of becoming an independent director in the form DIR-1.¹⁶

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

The regulations lay down certain obligations with respect to the independent directors:

1. A person shall not serve as an independent director in more than 7 listed entities and a person who is serving as a whole time director shall not serve as an independent director in more than 3 listed entities.¹⁷
2. The independent director should review the performance of non-independent directors and the board of directors as a whole, the chairperson and assess the quality, quantity and timeliness of flow of information

¹³Section 149 (1o) of *Companies Act, 2013* r/w Rule 5, *Companies (Appointment and Qualification of Directors) Rules, 2014*

¹⁴Section 150(1), *Companies Act 2013*

¹⁵Rule 6(1), *Companies (Appointment and Qualification of Directors) Rules, 2014*

¹⁶Rule 6(4), *Companies (Appointment and Qualification of Directors) Rules, 2014*

¹⁷Regulation 25(1), *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015*

between the management of the listed entity and the board of directors.¹⁸

3. An independent director who resigns or is removed from the board of directors of the listed entity shall be replaced by a new independent director by listed entity at the earliest but not later than the immediate next meeting of the board of directors or three months from the date of such vacancy, whichever is later.¹⁹

A Corporate Governance Report further needs to be prepared specifying the composition and category of directors and web links where details of familiarisation programmes imparted to independent directors is disclosed.²⁰

IV. INSIDER AND OUTSIDER SYSTEMS OF GOVERNANCE

Systems of corporate governance can be distinguished according to the degree of ownership and control and the identity of controlling shareholders. India has a system of ownership characterised by concentrated ownership or control (insider system) whereas the US and UK have a wide dispersed ownership (outsider system).

In outsider systems of corporate governance, the basic conflict of interest is between strong managers and widely-dispersed weak shareholders. In insider systems, on the other hand, the basic conflict is between controlling shareholders (or blockholders) and weak minority shareholders.²¹

V. JUDGING THE ROLE AND EFFICACY OF THE INDEPENDENT DIRECTORS IN THE INDIAN CONTEXT

The factors of considerable importance while analysing the role of Independent directors would be:

1. Independence of the Board vis-à-vis the extent to which the directors are present on the board.
2. Extent to which the independent directors are diligent in their duties.²²

Independent directors - Independence

The independence of the Board from the influence of the dominant shareholders can be measured by the proportion of the independent directors on the board to the total number of directors. As enunciated above, the companies Act requires that every listed company should have at least one-third of the total number of directors as independent directors and the Public Companies having paid up share capital of ten crore rupees or more or

¹⁸Regulation 25(4), *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015*

¹⁹Regulation 25(6), *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015*

²⁰Schedule V: Annual Report, Part C. *Corporate Governance Report* r/w Regulation 34(3) and 53(f), *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015*

²¹Maria Maher and Thomas Andersson, *Corporate Governance: Effects On Firm Performance And Economic Growth*, Organisation For Economic Co-Operation And Development (OECD), Summary, P. 3 , available at <https://www.oecd.org/sti/ind/2o9o569.pdf>, (Last accessed on 13-o2-2o17 at 2:37 am)

²²Santoshpande, *Effectiveness of independent directors on the boards of Indian listed companies – are the recent regulatory changes enough?*, P. 7, <http://tari.co.in/wp-content/uploads/2o14/o7/Article2-Santosh-Pande.pdf> (Last accessed on 13-o2-2o17 at 2:37 am)

the Public Companies having turnover of one hundred crore rupees or more or the Public Companies which have in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees shall have at least two directors as Independent Directors.²³

- **Faulty appointment process**

The appointment process under the Companies Act, 2013 mandates for the formation of a nomination and remuneration committee. However, this method is arguably effective only in the outsider systems since it removes the bias of the management in such systems.²⁴

However, it may not be so effective in India because even if the independent nomination committee were to nominate candidates, without the influence of the controlling shareholders, those candidates would ultimately have to be voted at a shareholders' meeting, where the controlling shareholders would exercise majority influence. While the nomination committee could manage the first step, it does not have control over the second step and the controlling shareholders would continue to have the ability to influence the shareholder decision on whether the candidate suggested by the nomination committee should be appointed or not. . Since it would be an embarrassment if the person nominated by the nomination committee failed to muster enough votes at a shareholders' meeting, due to opposition from the controlling shareholders, the nomination committee was likely to consult controlling shareholders before putting up the names for the appointment of independent directors.²⁵

- **Removal of the Directors**

As per Section 169, Companies Act, 2013, any director on the Board may be removed by passing an ordinary resolution at a general meeting.²⁶ The resolution may be proposed by the company or by the shareholders. The shareholders must collectively own 10% and call for an extraordinary General Meeting under Section 100 of the Act.

- **TATA Feud**

Cyrus Mistry who held the position of the chairperson in TATA chemicals was removed by passing a general resolution under Section 169 of the Companies Act. NusliWadia, who acted as a senior independent director did not support the move. However, a special notice was served to him seeking his removal from the position soon after he showed his support.

²³ Section 149(4), Companies Act 2013 r/w Rule 4, Companies (Appointment and Qualification of Directors) Rules, 2014

²⁴ Sarkar, J. & Sarkar, S., *Auditor and audit committee independence in India*, <http://www.igidr.ac.in/pdf/publication/WP-2010-020.pdf> (2010)

²⁵ Varottil, *Evolution and Effectiveness of Independent Directors in Indian Corporate Governance*, *Hastings Business Law Journal*, Vol. 6, No. 2, p. 281, 2010. Available at SSRN: <http://ssrn.com/abstract=154878>

²⁶ Section 169(1), Companies Act, 2013

NusliWadia filed a defamation suit and the Bombay High Court gave an interim order directing TATA sons to keep one of the seats of an independent director vacant until further orders.²⁷

There have been several instances in the past where independent directors have been removed.²⁸

- **Deficiency in the legislation**

Given that independent directors sit in judgement of the actions of the company, their appointment/removal from the board must be driven by the Nomination and Remuneration Committee (NRC). To lend credibility to the process, the decision of the committee must be backed by a rigorous board evaluation exercise and the results of the evaluation must be tested and benchmarked against some pre-defined criteria. Allowing controlling shareholders to remove independent directors from the board undermines the integrity of the entire process and the institution of independent directors itself.²⁹

VI. SUGGESTIVE REFORMS

There is a need to adopt a more transparent and independent approach for the appointment and removal of independent directors.

SEBI's consultative paper³⁰ points out to the need for the representation by the minority shareholders but at the same time keeping in mind that if all the independent directors are to be appointed by the "majority of minority", it may result in "abuse by minority".

Providing Autonomy

- **Appointment procedure**

Dominating shareholders have no spur to permit proportional board representation, and therefore, statutory mandates may be required to have proportional representation of the minority shareholders.

Two alternative approaches may be used to facilitate minority shareholder representation

Cumulative voting by the Shareholders

Election of independent directors by a "majority of the minority".³¹

²⁷ Ayesha Arvind, Hindustan Times, *Keep Wadia's seat vacant in three companies: Bombay HC to Tata Sons*, <http://www.hindustantimes.com/business-news/keep-wadia-s-director-seat-vacant-in-three-firms-bombay-hc-to-tata-sons/story-fz9GE9orOcCycA1AHnO8dN.html> (Dec 17, 2016 01:52)

²⁸ Some of the recent examples would be of the S. Kumars removing NitinKasliwal and Ricoh India in which the minority shareholders issued a notice to the company for removal of independent directors on the board.

²⁹ Institutional Investor Advisory Services, *Removal of independent Directors: A Sword of Damocles*, <http://www.iiasadvisory.com/single-post/2016/11/15/Removal-of-Independent-Directors-A-Damocles-Sword> (November 15, 2016)

³⁰ Consultative paper on review of corporate governance Norms in India, SEBI, *Concept of Corporate Governance*, http://www.sebi.gov.in/cms/sebi_data/attachdocs/135729o3546o2.pdf (Jan 2013), ¶ 11.1

- **Removal of directors**

The Removal procedure should be evaluated by an independent committee and only permitted, if there are grounds for violation of the Code of Conduct, as provided for, under the Act. This would prevent biasness by the majority shareholders.

VII. CONCLUSION

The Indian governance models had adopted heavily from the models in U.S. and U.K. Due to the differences in the Board composition and structure, some regulations regarding the independent directors are not as effective.

Although, it is difficult to accurately estimate the diligence of the Independent Directors, their role in establishing harmony amongst various parties and monitoring the performance of the Board of Directors can undoubtedly, be unheeded.

The reforms as have been suggested by SEBI through its consultative paper and under the Companies Bill, 2012, should provide greater autonomy and will, hopefully reduce the incidences of corporate frauds.

³¹Varottil, *Evolution and Effectiveness of Independent Directors in Indian Corporate Governance*, Hastings Business Law Journal, Vol. 6, No. 2, p. 281, 2010. Available at SSRN: <http://ssrn.com/abstract=154878> (2010)