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ROLE OF INDEPENDENT DIRECTORS IN MAINTAINING CORPORATE GOVERNANCE: AN INDIAN PERSPECTIVE

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Abstract

Corporate governance guaranteesbusiness openness, accountability, and ethical behaviour. Independent directors are crucial in corporate governance, checking the board and management's decision-making processes. This paper investigates independent directors' function in maintaining corporate governance in Indian enterprises. Secondary data analysis is used in the study, which focuses on the regulatory framework for independent directors and its impact on corporate governance practices. The findings indicate that the position of the independent director is critical in ensuring strong corporate governance, but structural and cultural issues restrict their efficacy. The paper concludes with proposals for strengthening the role of the independent director in corporate governance.

Introduction

Corporate governance has received more attention in light of the numerous business scandals that have shaken investor trust in recent years. Corporate governance refers to the framework and principles governing relationships between a corporation's management, shareholders, and other stakeholders.[2] The system serves a vital role in ensuring that the firm acts ethically and transparently, fulfils its goals, and safeguards the interests of shareholders and other stakeholders. The Securities and Exchange Board of India (SEBI) included independent directors in the 2013 Companies Act in India to improve corporate governance. Independent directors are non-executive directors who provide an objective perspective on the company's operations and serve as a check on the board and management's decision-making. The

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purpose of the present study is to examine the role of independent directors in sustaining corporate governance in Indian corporations.

Research Questions

This paper aims to answer the following research questions:

1. How have regulatory reforms and changes in corporate governance requirements influenced the role of independent directors in India, and how have these changes affected corporate governance practises in Indian companies?

2. What obstacles do independent directors encounter in fulfilling their responsibility in sustaining corporate governance in Indian corporations, and how might these obstacles be overcome?

Review of Literature

Bansal and Sharma (2020)[3]investigate the dynamic evolution of Independent Directors and their paramount significance in ensuring transparent and efficient corporate governance. The study delves deep into the provisions outlined in the Companies Act 2013 about Independent Directors and scrutinises their impact on bolstering board independence and accountability.

Moreover, the paper addresses the challenges confronted by Independent Directors in fulfilling their obligations, including potential conflicts of interest and the imperative of maintaining autonomy from management. It also includes examining real-world case studies to exemplify the practical implementation of Independent Directors' responsibilities and the consequences of their decisions on corporate governance practices.In summary, the paper presents a thorough and all-encompassing analysis of the present state of Independent Directors operating under the Companies Act 2013, enlightening readers about their pivotal role in fostering ethical decision-making and safeguarding stakeholders' interests in the corporate landscape of India.

[3]Bansal, K., & Sharma, G. (2020). Role and Importance of Independent Director: The Current Scenario under Companies Act, 2013. *Nyaayshastra L. Rev.*, *1*, 1.

In his study, Upinder (2019) thoroughly investigates the efficacy and autonomy of Independent Directors within the context of corporate governance in India. The research comprehensively explores the critical aspects related to Independent Directors, who play a pivotal role in ensuring transparency and accountability within corporate boards.

Initially, the author emphasises the significance of Independent Directors in advancing corporate governance practices. Moreover, he identifies and analyses the primary challenges of Independent Directors, which include potential conflicts within the boardroom, limited authority and influence, and reliance on management for information. Additionally, the study delves into examining regulatory frameworks and codes of conduct that govern Independent Directors in India, further scrutinising their impact on their independence.

Analysis

Legal and Regulatory Framework for Independent Directors

Several sections of the 2013 Companies Act[4] are pertinent to the function of independent directors in ensuring corporate governance in Indian corporations, such as:

Section	Details
Section 149(4)	Qualifications of independent directors: This section outlines the capabilities that independent directors must possess, including their ability to exercise independent judgment and experience in the relevant field.
Section 149(6)	Term of independent directors: This section sets out the maximum time of appointment for independent directors, which is five years, subject to reappointment by shareholders.
Section 149(10)	Code for independent directors: This section requires independent directors to adhere to a code of conduct that promotes ethical behaviour, transparency, and accountability.
Section 177	Audit committee: This section requires companies to establish an audit committee that includes at least one independent director and outlines the audit

[4]Companies Act 2013, Ministry of Corporate Affairs, Government of India.

	committee's responsibilities in overseeing financial reporting and risk management.
Section 178	Nomination and remuneration committee: This section requires companies to establish a nomination and remuneration committee that includes at least one independent director and outlines the committee's responsibilities in selecting and evaluating directors and determining executive remuneration.
Section 197	Overall maximum managerial remuneration: This section sets out the totalcompensationfor directors, including independent directors. It requires companies to disclose the salary paid to directors in their annual reports.

A minimum of one-third of a listed company's board of directors must consist of independent directors by the Companies Act of 2013. The Act defines an independent director as someone with no material or pecuniary relationship with the company or its management, who is not a promoter of the firm, and who has not worked for the company or its subsidiaries within the prior three years. The Act also stipulates independent directors' qualifications, appointment procedures, and responsibilities.

The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015,[5]reinforce the role of Independent directors. SEBI has also released recommendations regarding the recruitment and responsibilities of independent directors. According to SEBI criteria, an independent director must have sufficient knowledge and experience in the relevant field, no conflict of interest with the firm, and enough time to devote to company affairs. In addition, the SEBI requires that independent directors establish a separate committee to oversee the company's performance and provide suggestions to the board.

The Companies (Amendment) Act of 2017[6]significantly impacted Independent Directors in India, reinforcing their role in maintaining corporate governance. The Act clarified the definition of Independent Directors and emphasised their independence, ensuring they have no material pecuniary relationships with the company or its management. It introduced the concept of rotation, limiting Independent Directors to two consecutive terms of five years

[5]INDIA, G. O. Securities and exchange board of India (listing obligations and disclosure requirements) regulations, 2015.

[6]Das, S. C. (2018). Companies (Amendment) Act, 2017 and Its Impact on Corporate Social Responsibility and Corporate Governance. *The Management Accountant Journal*, *53*(12), 63-67.

each, promoting fresh perspectives on the board. The Act expanded grounds for disqualifying directors, including Independent Directors, for non-compliance and involvement in fraudulent activities. The mandatory establishment of the Nomination and Remuneration Committee (NRC) enhanced the transparency and professionalism in Independent Director appointments.

The Act also prohibited loans to directors, including Independent Directors and their relatives, mitigating potential conflicts of interest. These provisions aimed to enhance the credibility and accountability of Independent Directors, promoting transparent decision-making and ethical conduct within companies. Overall, the Companies (Amendment) Act of 2017 strengthened the governance framework in India and underscored the pivotal role of Independent Directors in fostering sustainable business practices.

1.4.2 The Role and Responsibilities

In India, independent directors are essential to maintaining corporate governance in businesses. Every listed company must have at least one-third of its board of directors comprised of independent directors, according to the Companies Act of 2013. The independent director's responsibilities include the following:

1. **Providing an objective viewpoint:** Independent directors are not part of the company's management; as a result, they can provide an objective perspective on various issues. They can contribute an impartial viewpoint to board meetings and independently assess concerns.
2. **Monitoring the company's performance:** Independent directors are accountable for evaluating the company's performance and ensuring compliance with all applicable laws and regulations[7]. Additionally, they provide that the company acts ethically and responsibly.
3. **Oversight of risk management**: Independent directors play a significant role in overseeing the company's risk management. They must ensure the organisation has established and adheres to adequate risk management policies and procedures.
4. **Appointment and evaluation of senior management:** The company's independent directors are responsible for appointing and appraising senior management. They

[7]Mittal, P. (2011). The role of independent directors in corporate governance. NUJS L. Rev., 4, 285.

must verify that senior management is qualified and capable of running the organisation.

5. **Ensuring transparency and accountability:** Independent directors must guarantee that the company maintains openness in its activities and is accountable to all its stakeholders, including shareholders, employees, and customers.
6. **Addressing conflicts of interest:** Regarding conflicts of interest, independent board members must ensure that they do not have any while serving on the board. They must quickly address a dispute and withdraw from the debate or decision-making process.
7. Contribution of Independent Directors to Board Committees: Independent Directors make significant contributions to the functioning of various board committees, offering their expertise and unbiased insights. They actively participate in committees dedicated to critical functions like financial oversight, board nominations, executive compensation, and corporate social responsibility. Their active engagement ensuresthorough discussions and effective decision-making, leading to improved governance outcomes. The various committees are as follows:

i. **Audit Committee:** The Audit Committee oversees financial reporting and internal controls and ensures the company's compliance with accounting standards and legal requirements. Independent Directors, leveraging their financial expertise and independence, provide valuable insights to assess the accuracy and transparency of financial statements. They scrutinise internal audit reports, evaluate risk management practices, and interact with external auditors to uphold the integrity of financial disclosures.

ii. **Nomination and Remuneration Committee (NRC):** The NRC is entrusted with identifying and nominating suitable candidates for directorship and executive roles. Independent Directors, as integral committee members, contribute by impartially evaluating potential candidates' qualifications, skills, and diversity. Their inputs on executive compensation packages align with industry benchmarks and incorporate performance-linked incentives, fostering sustainable growth.

iii. **Corporate Social Responsibility (CSR) Committee:** The CSR Committee centres on the company's social and environmental responsibilities. Independent Directors play a pivotal role in assessing and endorsing CSR initiatives that resonate with the company's values and positively impact society. They ensure transparent reporting of CSR activities and monitor their implementation to comply with regulatory mandates.

iv. **Risk Management Committee:** The Risk Management Committee identifies, assesses, and mitigates various risks that may affect the company's operations and reputation. Independent Directors' objective perspectives and expertise in risk assessment contribute to the effectiveness of risk management strategies. They cultivate a risk-aware culture and ensure alignment between risk management practices and the company's long-term objectives.

v. **Stakeholder Relationship Committee:** The Stakeholder Relationship Committee addresses stakeholders' grievances and fosters constructive engagement. Independent Directors facilitate open communication channels between the company and its stakeholders. Their unbiased approach in addressing concertos cultivates trust and augments the company's reputation in the market.

1.4.3 Comparative Analysis with USA, UK and Japan

1. **Legal and Regulatory Framework:**The Companies Act 2013 stipulates the criteria for identifying independent directors and outlines their responsibilities in India. In contrast, the USA's Sarbanes-Oxley Act 2002 imposes stringent regulations to safeguard against corporate fraud and misconduct. The UK's Corporate Governance Code emphasises the importance of independent judgment and board diversity. Japan's Corporate Governance Code underwent a revision in 2015, emphasizing the role of the Independent Director in enhancing corporate governance.
2. **Board Composition and Diversity:** Examining board compositions in these countries reveals varying degrees of diversity. For instance, India mandates that listed companies have at least one-third of the board as independent directors. In the USA, stock exchange listing requirements influence the proportion of independent directors UK encourages diversity in terms of skills, experience, and gender on boards. At the same time, Japan promotes greater independence by reducing the presence of executive directors.[8]

[8]García-Sánchez, IM., Rodríguez-Domínguez, L. & Frías-Aceituno, JV. Board of Directors and Ethics Codes in Different Corporate Governance Systems. J Bus Ethics 131, 681–698 (2015). https://doi.org/10.1007/s10551-014-2300-y

3. **Roles and Responsibilities:** Independent Directors play instrumental roles in strategic decision-making, risk oversight, and executive compensation committees in all countries. However, their involvement in stakeholder management and ESG (Environmental, Social, and Governance) matters differs. For example, UK Independent Directors actively engage with stakeholders, while Indian Independent Directors have increased focus on CSR (Corporate Social Responsibility) initiatives.
4. **Independence and Influence:** In India, Independent Directors face challenges in maintaining independence due to the dominance of promoter-driven companies. In contrast, US Independent Directors have more substantial legal protection and are empowered to lead internal investigations. UK Independent Directors have a reputation for being more assertive in holding management accountable, while Japan is witnessing a cultural shift towards greater independence.
5. **Challenges and Best Practices:** Challenges faced by Independent Directors in each country vary; however, they include conflicts of interest, lack of access to information, and time constraints. To address these, companies adopt best practices such as regular training, induction programs, and mentoring for Independent Directors. For example, the UK's Financial Reporting Council has published guidance on board effectiveness and Independent Director responsibilities.

1.4.4 Case Laws

1. **Satyam Scandal:** In 2009, the Satyam Affair rocked the Indian business community. The company's founder, Ramalinga Raju, admitted to committing fraud totallingRs 7,136 billion. The issue generated several concerns regarding the efficiency of independent directors in maintaining corporate governance. In this instance, the independent board members failed to fulfil their responsibilities and did not question management's judgements.
2. **Tata Sons disagreement:** Independent directors were instrumental in resolving the dispute The Tata Sons controversy, which began in 2016, involved the ouster of Cyrus Mistry as Tata Sons chairman. The debate raised many questions concerning the role of independent directors in sustaining corporate governance. The independent directors played a crucial role in resolving the issue. They played a vital role in

ensuring the company's interests were protected as mediators. The case demonstrates the significance of independent directors in conflict resolution and corporate governance.

3. **IL&FS crisis:** Infrastructure Leasing and Financial Services (IL&FS), a leading infrastructure development and finance company in India, failed in 2018. The failure of IL&FS has generated several problems regarding the function of independent directors in maintaining corporate governance. In this instance, the independent directors could not prevent the company's demise. They failed to fulfil their responsibilities and did not question management's actions. The case demonstrates the significance of enhancing the role of independent directors and ensuring that they successfully carry out their duties.
4. **Yes Bank crisis:** Independent directors failed to prevent the bank's financial health from deteriorating. Yes Bank, a significant private sector bank in India, suffered a financial crisis in 2020 due to its worsening financial condition. The incident prompted several questions regarding the role of independent directors in upholding corporate governance. In this instance, the bank's independent directors failed to prevent its financial health from deteriorating. They could not fulfil their responsibilities and did not question management's actions. The case demonstrates the significance of enhancing the role of independent directors and ensuring that they successfully carry out their duties.
5. **Infosys case:** Independent board members were instrumental in resolving the whistle-blower issue. In 2019, a whistle-blower accused Infosys, a large IT services provider in India, of unethical behaviour. Many questions about the role of independent directors in maintaining corporate governance were mentioned in the lawsuit. The independent directors played a crucial role in resolving the whistle-blower allegation. They played a vital role in ensuring the company's interests were protected as mediators. The case demonstrates the significance of independent directors in addressing corporate governance-related disputes.

1.4.5 The challenges faced

The following challenges may prevent independent directors from executing their duties and sustaining corporate governance in Indian corporations:

1. **Lack of Independence:** Independent directors may be subject to pressure from controlling shareholders, management, or other board members to act in their interests rather than the company's and its stakeholders.[9] This can compromise the independence of independent directors and make it easier for them to carry out their duties successfully.
2. **Limited Authority:** The authority of independent directors to make decisions or influence change within the organisation may be constrained. They may also need help enforcing their recommendations, especially if management or other board members disagree.
3. **Limited Knowledge:** Independent board members may need more information or skills to properly comprehend the company's operations, industry, and markets. This can make it difficult for them to recognise and successfully solve governance challenges.
4. **Lack of Resources:** Independent directors may need more money, time, and support to complete their obligations efficiently. They may also need helpaccessing the knowledge and data required to make informed judgements.
5. **Regulatory and legal challenges:** Independent directors may be confronted with regulatory and legal complexities that hinder their capacity to fulfil their responsibilities efficiently. These can involve compliance obligations, legal liabilities, and other complex and difficult-to-navigate regulatory regimes.

1. 5 Conclusion

In Indian corporations, independent directors are crucial in ensuring corporate governance. They provide an objective viewpoint and a wealth of experience and expertise to the boardroom, which helps to guarantee that decisions are taken in the best interests of the company and its stakeholders. To execute their tasks, independent directors encounter severalobstacles, including pressure from management or other board members, limited authority, lack of knowledge and resources, regulatory and legal complications, and competing interests. To overcome these obstacles, independent directors must maintain

[9]Sarkar, Jayati. "Board Independence & Corporate Governance in India: Recent Trends & Challenges Ahead." Indian Journal of Industrial Relations, vol. 44, no. 4, 2009, pp. 576–92. JSTOR, http://www.jstor.org/stable/27768232.

independence and objectivity, build strong relationships with other board members and stakeholders, continuously update their skills and knowledge, and ensure they have the necessary resources and support to carry out their responsibilities effectively.

1.6 Recommendations and Suggestions

The following recommendations can help us dive deeper into the field of the role of Independent Directors in maintaining corporate governance:

1. **Improve the selection process for independent directors:** A rigorous and transparent selection process should focus on selecting board members with the required abilities, experience, and independence. To foster a broader range of ideas, businesses should also consider the gender and racial diversity of the board.
2. **Offer continuing training and support for independent directors:** Businesses should give independent directors regular exercise and support to help them remain current on governance best practices, industry trends, and emerging risks. This may include access to industry professionals, workshops, and other training programmes.
3. **Foster a culture of openness and accountability:** Businesses should establish an openness and accountability culture that encourages independent directors to speak up when they observe governance issues or concerns. [10]This can be accomplished by fostering a climate in which independent directors feel comfortable addressing issues and by establishing reporting and resolution mechanisms.
4. **Increase independent directors' role in risk management:** Independent directors should play a more significant role in overseeing risk management, particularly in detecting and managing emerging risks that could impact the company's performance or reputation. This can aid in ensuring that the board is aware of the company's risks and that suitable steps are in place to manage them.
5. **Strengthen regulatory oversight and enforcement:** Authorities should increase their oversight and enforcement of corporate governance standards to guarantee that corporations comply with applicable laws and regulations. This may involve routine audits of corporate governance processes, stricter reporting requirements, and harsher fines for noncompliance.

[10]Mittal, P. (2011). The role of independent directors in corporate governance. NUJS L. Rev., 4, 285.

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