Chapter 7 Conclusion and Suggestions

Numerous shareholders who contribute to the capital of the company elect a Board of Directors to monitor the running of the company on their behalf. The Board, in turn, appoints a team of managers who actually handle the day-to-day functioning of the company and report periodically to the Board. Thus managers are the agents of shareholders and function with the objective of maximizing shareholders’ wealth. It has been equally true that large numbers of companies in India have a controlling shareholder or are dominated by business families. It has always been a challenge to effectively monitor management and ensure that controlling shareholder may not succeed in expropriating assets of other shareholders or behave in some other opportunistic manner.

Kraakman et al\textsuperscript{294} identify three types of agency problems: (i) the conflict between managers-agent and owners, being shareholders- principal, (ii) the conflict between controlling shareholders-agent and minority shareholders- principal, and (iii) that between the company itself (agent) and other stakeholders with whom the company contracts, such as creditors, employees and customers- principal. The central issue is the nature of the contract between shareholder representatives and managers. Such contracts are necessarily “incomplete”.

Over all these chapters it has been observed that independent directors assume critical role in this regards. Through this study the aim was to ascertain emerging role of independent directors. However, to be effective the concept of independence should be meaningful. Therefore, one may think of independence as requiring “both the willingness and ability to sustain...‘rigor and skeptical objectivity’ when its object is sponsored by or especially beneficial to the [controlling shareholder]”\textsuperscript{295}.


\textsuperscript{295} Langevoot supra note 269
One of the perceived weaknesses in the existing system of independent directors in India is the lack of clarity regarding their role. It is not clear whether independent directors are to perform an advisory role or a monitoring role (by overseeing management and controlling shareholders). It is also not clear whether independent directors are to act in the interest of the shareholder body as a whole or whether they are required to pay any specific attention to the interests of the minority shareholders. Taking lessons from Satyam and as an important aspect of legal reform in the field of corporate governance, policy makers and legislators have been increasingly placing reliance as well as responsibility on independent directors to ensure that companies demonstrate high levels of corporate governance. That the role and functionality of independent directors have been expanding with passing time is well established. Company Act 2013 that is an excellent indicator of such extension.

As mentioned in earlier parts of this study, MCA (Ministry of Corporate Affairs) Guidelines made important contributions to the corporate governance debate in India and addressed the agency problems between majority shareholders or promoters and minority shareholders.\textsuperscript{296} However, one of the greatest limitations of these guidelines was that they were voluntary in nature. As noted by Indian corporate law scholar Umakanth Varottil, the approach of the MCA Guidelines with respect to this agency issue remains incomplete since the guidelines “do not provide for additional mechanisms such as cumulative voting for election of independent directors or approval of related party transactions by a committee consisting only of independent directors or by independent shareholders.”\textsuperscript{297} However, with enactment of Company Act 2013 a mammoth task been accomplished. It not only mandates but also contains complete Code of independent directors.

Reinstating a strong belief that independent directors and their duties are not confined merely to public shareholders but also stakeholders, the Act makes explicit provisions in this regards. Moreover the Act provides enabling


\textsuperscript{297} Id.
environment to the independent directors so that they may function in a free and fair manner. A quick overview of relevant provisions demonstrates that right from appointment of independent directors to their duties and liabilities, every aspect has been clearly laid out. In fact numerous suggestions and recommendations of erstwhile committees formed by MCA and SEBI have been duly incorporated and certain novel procedures have been laid out. It is has been duly realised that it is not enough to have an independent board; an enabling environment that helps independent directors to exercise their independence is also required.

**Definition of independent directors**

It was felt that the term ‘independent’ as defined in Clause 49 and other guidelines adopted highly subjective criteria. Present Act has been formulated a set of criteria that defines the “independence” of a director itself in much more objective manner in consonance with international best practices.

**Nomination committee and data bank**

Most committees formulated to report on corporate governance had recommended that appointed of independent directors should not be made by the promoters/board but a separate nomination committee should be formed for such appointment. Taking a serious note of such recommendations Company Act 2013 mandates that a Nomination and Remuneration Committee shall be appointed for the purpose of identifying qualified persons to become directors.298

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298 **178. (1)** The Board of Directors of every listed company and such other class or classes of companies, as may be prescribed shall constitute the Nomination and Remuneration Committee consisting of three or more non-executive directors out of which not less than one-half shall be independent directors:
Provided that the chairperson of the company (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.

(2) The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal and shall carry out evaluation of every director’s performance.

(3) The Nomination and Remuneration Committee shall formulate the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees.
Moreover by virtue of Sec. 150 selection of independent directors can be made from a data bank containing names, addresses and qualifications of persons who are eligible and willing to act as independent directors. Such data shall be maintained by anybody, institute or association, as may be notified by the Central Government.\(^{299}\)

### 7.1 Suggestions

Some of the suggestions are as under:

#### 7.1.1 Board composition

Time and again it has been suggested that the board should consist of a majority of independent directors. Adequate representation of independent directors on corporate boards is necessary to make their voice heard and their decision count, especially due to promoter dominance in Indian companies. However, the Company Act has provided that every listed public company shall have at least one-third of the total number of directors as independent directors and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies.\(^ {300}\)

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\(^{299}\) **150.** (1) Subject to the provisions contained in sub-section (5) of section 149, an independent director 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:

Provided that responsibility of exercising due diligence before selecting a person from the data bank referred to above, as an independent director shall lie with the company making such appointment.

(2) The appointment of independent director shall be approved by the company in general meeting as provided in sub-section (2) of section 152 and the explanatory statement annexed to the notice of the general meeting called to consider the said appointment shall indicate the justification for choosing the appointee for appointment as independent director.

(3) The data bank referred to in sub-section (1), shall create and maintain data of persons willing to act as independent director in accordance with such rules as may be prescribed.

(4) The Central Government may prescribe the manner and procedure of selection of independent directors who fulfil the qualifications and requirements specified under section 149.

\(^{300}\) Sec. 149(4).
7.1.2 Representation of minority shareholders

Recognising the current corporate sector scenario in India where large number of family run companies dominates the scene, it had increasingly been felt that minority shareholders have no say in appointment of board or major decisions that it makes. At times it was felt that the management and controlling shareholders worked hand in glove with each other to the detriment of minority shareholders. Company Act 2013 makes a welcome provision in terms of appointment of director elected by small shareholders. Thus by virtue of Sec. 151 listed company may have one director elected by such small shareholders.\(^{301}\)

7.1.3 Mechanism of check and balance

In order provide that the independent directors and the board provide counter forces to one another, there is an inbuilt check and balance system created in the statute. Thus one hand independent directors have been mandated to have at least one meeting during the financial year where non-independent will not remain present and in such meeting an evaluation of other directors and board shall be made.\(^{302}\) On the other hand, performance of independent directors shall be evaluated by the entire Board of Director, excluding the director who is evaluated and only based on such performance report his/her term will be extended.\(^{303}\)

Aforesaid points makes it amply clear that the legal and regulatory merit in proactive steps being taken by the regulator to safeguard the interest of the minority shareholders. In this scheme of things, the board of directors, and especially the institution of independent directors, becomes an important regulatory mechanism for the protection of other stakeholders as well.\(^{304}\)

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\(^{301}\) 151. A listed company may have one director elected by such small shareholders in such manner and with such terms and conditions as may be prescribed. Explanation.—For the purposes of this section “small shareholders” means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.

\(^{302}\) Supra note 278.

\(^{303}\) VIII. Evaluation mechanism:
(1) The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated.
(2) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

\(^{304}\) See chapter 6 for details.
In addition to these merits of the legal framework, the researcher seeks to point out couple of essential issues that may be looked into to further strengthen the enforcement and compliance of laws. One, closed ownership structure of many Indian firms explains the compliance discrepancy between top private sector companies and other private companies. While top companies have strong incentives to increase transparency and compliance as they are competing for foreign direct investment, smaller private companies continue to face many compliance obstacles.\(^{305}\) There needs to be created better awareness and compliance related benefits to such smaller private companies. Two, the closed ownership structure of Indian firms has also meant that there is little shareholder activism in India, and investors spend little time communicating their concerns to the board of directors or the management of a firm.\(^{306}\) It is therefore suggested that shareholder activism in addition to corporate governance measures will go a long way in attaining healthy corporate sector in India.

Many commentators view the conflicts between SEBI and the MCA as a leading cause of lax enforcement of corporate governance standards.\(^{307}\) Experts have noted that the “[l]ack of cooperation and coordination between key government departments, in particular MCA and SEBI,” further weakened enforcement and implementation efforts, resulting in “overlap of jurisdiction or regulatory gaps.”\(^{308}\) A number of commentators have challenged SEBI’s authority to promulgate extensive corporate governance rules.\(^{309}\) Despite SEBI’s long-term involvement in formulating corporate governance standards, such debates do persist. For example, in a recent editorial, a Special Secretary to the Ministry of


\(^{306}\) See Jayati Sarkar & Subrata Sarkar, Large Shareholder Activism in Corporate Governance in Emerging Economies: Evidence from India, 1:3 INT’L REV. FIN. 161 (2000 )


Finance noted that “SEBI must accept that its powers are limited and subordinate to the MCA and not coextensive with it, and hence, has to refrain from framing its own rules concerning corporate governance.”\(^{310}\) It is therefore suggested that with enactment of Company Act 2013, SEBI and MCA function in a co-ordinated and co-operative manner so as to ensure better compliance.

In emerging economies such as India where investor awareness is low and market regulation is relatively weak, larger dependence regarding regulation of corporate sector is State sponsored. The traditional closed or government-controlled ownership structures of Indian firms have resulted in weak boards and weak board practices. As identified by the World Bank, “a key missing ingredient in India today is a strong focus on director professionalism.”\(^{311}\)

Having made a theoretical and historical inquiry into the evolution of independent directors, this study examined how independent directors have attained a mandatory position. An exploration into Anglo-American concepts and models makes it amply clear that independent director as concept has not only been transplanted in India but also gained much deeper roots and flourishing. The hypothesis of this study that the scope and function of independent directors have emerged to address not only conventional management-shareholder agency problem but also minority-majority shareholder problem more peculiar in India stands proved. Further that independent director’s concept can be extended even to resolve the third set of agency problem i.e. the company and other stakeholders also holds true. Interestingly, at the time when this study was initiated the new Company Bill was in the pipeline. However, with the Bill finally being enacted, the hypothesis of this study was further strengthened.

The Guidelines appear to have addressed these concerns, at least to some extent, by requiring that for every agenda item at the board meeting, there has to

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be prepared an “Impact Analysis on Minority Shareholders” which discusses any impact that the agenda item may have on the rights of minority shareholders.

Deepak Parekh, Chairman of the Housing Development Finance Corporation (HDFC), India’s leading housing finance company, noted, “You can frame any amount of rules, regulations and guidelines and laws. But corporate governance must come from within..... It has to be voluntary, it should come from the top, and it should percolate down to the entire organization.” Mandatory requirements may work better in certain contexts, but they are of little use without effective enforcement. Of course it may be that for the Indian context the best approach to corporate governance would combine mandatory rules (minimums) with flexible voluntary guidelines.313

Thus it is evident that the scope and functionality of independent directors is not limited to solving agency problems of shareholder and management, but assumes extended role. Whilst independent directors may always discharge conventional duties, present company law statute assigns much scope for their effective role playing in corporation. During the course of research it becomes amply clear that independent directors are provided much needed elbow room in the Board. The hypothesis thus stands proved in the light of affirmative answers to research questions framed and inquired. Independent Directors are here to stay and make their mark on corporate governance and functionalities. They are well equipped to voice concerns of minority shareholders and stakeholders, thereby advancing overall interest of the Corporation through their close questioning and asking hard questions.