Chapter 7
CHAPTER-7

Independent Director System Enabling Model

The role and importance of Independent directors in a unitary board structure is unquestionable and almost there is global convergence on this point. Gupta (1988) has remarked, “There can be no denying the fact that excellence in board functioning cannot be secured without first ensuring its independence from the dominance of one person, a family or group. Other attributes will come into play only if independence is first ensured.” Goplasamy (2006) on this point writes, “An active and involved board consisting of professional and truly independent directors plays an important role in creating trust between a company and its investors, and is the best guarantor of good corporate governance”.

The present study reveals that UK has not only ensured majority presence of (more than 60%) Independent Directors in their boards but also ensured the presence and compliance of associated enabling factors to strengthen its Independent Directors system in each board. The resultant output from the UK independent director system is, therefore, very effective in avoiding board unbalance and the situation of any one group having unfettered control and power over the board decisions. As a result of the benchmarked standards on the matter of board independence UK is now is in position to pull its corporate governance to still greater heights even without the presence of a mandatory corporate governance provisions.

The importance of Independent Directors in the Indian context is much more than that of UK because of the concentrated shareholding structure with dominant group, multinationals, GOI, family or promoter group having the direct influence over the top management of a corporation even bypassing the board. (Figure-7.3). The average Indian boards as a result are severely unbalanced. The large and significant difference on most of the parameters empirically studied showing presence of larger numbers of executive chairman, lesser separation of roles between chairman and CEO, larger presence of promoter chairman, greater presence of Executive directors in boards, absence of nomination committee, faint presence of other enabling factors also point
toward the same. In this situation the maximum 50% stipulation of independent directors as per The Revised Clause 49 are not enough unless they are given the tools and enabling and empowering tools and tackles to deal with the unbalance (Figure-7.1). In this situation the individual directors need to be enabled and empowered. Indian corporate governance system has till date not given much emphasis on these enablers. The same is also revealed when the structural components of Combined Code and the Revised Clause is studied in minute detail. (Figure-1.4, 1.5, 1.6 & 1.7).

Iyer, L.V.V. (2008) writes in Economic Times, Calcutta edition, dt.d. 21³ March'2009 on the backdrop of Satyam Fraud, “It is self evident that the institution of independent directors and audit are the pillars of corporate governance without which corporate governance becomes a sham- an edifice in quicksand. Clause 49 of the Listing Agreement has no doubt brought about a conceptual primacy in this regard. However, in practice these two institutions have been rendered a farce of sorts.” The independent directors are inducted in the board based on fulfilling the criteria of definition of independence as per the Revised Clause-49. These Independent Directors are supposed to take the decisions in an objective and impartial manner independent from management but has few resources at his/her command to make independent assessment of topics under consideration.

It is in this context of the need for strengthening of the Independent Directors in India and based on current comparative corporate governance practices between India and governance practices of UK companies, I offer a model to which I call ‘Independent Director Enabling System Model’ which seeks to emphasize that there is need to change our perceptions of board independence and not to confine it within the periphery of just fulfilling the numerical strength of individual Independent Directors as per The Revised Clause. There is urgent need to install the strong presence of such enablers as depicted in the Independent Director System. (Figure-7.1). A figurative sketch (Figure-7.1) of the Independent Director System with individual directors at its centre and other enabling factors has been shown. The ‘Independent director system enabling model’ conceived in wheel and spike shape in another figure (Figure-7.2) visualize the reasoning that only when all factors forming the independent director system are strengthened, which can be done by putting provisions of each factors
against mandatory side of the Revised Clause 49 and ensuring strict compliance of the same, that the independent directors will be enabled and empowered and the problem of board unbalance and unfettered power and control over the board of one group will be avoided. A unified approach is, therefore, required to make the independent directors enabled and empowered with the presence and strengthening of such above factors. Lorsch (2000) writes in terms the benefits of an enabled and empowered board, in USA context, which holds true for every other country and addresses to CEO, “empowered directors can help them (CEO) and their companies, and if they encourage this trend, board empowerment can be achieved with minimal fuss and maximum benefit to CEOs, shareholders, and the US economy”. The current study further calls for further research to add further other enabling factor which is helpful in Indian condition. But the key concept is that when we talk of Independent directors and their effectiveness in a board we should take other enabling parameters and their simultaneous presence in the board. The study, therefore, suggest that each of the factors as mentioned in the model envisaged above should be incorporated into our corporate governance system (more specifically into mandatory section of the Revised Clause 49). The factors recommended in the Model along with the position held on the issue by reputed organizations, codes, guidelines and researchers has already been discussed in the earlier chapters. Factors which the current ‘Independent Director System Model’ (Figure-7.2) seeks to enforce by incorporating into the mandatory section of The Revised Clause 49 have been depicted in the Figure 7.1 and the same are discussed below:

1. **Nomination Committee**: The manner of selection of independent directors is key area which needs immediate improvement. A professional approach where right and functional candidates The Satyam case in India might invoke criticism on role and function of independent directors in India but the real culprit seems to be the lack of independent selection process and the absence of effective enabler of the independent director system as pointed out in the model.

2. **Lead Independent Director**: In Indian condition the Lead Independent Directors apart from other important roles can play helpful role in Board agenda taking into accounts views of other Independent Directors of the board. The group of
Independent Directors can be effectively sidelined for want of an effective unifier like Lead Independent Director. Bansal (1989) writes, "Many of the evils afflicting the boards are due to the fact that the directors have little participation in the formulation of agenda and minutes of the board. Consequently, agenda items reflect the proclivities of the Chief Executive Officer and his close aides."

3. **Meeting without management:** There should be an opportunity for the Independent directors to meet periodically (at least annually) outside the presence of the CEO and other inside directors as well as non-independent executive directors. The purpose is to give them an opportunity to discuss in private in order to foster better communication and inquiry. NYSE on the issue notes, "Board must convene regular sessions (at least once a year) in which the non-management directors meet without management. The Business Roundtable (2002), which is an association of CEO in USA, carries the view "Independent Directors should have the opportunity to meet outside the presence of the CEO and any other management directors". Salmon (2000) on the need of the meeting without management writes, "For one thing, chances are that their outside members don’t know each other well. They fail to develop confidence and trusts in each other and a resulting sense of cohesiveness. For that reason alone, I believe it’s imperative that outside directors meet from time to time without management."

4. **Induction and continuous development:** While agreeing on the issue Iyer, L.V. (2009) writes in the backdrop of Satyam Scandals, "Continuing education for independent directors would be highly desirable. The corporate governance report should give details of such management development programmes attended by the independent directors of the company." WCFG (2005) in its London Declaration 2005, taken at 6th International Conference on Corporate Governance, held on 12-13, May 2005, at London and attended by 33 countries including India includes among its 10 step action plan the provision for education and training and stated, "The most important ingredient for improving the quality of boards and corporate governance decision making process is a strong commitment to continual education and training.... There needs to be proper education and study of financial statements and identification of frauds before they occur."
Bansal writes on the issue by comparing with that of UK, 
"... it is surprising that there has been a singular lack of awareness regarding the need for special training for directors. England has however taken a lead in this regard by opening an Institute of Directors concerned with conducting various types of training programmes for directors." In Indian context not enough unified efforts seems to be visible on the scale and dimensions as is present in UK.

5. **Performance Evaluation:** Current Indian practices are mainly limited to CEO which is required to be extended to each members of the boards including the Chairman and the board as a whole as is present in UK companies. The provision for the same is required to be kept among mandatory/non-mandatory provisions of The Revised Clause-49.

6. **Poor definition of independence and enforcement** - The definition of Independence which takes care of Indian conditions of caste, creed, region, religions etc are required to be adopted to avoid wrong selection. "Bob Garratt writes in his book, The Fish rots from the Head, "I realize that at present many 'independent' directors are not truly independent. It is a key challenge for corporate governance in the twenty-first century to ensure that they become so".

7. **Safeguard Provisions:** Almost all UK companies Annual Reports mentions about the provision. In Indian Annual reports it does not find any place. Safeguard on the line of UK pattern is required.

8. **Information Receipt:** The board must be given sufficient information to exercise fully its governance functions. Disclosure on this important area is largely observed in UK annual reports which are not seen in Indian annual reports and are desirable. The information receipt should be accurate, relevant and timely (ART) and there should be provision of personal liability from the Chairman and Company Secretary. Generally board members should receive information prior to board meetings so they will have an opportunity to reflect properly on the items to be considered at the meeting. Bansal(1989) discusses in details and writes, If anything goes wrong owning to absence of information etc, the board cannot escapes liability by pleading such an alibi. It is thus incumbent on directors to have up-to-date information regarding the
progress of the company so as to be able to effectively discharge their obligations.” OECD (1999) suggests, “Non-Executive board members do not typically have the same access to information as key managers to the company. In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information”. The Ganguly Committee on Banks and Financial Institutions (2002) speaks on the matter, “The Group notes that the effectiveness of the Boards largely depends upon the flow of information to and from the board. The information furnished to the board should be wholesome and complete and should be adequate to take meaningful decisions.” In this regard we require to take a lesson from UK practice where not only timely information is ensured but one single individual, the company secretary is held responsible for the same. It is worth noting that the removal of company secretary is a matter of board as a whole and UK guidelines is specific over this point.
Figure 7.1: Independent Director System
Figure 7.2: Independent Director System Enabling Model
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