CHAPTER 4

ROLE OF DIRECTORS IN CORPORATE GOVERNANCE

“Corporate Governance is about promoting corporate fairness, transparency and accountability” — James D. Wolfensohn
4.1 Introduction

The last decade of the twentieth century witnessed the opening up of Indian economy. The liberalization, privatization and globalization have resulted in integration of India economy with world’s economy in terms of product, capital and labour market. This integration has augmented the spread of capitalism and made the parameters like demand efficiency, corporate culture, model code of conduct and business ethics, mandatory for the very survival and growth of corporations in the world market place. In the recent years, there have been perceptible changes in the corporate ownership on account of exponential growth of capital market activities and active monitoring of corporate activities by the financial institutions. The investors are demanding more transparency in business operations, adequate and qualitative financial and non-financial information and more accountability on company board than ever before.

Corporate Governance and corporate management are two sides of the same coin. You can’t for long have one without the other. By corporate governance, we mean the process structures, and relationships through which the board of directors oversees what its executives do. By Corporate Management, we mean that what the executives do to define and achieve the objectives of the company. If good management is the face of coin, good governance is its other side.¹

A company is an artificial person created by law. It cannot, by its very nature, act on this own and has to act through or by agents. These agents are popularly called directors. These directors are the directing mind of the company through whom the business of the company is carried on or superintended. Unless powers are delegated to an individual director, individual directors of a company have no authority vis-à-vis the company. They can act only through the board of directors in a meeting.

The board of directors of a company is the most important pillar on which the whole structure of corporate governance is to be built. To make, the mission of

Corporate Governance meaningful, the Board of Directors is desired to adopt a radical change in their perceptions. They have to promote co-ordination amongst various components, but not for mutual benefits. To Board of Directors, corporate governance inevitably necessitates to shade away their feudal character and to develop more realization for social responsibilities. Directors play a very important role in corporate governance. They are the backbone of a good corporate governance. They ensure effective compliance of legal and ethical standards.

4.2 **Board Leadership**

A good leader attract, develop and retain best talent in the organisation. Board of director should retain a strong leadership bench and build leadership capability for the future. With the team of superior leaders at all levels, company can outperform competitors and dominate the industry.

Succession planning is more than just deciding who will be the next CEO. Boards should proactive in developing leadership skills throughout their organization by developing a culture of accountability; coaching young management; and developing both formal and informal structures that indentify and enhance leadership potential. An organization’s succession program also needs to be revamped to match business needs. Leadership development as well as succession planning must be incorporated in to the strategic business plan in order to have a real impact. Succession planning and leadership development should form a part of the systems perspective of the organization. Succession management is an organization-wide function and it is not merely concentrated at top tier. Ronald A Heifetz of Harvard observed that instead of telling people what to do , real leaders focus their attention on helping people find their own way through adaptive challenges and overcome problems without readily apartment solutions.

Organizations need to create a culture where everyone be made accountable for providing solutions to business issues. Managers are not solely responsible

---


for finding solution to business problems. The rest of the team should also develop leadership qualities in order to assist the management in decision making process.  

A company should consciously develop managers as avenues for developing leadership skills in the lower ranks. The culture of learning helps a lot in developing leadership traits, instead of putting blame on others. If personnel in an organization are given tasks in informal leadership roles without lead task forces of projects then, this will help in developing leadership qualities. In addition, investment in formal training and development programmes under top-down approach will help in leadership development among personnel.

4.3 Factors that Prevent Boards from Exercising Visionary Leadership

There are number of factors that prevent boards from exercising the kind of visionary leadership. Taken together, these factors provide a checklist for assessing your board and identifying areas to target for improvement. Examining these barriers to visionary board leadership can be the first step in revitalizing an existing board or building a powerful board from scratch. Let's look at some of them now:

4.3.1 Time Management

Lack of time to attend meetings, read materials and maintain contact with each other in between meetings. The board members need to organize themselves for maximum effectiveness and avoid wasting time on trivial matters.  

Time management held board to do everything to organize the maximum effectiveness and avoid wasting time on trivial matters.

4.3.2 Resistance to Risk Taking

In order to be innovative and creative in its decision-making, boards must willing to take chances, to try new things, to take risks. Success in new venture is never granted. Boards need to acknowledge the attention point and discuss it with funders and other key supporters. Board leadership must strike

4 Supra n. 2.
5 http://www.createthefuture.com стратегического мышления, Date: 8 January 2012, Time: 3:49 P.M.
a balance between taking chances and maintaining the traditional stewardship role.7

4.3.3 Strategic Planning

Strategic Planning is necessary for compete in the market. Strategic planning offers boards an opportunity to think about changes and trends that will have significant impact and develop strategies to respond to challenge. Some boards are not involved in strategic planning at all and others are involved in superficial way. Therefore, the boards lose an important opportunity to exercise visionary leadership skills.8

4.3.4 Complexity

Board members frequently lack a deep understanding of critical changes, trends and developments that challenge fundamental assumptions about how it defines its work and what success looks like. This lack of knowledge results in lack of confidence on the part of the board to act decisively and authoritatively.9

4.3.5 Micro Management

It is critical that the board focuses its attention on items of critical importance to the organization. The board must avoid the temptation to micro-manage or meddle in lesser matters or in areas that are more appropriately handled by the professional staff.10 While individual board members can certainly lend their skills and insights to management as operational volunteers, the job of the board as a body is not to help manage, but in a trustee sense to own the business on behalf of members.11

7 Supra n. 5.
8 Ibid.
9 http://www.cymtrix.com/cgi-bin/site/archive.html?default_siteObject_siteObjectID=237154, Date: 8th of January 2011, Time: 3:55 P.M.
10 Supra n. 5.
11 John Carver, "Reinventing Governance", http://www.asaecenter.org/Resources/AMMagArticleDetail.cfm?ItemNumber=2363, Date: 28th of September 2011, Time: 8:10 P.M.
4.3.6 Clinging to Tradition

Maria and Scott- Morgan in “The Accelerating Organization” point out that continuous shedding of operating rules is necessary because of changing environment conditions. But shielding becomes more complicated in systems involving human beings, because their sense of self-worth is attached to many old rules. This human tendency to hold on to the known prevents boards from considering and pursuing new opportunities which conflict with the old rules.12

4.3.7 Confused Roles

Some boards assume that it is the job of the executive director to do the visionary thinking and that the board will sit and wait for direction and inspiration. This lack of clarity can result in boards that do not exercise visionary leadership because they do not think it is their job.13

4.3.8 Past Habit

Time was when clients, members and consumers would just walk in the door on their own. Viewing things in this way, boards did not consider market place pressures, or for that matter a competitive market-place. All that has changed yet for many boards their leadership style has not kept pace with this new awareness. They do not want to change.14

4.4 Director

‘Director’ includes any person occupying the position of director, by whatever name called.15 The important factor to determine whether a person is or is not a director is to refer to the nature of the office and its duties. It does not matter by what name he is called. If he performs the functions of a director, he would be termed a director in the eyes of law even though he may be named differently. A director may, therefore, be defined as a person having control over the direction, conduct, management or superintendence of the affairs of a company. Again, any person in accordance with whose direction or

12 http://www.createthefuture.com/strategic_thinking.htm, Date:- 8th January 2012, Time:- 3:49 P.M.
13 Supra n 9.
14 Ibid.
15 The Companies Act,1956.; Section 2 (13).
instructions, the board of directors of a company is accustomed to act is deemed to be director of the company. But such a person shall not be deemed to be a director if the Board acts on advice given by him in a professional capacity.\textsuperscript{16}

4.5 Director’s Interest

Every director of a company is required to disclose the nature of his concern or interest at a meeting of the Board of directors in a contract or arrangement, or proposed contract or arrangement, entered into or to be entered into, by or on behalf of the company, if the director is in any way, whether directly or indirectly, concerned or interested in the contract or arrangement. The provisions enacted in the section 299 (and also of sections 297 and 300) are founded on the principle that a director is precluded from dealing on behalf of the company with himself and from entering in engagements in which he has a personal interest conflicting, or which possibly may conflict, with the interest of those whom he is bound by fiduciary duty to protect.\textsuperscript{17}

4.5.1 Disclosure of Interest

Every director a company who is any way, whether directly or indirectly, concerned or interested in a contract or arrangement, or proposed contract or arrangement, entered into or to be entered into, by or on behalf of the company, shall disclose the nature of his concern or interest at a meeting of the Board of directors.\textsuperscript{18} The required disclosure must be made by a director ‘at a meeting of the Board of directors’. This indicates that no other mode of disclosure than that stipulated by the section, namely a formal disclosure at a Board’s meeting, is permissible and where therefore a director fails to disclose at a meeting of the Board, he would fall a prey to the serious consequences of the failure.\textsuperscript{19}

Subsection (6) of section 299 provides that nothing in this section shall apply to any contract or arrangement entered into or to be entered into between two

\textsuperscript{17} North-West Transport Co. v. Beatty (1887) 12 App. Cas. 589.
\textsuperscript{18} The Companies Act, 1956.; Section 299 (1).
companies where any of the directors of the one company or two or more of them together holds or hold not more than two percent of the paid up share capital in other company. A contract or arrangement in which a director is interested but of which he fails to disclose interest therein is not void and unenforceable vis-à-vis the company. The failure on his part to make such a disclosure, though it has been made punishable, does not have the effect of rendering the contract void or unenforceable. Such a contract is also not hit by section 23 of the Indian Contract Act, as an agreement opposed to public policy.  

4.5.2 Interested Director not to Participate and Vote in Board’s Proceedings

The directors should be in a position to take independent, unbiased and uninfluenced decision on the matter in which a co-director is interested. The interested director shall not take part in the discussion at the meeting of the Board on the contract or arrangement in which he is interested. He/She shall not vote on the resolution in connection with such contract or arrangement. She/he shall not count for the purpose of forming a quorum at the time of such discussion and voting. 

These three prohibitions shall not apply in the case of a director who is concerned or interested in a contract or arrangement in the following cases:-

(a) Private company which is neither a subsidiary nor a holding company of a public company.

(b) A private company which is a subsidiary of a public company, in respect of any contract or arrangement entered into, or to be entered into, by the private company with the holding company thereof.

(c) Any contract of indemnity against any loss which the directors, or any one or more of them, may suffer by reason of becoming or being sureties or a surety for the company.

(d) If the contract or arrangement is entered into or to be entered into by any company (public or private) with a public company, or with a private company which is a subsidiary of a public company, if the interest of the

---


21 The Companies Act,1956.; Section 300 (1).
director of such other contract or arrangement consists solely because he is a director of such other company and holds not more than shares of such number or value therein as is requisite to qualify him for appointment as director thereof, i.e. qualification shares, he having been nominated as such director by the first-mentioned company.

(e) If the contract is entered into or to be entered into by the any company (public or private) with a public company, or with private company which is subsidiary of a public company if the interest of the director in such contract or arrangement consists solely in his being a member of such other company holding not more than two per cent of its paid-up share capital.

(f) If it is a public company or a private company which is a subsidiary company which has been exempt from sub-section(1) by a notification issued by the Central Government under sub-section (3) of the section 300.  

22

4.5.3 Register of Contracts, Companies and Firms in which Directors are Interested

Every company shall keep a register of contracts and arrangements in which directors are interested as provided in Sections 297 and 299 of the Companies Act, 1956. The register should contain the following particulars of contracts, companies and firms in which directors are interested, to the extent they are applicable in each case:-

(a) the date of the contract or arrangement.
(b) the names of the parties thereto.
(c) the principal terms and conditions thereof.
(d) the date on which the contract or disclosure was placed before the Board of Directors and
(e) the names of the directors voting for and against the contract or arrangement and the names of those remaining neutral.

22 Id.; Section 301 (2). See also K.M.Ghosh & Dr. K.R. Chandratre “Company Law with Secretarial Practice Part-2”, (2008), p. 3916.
The register shall be placed before the next meeting of the Board and shall be signed by all the directors present at the Meeting.\textsuperscript{23} The register shall also specify the names of companies or firms in which a director is interested if he has given notice of the same under Section 299(3) of the Act.\textsuperscript{24} For not maintaining the register in proper form as required by section 300 of the Companies Act the company and every officer who is in default shall be punishable with fine up Rs 5,000 for each default.\textsuperscript{25} The registers are to be kept at the registered office of the company. Any member may inspect, take extracts there from and on payment of fees may obtain copies of the same.\textsuperscript{26}

4.5.4 Disclosure to Members to Director’s Interest in Contract Appointing Manager and Managing Director

Where a company enters into a contract for appointment of a Manager, or varies any such contract of a manager already in existence and in which a director is concerned or interested, the company shall within 21 days from such entering into or variation of the contract send to every member an abstract of the terms of the contract or variation specifying the nature of concern or interest of the director.\textsuperscript{27}

If a director becomes concerned or interested after such contract or variation, then also within 21 days a memorandum explaining the concern or interest of the director shall be sent to each member. If Board of directors by resolution appoint a manager or managing director or whole-time director or varies any existing contract, then within 21 days thereof the company shall send to every member of the company an abstract of the terms of the contract or variation clearly specifying the nature of the interest of any director in such contract or variation.\textsuperscript{28}

For failure to disclose to the members, director’s interest in contract appointing managing director or manager, the company and every officer who

\textsuperscript{23} Ibid.
\textsuperscript{24} The Companies Act, 1956; Section 301 (3).
\textsuperscript{25} Id.; Section 301 (4).
\textsuperscript{26} Id.; Section 301 (5).
\textsuperscript{27} Id.; Section 302 (1).
\textsuperscript{28} Id.; Section 302 (4).
is in default shall be punishable with fine up to Rs. 10,000. All contracts of
appointment of a manager or managing director shall be kept at the registered
office of the company and shall be open for inspection by any member. A
member may take the extract or copies of the contract on the payment of
fees.30

4.6 Remuneration of Directors

The remuneration payable to the directors of a company, including any
managing or whole-time director, is determined either by the Articles of the
company, or by a resolution passed by the company in general meeting.31 If
article so require the special resolution is to be passed. Directors have no right
to be paid for their services and cannot pay themselves or each other, or make
presents to themselves out of the company’s assets unless authorized to do so
by the instrument which regulates the company (i.e. the Articles) or by the
shareholders at a properly convened meeting.32 The Articles may also require
that a special resolution is to passed for the purpose.33 Remuneration payable to
the directors is part of the overall managerial remuneration which cannot
exceed 11 percent of the net profits.34 Any remuneration for services rendered
by any such director in any other capacity shall not be included in the
remuneration, if the services are of a professional nature and in the opinion of
the Central Government, the director possesses the requisite qualifications for
the practice of the profession.35 If the Central Government is of the opinion
that the director has the requisite qualifications to render the professional
services then it is not bound to impose any restrictions on the amount of the
remuneration payable to him for his professional work.36 A director may
receive remuneration by way of a fee for each meeting of the Board, or a
committee thereof, attended by him.37

29 Id.; Section 302 (5).
30 Id.; Section 302 (6).
31 Id.; Section 309 (1).
32 Lindley L.J. observed in Re George Newman & Co., (1895) 1 Ch. 674.
34 The Companies Act, 1956; Section 198.
35 Id.; Section 309 (1).
36 Sree Gajanana Motor Transport Co. Ltd. v. Union of India, (1992)73 Comp. Cas. 348 (Kar.).
37 The Companies Act, 1956; Section 309 (2).
A director who is either in the whole-time employment of the company or a managing director may be paid remuneration either by way of monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by other. Without the approval of the Central Government such remuneration shall not exceed five percent. of the net profits for one such director, and if there is more than one such director, ten per cent. for all of them together.38 If the increase in remuneration of managerial personnel is in accordance with the provisions of Schedule XIII, then the Central Government approval will not be necessary.

In granting sanction in any matter, e.g. approval of remuneration paid to directors for services as technical adviser, the Central Government may impose such conditions as it may think fit and if such conditions are not complied with, it can revoke the approval or sanction. This power is to be exercised subject to any express provision in the Act. The conditions imposed must be reasonable and relevant to the matter before the Government.39 With the approval of the Central Government a director may be paid remuneration by way of a monthly, quarterly or annual payment.40

By passing special resolution the company can pay remuneration to directors. The total remuneration paid to one or more directors should not exceed the following:-

(i) One percent, of the net profits of the company, if the company has a managing or whole time director or a manager.

(ii) Three percent, of the net profits of the company, in any other case.41

The company in general meeting with the approval of the Central Government may authorize payment to one or more directors out of the net profits at any other enhanced rate. If any director draws or receives directly or indirectly by remuneration in excess of the permissible limit or without requisite approval, where necessary, he will have to refund such excess or unauthorized sums to the company. He will hold such sums in trust so long the same are not

38 Id.; Section 309 (3).
39 Canara Workshops Ltd. v. Union of India, (1966) 36 Comp. Cas. 63 (Mys.) (DB).
40 The Companies Act, 1956; Section 309 (4) (a).
41 Id.; Section 309 (4) (b).
refunded to the company. The company can not waive refund of the remuneration received by a director in excess of permissible limit or without requisite approval. The Central Government in an appropriate case may, however, permit the company to waive such contravention.

Director who is in receipt of commission, Managing Director or Whole-time director cannot at the same time receive any commission or remuneration from any subsidiary company. A director who performs any additional task would become an employee of the company and therefore fall with in the purview of the Employees’ State Insurance Act, 1948(34 of 1948). Where there was nothing on record which showed that any of the directors received any additional amount over and above their remuneration for being on the Board of directors they were not covered by the Employees’ State Insurance Act, 1948.

4.6.1 Provision of Increase in Remuneration to Require Government Sanction

Any increase in remuneration of any director, managing director or whole-time director or manager, irrespective of the fact whether such remuneration has been fixed by Memorandum, Articles, Agreement or by Resolution of the Board of directors or the Company shall not have any effect unless:

(a) such increase is in accordance with the conditions specified in Schedule XIII to the Act, where the Schedule applies;

(b) it is approved by the Central Government in any other case.

Any amendment increasing remuneration shall be void to the extent that the Central Government disapproves. Provided that the Central Government’s approval will not be necessary if such provision or amendment increase the fee for attending Board Meeting or Committee meeting not exceeding the prescribed sum for each meeting.

42 Id.; Section 309 (5A).
43 Id.; Section 309 (5B).
44 Id.; Section 309 (6).
47 The Companies Act,1956; Section 310.
In granting sanction in any matter, e.g., approval of remuneration paid to directors for services as technical adviser, the Central Government may impose such conditions as it may think fit and if such conditions are not complied with, it can revoke the approval or sanction. This power is to be exercised subject to any express provision in the Act. The conditions imposed must be reasonable and relevant to the matter before the Government.\footnote{Canara Workshop Ltd. v. Union of India, (1966) 36 Comp. Cas. 63 (Mys.) (DB).} In case of appointment or re-appointment of a managing director, whole-time director or a manager increasing the remuneration which he was receiving immediately before such re-appointment or appointment shall not have any effect:

\begin{enumerate}
    \item unless such increase is in accordance with the conditions specified in Schedule XIII, where it is applicable;
    \item in any other case unless it is approved by the Central Government.
\end{enumerate}

Such appointment or re-appointment shall become void to the extent the central government disapproves.\footnote{The Companies Act,1956; Section 311.} The sanction of the Central Government is necessary even though the remuneration that will be paid on such appointment or re-appointment would be within the limit provided in Section 309 of the Companies Act.\footnote{CR Datta, “The Company Law Part-3”, (2008) p. 4962.}

\section*{4.7 Managerial Remuneration}

Payment of compensation or reward to directors for the services provided by them to the company is called under the Act ‘remuneration’. To remunerate means to pay, recompense, or reward for work, trouble, etc.; a sum of money paid for a service given.\footnote{The word ‘remuneration’ is inclusively defined in the Explanation appended to the Section 198 of Companies Act. This definition is relevant for the purposes of all the provisions of Act and the Schedules which deal with director’s remuneration. The definition is very wide in scope, it excludes virtually nothing paid in cash or kind. The definition covers the following types of expenditure incurred by the company for the director or his family:}

\begin{enumerate}
    \item rent free accommodation;
    \item any benefit or amenity in respect of accommodation free of charge;
    \item any other benefit or amenity free of charge or at a concessional rate;
    \item any personal obligation; and
    \item insurance on the life of, or to provide any pension, annuity or gratuity for , any of the director or his/her spouse or child.
\end{enumerate}

or spends for or for the benefit of a director, in whatever form and by whatever name, would amount to remuneration. Salary, commission, perquisites, amenities and every other personal obligation of the director is remuneration under this definition.

4.7.1 Overall Maximum Managerial Remuneration and Managerial Remuneration in case of Absence or Inadequacy of Profits

A company may pay to its Director and Manager in respect of any Financial Year remuneration not exceeding 11% of its Net Profits of that year.\textsuperscript{52} However, the company may with the approval of the Central Government pay to its directors, managing directors, whole-time directors and manager a minimum remuneration in case of no profits or inadequacy of profits subject to the provisions of section 269 read with Schedule XIII.\textsuperscript{53} The Central Government should, however, consider the matter in the light of section 198(4) of the Act and the financial position of the company.\textsuperscript{54}

Remuneration does not include the fees paid under section 309(2) to directors for attending Board or Committee Meetings.\textsuperscript{55} A director can not be said to hold any office or place of profit if he receives the remuneration by way of fees for attending meetings to which he is entitled as such director. But, he will be said to hold any office or place of profit when besides such remuneration or sitting fees for attending meetings, he obtains from the company a remuneration such as salary, fees, commission, perquisites, etc.\textsuperscript{56}

The Managing or Whole-time Director(s) under section 309 and Manager under section 387 may be paid monthly remuneration within the maximum

\textsuperscript{52} The Companies Act 1956; Section 198 (1).
\textsuperscript{53} Id.; Section 198 (4).
\textsuperscript{54} Hind Ceramics Ltd. v. Company Law Board, (1972) 42 Comp. Cas. 610(Cal.)
\textsuperscript{55} The Companies Act 1956; Section 198 (2).

See also Section 309(2), “A director may receive remuneration by way of a fee for each meeting of the Board, or a committee thereof, attended by him:

Provided that were immediately before the commencement of the Companies (Amendment) Act 1960, fees for meetings of the Board an and any committee thereof, attended by a director are paid on a monthly basis, such fees may continue to be paid on that basis for a period of two years after such commencement or for the remainder of the term of office of such director, whichever is less, but no longer.

\textsuperscript{56} A. R. Sudarsasnam v. Madras Pursawalkam Hindu Janopakara Saswatha Nidhi Ltd., (1985) 57 Comp. Cas. 776(Mad.)
limit specified in section 198(1).\textsuperscript{57} If any officer of the company or an employee is paid commission or remuneration at a certain percentage of the net profits of the company then the calculation of net profits will be in the same manner as provided in case of directors and manager. The calculation is to be made according to the provisions of section 349 and 350 of the Act. The basis of calculation will be the same if the payment of commission or remuneration is based on net profits of the company.\textsuperscript{58}

### 4.7.2 Prohibition of Tax-Free Payments

No company shall pay any remuneration to its directors, manager, secretary, officer or employee free of income – tax including super-tax. This restriction even applies to payments made for working in any other capacity. The remuneration should not also be calculated by reference to or varying with any tax payable by such person or the rate, standard rate or amount of tax.\textsuperscript{59} For paying tax-free remuneration to any officer, etc. the company and every officer who is in default, shall be punishable under section 629 A with fine up to Rs. 5,000 and where the contravention is a continuing one, with a further fine up to Rs. 500 for every day of default.\textsuperscript{60}

The definition of tax as used here is not exhaustive. It has been clarified that the expression is limited to any kind of income-tax. Now the words ‘income tax’ used in the Finance Acts and the Income – Tax Act have been held to include surcharge and additional surcharge wherever provided in the Act.\textsuperscript{61} An income cannot be taxed twice. If income has accrued to the assessee and is liable to be included in the total income of a particular year accrual cannot be ignored to tax it as income of another year on the basis of receipt.\textsuperscript{62} In such case, it shall not be tax due and payment made in the subsequent year shall not be tax free.

---

\textsuperscript{57} The Companies Act, 1956 ; Section 198 (3).
\textsuperscript{58} Id.: Section 199.
\textsuperscript{59} Id.: Section 200. See also CR Datta, “\textbf{The Company Law Part-3}”, (2008) , p. 3002.
\textsuperscript{60} Id.: Section 629 A.
\textsuperscript{61} \textit{CIT} \textit{v.} Srinivasan (K) (1972) \textit{83} \textit{ITR} 346 (SC): \textit{AIR} \textit{1972} SC 491.
4.7.3 Avoidance of Provisions Relieving Liability of Officers and Auditors of Company

A Company cannot make any provision in its Articles or agreements or any other instrument exempting any officer or auditor of the company from liability for any negligence, default, misfeasance, breach of duty or breach of trust of which he may be guilty in relation to the company. The company cannot also indemnify such an officer or auditor for any loss or damage arising out of such wrongful acts. The only exception is where the officer or auditor incurs liability in defending any proceedings, civil or criminal, in which judgment is given in his favour or in which he is acquitted or discharged or in connection with any application under Section 633 of the Act in which relief is granted to him by the Court.63

4.8 Restriction on Number of Directorship

Before appointing a person as director, it is necessary to check whether as a result of his appointment the person would cross the statutory limit on the number of directorship. A person cannot hold office as director at the same time in more than 15 companies.64 These 15 companies must be Indian Public Companies as directorship in Foreign Companies or in Private Companies is not counted in reckoning 15 directorships. A person who is a director of 15 public companies, if appointed director of another company, such appointment will have no effect unless within 15 days the director vacates his office in any of the 15 companies in which he is already a director.65 If a person holding the office of director in 14 companies or less is appointed director of two or more companies, he will have to choose the directorship which he wishes to retain so that the total directorship remain within the limit of 15 directorship.66 Unless such a choice is made within 15 days all the new appointments shall be void.

For the purposes of Sections 275,276 and 277 the following companies shall be excluded: (a) a private company(not being subsidiary or holding company of a public company);(b) an unlimited company;(c) an association or company

---

63 The Companies Act,1956; Section 201.
64 Id.; Section 275.
65 Id.; Section 277 (1).
66 Id.; Section 277 (2).
not carrying on business for profit or prohibits payment of dividends; (d) a company in which such a person is an alternate director.\footnote{The Companies Act, 1956; Section 278.}

Any person who holds office, or acts, as director of more than fifteen companies punishable with fine which may extend to fifty thousand rupees in respect of each of those companies after the first fifteen.\footnote{Id.; Section 279.}

4.9 \textbf{Board’s Sanction to be Required to Certain Contracts in which Particular Directors are Interested}

Without the consent of the Board a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner in such a firm, or a private company of which the director is a member or director, shall not enter into any contract with the company - (a) for the sale, purchase or supply of any goods, materials or services; or (b) for underwriting the subscription of any shares in, or debentures of, the company.\footnote{Id.; Section 297 (1).} In the case the company has a paid-up share capital of Rs. 1 Crore or more the further approval of the Central Government would be required.\footnote{Ibid.} Consent of the Board shall be given by resolution at a Board Meeting and not by resolution by circulation.\footnote{Id.; Section 297 (4).}

The consent of the Board of directors is not necessary if the contracts are for purchase of goods and materials from the company or the sale of goods and materials to the company is for cash at prevailing market prices.\footnote{Id.; Section 297 (2) (a).} The restriction under Section 297 does not apply to any transactions in which the Company or the Director, etc., regularly trades or does business and the total value in a year does not exceed Rs. 5,000.\footnote{Id.; Section 297 (2) (b).} This restriction also does not apply to transactions entered into in the ordinary course of business by a banking or insurance company.\footnote{Id.; Section 297 (2) (c).} When the value of a contract exceeds Rs. 5000 in a year but there is an urgency in entering into the contract, the
consent of the Board of Directors may be obtained within 3 months of the date of entering into the contract.\textsuperscript{75}

The consent the Board of directors shall be given by Resolution at a Board Meeting and not by resolution by circulation. The consent is required to be taken generally before and in emergency cases at least within 3 months of the date of the contract.\textsuperscript{76} The consent referred to in the section is not a general consent to all contracts. The consent must be to specific contracts.\textsuperscript{77}

For entering into any contract with the company in which particular directors are interested without the consent of the Board, the directors concerned shall be punishable under residuary Section 629 A of the Act, with fine up to Rs. 5,000 and where the contravention is a continuing one, with a further fine up to Rs. 500 for every day of default.\textsuperscript{78}

\textbf{4.9.1 Type of Companies Covered}

Section 297 applies to all type of companies. The Section applies to public as well as private companies. But is does not apply to Government companies in respect of contracts entered into by it with any other Government company.\textsuperscript{79} It also does not apply to foreign companies where they are contracting with a company incorporated in India, because a foreign company is not a ‘company’ for the purposes of the Companies Act although such a company is a body corporate. Section 297 applies only to companies and not bodies corporate.\textsuperscript{80}

Absence of the consent will make the contract voidable at the option of the Board of Directors.\textsuperscript{81} But if the Board of Directors without avoiding the contract acts upon it, the consent will be implied and the company would be bound to pay for the benefit it receives.\textsuperscript{82}

\begin{itemize}
\item \textsuperscript{75} \textit{Id.}; Section 297 (3).
\item \textsuperscript{76} \textit{Id.}; Section 297 (4).
\item \textsuperscript{77} \textit{Walchandnagar Industries Ltd. v. Ratanchand}, (1953) 23 Comp. Cas. 343 (Bom.): \textit{AIR 1953 Bom. 285}.
\item \textsuperscript{78} The Companies Act, 1956; Section 629 A.
\item \textsuperscript{79} Notification No. GSR 233 (E), dated 31 January, 1978.
\item \textsuperscript{80} K.M.Ghosh & Dr. K.R. Chandatre “\textit{Company Law with Secretarial Practice Part-2}”, (2008), p. 3856.
\item \textsuperscript{81} The Companies Act,1956; Section 297 (5).
\item \textsuperscript{82} \textit{Mohan Lal Seth v. Grain Chambers Ltd.}, \textit{AIR 1959 All. 276}.
\end{itemize}
Where the agreement was approved by the Board of Directors. The director interested had disclosed his interest therein. There was no violation of Section 299 of the Companies Act, 1956 and the Agreement was valid. The Board having approved the agreement, the same was not in way invalid because there was no requirement of law to place the agreement before the general body of the company.  

Appointment of an Additional Director of person who is related to the Director does not constitute a contract or arrangement of the company with a Sitting Director.

A director is precluded from dealing on behalf of the company with himself and from entering into engagements in which he has a personal interest conflicting or which possibly may conflict with the interest of those with whom he is bound by fiduciary duty. In these cases disclosure is necessary and the Central Government’s approval has to be obtained. Section 297 will apply to contract with a firm in which director is interested whether the firm or company is an Indian firm or foreign firm.

### 4.10 Only Individuals to be Directors

The Office of a director is to some extent an office of trust. There should be somebody readily available who can be held responsible for the failure to carry out the obligations of such an office. It will be difficult fix that responsibility if the director is a body corporate, association or firm. No body corporate, association or firm shall be appointed director of a company, and only an individual shall be so appointed. No company shall appoint or re-appoint any individual as director of the company unless he has been allotted a Director Identification Number under Section 266B.

Where of the three persons elected as directors, one had died an another was not a shareholder of the company at all, he was an employee of the company which was a shareholder in the company. Therefore, he could not be elected as

---

84 Shailesh Harilal Shah v. Matushree Textiles Ltd.,(1995) 82 Comp. Cas. 5 (Bom)(DB).
86 Oriental Metal Pressing Works(p) Ltd. v. Bhaskar Kashinath Thakoor, (1961) 31 Comp. Cas. 143 (SC)
87 The Companies Act, 1956; Section 253.
director by virtue of Section 253 of the Companies Act, 1956 read with the Articles of Association of the Company.  

4.11 **Subscriber of the Memorandum Deemed to be Directors**

In default of and subject to any regulation in the articles of a company, subscribers of the memorandum who are individuals, shall be deemed to be the directors of the company, until the directors are duly appointed legally. If the Articles do not appoint directors then the subscribers who are individuals are treated as directors. If the Articles provide for appointment of directors by the subscribers then until the directors are appointed subscribers are deemed to be the directors. The number of directors and the names of the first directors shall be determined in writing by the subscribers of the Memorandum or a majority of them. The Powers given to the subscribers remain in force notwithstanding the first General Meeting of the company after the incorporation has been held without any directors being appointed at that Meeting.

4.12 **Restriction on Appointment of Director**

Before a person is appointed a director of a company by its Articles or named as director or proposed director in its Prospectus or in the Statement in lieu of prospectus he must (a) file with the Registrar of Companies a written consent to act as director, and (b) acquire or undertake to acquire qualification shares. This he must do before registration of the Articles or publication of the Prospectus or fling of the Statement in lieu of prospectus, as the case may be. The written consent and the undertaking may be by the proposed director or his agent authorised in writing.

4.12.1 **Qualification of Shares**

Every Director or proposed director must take or agree to take from the company requisite number of qualification shares as prescribed under the

---

89The Companies Act,1956; Section 254.
91Regulation 64 of Table A, Schedule of The Companies Act,1956
92Morley (John) Building Co. v. Barras, (1891) 2 Ch. 386: 60 LJ Ch. 496: 64 LT 856.
93The Companies Act,1956; Section 266(1).
articles of association of the company or to be prescribed under in the articles of proposed company. With regard to the qualification shares the director or proposed director must do any of the following things:-

- He may agree to take the qualification shares by stating the number in the memorandum of association of the company.\textsuperscript{94}

- He may agree to take and pay for the qualification shares, unless he has already taken the shares and paid.

- He may file electronically with the Registrar an undertaking in e-Form No.32 to take from the company his qualification shares, if any, and pay for them.\textsuperscript{95} The person shall, as regards those shares, be in the same position as if he had signed the memorandum for shares of that number of value.

- He may file with the Registrar an affidavit to the effect that shares, not being less in number of value than that of his qualification shares, if any, are registered in his name.

4.12.2 Number of Companies of which One Person may be Appointed Managing Director

A public company and a private company which is subsidiary of a public company shall not appoint a person as its Managing Director if he is a Manager or Managing Director of another public or private company.\textsuperscript{96} A public company or a private company which is a subsidiary of a public company may appoint or employ a person as its Managing Director, if he is the Managing Director or Manager of one and not more than one other company including a private company which is not a subsidiary of a public company. To appoint a person who is already a Managing Director or Manager of another company as a Managing Director of a public or private

\textsuperscript{94} Id.; Section 266(1)(b)(i). In the case of company having a share capital, every subscriber to the memorandum of association is required to take at least one share in the company vide section 13(4)(b); but to comply with the requirement under section 266(1)(b)(i), taking only one share would not suffice, if the articles of association stipulate a higher number of shares as share qualification of directors.

\textsuperscript{95} The undertaking attracts stamp duty under the Stamp Act.

\textsuperscript{96} The Companies Act,1956; Section 316(1).
company which is a subsidiary of a public company a unanimous Resolution of the Board of directors is necessary.\textsuperscript{97}

The Notice convening Board Meeting must contain specific mention that a Resolution would be moved appointing as Managing Director a person who is also a Manager or Managing Director of another company. Any resolution of the Board of Directors of a company relating to appointment, re-appointment or renewal of the appointment or variation of the terms of appointment of a Managing Director is to be filed with the Registrar of Companies.\textsuperscript{98} Where at the commencement of this Act, any person was holding the office of managing director or of manager in more than 2 companies he was to choose not more than 2 of those companies within one year from the commencement of the Act.\textsuperscript{99} Then Central Government may permit any person to be appointed as a Managing Director of more than 2 companies if it is necessary that the companies should for their proper working function as a single unit and have a common Managing Director.\textsuperscript{100}

This section shall not apply to Government Company in which the entire paid up share capital is held by the Central Government or by any State Government or Governments or by the Central Government and one or more State Governments.\textsuperscript{101} No company shall appoint or employ any individual as its managing director for a term exceeding five years at a time. Any individual holding at the commencement of this Act the office of managing director in a company shall, unless his term expires earlier, be deemed to have vacated his office immediately on the expiry of five years from the commencement of this Act.\textsuperscript{102}

### 4.12.3 Maximum Number of Permissible Directorship

Before appointing a person as a director, it is necessary to check whether as a result of his appointment the person would cross the statutory limit on the

\textsuperscript{97} Id.; Section 316 (2).
\textsuperscript{98} Id.; Section 192 (4) (c).
\textsuperscript{99} Id.; Section 316 (3).
\textsuperscript{100} Id.; Section 316 (4).
\textsuperscript{101} Notification No. G.S.R. 577(E), dated 16-7-1985, published In the Gazette of India, Extraordinary, No. 306, Part II, section 3(i), page 1 : Chartered Secretary, September 1985, page 726: (1985) 58 Comp. Cas. (St.) 169.
\textsuperscript{102} The Companies Act.1956; Section 317.
number of directorship. The Act limits the number of directorship any individual can hold at a time. Section 275 of the Companies Act, 1956 provides that no person shall hold office as director in more than fifteen companies at the same time. Thus, a person can be a director in not more than fifteen companies and if he is appointed a director in a company so that the total number of his directorship would exceed fifteen, he should, within fifteen days of this new appointment, exercise an option whether to relinquish any of his fifteen directorship or not to continue to hold his sixteenth directorship. If he does not exercise the option within the fifteen day time, and does not vacate his directorship in any of the fifteen companies, his appointment in the sixteenth company shall become void immediately on the expiry of the fifteen days. A person acting as director in contravention of this provision will be liable to prosecution and fine up to Rs. 50,000 in respect of each company beyond the first 15 companies. For mere holding the office of directorship in more than 15 companies a person will be liable to the same punishment.

4.13 Board’s Report

Board’s Report or Director Report is an annual report by the directors of a company to its shareholders, which forms part of the company’s accounts required to be sent to the shareholders and filed with the Registrar of Companies under the Companies Act.

4.13.1 Contents of the Board’s Report

A report of the Board of directors should be attached to the balance sheet of the company. The Board’s Report or Directors’ Report shall, inter alia, deal with the following:

(a) The state of the company’s affairs.
(b) The amounts, if any, which the Board proposes to carry to any Reserves in the Balance Sheet.
(c) The amount which it recommends for payment as Dividend.

104 The Companies Act, 1956; Section 279.
(d) Any Material Changes and Commitments affecting the Financial Position of the company which have occurred between the end of the Financial Year of the company to which the balance sheet relates and the Date of the Board’s Report.

(e) Particulars regarding Conservation of Energy, Technological Absorption and Foreign Exchange earnings and outgo in the prescribed manner.

Apart from the above, the Board’s Report shall also deal with the following matters:

(1) Material Changes
(2) Particulars of Employees
(3) Director Responsibility Statement
(4) Failure to complete Buy-Back
(5) Fullest Information and Explanation on every Reservation, Qualification or adverse remark in Auditors Report.105

4.13.2 Certificates Required to be Annexed to the Board’s Report.

The following Certificate is also required to be annexed/attached to the Board’s Report:

(i) Certificate from the Auditor or Practising Company Secretary regarding compliance of conditions of Corporate Governance as stipulated in Clause 49 of the Listing Agreement only in the case of Listed Companies.

(ii) Compliance Certificate from a Company Secretary in whole time practice in case of companies having paid –up share capital of Rs. 10 Lakhs or more and not employing full time Company Secretary.106

In the case of Non-Banking Financial Company(NBFC), a Miscellaneous Non-Banking Company(MNBC), or a Residuary Non-Banking Company(RNBC), the Board’s Report has also to contain certain information prescribed in this behalf by the Reserve Bank of India.

105 Supra n. 103 p.3074. See also section 217 of the Companies Act, 1956.
106 The Companies Act,1956; Section 383 A (1).
4.13.3 Particulars in Respect of Certain Employees should be Included in Board’s Report

Particulars of the employee also should be included in the Board’s Report which is to contain the following particulars besides any other particulars as may be prescribed by the Central Government.

(a) Name of every Employee of the Company who-
   (i) If employed throughout Financial Year, was in receipt of remuneration of not less than the prescribed Remuneration
   (ii) If employed for a part of the Financial Year was in receipt of remuneration at a rate not less than the prescribed sum per month; or
   (iii) If employed throughout the financial year or part thereof, was in receipt of Remuneration at a rate which is in excess of that drawn by the Managing Director or Whole-time director or Manager and holds by himself or along with his spouse and dependent children, not less than 2% of the equity shares of the company.

(b) Whether any such Employee is relative of any Director or Manager of the company and if so, the name of such director.\(^{107}\)

4.13.4 Omission to Submit Statement, When not an Offence

A company is under a statutory liability to submit a statement showing the name of the employee of the company if such employee employed throughout the financial year or part thereof, was in receipt of remuneration in excess of that drawn by the managing director or whole time director or manager and held not less than 2 per cent of the equity shares of the company. The Act nowhere indicates that even if there was no such employee the company was still liable to submit a statement showing that there was no such employee of the company during the relevant period. Omission to submit any such statement indicating that there was no such employee in the company during the relevant period could not fasten penal liability on the petitioners. Thus, no prima facie

\(^{107}\) Id.; Section 217 (2A).
case of alleged violation of section 217(2A) was made against the petitioners in the complaint.\textsuperscript{108}

4.13.5 Signing of the Board’s Report

The Board’s Report and any addendum to it must be signed by the chairman of the Board (or the chairman of the meeting) on behalf of the Board of directors. The Board must authorize the chairman to sign it.\textsuperscript{109} It is a standard and desirable practice to approve the Director’s Report by a Board resolution.

Section 217(5) makes all directors of a company responsible to ensure that the company duly complies with the provisions of section 217. If any director fails to take all reasonable step to ensure that the company has duly complied with provisions of sub-sections(1) to (3) of section 217, he/she shall be liable to be punished with imprisonment up to 6 months or with fine up to Rs. 20,000 or with both. But the punishment by way of imprisonment shall not be imposed unless the default was committed willfully.\textsuperscript{110}

Where any person who is charged with the responsibility of ensuring compliance with the provisions of sub-sections (1) to (3) of section 217, makes a default in doing so, he shall be liable to be punished with imprisonment up to 6 months or with fine up to Rs. 20,000 or with both. The punishment by way of imprisonment shall not be imposed unless the default was committed willfully.\textsuperscript{111}

4.14 Disqualification of Directors

Apart from share qualification, there are no qualification requirements imposed by the Companies Act or any other law for directors. In fact, the company act as such does not lay down anything specific on this subject. There is no age limit for a director except in the case of a managing or whole-time director, namely, not less than 25 years and not more than 70 years of

\textsuperscript{108} Amit Kumar Sen v. Rao ( KA), Deputy Registrar of Companies, West Bengal(2006) 132 Comp Cas 675 (Cal).
\textsuperscript{109} Id.; Section 217 (4).
\textsuperscript{110} Id.; Section 217 (5).
\textsuperscript{111} Id.; Section 217 (6).
Any person can, therefore, become a company director whatever his qualification and age may be. However, a person to be appointed as director must be a major. A minor cannot be appointed as a director. Although the Act is silent on the qualification of directorship, it does prescribe certain contingencies, which disqualify a person from being appointed as a director. Section 274 specifies certain grounds, which disqualify a person from being appointed director of any company.

The disqualifications specified in section 274 apply to all types of directors, nominee directors, directors appointed by the Government or Company Law Board, etc.

A person is disqualified if:-

(a) He has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force.

(b) He is an undischarged insolvent.

(c) He has applied to be adjudicated as an insolvent and his application is pending.

(d) He has been convicted by a Court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months, and a period of five years has not elapsed from the date of expiry of the sentence.

(e) He has not paid any call in respect of shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call.

(f) An order disqualifying him for appointment as director has been passed by a Court in pursuance of section 203 and is in force, unless the leave of the Court has been obtained for his appointment in pursuance of that section.

(g) Such person is already a director of a public company which has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day of April, 1999; or has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or

---

112 Even the condition regarding maximum age (70 years) can be waived if the appointment is approved at a general meeting by a special resolution.
more. Such person shall not be eligible to be appointed as a director of any other public company for a period of five years from the date on which such public company, in which he is a director, failed to file annual accounts and annual returns under sub-clause(A) or has failed to repay its deposit or interest or redeem its debentures on due date or pay dividend referred to in clause(B).\textsuperscript{113}

4.14.1 Private Companies Right to Provide for Additional Disqualifications

A private company which is not a subsidiary of a public company, by its articles, provide that person shall be disqualified for appointment as a director on any grounds in addition to other grounds specified in sub section (1) Section 274 of Companies Act. Thus, a private company which is not subsidiary of a public company is free to prescribe in its articles additional disqualifications for directors. If the articles of such a company mention certain disqualifications, a person suffering from these could not be appointed as its director. This can be done by negatively wording a provision in the articles so as to debar a person who does not hold the stated qualification from being a director of the company, e.g. unless a person holds so many number of shares for the specified period or shares of specified value.

A public company or a private company which is a subsidiary of a public company cannot, in its articles or otherwise, prescribe any disqualifications in addition to those specified in section 274(1) stated above.\textsuperscript{114} By implication a public company is prohibited from providing for any additional disqualification. But the principle of necessary implication can be invoked only when there is nothing else to take contrary view. Since the provisions of the Securities Act make detailed provisions for formation and governance of the Stock exchanges, for rules( including Articles of Association) relating to constitution of the governing body of the stock exchange the principle of necessary implication is not available in case of stock exchanges.\textsuperscript{115}

\textsuperscript{113} The Companies Act, 1956; Section 274 (1).
\textsuperscript{114} Cricket Club of India Ltd. v. Madhav L. Apte,(1975) 45 Comp Cas 574 (Bom).
4.14.2 Removal of Disqualification

The Central Government may, by notification in the Official Gazette, remove-

(a) The disqualification incurred by any person in virtue of clause (d) of sub-
    section(1), either generally or in relation to any company or companies
    specified in the notification; or

(b) The disqualification incurred by any person in virtue of clause (e) of sub-
    section(1).116

Neither a public company not a private company one can dispense with or
relax any of the statutory disqualifications specified in section 274(1). A
limited power of granting dispensation form the disqualification specified in
clauses (d) and (e) of section 274(1) has been vested in the Central
Government. No other body or authority, e.g. a court of law or shareholders,
has that power. The application to the Central Government for removal of
disqualification will be made electronically in e-Form DD-C prescribed under
the Rules.117

4.14.3 Directors Appointed for a Definite Period

A company whose directors are appointed for definite period has no inherent
power to remove them before the expiration of that period. If the articles
contain no power to remove directors before the expiration of their period of
office, if they authorize the shareholders by special resolution to alter any of
the articles, there must be a separate special resolution altering the articles so
as to give powers to remove directors before a resolution can be passed to
remove any of them.118

4.14.4 Punishment in Criminal Case

Where the articles of a company provided that a director “Convicted of an
indictable offence” should vacate his office, the defendant, a director, pleaded
guilty of an offence before a Court of Summary jurisdiction and was
convicted: Held by the Court of Appeal that whether or not an offence was
indictable within the meaning of articles of the company depended on the

116 The Companies Act, 1956; Section 274(2).
117 K.M.Ghosh & Dr. K.R. Chandratre’s, “Company Law with Secretarial Practice Part-2”, (2008),
p. 3571.
118 Towers v African Tug Co, (1904) 1 Ch 558.
nature and quality of the offence when committed irrespective of the procedural manner in which it might subsequently be dealt with (dealt with under summary jurisdiction) and therefore as the offence of which the director was convicted was one which could be dealt with on indictment, he was convicted of an ‘indictable offence’ within the meaning of the articles and the company was entitled to the declaration that the director had vacated his office and had been disqualified.\textsuperscript{119}

4.14.5 Locus Standi of Share Holders to seek Declaration as to Director’s Disqualification

The shareholders are vitally interested in the proper and lawful management of company, inasmuch as they are represented by the directors, and obviously they must see that company is managed and controlled by the competent and untainted person to protect their interest. If a company masts the office of director with disqualified persons, it certainly brings disrepute to the company itself and it may have adverse effect on the business of the company. The aforesaid amended portion of section 274, is punitive measure for the benefit and protection of the deposit holders against failure, either willful or otherwise in repayment of deposit on due date. Not only the shareholder of a particular company in which tainted directors are should to be appointed from a defaulting company, any person in the member of the public who is interested to transact with that limited company can also come in and question the appointment of the tainted directors. This section intends to indentify those directors under whose management the default has occurred. So, shareholders have locus standi.\textsuperscript{120}

4.15 Director’s Statement of Responsibility

There has been a demand for framing model code of corporate governance. There is need to define the scope of the Director’s responsibilities. This is sought to be achieved by recommending that there should be a specific statement of the responsibilities of the Directors of a company. Companies Act

\textsuperscript{119} Hastings & Folkstone Glass Works Ltd. v. Kalson(1948) 2 All ER 1013 (CA) reversing (1948) 1 All ER 711.

requires the directors to prepare financial statements for each financial year, which give a true and fair view of the state of affairs of the company at the end of the year and of the profit or loss of the company for that period. In preparing these annual accounts, the directors are required to select suitable accounting policies, apply them consistently and make judgments and estimates that are reasonable and prudent.

The directors must also specify whether applicable accounting standards have been followed and, if not, disclose and explain any material departures in the financial statements. The annual accounts must be prepared on the going concern basis, unless it is inappropriate to presume that the company will continue in business. The directors are also responsible for the maintenance of adequate accounting records in compliance with the Companies Act, 1997, for safeguarding the assets of the Company, and for preventing and detecting fraud and other irregularities.

The key point is that the code of corporate governance should not be limited to Director’s Statement of Responsibility. Governance standards needed to be recommended by industry associations and other professional bodies, and, if required, such standards may need to go beyond the scope of their legal or regulatory codes of conduct. Professionals like company secretaries, chartered accountants, lawyers, consultants, as well as financial institutions and their nominee directors could also be covered by the concept of a code of corporate governance, as their actions impinge upon corporate functioning. The actions of the shareholders and the representative bodies at general meeting, and the manner, in which corporate meetings are conducted, are also matters of good corporate governance.\(^\text{121}\)

\section*{4.16 Independent Director}

In order to fulfill the canons of good corporate governance, there is considerable unanimity amongst regulators, policy makers, academia and other bodies that a degree of independence of the board of directors is an essential prerequisite for improvement of the effectiveness of the Board of

Directors. The objective of independence of Board of Directors would be to evolve a framework, which would give judgments, after examination of all pros and cons, not only in the best interest of shareholders but the other stakeholders.

If the Board is composed of a right mixture of executive and non-executive directors and among non-executive directors, if comprises of independent directors who could discuss without any bias matters pertaining to company’s affairs, the good corporate governance will automatically follow. Independence of the Board is critical to ensuring that the Board fulfills its oversight role objectivity and holds the management accountable to the shareholders.

Independent directors bring an element of objectivity to Board processes in the general interest of the company and thereby to the benefit of minority and small shareholders. They help the company boards to get the most of their business and provide fresh, independent judgment to the strategic thinking and decision making. The independent director provide and assurance to all those dealing with the company that the Board decisions will not be based on a narrow vision or short-term developments and expectations. Various Codes on Corporate Governance have underlined the significance of associating independent directors on the Board. The Listing Agreement has placed considerable emphasis on the inclusion of independent directors on the Board as well as on various Board committees.  

4.16.1 Selection of Independent Director

The selection and appointment of independent directors should be transparent and on certain valued basis. Therefore, the companies should have an entirely independent nomination committee which should determine the qualifications for Board membership and should identify and evaluate candidates for nomination to the Board. It would be more appropriate that the code of Corporate Governance of a company should specifically include the qualifications and attributes that the company seeks of an independent director. A critical element of a director being independent is his independence.

to the management both in fact and perception by the public. In considering the independence, it is necessary to focus not only on whether a director's background and current activities qualify him as independent but also whether he can act independently of the management. In other words, the independent directors must not only be independent according to the legislative and stock exchange listing standards but also independent in thought and action i.e. qualitatively independent. Such qualitative independence will ensure that directors think and act independently without regard to management's influence.  

Identification of people requires extensive and time consuming networking as most of the appointments are done on the basis of networking. The management consultants, business journalists and public relations specialists can provide the suggestions for such vacancies. Other networks can be industry federations, charities, training and enterprise councils and so on.  

4.16.2 Training of Independent Directors

As the board of directors is primarily responsible for good governance practices, which is quite different from management, it call for new areas of knowledge and different skills. The development needs of each director may need to be considered. They may involve carefully designed induction or orientation programmes on the company and its work. It may be accomplished through a Board taskforce or one of the Board Committees or through participation in the growing number of director-level courses and programmes conducted by reputed institutions.

The specialized programmes are expected to develop sound understanding of the role and responsibilities of an independent director in the changing global environment. The programme should be well balanced on the leadership, strategy, business and financial risks, performance evaluation, financial reporting, legal and regulatory compliances and key corporate governance issues such as code of conduct, business ethics, values, accountability, disclosures and social responsibility. An induction programme of an

independent director may accelerate the process at which a director can really contribute to the Board. It is advisable to design a checklist for induction programmes of new directors. The checklist may include, interalia, rules, regulations and company and other laws, Board structure, membership and processes, knowledge of the business, corporate strategies, organization and management, knowledge of financial, expectations on appointment.\textsuperscript{125}

The best practices followed in the induction of the independent director are:

- A clear contract and covering letter.
- Time to be spent with the other executive directors.
- A copy of business plan and competitors’ profile and strategies.
- An opportunity to attend board meetings as an observer before the appointment confirmation.
- Introduction to the key customers and suppliers.
- A formal 1-2 day induction programme, including many of the elements above, but also presentation from various divisions on their strengths, weakness and ambitions.

Independent Directors should be able to contribute to the strategic decision making. The company provides training to improve performance and it can be provided to experienced independent directors who must be serving on several boards but may be ignorant or incompetent in some critical areas. Such training should be indentified at the initial stage. Refresher training is required to improve upon the performance, as the independent director may feel the need to acquire rapid knowledge of the industry.\textsuperscript{126}

The Narayana Murthy Committee made a non-mandatory recommendation that companies should be encouraged to train the board members in the business mode of the company as well as risk profile of the business parameters of the company, their responsibilities as directors and the best ways to discharge them.\textsuperscript{127} Realising the desirability of training of independent directors, the Naresh Chandra Committee recommended that Department of

\textsuperscript{125} Supra n. 122 p.166.
\textsuperscript{126} Supra n. 124 p.126.
\textsuperscript{127} http://kannanpersonal.com/corpgovern/narayanamurty/key-issues.html, Date:- 8\textsuperscript{th} of January 2011, Time:- 4:33 P.M.
Company Affairs (Now Ministry of Corporate Affairs) should encourage institutions of prominence including their proposed Centre for Corporate Excellence to have regular training programmes for independent directors. In framing the programmes, and for other preparatory work, funding could possibly come from Investor Education and Protection Fund.  

4.16.3 Role of Independent Director

Corporate Governance principles all over and listing requirements assign tasks that have a potential for conflict of interest to independent directors, examples of these are integrity of financial and non-financial reporting, review of related party transactions, nomination of board members and key executives remuneration.

4.16.3.1 Towards Share Holders and Stake Holders

The shareholders, especially the minority shareholders, look to independent directors providing transparency in respect of the disclosures in the working of the company as well as providing balance towards resolving conflict areas. In evaluating the board’s or management decisions in respect of employees, creditors and other suppliers of major service providers, independent directors have a significant role in protecting the stakeholders interests.

One of the mandatory requirements of audit committee is to look into the reasons for default in payments to deposit holders, debentures, non-payment of declared dividend and creditors. Further they are required to review the functioning of the “Whistle Blower mechanism” and related party transactions. These, essentially safeguard the interests of the stakeholders.

4.16.3.2 Independent Director vis a vis the Board

Independent directors primarily provide inputs to all key-decisions, such as strategies, performance evaluation and risk evaluation, affecting the company. Significant Contribution is expected when matters relating to the committee on which they are members are being discussed. They should ensure that the

---

128 Executive Summary of Naresh Chandra Committee Report [http://finmin.nic.in/reports/chandra.pdf](http://finmin.nic.in/reports/chandra.pdf), Date:- 8th of January 2011, Time:- 4:36 P.M.

Board addresses areas of concern on the running of the company and that these are recorded in the minutes if not resolved. While the legal duties and objectives are the same as executive directors, the time devoted by independent non-executive directors to the company's affairs is significantly less and therefore the degree of care, skill and diligence is lower than that expected from executive directors. Liability might still attach from general breach of duties of Board, it is for each such director to reach a view as to the degree of care skill and diligence to be applied in each circumstance.

Perhaps the single most important role that independent directors play directly in relation to the board is the objective view that they bring in while evaluating the board and the management decisions, creating a balance in the interest of the shareholders. These areas are executive remuneration, succession planning, and changes in corporate control, take-overs and acquisitions and the audit function.130

4.16.3.3 Committee Membership

Clause 49 of the listing agreement and most corporate governance requirements and provide that “independent directors” shall necessarily be appointed to key committees such as nomination, remuneration, investor relations, and perhaps the most important, on the audit committee.131

4.16.3.4 Role in Audit Committee

Clause 49 of listing agreement provides that two-thirds of the audit committee shall have independent directors, with a minimum of three members, and the chairman of the audit committee should be independent director. The clause specially provides that the chairman of the Audit Committee shall be present at the Annual General Meeting to answer shareholder queries. The main role of independent director with audit committee is to oversight of company financial reporting process, recommending to board on the appointment, re-appointment of statutory auditor, review with management the financial statement and performance of statutory and internal auditors, discuss the findings of auditors, discuss the scope of auditor, review reasons for defaults

130 Ibid.
131 Ibid.
into payments, reviewing the whistle blower mechanism, review/application of funds of public issues, rights issues, preferential issues etc, and disclose shareholding in the listed company, etc.\textsuperscript{132}

4.16.3.5 Role as Senior Management

Independent director have a direct role in reviewing performance of senior management in their functioning. Many corporate governing requirements stress on this by providing for their nomination on the remuneration committee, which involves review of their performance in relation to remuneration.\textsuperscript{133}

4.16.3.6 Role as Special Expertise

Very often, independent directors, bring in special expertise, that provides guidance to the company in its strategic polices. The role of such independent directors takes significant importance in evaluating decision of the management of the company. It is necessary for the directors to have appropriate information to understand and monitor the risks that their company faces. For this learning-avenues in updating their skills must be introduced. Directors whether independent, executive, non-executive must seek to balance their roles as strategic advisors and setting good governance practices.\textsuperscript{134}

4.16.4 Responsibilities of Independent Directors

To execute their role, independent directors, have similar responsibilities to those of other directors. The fiduciary duties of care, diligence and acting in good faith apply equally to independent directors as to other directors. In view of faith imposed on them by various agencies they are more bound to execute their functions with impartiality.

It is necessary for the independent directors to:

a. prepare themselves thoroughly for the meeting.

\textsuperscript{132} Ibid.

\textsuperscript{133} S. Gopalakrishnan, “Role & Responsibilities of Independent Directors”, \textit{The Chartered Accountant}, January 2005, p.866

\textsuperscript{134} Ibid.
b. be objective in forming sound decision relating to the company and its business.

c. be open minded, free and frank in expressing their opinions and at the same be willing to engage in meaningful debates.

d. be committed to decisions made as a Board.

e. continuously seek information both from within and if required outside professional knowledge to keep abreast with the latest developments in the areas of the company’s operations.

f. be informed on laws and regulations influencing their functioning as directors.

g. utilize the expertise they possess to the good advantage of the company.

A final point on their responsibility, and indeed the whole boards, is a requirement to act in the larger genuine interest of true growth and development of the company.\(^{135}\)

### 4.16.5 Duties and Criminal Liability of Independent Directors

Various statues make directors criminally liable for acts of commission and omission. In this context Naresh Chandra Committee has opined that not even the most stringent international tenet of Corporate Governance and oversight assumes that an independent director who interacts with the management for no more than two days every quarter will be in the know of every technical infringement committed by the management of a company in its normal course of activity. Indeed, making independent board members criminally liable for such infringements is akin to assuming that they are no different from executive directors and the management of a company. In the view of Naresh Chandra Committee Independent directors are not managers but they are fiduciaries who perform wider supervisory functions over management and executive directors. The committee further observed that it would be very difficult to attract high quality independent directors on the boards of Indian Companies if they have to constantly worry about serious criminal liabilities.

\(^{135}\) Id. at 865.
under different Acts. It is up to each non-executive director to reach a view as to what is necessary in particular circumstances to comply with the duty of care, skill and diligence they owe as director to the company. In considering whether or not a person is in breach of that duty, a court would take into account all relevant circumstances. These may include having regard to the above where relevant to the issue to liability of a non-executive director.

In case of any proceedings against Independent Director, defence of ignorance of this responsibility shall not be permitted. Irani Committee has recommended that an independent director should be held liable only in respect of any contravention of any provisions of the Act which had taken place with his knowledge (attributable through Board processes) and where he has not acted diligently, or with his consent or connivance. It also provides that if the independent director does not initiate any action upon knowledge of any wrong, such director should be held liable.

4.16.6 Exempting Independent Director/ Non-executive Director from Certain Liabilities

To attract high quality managers on the boards of Indian Companies would be difficult if they have to constantly worry about criminal liabilities under the different acts. The Birla Committee recommends that non-executive directors be exempt from certain liabilities. The different Acts in question are the Companies Act, Negotiable Instruments Act, Provident Fund Act, ESI Act, Factories Act, Industrial Act and Electricity Supplies Act. Independent directors should be free from litigation and other related costs. There is one possible legal issue that has concerned members of the committee. The three strata of directors are executive directors, non-executive/independent director who are members of the chairmen of audit committee, and other non-executive/independent directors. Executive directors ought to be more liable than non-executive or independent director.

The companies are expected to purchase a reasonable amount of insurance for directors and officers. This should cover independent directors even when they cease to be directors. If the offences related to the period when they were directors, then this insurance cover would pay for the litigation and pecuniary penalties, if any, and mitigate the corporate and individual risk of being an independent director.\textsuperscript{139}

4.16.7 Remuneration of Independent/Non-Executive Directors

Remuneration of non-executive director/independent directors should be sufficient to attract and fairly compensate high quality individuals. Criteria for remuneration and compensation of non-executive or independent directors should be their time, effort and contribution. It may comprise an annual fee, a meeting attendance fee and additional fee for the chairmanship of committees. They should not hold options over shares in their company. If exceptionally, some payment is made by means of options, shareholder approval should be sought in advance and any shares acquired by exercise of the options should be held one year after they leave the board.\textsuperscript{140} All directors, executive and non-executive should be adequately compensated and remunerated for their time and effort, even in the absence of profits.

Naresh Chandra Committee has observed that the current statutory limit on sitting fees should be reviewed, although ideally it should be a matter to be resolved between the management and the shareholders. In addition, loss-making companies should be permitted by the DCA to pay special fees to any independent director, subject to reasonable caps, in order to attract the best restructuring and strategic talent to the boards of such companies. The present provisions relating to stock options, and to the 1 per cent commission on net profits, is adequate and does not, at present, need any revision. However, the vesting schedule of stock options should be staggered over at least three years, so as to align the independent and executive directors, as well as managers two levels below the Board, with the long-term profitability and value of the company.\textsuperscript{141} The Board itself or, where required by the Articles of

\textsuperscript{139}C V Baxi, "Corporate Governance Critical Issues", 2007, p.130.
\textsuperscript{140}KH Spencer Pickett, "The Internal Auditing Handbook", (2010) p.84.
\textsuperscript{141}http://www.nfcgindia.org/chapter4.htm, Date: 8\textsuperscript{th} of January 2012, Time: 6:22 P.M.
Association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the Articles of the Association. Where permitted by the Articles, the board may however delegate this responsibility to a committee, which might include the chief executive.

4.16.8 Independent Directors on Audit Committees of Listed Companies

The Naresh Chandra Committee has recommended that Audit Committees of all listed companies, as well as unlisted public limited companies with a paid-up share capital and free reserves of Rs. 10 crore and above, or turnover of Rs 50 Crore and above, should consist exclusively of independent directors. However, this will not apply to:

(1) unlisted public companies, which have no more than 50 shareholders and which are without debt of any kind from the public, banks or financial institutions as long as they do not change their character, and

(2) unlisted subsidiaries of listed companies.142

According to Clause 49 II(A) of listing – agreement, the audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.143

The board should establish an audit committee of at least three, or in the case of smaller companies two, independent non-executive directors. In smaller companies the company chairman may be a member of, but chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman. The board should satisfy it self that at least one member of the audit committee has recent and relevant financial experience.144

4.16.9 Categories of Non-Independent Directors

According to opinion of Institute of Company Secretaries of India (ICSI), in addition to the definition given earlier in the Chapter, the following may also not be regarded as “Independent Director”.

142 http://www.nfcgindia.org/library/nareshchandra/Chapter%204%20-%20Independent%20Directors.htm, Date:-8th of January 2012, Time:-6:30 P.M.
143 http://www.directorsdatabase.com/Clause49.asp, Date:-8th of January 2012, Time:-6:30 P.M.
1. Members of the immediate family of an individual who is or has been employed by the company, or any of its affiliates as an executive officer in any of the past three years.
   The expression “immediate family” includes a person’s spouse, parents, children, mother-in-law, father-in-law, brother-in-law, sister-in-law, son-in-law, daughter-in-law and any person who resides in such person’s home.

2. Consulting advisory or personal service contract with the company, its executive officers or its affiliates.

3. Officers in organizations, which are suppliers, customers or vendors of the company.

4. Members of the Board of Directors of company owned by a substantial shareholder of a company.

5. Officers or employees of other companies controlled by the CEO or the company’s majority owners.

6. A partner or controlling shareholder or an executive officer of any “for-profit organisation” to which the company made, or from which the company received payments (other than those arising solely from investments in the company’s securities) that exceeds 5% of the company’s or business organisation’s consolidated gross revenues for that year.

7. A director of the company having business or financial relationship with substantial shareholder of the company.

8. Members of immediate family of another person who fails to qualify as independent under any of the situations explained herein.

A person who is appointed as an Alternate director to an Independent Director need not be independent. His case will be determined on the basis of criteria of independence laid down in the Listing Agreement as well as in the foregoing enunciation. However, the Companies Bill, 2008 provides that a person who is proposed to be appointed as an alternate director for an independent director
should be qualified to be appointed as an independent director under the provisions of this Act.\textsuperscript{145}

4.16.10 Importance of Independent Directors

Independent directors are the cornerstones of good corporate governance. The presence of independent representatives on the board, capable of challenging the decisions of the management, is widely considered as a means of protecting the interests of shareholders and, where appropriate, other stakeholders. Theirs is the duty to provide an unbiased, independent, varied and experienced perspective to the board. Independent directors endowed with expertise and an independent disposition can bring about the much-needed transformation in boardrooms and board meetings can become effective strategy sessions rather than remain as occasions where form supersedes substance. For a family business, independence is even more important. The independent director can help with issues where the family tends to lacks objectivity and independence such as:

- Hiring, firing, promoting, and compensating family members as well as determining succession plans.
- Bringing expertise and perspective to a business which is run on tradition and sentimental loyalty rather than by current best business practices.
- Acting as a neutral bridge between family owners and non-family managers.

A board with a majority of independent directors can bring expertise and objectivity which assures owners that the company is being run legally, ethically, effectively and in the best interest of its owners and also look at issues with no vested interest or hidden agendas. Having a majority of independent directors allows outside directors to feel they have support in raising contrary points of view. Otherwise it may be difficult for a single

\textsuperscript{145} Infra n. 150 for more details.
outside director to raise an issue that may be sensitive to the family or founder.\textsuperscript{146}

\section*{4.16.11 Status of Independent Director}

The difference between the independent director and his duties is far from the real issues of the business. The managing director or chairman of the board had the power to take decisions. Directors collect their fees for attending the board meetings and enjoying a good lunch. An independent director adds value to the board process by his expertise and strategic business insights. The independent director represents the larger shareholders within the company. Now, shareholders want to approve the board decisions before they are taken.

The importance has been given to the independent director by the regulator as well. The audit committee and remuneration committee consists of independent directors as chairman. Independent director needs to “Whistle Blow” or resign when companies are not willing to address the concerns raised by shareholders. Independent director should help the board in this regard. The shareholder’s interest is to be seen by all the directors not just by the part-time directors. Independent directors are being considered as a peer group and changes are recommended to enable them to play a dominant role. So it is suggested that the workload of independent director is expanded to make the board effective. Board reforms are being taken place in the fast pace in that direction.\textsuperscript{147}

\section*{4.16.12 Performance Evaluation of Independent Directors}

Performance of the Independent Director should be evaluated regularly. It is necessary to check their effectiveness and efficiency. Every director, executive or non-executive are required to posses diverse skill sets for

\textsuperscript{146} \url{http://www.lexvidhi.com/article-details/-independent-directors--a-required-force-for-corporate-governance-219.html}, Date:- 8\textsuperscript{th} of January 2012, Time:-11:58 P.M.

\textsuperscript{147} Dr. S. L. Gupta, Dr. B. S. Hothi and Abhishek Gupta, “Corporate: Independent Directors in the Board”, \url{http://www.niapune.com/pdfs/Bimaquest/vol11-issue1/File-6%20A%20GUPTA.pdf}, Date:- 10\textsuperscript{th} of January 2012, Time:- 12:50 P.M.
efficient operations of the company, the independent directors are expected to maintain a position of independence in order to give appropriate opinion, organize effective action. They should have to maintain the balance of conformance and performance roles to maintain unique position in Board Structure. Independent directors are expected to provide valuable contribution to the progress of the company. The evaluation mechanism should be used to be a platform for fruitfully turning out a real performance measurement Independent Directors.

The Narayana Murthy Committee constituted by SEBI recommended a mechanism for evaluation of non-executive directors including independent directors. The Committee noted that evaluation of Board members is in a germane stage in India. It is necessary to have a robust process in place for such evaluation. It is also necessary to ensure continuity of top leadership, including CEO succession planning. However, the Committee believes that this should be of a recommendatory nature at first, before becoming a mandatory requirement. This will help companies develop robust processes for Board evaluation. This may be made mandatory after a period of 4 - 5 years. The non–mandatory recommendation of the committee is that The performance evaluation of non-executive directors should be by a peer group comprising the entire Board of Directors, excluding the director being evaluated and peer group evaluation should be the mechanism to determine whether to extend or continue the terms of appointment of non-executive directors.148

4.16.13 Limitation of Independent Directors

We discuss some of the major limitations of the role and functions of independent directors in particular and other categories of directors in general. Let us mention at the outset that the limitations arise on account of two sources; one is an internal source; personality factors of an individual director; while the second is the external source; ownership of a firm; board composition and structure; board process; board strategies; among others. It is pertinent to note that the mere presence of independent directors on a
company’s board is not enough. We have significant evidence world-wide of
corporate failures and poor board performance even with adequate number of
experience independent directors. It is not, therefore, their mere presence on
the board but the value they add to the board process which will ensure
effective corporate governance.149

4.16.14 Duty to Inform the Company in Certain Cases

It is quite possible for a director to lose his independent status during the
tenure of his office as an independent director with the company. The terms of
independent director’s association with the company should include a
provision that if, at any time, during his tenure, any change occurs in his
independent status, it shall be communicated to the company forthwith. The
company should make adequate disclosures to the shareholders of the manner
in which the independent status of director has changed. The Board also must
ensure that the present proportion of independent directors in the composition
of the total Board as well as the various Board committees is maintained.

To ensure that the independent status of a non-executive director is not
compromised, the Board must take adequate preventive measures. In case a
non executive director enters into any contract or arrangement with the
company, he must be treated as a non-independent director. Accordingly, he
will cease to remain a member of those committees, which are required to
have a certain number of independent directors.150

4.17 Directors Nominated by Financial Institutions

The All-India Financial Institutions and Investment Institutions collectively
have substantial stake in the companies assisted by them not only by way of
terms loans but also as shareholders in some cases. The Institutions appoint
official as well as non-official nominees on the Board of these companies,
inter alia, to serve as valuable link between industry and Institutions not only
for effective project monitoring and follow up but also to serve the interest of
sound public policy. Since the interest of Financial Institutions, shareholders
and of the company, basically coverage, interest of Institutions will be well

149 Supra n. 139 p.146.
served only when the project is implemented within the estimated cost and time schedule and is run on sound commercial principles within the policy framework of Government. Therefore, the nominee appointed by Institutions by taking active interest in the deliberations of the company at the board level is expected to see that these objectives are fulfilled.151

4.18 Role of Directors Nominated by Financial Institution

The nominee director should be vigilant and if any undesirable practice prevalent in the company, including any abuse by the promoter group of its powers and privileges comes to his knowledge, he should bring this to the notice of the board and his nominating institution. The nominee director should make such suggestions as would be conducive to better management practices, effective functioning of the board, improvement in productivity, efficiency and continued growth of the assisted companies. The nominee director is expected to keep himself updated with the polices and current developments in the industry and to see that the company is run on sound lines within this dynamic set up. It goes without saying that the nominee director as well as the other directors on the Board are expected to have high degree of probity and independent approach.

The nominees generally ensure that the need-based information on operating plan, periodical feed-back report on performance as well as certificate on statutory compliances is submitted and discussed at the Board Meetings. The nominee, apart from keeping a vigil on the interest of his nominating institutions, acts as glue for keeping diverse interest attuned to overall well being enterprise. Basically, nominee is neither a monitor nor a mentor.

It is to be recognised that nominee a basically a “Non-Executive Director” and his role, responsibility and adherence to regulations is the same as of any other Director. In the circumstances, the expectation from a nominee has to be no different. However, the shareholders, public and society at large perceive a nominee as a super Director with too have much power. The effectiveness and success of nominee is a function of culture and environment of the concerned

---

enterprise. The Instrumentality of nominee Director is one of the tools for supervision by Institution it has served the intended purpose well.\textsuperscript{152}

4.19 Changing Role of Nominee Directors

By virtue of a clause in their loan agreement, Indian Financial Institutions have a right to nominate a director on the board of the company. Nominee directors are no different from whole time directors or independent directors. In the changing business scenario, they will have to play an equally proactive role as the other directors and handle the responsibility of protecting the interest of the company as a whole, which means aligning the interest of the promoters and FIs\textsuperscript{153} with the interest of minority shareholders, other stakeholders and society at large.\textsuperscript{154}

4.19.1 They Myth About the Nominee Director

That the nominee director is a watchdog to protect the interest of the financial institution that he represents is a myth. A director is a director. Once a nominee director sits on the board of a company, he is the custodian of the interest of all the shareholders of the company. Therefore he/she should ensure that decision taken at board meetings are in the best interest of all shareholders as well as stakeholders.\textsuperscript{155}

4.19.2 From Passive to Proactive Role

The pace and complexity of change, the disruptive technologies that we are witnessing, are changing the world by the week. As a result, the directors of today are facing an era of uncertainty. If FIs really wish to protect the larger interest of the company they will have to help nominee directors in managing a migration path from the role of a passivity to a proactive role. Research Conducted by Asian Centre for Corporate Governance (ACCG) shows that the general profile of nominee director is retired or existing officers of FIs. Both these categories of people( without meaning any offence) are

\textsuperscript{152} Ibid.
\textsuperscript{153} FIs means Foreign Institutions
\textsuperscript{155} Ibid.
relatively less-equipped to deal with the era of uncertainty as well as complex
business situations. The former category of directors, after retirement, do not
have any secretariat or adequate wherewithal to discharge their duties. The
latter, due to the pressures of their present job, have very little time for
preparing themselves to engage in a meaningful dialogue/debate in board
meetings. Therefore they find themselves at a loss during board meetings. As a
result, most nominee directors have to play a passive role. Some nominee
directors play a passive role because they are overawed with the presence of
top industry leaders or other personalities in the boardroom.  

4.19.3 Improving the Quality of Nominee Directors

While it could be argued that retired officials or full-time officials of financial
institutions can protect the interest of the FIs they represent in the best manner,
if the nominee directors play a passive role this argument might go against the
real issue of ‘shareholder value maximisation’. Therefore the moot issue is of
improving the quality of nominee directors. Training nominee Directors is a
definite way to improve their quality. Some financial institutions are more
proactive than others.

4.19.4 Tapping Professional Talent

In addition to retired officials and full-time directors, financial institutions
may like to tap the large talent pool of professionals available in the country
like management consultants, legal experts, scientists, academicians, etc. If
briefed properly and through an exercise of trust and confidence building,
these professionals will be able not only to protect the interests of the FIs but
also proactively participate in Board meetings and enhance ‘shareholder value
maximization’.

4.19.5 Avoiding a Tug of War

Promoters as well as nominee directors of financial institutions will have to
bring about a transformation in their way of looking at their individual roles.
In other words they require re-engineering their mindsets, shedding some old

---

156 Ibid.
157 Ibid.
158 Ibid.
prejudices and avoiding a tug of war because the interests of the promoter cannot be and should not be at variance with the interest of FIs. Going forward, the interest of both cannot be at variance with the general interest of the company as a whole — i.e. the interest of all shareholders and stakeholders together.\textsuperscript{159}

4.19.6 Enhancing the Effectiveness of Nominee Directors

A system of proper study of agenda papers one week before the board meeting and a brief report by the nominee director one week after each board meeting, capturing the major issues discussed and important decisions taken, can go a long way in enhancing the effectiveness of nominee directors. Through this system the nominee director will be able to contribute in a focused manner in every board meeting. It will also keep all the concerned executive directors as well as the chairman of the financial institution in the loop. This is a mechanism through which financial institutions can ensure the effectiveness of their nominee directors from the professional category as well as measure their performance.\textsuperscript{160}

4.20 Distinction between Manager and Director

In India, as indeed elsewhere, is that often an effective manager or a generally more successful manager is perceived as eligible for a board position. This is highly erroneous view and belief, for the simple reason that there is a distinction between a manager and a director — legal, social, psychological and organizational. One needs the experience of a manager but one may not have the traits to become a director unless by some intervention the mindset changes very early in the career life cycle, it would be futile to expect any radical contribution from the independent directors. The ‘timbre’ should be groomed from the early phase of a managerial career so that a person gets a chance and opportunity to develop a competency profile which may suit emerging industry requirements. For such a thing to happen, we need training centers and accredited trainers for potential and existing directors. Presently,


\textsuperscript{160} Ibid.
we do not have adequate institutional arrangements to engage in such a gigantic task which compounds the existing limitations.\textsuperscript{161}

4.21 Review

The growing complexities of modern business and corporate management, particularly in the wake of intense global as well as domestic competition following liberalization of economic polices have placed greater responsibilities on company directors. While the shareholders of corporate body, are no doubt its true owners, it is the Board of Directors which is responsible for the overall management of the company. The responsibility of Directors include, inter alia, the active participation in the formulation of policies as also overseeing the operations of the company. Therefore, the Directors have to be not only persons of competence but also be aware of the duties, functions and obligations to the shareholder and society at large. The Board is accountable in various ways to number of different stakeholders. The Directors are expected to achieve a harmonious balance between competing interest, viz., shareholders, investors, consumers, employees, Government and the society at large. The Board should maintain a proper balance between short-term priorities and long-term priorities of the company.

The Boards of directors are expected to play sheet anchor role in corporate governance. Playing of such a role is possible when there is a clear-cut demarcation and delineation of their duties and activities. The success of the Board of directors depends upon how constructively they participate in the proceedings of the meetings of the boards. They can contribute through the strategy of asking well directed question critically but constructively in these meetings. They should not go beyond the strategic issues and should avoid any interference in routine activities. There should be participative atmosphere even within the Board of directors. Any kind of confrontation among the directors should avoided.

With regard to nomination of directors, literature suggests that directors should independent irrespective of the executive or non-executive status. As it

is quite objective to define the parameters of independence, it up to the nomination committee to select a person who is unbiased and work for best of the company not towards the interest of club directors. Each and every member of the board should be professionally qualified and should have minimum five years of experience in that line of business as lay man cannot be expected to steer the ship of the company in right direction.

The code of corporate governance should be a voluntary and ethical code of business of the company because it is difficult to enforce such a code, given the reputation of our country of manipulation and circumvention of laws. Moreover, corporate governance is not the subject that is limited to fixing the accountability of corporate sector alone. There is need to evolve voluntary code of conduct not only for corporate sector but also for the enforcement and regulatory agencies. Thus, overall scenario calls for setting up of behavioural standards, ably supported and protected by structural system under the full glare of public responsibility.

Corporates develop and implement several programmes for leadership development including formal coaching and mentoring from both internal managers and external leadership consultants. Some Corporates have structured team and peer coaching and internal collaboration. The organization needs to keep pace with the rapidity of change. This helps in nurturing visionary leadership. Good Leader play a important role in a company in compliance of good corporate governance practices.