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A Study on the Relationship of Role of Independent Directors with Corporate Governance of a Company

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ABSTRACT

The value of independent directors has received significant attention from the worldwide corporate governance movement. The prevention of fraud, misconduct, and other potential problems in corporate governance is seen as being significantly aided by independent directors. They are also thought of as a way of balancing the interests of the individual, the economy, and society. The supervision role of the board of directors is highlighted by the agency viewpoint on corporate governance. This study intends to investigate how the independent director's interaction affects financial performance and managerial quality as well as the overall performance of the company in making decisions. The research investigates if the board's independence has an effect on maximising corporate value. To ensure that the board fulfils its tasks honestly and keeps management responsible, it is crucial that management be independent. The present situation of companies in India and the function of independent directors in corporate governance are the main topics of the essay. Nevertheless, there are various problems with the way independent directors are currently used in India, including a lack of expertise, a lack of independence, a lack of drive, and a lack of knowledge. The need of independence for independent directors is emphasized throughout the article in order to preserve sound corporate governance.

***Keywords**: Corporate Governance, Independent Director, Stakeholders, Company.*

I. INTRODUCTION

A corporation type of business runs on the corpus that is owned by several stakeholders, such as creditors, investors, workers, customers, shareholders, the community, etc. So, it is an unquestionable fact that a firm relies mostly on cash collected from the public at large to do operations. So, a corporation acts as a conduit for significant capital needed to run the firm. The idea of good governance enters the system at this point. Under these circumstances, it is appropriate to recognise that with such a significant amount of funds being generated and investments being made, it begs the question of who will be responsible for making such

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substantial investments.

The efficiency of independent directors are critical to the overall structure of strong corporate governance. Independent Directors are thought of as management's mentors and supervisors who will make sure that management decisions add value for shareholders.[2] They are also in charge of defending the interests of minority shareholders. Nevertheless, in light of the resignation of four independent Satyam Scandal directors and the subsequent ouster of Tata Sons' chairman, their function has come under scrutiny. When it concerns the boards, independence enables a director to remain impartial and assess the performance and health of the firm without being influenced unfairly by interested parties or facing any conflicts of interest.

“Most of independent directors gives outside directors the impression that they have backing when bringing forth opposing viewpoints. Therefore, it can be challenging for just one outside director to bring up a matter that could be delicate for the founder or family. As their name implies, independent directors (ID) are accountable to the shareholders and are required to be impartial towards the management. This means that they have a duty to thoroughly understand and scrutinize firms' behaviour with regard to pertinent concerns.” There is a greater emphasis on their function and obligations as guardians of stakeholders' interests now than there was before since some of the biggest corporate frauds in the nation have recently entered the market as a result of an increase in independent director’s resignations.[3]

The fact that promoters control the majority of Indian firms and independent directors are only really independent on paper is a major contributing factor to the emergence of these frauds. They are from a recognized close group or are people the promoter is acquainted with. The genuine independence of directors is disturbed by the promoters' contact with independent directors. “While the Companies Act of 2013's Code for Independent Directors highlights the role, responsibilities, and obligations of Independent Directors, questions are being raised about their true independence and ability to carry out their roles and responsibilities.[4] When the chairman of Satyam Computers is accused of making false representations in the company's records over a period of years, the independent director is held accountable for failing to see the error. Similar issues with independent directors were also brought up during the boardroom spat

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[2] Pranav Mittal, The Role of Independent Directors in Corporate Governance, NUJS LAW REVIEW, 4 NUJS L.Rev. 285 (2011).

[3] Indrajit Dube & Aparup Pakhira, Role of Independent Director in Corporate Governance – Reference to India, CORPORATE BOARD: ROLE, DUTIES & COM POSITION, V olume 9, Issue 1, 2013.

[4] Kumar, Ajay Garg, Influence of Board Size and Independence on Firm Performance: A study of Indian Firms, Vikalpa, July-Sept (2007), Vol-32, Sl.No-3, PP- 39-60.

between Ratan Tata and Cyrus Mistry. The SEBI Chairman expressed his worries and claimed, Auditors committee is not functional, independent directors are not independent, and there is no stewardship code, in the recent example of Infosys, which is viewed as a standard for sound corporate governance procedures in India."

(A) Review of literature

Sapovadia (2002) "expanded the meaning of corporate governance. The WorldCom and Enron stories at the beginning of the century and Satyam very recently exposed the lacunae in good corporate governance. While all this opened up a fresh debate on the meaning of good corporate governance and its standards, it also ended up in a host of researches investigating the reasons for failure of corporate governance. Corporate Governance is now an issue and important factor that can be used as tool to maximise wealth of shareholders of a corporate.

Branston et al (2006) provided a solution to the very basis for failure of corporate governance is formed. It suggested a strategic decision-making perspective that makes corporate governance a central policy issue.

Walter (2006) has pointed out a lack of diversity on the board of directors and potential shareholders. A diverse board may not be the solution but still in crucial for good corporate governance. Investigating further, they point out several factors that lead to failure of corporate governance. Analysing the reasons behind the failure of the Australian firm RAMS Home Loans Group as a public company.

Kiel & Nicholson (2005) adding some more dimensions, points out lack of proper control mechanisms and ethical standards amongst corporate. Elaborating these reasons, they claim failure to cope with interpersonal relations is the reason behind the above.

Kochhar (2008) while the regulations by state, regulatory bodies and their role has constantly been under attack, the role of independent directors has come under a scanner too, particularly in India. Suggestions have been made to make amendments in both these aspects.

Sexton (2001) puts down another reason that has been listed as existence of a dominant director that renders all others as passive players while non-executive directors do not give sufficient time to company affairs. Similar thoughts had been echoed earlier by ***Davis (1993)*** when examining the establishment of a Corporate Governance Panel as a voluntary proxy for a Securities and Exchange Commission in Great Britain.

Bhat & Kumar (2008) examined and listed that while good corporate governance in Indian organizations like ICICI and HDFC have been examined, the Satyam fiasco has opened it all up. Poor corporate governance has been the bane of Indian industry and the erosion of investor confidence and it is now clear that certain key IT, media and entertainment scripts are being brazenly manipulated on the stock exchanges (Chemical Business, 2002) Kriplani (2009) in a study with reference to Satyam states poor governance can lead to disaster, and India has seen plenty of that in recent years.

Range & Lublin (2009) have been optimistic in their approach. Before Satyam, Mumbai brokerage First Global estimates, shareholders had lost some $2 billion from scandals and bad governance since 2003. Corporate ethics and accounting have been traditionally poor in India, despite the exposure of many companies to international standards.

Chakrabarti et al. (2008) claim the Indian corporate governance system has both supported and held back India's ascent to the top ranks of the world's economies. Still, Indian corporate governance has taken major steps toward becoming a system capable of inspiring confidence Rajagopalan & Zhang (2008) have also highlighted several reasons for failure of corporate governance in India and China."

II. FRAMEWORK AND WORKING OF INDEPENDENT DIRECTORS

In today's highly competitive business environment, a company's success depends largely on the performance of its management or board of directors, who act as the primary decision-makers and implement various company policies, including those pertaining to strategic moves that must be made when appropriate and in accordance with good corporate governance. Independent directors play a crucial role in this process. The independent directors, as stated above, must not rely on the management's information regarding policy matters or any decisions that occasionally need to be made for the proper, lawful functioning of the organisation. Instead, they must have in-depth knowledge of the affairs and fundamental principles on which the company was founded and must lead the board to a final result under corporate governance system within the context of the foregoing. The independent director is given the duty of being the watchdog and the conscious custodian of corporate governance to guarantee optimum accountability since the Board of Directors is made up of both executive and non-executive directors.[5]

"Here, the Companies Act of 2013's Section 149(6)[6] comes into effect. "Section 149(6) of the Companies Act, 2013 comes into play here. Section 149(6) lays down, that an independent

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[5] Dr. Kotishwar Aarugonda, The Role of Independent Directors in Corporate Goverance- A Critical Evaluation, INTERNATIONAL JOURNAL OF RESEARCH IN COMPUTER APPLICATION COMMERCE AND MANAGEMENT, 1. 27-34 (2011).

[6] The Companies Act, 2013, Sec 149(6).

director would mean a director other than a managing director, or a whole-time director or a nominee director which is to say that the independent director would be a part of non-executive director in relation to a company. The Companies Act of 2013's Section 149(4) establishes the obligation for independent directors to serve on the board. Every public listed company must have independent directors make up at least one-third of the total number of directors, according to Section 149(6). The difficulty now is that it doesn't handle the hotly contested topic of CEO duality. Nevertheless, it should be noted that under Regulation 17 of SEBI (Listing Obligations and Disclosure Regulations), it is required that the board have a thoughtful mixture of executive and non-executive members, with at least one woman director being a requirement of the latter group."

III. ROLE OF INDEPENDENT DIRECTORS IN A COMPANY

Many studies have shown that there is an unbreakable link between sound corporate governance and a company's financial success. In a similar vein, recent research from Harvard and the University of Pennsylvania suggests that businesses with excellent portfolios that uphold strong shareholder rights actually outperform those with inferior portfolios by a margin of at least 10% to 12% annually.[7] In the current era of globalisation, when we are actively seeking foreign investors for our market and economy, this is the obvious reason why investors choose firms with strong corporate governance procedures. So, having effective corporate governance and behaviour is crucial to guaranteeing a company's legitimacy.

Independent directors must be totally free from the control of the company's management in order to function in the position of trustees for shareholders. This implies that independent directors have a responsibility to be fully informed about management operations and to have the ability to challenge them when necessary. The independent director has a responsibility to defend the interests of small stakeholder groups.

In accordance with corporate governance procedures, independent directors are required to actively participate in the business of the firm by routinely attending board meetings and keeping themselves informed of the topics pertaining to the company to which they are related. The independent directors will ensure that they have sufficient knowledge of the environment in which the company operates and will gather and report any matters that they believe to be unethical in the interest of the company's expansion and at odds with the fundamental principles for which the company was founded. They will then inform the relevant parties of these matters.

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[7] Meenu Gupta, A Study on Independency of Independent Directors in Corporate Governance, (January 25, 2019), https://www.icsi.edu/media/portals/86/Independent%20Directors.pdf.

Adam Smith's theory of the ‘Invisible hand’ (Smith, Adam)[8] “cannot be applied to the job of independent directors since their primary responsibility is to ensure that they exercise their full authority for the benefit of the firm and the minority shareholders. The Independent Director must be completely objective and have no personal stake in the success of the firm while simultaneously looking out for the interests of the company.” The board's independence is seen as a crucial step in ensuring the independent directors perform better in corporate governance.[9]

IV. Importance of Independency of Independent Directors

The responsibilities of directors on the board of a company include monitoring management's decisions to maximize shareholder value and protecting the interests of shareholders. Board composition is crucial to ensuring that these goals are achieved through independent and objective functioning. However, existing literature indicates that the lack of openness and transparency in board procedures, promoters' majority shareholdings, and other factors prevent the board of directors from safeguarding shareholder interests.

It is advised that the board be made up of independent people in order to guarantee its efficient and successful functioning. Higher shareholder engagement in the company and a better corporate image are both influenced by an independent board with stricter corporate transparency rules, which raises shareholder value. Moreover, independent directors' independence may assist management and shareholders' interests align and improve the quality of decision-making.

Enron and WorldCom are high-profile scandals that highlight the board's lack of commitment to shareholders and raise concerns about the responsibility of independent directors in ensuring that management's policies align with the company's long-term strategic goals. Independent directors can provide an impartial viewpoint that is free from hidden agendas and unconnected to the firm or its management.

Due to a number of new issues, “including shareholder activism, board diversity, related party transactions, reputational risk, shareholder relationships, technological innovation, corporate ethics, management evaluation, regular regulatory reforms, and on-going shareholder pressure, the board of directors' role has grown more difficult.” The appointment of independent directors is required by regulators in order to guarantee that the board is composed of a limited number

[8] India Business Law Journal - Nishith Desai Associates. Retrieved June 1, 2018, from http://www.nishithdesai.com/fileadmin/user_upload/ pdfs/Research%20Articles/New_directions.pdf 4 (n.d.). Do Independent Directors Add Value? (1999) by Jeffrey Lawrence

[9] Independency of Independent Directors in Corporate Governance - ICSI. Retrieved June 1, 2018,from (M. Gupta)

of persons with in-depth expertise of the business.

In promoting openness and accountability and introducing principles of corporate governance, SEBI and the Ministry of Corporate Affairs require that 10-15% of the board's composition consist of independent directors.[10] This rule is enforced to introduce greater oversight over the company's functioning, as seen in the case of Satyam, where senior management encouraged fraud and questionable business activities. The Corporate Affairs Ministry is enforcing this rule to ensure greater evaluation of the functioning of these companies.

V. Relation between Corporate Governance and Independent Directors

"Making sure corporate governance can draw in significant funding for business operations and that every business decision is equitable and open to its stakeholders will help the firm draw in investors and ensuring that it has a strong board of directors. In order for the board to carry out its duties with impartiality and keep the management responsible to the firm, independence of the board is essential. According to common practise across countries, independent directors are a solution." With regard to their qualifications, experience, compensation received, the number of other companies in which independent directors hold positions, disclosure by the company, etc., the impact of independent directors' presence on corporate boards and their independence in the performance of their duties have been analysed for Infosys.[11]

The J.J. Irani Committee, 2004[12] (referred to as "the Committee") suggested that Cl. 49's restrictions be expanded to include all "big" corporations. The Committee reiterates its conviction that independent directors are crucial to good corporate governance and that their inclusion in sufficient numbers will enhance governance. The Committee disagrees with a "one size fits all" approach and advises a strategy that is attentive to the different types of firms in order to broaden the scope of Clause 49. Wherever a firm has a stake in the public good, independent directors must make up at least one-third of the board. On the problem of nominal directors on the board who represent institutions, the Committee expressly advises against equating such directors with independent directors since they simply serve to further sectional interests. It goes into detail on circumstances in which independence may or may not exist. The traditional method of hand-picking independent directors was condemned in the 1999 Report

[10] Vijaya Batth, Dr. Bhagirathi Nayak, Dr. Pratima Sarangi. (2016). Role of Independent Directors in the Changing Business Scenario in India.

[11] Jitendra Singh, Mike Useem & Harbir Singh, Corporate Governance in India: Is an Independent Director a Guardian or a Burden

[12] See Report of the Expert Committee on Company Law, available at http://icai.org/resource_ file/ 10320announ121.pdf

of the Kumar Mangalam Birla Committee[13] on Corporate Governance since such selection alone eliminates the directors' independence.

Effective and efficient independent directors are crucial to the framework of strong company governance. It ought to be mentioned that while directors are often regarded as officers in default, independent directors are also regarded as the company's supervisors. They provide management with guidance to make sure all decisions benefit the company's diverse stakeholders and safeguard the interests of the minority shareholders. Nevertheless, since the resignation of the independent directors of Satyam Computers and the esoteric instance of Mr. Cyrus Mistry's expulsion from the board as detailed in more detail below, the functions of independent directors have been under continual scrutiny.

VI. Corporate scams

1. Tata Sons case

The decision to remove Mr. Cyrus Mistry from his position as chairman of Tata Sons has resulted in some kind of crisis and jeopardised the Tata family's position as the unchallenged moral authority in India Inc. The board of Indian Hotels Company Limited's independent directors unanimously affirmed their trust in Mr. Mistry. Mr. Mistry and the independent directors are both equally culpable for poor governance since boards are held jointly accountable. According to Mr. Cyrus, all problems are hotspots and legacy concerns. What considerations propelled Mr. Mistry's support from IHCL and the independent directors of Tata Chemicals? Do they know the truth? If that's the case, why did they keep quiet for so long, enabling the problem to become worse? Why do they support Mr. Mistry when they have shared responsibility for IHCL affairs from the year 2000? Do Mr. Mistry's independent directors' support for him match the standards of good governance? Does what they're doing maintain the stock's value? Does a divided board increase or decrease shareholder value? A great example of sound corporate governance was the Group's corporate structure, which was in existence for more than 50 years under Mr. J. R. D. Tata and subsequently for more than 20 years under Mr. Ratan Tata. Mr. Mistry consciously disrupted this established corporate structure by appointing himself as the only Tata Sons representative on the boards of Tata operational firms. The Governance Standards Framework, which Mr. Mistry personally developed in 2015, stipulates that all employees of a Tata company must immediately resign from the Boards of all Tata firms where they are serving as Non-executive Directors when their employment expires. So, upon

[13] See The Report of the Kumar Mangalam Birla Committee on Corporate Governance, available at http://www.sebi.gov.in/commreport/corpgov

quitting his role as Executive Chairman of Tata Sons, Mr. Mistry should have instantly resigned from the Boards of all other companies in line with his own regulations. Yet by rejecting, he has wilfully chosen to go against the Governance Rules Framework.

2. <u>Satyam Computers case</u>

The lack of the required conditions may prohibit the board of directors from doing their tasks effectively, even if they are great and independent. The Satyam episode serves as an example of a few of the factors raising concerns about independent directors' effectiveness in India. Corporate governance issues were discovered during the Satyam fraud investigations, which has spurred a conversation about independent directors and the need to enhance corporate governance institutions in India. The independence of Satyam's independent directors came into question when investors and regulators questioned B. Ramalinga Raju's offer to purchase a business that was promoted by his family. After the Satyam affair, almost 350 independent directors in India promptly resigned from their positions. The departure of the independent directors serves as notice to investors that there is a problem with the board of directors. This may be accounted for by the fact that a sizeable proportion of independent directors lack faith in their capacity to manage the ramifications from the decisions made by their companies. This might be because they lack influence over the company's operations or because they are either oblivious of unlawful activities and have lost their ability to successfully convince the board to take necessary action. Neither of these two possibilities is encouraging for the way things are now in India's economic world. It also draws attention to a separate paradox: Is it possible for independent directors to be said to be independent if their employers dictate their hiring decisions? If anything, this would support the idea that independent directors should have a larger role on boards. Following the Satyam incident, there is optimism that corporate India would pay attention to the independent directors' responsibilities, which is of the highest significance to both investors and the management of the company. Independent directors are chosen to function as the shareholders' guardians.

VII. SUGGESTIONS

Independent Directors play a crucial role in improving corporate governance of a company. Here are some suggestions on how they can fulfil their role effectively:

1. Ensure compliance with laws and regulations: Independent Directors should ensure that the company complies with all applicable laws and regulations, and that the company's policies and procedures are in line with best practices.
2. Advise on risk management: Independent Directors should advise the company's

management on risk management strategies and ensure that appropriate systems and controls are in place to mitigate risks.

3. Foster transparency and accountability: Independent Directors should foster a culture of transparency and accountability within the company by ensuring that all stakeholders have access to relevant information, and that the company's performance is regularly reviewed and evaluated.
4. Maintain independence: Independent Directors should maintain their independence and avoid any conflicts of interest that could compromise their ability to fulfill their duties.
5. Continuous learning and development: Independent Directors should continuously update their knowledge and skills through training and development programs to stay up-to-date on emerging trends, risks, and best practices in corporate governance.

By fulfilling these responsibilities effectively, Independent Directors can contribute to improving the corporate governance of a company and ultimately enhance the company's long-term sustainability and success.

VIII. Conclusion

The study mentioned highlights the Board of Directors' position being criticized continuously due to corporate frauds and scams resulting from a failure to uphold corporate governance standards. The author suggests that having an independent board is essential to ensure efficiency within the organization. Non-executive board members with no financial ties to the company contribute to the effective administration of the business and represent the interests of all stakeholders, including minority shareholders. "The independent directors have a fiduciary responsibility to the company and can be held legally accountable for their actions and inactions in civil and criminal courts. Independence enables directors to remain impartial and evaluate the firm's performance without being influenced unfairly by interested parties or facing any conflicts of interest."

In summary, Independent Directors play a vital role in enhancing the corporate governance of a company. They provide oversight, ensure compliance, advise on risk management, foster transparency and accountability, evaluate and monitor performance, maintain independence, and continuously update their knowledge and skills. By fulfilling these duties, Independent Directors can help ensure the company operates sustainably and responsibly, taking into account the interests of all stakeholders, including shareholders, customers, employees, and society. Ultimately, effective corporate governance led by Independent Directors can improve the company's long-term success and contribute to the broader economic and social well-being of the communities in which the company operates.

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