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TODAY'S COLUMNIST

Independent directors are for small investors

*With Sebi's new mandate, the coming years will see changed levels of corporate governance*

PRITHVI HALDEA

Posted online: Wednesday, October 05, 2005 at 0000 hours IST

FEEDBACK EMAIL PRINT



In about three months, corporate India would hopefully begin to change forever. Sebi has mandated that by December 31, half the board of directors of all listed companies should comprise of independent directors (IDs). Extension of the deadline appears remote; M Damodaran, the Sebi chairman, has warned of stern measures for non-compliance, which will become a "continuing offence," with a fine for each day of the offence. And he is right. This issue has been debated enough—for as long as five years,

including fine-tuning of the guidelines by a panel headed by Infosys founder NR Narayana Murthy, which had charted various corporate governance rules for companies, including specifying the number of IDs on their boards.

The issue of IDs should be seen against the background of several global financial scandals involving listed companies, which alerted regulators. In 2003, both NYSE and LSE made it mandatory for boards of listed companies to have at least half their directors as independent ones (earlier one-third). Look at it another way: if a company accepts outside shareholders (because that suits it, as they provide the funds), where is the logic of not accepting outside directors, who would essentially look after the interests of the outside shareholders? IDs, in fact, are substantially about small investor protection.

First the basic question: why IDs? For decades, we have witnessed a blatant pursuit of private gains by promoters. Little wonder we have sick companies, but never poor promoters! IDs are expected to ensure compliance, prevent malpractices and act in the interests of the non-promoter shareholders. Thus, it is important not only to have IDs, but also have them in a sufficient number to exert an influence.

• **More firms in the middle range now accept good governance makes sense**  
 • **There's no paucity of**

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**Untrained or trained  
independent directors  
if Harassment to them on  
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can ever be truly 'independent' directors. Typically, only such directors are invited to the boards as are known to the promoters. The 'independence' may thus get compromised, compounded by high remuneration. However, the bottom line is the increasing accountability of IDs. In order to safeguard their own reputations, they would prevent misdemeanour. The question of remuneration, of course, is a ticklish one—it ought not to be so low as to disinterest competent persons from accepting board positions, nor too high to impact their independence.

As the deadline approaches, it is certain that most companies will try to beat the guideline by getting such people on board who are within their 'control.' While the top companies will find such people, who will also be competent, on their own, the bottom companies would hire their friends and relatives, qualified or not, to fulfill the requirement.

However, more and more companies in the 'middle' range are now accepting that good governance makes good business sense and are really serious about IDs. This is also borne out by the increasing realisation that if they have to have IDs, they may as well get professionals. Who would, with their expertise, not only add value to their companies, but also build confidence among investors. Moreover, they are concerned about the reactions of the regulators, media and investors after December 31, when there would be a huge analysis as to how Corporate India went about fulfilling this mandate.

The major opposition to the concept of IDs, as expected, has come from the companies themselves, specially from the 'old generation' ones. They surely do not want 'strangers' on their boards. They also aver that an outside director may actually be harmful, as his knowledge is limited to the few meetings and he may, just to prove a point, stall even good policies. The reality is that most companies have more to hide than tell. Hence, the opposition.

As a last resort, another argument, a ridiculous one, has done the rounds. Coming mainly from some industry associations, obviously on behalf of the companies they represent, that there is a paucity of qualified/trained IDs. However, the truth is that there is enough talent in the country, and there are thousands of professionals who are both willing and qualified. The problem is how to find them. A few months ago, the National Foundation for Corporation Governance (NFCG) had asked the apex chambers and professional bodies to prepare a database of IDs. Nothing much happened thereafter.

A new website, primedirectors.com (with which the author is involved) thwarts the ground that there aren't enough professionals. More important, the website addresses the core issue of how to reach out to the professionals to get them on the boards. Presently, companies can only contact persons known to them or through word-of-mouth, thereby limiting the horizon. On the other hand, interested professionals do not know how to let the listed companies know about themselves and get invited. This website is a free-of-charge platform both for the professionals to enroll and for the listed companies to reach them. The response to the website has been overwhelming. As of October 3, as many as 2,710 professionals had already filed/are filing their profiles. The analysis is also interesting; for example, as many as 42 are professors at IIMs/IITs/IISc, while 79 have doctorates to their credit.

The real hurdle in getting the right professionals, of course, is the harassment on account of matters on which the IDs have no control. This includes the practice of some government departments to issue notices to all directors for any lapse of default by the company. There is now some relief from the Supreme Court: IDs would no longer be liable under section 138, for dishonoured cheques.

Any which way, the coming years would witness new levels of corporate governance in India, substantially aided by the new breed of IDs.

*The writer is the managing director of PRIME Database*

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