



## RESEARCH PAPER ON ROLE OF INDEPENDENT DIRECTORS

**AUTHOR** - NAIVEDHYA KUMAR, STUDENT AT SCHOOL OF LAW, NARSEE MONJEE INSTITUTE OF MANAGEMENT STUDIES, DEEMED TO BE A UNIVERSITY, MUMBAI, (INDORE CAMPUS)

**BEST CITATION** - NAIVEDHYA KUMAR, RESEARCH PAPER ON ROLE OF INDEPENDENT DIRECTORS, *LAW AND SOCIAL POLICY REVIEW*, 1 (1) of 2023, Pg. 148-152, APIS - 3920-0015 | ISSN - 2583-8180

### ABSTRACT

*The Companies Act, 2013 requires that at least one-third of the directors of any publicly traded business be "Independent Directors," defined as directors who are not employees of the firm. Independent directors' part in Corporate Governance has been under the microscope as of late. Some believe that the boardroom environment has improved after the introduction of Independent Directors. Others have argued that it serves as a useful deterrent against fraud and poor management. Because they are not selected by any one shareholder, Independent Directors have an undivided responsibility to the firm as a whole.<sup>248</sup> Theoretically, the Independent directors have no vested interests in the firm and may thus vote and participate in other corporate matters independently. The majority of shareholders, however, have the power to vote out the Independent director. Independent directors' ability to protest to policies that favour one party solely can be utilised to safeguard the interests of minority shareholders.*

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<sup>248</sup> Avtar Singh, Company Law, Eastern Book Company, 2016



## INTRODUCTION

A company's reputation and governance standards might benefit from having independent directors on the board. As far as we know, he or she has no ties to the firm that would compromise their objectivity. The Act includes a new definition of "Independent Director" and various additional criteria for the nomination, duties, function, and obligations of such directors. The need of having impartial board members was recognised when India adopted corporate governance practises. The required clauses were not included in the Companies Act of 1956. The Ministry of Corporate Affairs revised the Act in 2013 to fill the void.<sup>249</sup>

The balance between a company's management and its owners is crucially influenced by its independent directors. Independent directors are useful for achieving both profit maximization and safeguarding the interests of shareholders. For the sake of clarity, let's define "independent director" as a member of the board of directors who is not an employee of the corporation and hence is free from bias. The independent director is neither involved in day-to-day operations, nor is he a member of the company's management team.<sup>250</sup>

## APPLICABILITY ON APPOINTING AN INDEPENDENT DIRECTOR

### Listed Public Company

At least one-third of a public company's board must be made up of unaffiliated individuals. The value of any fraction included in that third will be rounded up to the nearest whole.

### Unlisted Public Company

The minimum number of independent directors required of any kind of publicly traded company

may be set by the Central Government. Businesses in the following categories are required to have at least two independent directors under Rule 4 of the Companies (Appointment and Qualification of Directors) Regulations, 2014.

- "Public companies with paid-up share capital of Rs. 10 crore or more."
- "Public companies with a turnover of Rs. 100 crore or more."
- "Public companies with aggregate outstanding loans, debentures, and deposits, exceeding Rs. 50 crore"<sup>251</sup>

### APPOINTMENT OF INDEPENDENT DIRECTORS

- Independent directors shall be appointed in a manner that is separate from the appointment of management; in making its selections of "independent directors, the Board shall ensure that there is an appropriate balance of skills, experience, and knowledge in the Board to enable the Board to effectively discharge its functions and duties. Independent director may be picked from Data bank."
- The shareholders' meeting must approve the nomination of the company's independent directors. Included in the explanation "of the meeting to approve the appointment of the independent director shall be a statement that, in the opinion of the Board, the independent director proposed to be appointed satisfies the conditions specified in the Act and the rules made thereunder and that the proposed director is independent from the management."
- **ROLE OF INDEPENDENT DIRECTOR**
- When it comes to the interests of the firm and its constituents, an independent director's position is crucial. The Act's

<sup>249</sup> "Indicative Independent Director Definition - IFC. Retrieved June 1, 2018, from <https://www.ifc.org/wps/wcm/connect/9d10d4804091a9a7b3f4b3cdd0ee9c33/Independent+Director+IFC+D+efinition+2012.pdf?MOD=AJPERES>"

<sup>250</sup> "Independency of Independent Directors in Corporate Governance - ICSI. Retrieved June 1, 2018, from (M. Gupta)

<sup>251</sup> "Do Independent Directors Add Value? (1999) by Jeffrey Lawrence and .... Retrieved June 1, 2018, from [https://law.unimelb.edu.au/\\_\\_data/assets/pdf\\_file/0020/1710254/143-IndependentDirectorsReport2.pdf](https://law.unimelb.edu.au/__data/assets/pdf_file/0020/1710254/143-IndependentDirectorsReport2.pdf)"



Schedule IV specifies responsibilities for Independent Directors, including safeguarding stakeholder interests (especially those of minority shareholders), reconciling differences between minority shareholders, evaluating management's performance, and mediating disputes between management and shareholders.<sup>252</sup>

- The purpose of the meeting is to evaluate the other directors' performance and the flow of information between the Business and the Board. At least once a year, they must convene to discuss the company's performance under the Act and provide feedback to the chairperson. The effectiveness of the Company's Board of Directors would be greatly improved if this were implemented.<sup>253</sup>
- The Act of 2013 restricts the responsibility of independent directors to problems directly affecting them. "only in respect of actions of omission or commission by a firm which had happened with his knowledge, traceable via board proceedings, and with his permission or connivance or where he had not acted conscientiously," as Section 149 (12) puts it, "is an Independent Director liable." (Bath) That's why the Independent Director can't be held responsible for things that aren't within his jurisdiction and expertise.
- Boards with independent directors have been shown to be effective in detecting and preventing fraud. Several high-profile incidents of fraud in India have piqued the attention of the media, prompting the Independent Directors to reevaluate the fraud risk management framework they helped create. As a

result, the Independent Directors are afforded a wide range of discretionary authority that serves to both facilitate the company's operations and safeguard the interests of its many constituencies. The board is now obligated to look out for the best interests of the shareholders.

- **TENURE OF INDEPENDENT DIRECTORS**
- Section 149(10) and (11) of the Companies Act, 2013 specify the number of years that an independent director may serve in such role.
- Every independent director chosen under Section 149(10) may serve for a maximum of five (5) consecutive years.<sup>254</sup>
- The nomination of an independent director for a term of 5 years or less is permitted, as stated by the Ministry of Corporate Affairs in its General Circular 14/ 2014. A single term is defined as any appointment of five years or less.
- In accordance with this provision, the independent director shall be eligible for reappointment upon the adoption of a special resolution, and such eligibility shall be disclosed in the board report.
- In addition, no individual shall be appointed as an independent director for more than two consecutive periods under subsection (11). Nonetheless, such independent directors shall be eligible for reappointment after serving for a total of three consecutive terms.
- The Ministry of Corporate Affairs made it clear in its General Circular 14/2014 that a person must retire from the position upon completion of two consecutive terms, even if the total number of years is less than 10.<sup>255</sup>

<sup>252</sup> "The Independent Director: Has it been Indianised enough? .... Retrieved June 1, 2018, from <http://docs.manupatra.in/newsline/articles/Upload/51D72E8E-0E3D-436C-8816-07816F8789EC.pdf>

<sup>253</sup> the role of independent directors in controlled firms in india - Manupatra. Retrieved June 1, 2018, from <http://docs.manupatra.in/newsline/articles/Upload/8BC687F7-9B76-4342-A173-28F598A94BE9.pdf>

<sup>254</sup> "<http://www.livewall.in/independent-directors-really-independent-indian-companies-dominatedpromoters/>

<sup>255</sup> <https://repository.law.umich.edu/cgi/viewcontent.cgi?article=2722&context=articles>



- **RETIREMENT BY ROTATION**
- Contrary to the other directors, the independent directors are exempt from mandatory retirement as per paragraph (13) of section 149.
- **SELECTION OF INDEPENDENT DIRECTORS**
- Appointing an independent director means getting someone who can help with company governance without being biased. Part IV of Schedule IV to the Companies Act 2013 specifies the procedures to be followed for appointing an independent director<sup>256</sup>.
- Independent directors are not beholden to the administration of a firm, as stipulated in clause (1) of Part IV of Schedule IV. An independent director should be appointed by the board of directors, who shall also ensure that the board's collective expertise is well-rounded. As a result, the board will be better able to carry out its responsibilities under Section 150. (1).
- Thus, the board can propose candidates for independent director positions. In addition, the board has the opportunity to use the database to choose itself an independent director. Anybody, so long as they've been told by the central government, can access the database. If the board wants to nominate someone as an independent director, it's up to them to do their homework beforehand.<sup>257</sup>

### **SUGGESTIONS TO IMPROVE THE FUNCTIONING OF INDEPENDENT DIRECTORS IN THE BOARD**

The Independent Director should speak out confidently and offer pertinent questions at board meetings. A director's independence is supposed to be so strong that they can take a strong stance on any subject brought up at a

board meeting and still feel completely comfortable asking the appropriate questions of the board.

- An independent director's duty includes looking out for the company's minority shareholders
- And ensuring that there is no interlocking directorate.
- The company's independent directors have a responsibility to make the best decisions possible in light of all available facts and data.

It is also stated that the independent director should protect minority shareholder interests, uphold corporate openness, and uphold corporate integrity. The job of the independent director is crucial in all areas, including but not limited to the following: reviewing audit reports; appointing KMP; making strategic choices; managing risks and internal controls; and protecting the interests of minority shareholders.<sup>258</sup>

### **CONCLUSION**

The Indian corporate sector has evolved over the years, expanding the rights and responsibilities of independent directors and providing them with a more precise definition of their role. With the number of corporate scams and scandals on the rise, now is the time to discuss the hazards that might arise when independent directors carry out their responsibilities. It's also crucial to stress the safeguards in place to ensure that independent directors will carry out their responsibilities with due care and attention. As independent directors are the bedrock of corporate governance, bolstering their performance is crucial to raising the bar on governance practises generally.

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