

The naked truth about independent directors

Prithvi Haldea

Corporate governance is not an execution but an oversight mechanism to ensure honesty in a company. (This presumes that dishonesty exists in most companies). So the oversight structure has to be very strong and competent to be able to detect malpractices. *If almost the entire foundation of corporate governance rests on the shoulders of the independent directors (IDs), it is now beyond debate that the foundation indeed is extremely fragile.*

I am amused at most of the reactions in recent times to the subject of ID. Some reputed persons, who are IDs themselves, have written articles, spoken at conferences and debated on electronic media defending the present institution of ID. Most of these are eminent, and honourable, people (in any case, only such people are invited to write or speak on this subject). But they are only talking from their own personal experiences and they represent at best 1 to 2 % of the listed companies. They are only defending themselves, and appear oblivious of the larger community of IDs. Should we be concerned about corporate governance only in 1 to 2 % of the companies? Interestingly, even these eminent persons now admit in public that if the promoter of a company and its CEO/CFO are intent on committing a fraud, there is little an ID can do to prevent it!

Most of these eminent people, in any case, have no choice but to defend the institution of ID, and in its present format, as they have to justify their being on the boards of companies, and also because most of them derive a very handsome earning from this “profession”.

Many are brushing aside Satyam as a one-off case. But what makes Satyam relevant is that a huge scam could be created, and that too for several years, under the very eyes of some of the most reputed IDs. More scams under the ‘watchful’ eyes of lesser qualified IDs are, as such, highly probable.

Satyam, in fact, is a watershed event for the institution of ID. *It has demonstrated that even highly credible, qualified and educated persons are no insurance for corporate governance, that they are not independent of the promoters, providing blind support to them, and that they are no watchdogs of the minority shareholders whose interests they are supposed to serve.*

I have been arguing for long against the very institution of ID, especially the way it is practiced in India, and that that these IDs are more of a myth and that they, in fact, are ending up serving a negative purpose, that of providing a false sense of security to the minority shareholders. The Satyam case has vindicated me, and re-opened up this debate.

Actually, the debate on corporate governance in some form or the other has been on for the past five years. It is amazing that, as role models, the same handful of names continue to be reeled out even now...Infosys, Tatas, Godrej, HDFC, Hero Honda. Surely, these are our showpieces but they constitute just a handful of the over 2500+ listed companies that are governed by Clause 49. The bottom line is that these cited companies would have had good corporate governance even without Clause 49! The debate has to be extended to the entire listed world. The issue is even more critical now as the reputation of the entire India Inc. is at stake. Capital will also become scarce, hurting the growth of the economy. It is important to rise above the letter and imbibe the spirit.

Significantly, no strong voices have been heard from the corporates decrying the ineffectiveness of IDs. Most of them, in fact, appear comfortable with the present state of affairs, even stating that Clause 49 is near-perfect, and that no additional regulatory burden should be imposed upon them. The need, therefore, is for the regulators, shareholders and other stakeholders to now rise to the occasion and demand the necessary changes.

Need to agree on the real meaning of “independent” directors

As a part of the present defense, attempts are being made to redefine the role of IDs. This will, as ever, again dilute the debate and make us look for answers elsewhere. Many argue that the role of IDs is to contribute to the development of the corporate strategy and to review the performance of the management in meeting the agreed goals and objectives, with their wider experience and fresh perspectives, and to also add value to the company in various other areas through their knowledge. Many even suggest that IDs are not just for the shareholders, their role is protection of interest of all stakeholders. The argument is stretched further that “independence” means independence of mind.

This, however, is not the real role of IDs. *Let it be clear that IDs are mandated only for the listed companies, and this is so as these companies have raised money from the public. For this very reason, the unlisted companies-there are over 8.60 lakh of them, and some of them even larger than the largest of the listed firms-do not require IDs. So by implication, the fundamental and the primary role of IDs is protection of public shareholders, which should be achieved by opposing ideas that are detrimental to their interests, and establishing financial controls to ensure that promoters do not enrich themselves, through unfair means or outlandish remunerations at the expense of the minority. Any thing else the IDs do should be seen as only a bonus to the company. So the only real meaning of “independent” is that such persons should be independent of the promoters (and the management, which incidentally in India is a combined position in most cases).*

IDs are also clearly not representatives, of sorts, of the regulator to enhance a company's value. Regulations, in any case, are not supposed to direct companies to hire people to add value to their enterprises. No one else either mandatorily expects value from them. It is for this very reason that nobody has ever complimented IDs for good business decisions or questioned them for wrong ones, which goes on to prove that no one expects them to take business decisions in the first place. In any case, not many of the IDs would be industry experts, as such people would be running their own companies and probably be competitors!

How valid are IDs in India?

The natural conflict between promoters, whose primary motivation would be to enrich themselves, and the IDs who are supposed to prevent this from happening, is at core of the problem. However, how is this conflict resolved in India? By allowing the promoters themselves to get such persons on their boards who will not even recognize this conflict, leave aside resolving it.

ID is not an Indian concept. IDs may have made some sense in the US, for example, where companies are widely held and where the undue enrichment of the CEOs had to be curtailed. In India, most companies are family-run; their stranglehold on their companies is near-complete. Requiring such families to induct IDs is debatable; giving these families the unbridled power of appointment of IDs defeats the very objective of independence.

Ask Indian promoters about IDs, and they laugh “I am going to take all decisions, it is my company, I own most of it, and I know more about my business than any one else. I have put my huge money on the block, so I deserve not only an equal but a better treatment than other shareholders. The Board is a mere formality.” It is, of course, another matter that most of the promoters’ contribution itself may have come through dubious means of over-invoicing/book entries. The situation is worse where the promoters hold 90% of the stock, as has been the case with most IPOs in the past few years. Small public stakes cannot put any effective pressures on the promoters, and they look at the institution of ID with even more contempt.

Then there is the mutualisation conflict. While we have addressed the conflict in the case of management of stock exchanges, the mutualisation conflict stays at the corporate level-the owner, chairman and CEO positions in most cases vests with the same individual. This power decimates the role of IDs.

Finally, are we not expecting too much from IDs? *Is it, first of all, even reasonable to expect corporates to be islands of virtue in an ocean of corrupt society? Crime, corruption, dishonesty is now a part of our daily lives...flowing even among the law makers. So it would be foolish to expect India Inc to be a monastery.* It is well known that some of the top corporate houses have grown large through not-so-proper means! Speed money is the order of the day. In fact, many promoters tell me that good governance is bad business! In such an environment, what can be expected of an ID?

How is an ID appointed?

The problem starts from the very beginning. The promoter identifies a person and puts up his name before the company’s nomination committee, where it is invariably approved. The name is then taken to the shareholders meeting where again it is more of a formality, given the manner in which most shareholders’ meetings are conducted. The defense that all directors are appointed only with the shareholder’s approval is hollow; no one has heard of even one director’s appointment being rejected at the shareholders meeting. The promoters’ arrogance can also be seen in the justifications for appointment of directors which are often very meagre. There is no prescribed format for this, and companies can get away with just a one-line description about the proposed director.

Meaningless compliance

IDs are required by the regulations. Hence, companies main aim is compliance, in any which way.

To recall, after several extensions, the deadline for compliance (requiring 50% of the board to comprise of IDs) was finally extended in March 2005 to 31st December 2005. On expiry of the deadline, it was made to believe that almost all companies had complied. Having cried hoarse all year about non-availability of professionals to become IDs (the number put out was 30,000 IDs), it was amazing how easily the corporates had found them (the number of IDs appointed since January 2006 has turned out to be only 3,664).

However, still to answer the corporate outcry of lack of enough professionals in the country, I had created primedirectors.com. This website now has over 19,000 profiles, many of them of outstanding people, but corporates have shown very little interest, despite this being a free service. (Surprisingly, corporates are even today complaining that they cannot find good IDs. Are they in a sense admitting that the IDs that they have put on their boards are not good people-and hence the CG in their companies also is not what it should be- and that they hired bad people only for compliance purposes?)

Rapid compliance by the corporates was not surprising because it was easy to comply in letter. What many companies did was to reshuffle the relationships with their existing directors, and designate them as ID; more than 3,000 persons, as on 1 January 2006, who were already on boards, were re-designated as IDs. (Is it fair to expect such persons to suddenly reverse their roles and become independent?). Or in hundreds of cases, the executive chairmen were redesignated as non executive chairmen thereby requiring only 33% of the directors to be IDs.

Moreover, while there are prescriptions of who cannot be an ID-like lack of pecuniary relationship, there are many loopholes in the guidelines. More significant is that there are no positive eligibility norms and the cost of compliance is zero.

After directorsdatabase.com, run by Prime, pointed out several loopholes in the regulations, some, but only some, have been plugged. This includes, for example, beating the regulation on the numbers front. The initial regulations stipulated that if a company has a non-executive chairman, only one third – and not 50% - of its board should consist of IDs. This exemption, however, was widely misused. Prime found that in as many as 30% of the companies, promoters or promoters of the promoter companies or even their relatives had designated themselves as non-executive chairmen, thereby claiming exemption. Prime had suggested that a non-executive chairman should neither be from the promoter group nor be related to any promoter-director or to any other director nor, in fact, to any key executive in the promoters' group companies, and if he is, then the one-third exemption should not be available. This suggestion was accepted.

WHO TYPICALLY ARE INDIAN IDs?

Courtesy the several loopholes in the guidelines and the ingenuity of India Inc., we now have a huge body of IDs, though only in letter, but hardly independent in spirit.

There are a total of 6,443 individuals serving as IDs on the boards of 2,213 listed companies*.

The IDs on Indian boards present a very interesting, yet a disconcerting, picture. An analysis of IDs reveals that there are four categories of IDs.

“Home Directors”

Let us accept this stark reality. No promoter in his senses would invite a stranger on his board (and by the same logic, no person of any repute would expose himself to a strange company by accepting its directorship!). A board position provides huge access to company information, including confidential information, that a promoter may not feel comfortable giving to a stranger, for fear of misuse. An unknown quantity can also create impediments. Moreover, most promoters have too much to hide and they often resort to window dressing, something that would not be possible with a stranger around.

Little wonder, the home directors' category is the most overwhelming one. These comprise persons known personally to the promoters-relatives, friends, neighbours, ex-employees, ex-teachers etc. Several loopholes exist to get home people on boards. For example, according to the Companies Act, all persons from the wife's and mother's side are not considered as relatives. So a company can get on its board, for example, the promoter's father-in-law or wife's brother or mother's brother, and call him independent! One can also get a friendly professional (lawyer, accountant etc.) on the board and stop all pecuniary relationship with the company but pay him cash or through another group company!

Such home directors can even include the family barber or a servant, just about any one! How? Because while almost all jobs require a qualification and/or experience, there are no eligibility requirements for an ID. As such, technically, every single Indian, who is above 21 years of age, is qualified to become an ID, which means over 60 crore Indians are eligible to become IDs! And that too for handling such a professional and technical job.

Even if one grants that many of these home directors are qualified and competent people, their home connection, and not independence, will always take precedence.

My estimate is that nearly 75% of all IDs are “home” members who, therefore, are natural allies of the promoters and are not independent in any sense.

“Value Directors”

Value Directors are those that either bring knowledge and expertise to the company-lawyers, finance professionals, technocrats etc- or they provide networking to the company by opening doors to the government, politicians and institutions. Such persons are also hired to give a sense of comfort to both the institutional as well as the retail investors. Many of these would be people of high integrity. So, where is the problem, especially if the value they deliver to the company would also benefit the minority shareholders? The problem is that this is not their primary task and they should, in fact, be called Value Directors or Professional Directors and not IDs as almost all of such people are also either personally known to the promoters or have been referred by some one close to the promoters (and are paid extremely well) . So despite their ability to identify promoters' wrongdoings, they would still by and large support the promoters.

It is, therefore, not surprising that there are any number of companies where the Value Directors remained calm when promoters went on a rampage with corporate actions which enriched them, at the cost of minority shareholders, actions like preferential issue of warrants, mergers and amalgamations of group companies, managerial remuneration and the like.

If at all most of the Value Directors ever raise their voice in the boardroom, it would be more because an action may adversely impact their own personal reputations.

This category, incidentally, now includes a large number of civil servants, who have realized that post-retirement, one of the best avenues to pursue is directorships. Of course, many could have also been appointed as a quid pro quo for favours received in the past. I regularly receive phone calls from this class asking me to recommend their names to some companies. The website-primedirectors.com has also attracted as many as 469 civil servants, aspiring to become IDs.

Interestingly, while there are 196 IAS officers presently on boards as IDs, there are only 24 IRS officers. Why? The IRS officers, in fact, are better qualified, and have a better understanding of corporate finance, having scrutinized hundreds of balance sheets and scams in their lifetimes. That precisely could be the reason why they are not a preferred class as they could make life very uneasy for the promoters!

In my estimate, about 15% of all IDs fall into the Value Directors category.

“Celebrity Directors”

This is the category which comprises of people whose main reason to be invited to become an ID is to add an aura of respectability and news value to the company, as also to impress both the institutional as well as the retail investors. This category includes film stars, lyricists, sportsmen, defence personnel, fiction writers and the like. This is quite like the 80s when the IPO flood required companies to stand out and many of them hired celebrities as a selling tool for their IPOs, like Sunil Gavaskar or Field Marshall Manekshaw. We have only now legitimized these celebrity directors by giving them the respectable title of an ID.

Most people in this category also would be people of high integrity. However, they would have very little clue to the world of corporates or of promoters' designs. They are just happy renting their names. These people may not be known personally to the promoters. But since they neither add knowledge nor do any harm to the company, promoters are comfortable with them.

In my estimate, about 5% of all IDs fall in this category.

“PSU Directors”

This is the category which comprises of people who are appointed on the boards of listed PSUs. These people are typically appointed by the political high command or the concerned minister. Most of these people are either politicians who need to be rewarded or are people who are bureaucrats who protect the interests of the dominant shareholder-the government- or are individuals that the politicians would like to favour. These people either carry out the mandate of the respective ministries or simply pursue their personal agenda of benefitting from these PSUs, and are clearly not concerned about the minority shareholders. Most PSU board meetings are conducted at the pleasure of the minister or the joint secretary. In a sense, these directors are also home directors; instead of being appointed by the dominant private promoters, they are appointed by the dominant government promoter.

In my estimate, about 5% of all IDs fall in this category.

THE MYTH OF INDEPENDENT DIRECTOR

Appointed by the promoters...

It is clear that none of these four categories would serve the interests of the minority shareholders primarily because they are invited by the promoters to the board. As such, the entire concept of ID is a myth. The IDs only comply with the statutory definition of independence.

In a recent article in Business Today, several well-renowned people accepted that they had joined as an ID as the company belonged to an old friend! How can one even expect them to be disloyal to their friends in the boardroom?

Given the nature of IDs, dissents are naturally rare. And given their relationship with the promoters, the rare dissent would never be made public. Little wonder, there has not been even a single such case nor any resignation by an ID citing dissent as the reason. Does it mean that promoters have really behaved well all these years? Or does this go on to show that the word dissent just does not exist in the vocabulary of IDs?

Compounded by lack of knowledge...

Promoters have to be smarter than the IDs; that is why the promoters have been able to set up an enterprise, and even raise money from the public! The IDs would, as such, in most cases have a handicap versus the promoters in terms of knowledge and confidence!

But what if IDs lack even basic knowledge? An analysis of educational qualifications of the IDs reveals that as many as 198 of them are non-graduates, of which nearly 75% have not gone beyond schooling. Another 3,500+ are only graduates. While education by itself may not be the sole qualification criteria, it is indisputable that education does expand the knowledge and querying base of an individual.

It is well known that scams can be perpetrated by the promoters in almost all areas of a company's operations-sales, purchase, inventory, personnel, expenses. In each of these areas, there are literally hundreds of ways a promoter can siphon off money or present a false picture. Most IDs do not, on the other hand, even understand the basics of finance, and have no noteworthy corporate qualification or experience. Ask them questions about balance sheets, profit and loss account, sundry debtors, sundry creditors, forex hedging or accounting standards, and they would be embarrassed! Worse, many of them have never invested in the equity markets, and they actually proudly proclaim so. Finally, the devil lies in the details which most IDs either do not get to see or they fail to comprehend. IDs also do not have any independent means of verifying the information provided to them by the management. A macro view on all matters, which the IDs typically display, is clearly not enough.

It is ironical that a low level operator in a broking firm has to pass the NCFM exam. To sell a mutual fund, a person has to pass the AMFI test. But to be at the helm of a corporate, one does not need to have any qualification or pass any exam!

Further compounded by very high remuneration...

Each meeting of the board or a committee can fetch an ID Rs. 20,000. On top of this, the law allows 1% of profits to be distributed among the IDs. Furthermore, there is no limit on ESOPs that can be granted to the IDs. Then an ID can be on the boards of subsidiary companies and derive remuneration from there. Finally, expenses on

travel, boarding and lodging etc can be substantial. There are also examples of board meetings being convened only for allowing an ID to undertake travel.

A study currently under process by Prime reveals the huge payouts being made to IDs. The best case is of a retired bureaucrat who earned a royal sum of Rs.2.20 crore in 2007-08 as an ID. This fee came from 10 listed companies and 2 foreign companies, but excludes remuneration from 4 unlisted companies (a couple of these being very large firms), which could have paid big sums too.

The remuneration data captured by Prime is based only on the official disclosures in the annual reports. It is widely believed that, in addition, there are cash payments, payments in kind and payments to front entities of the IDs. I know of at least 4 cases where IDs have asked for huge payouts in the form of donations to NGOs/educational institutes owned indirectly by them!

Surely, the value and celebrity directors would typically look for very high remuneration. And why not? For retired valuable people specially, this is no social service. What can be better than an opportunity to earn a huge fee plus business class travel, five star hotels, air-conditioned taxis, an extra night stay and possibilities of getting to meet up regularly with your son or a married daughter in another town?

I have no issues regarding high remunerations to Value Directors; they could probably deserve even more. In fact, the very fact that they are being paid so much, and by choice, means they deserve this. But then, they should not be considered as IDs because with very high remunerations, independence is very likely to get severely compromised. This becomes even more acute as nearly 48 % of the IDs are retired people, who naturally would be significantly dependent on the ID remuneration, more so if the remuneration is very high, and would therefore lead to conflict of interest. The IDs would be guided more by their own economic rationale.

Interestingly, the law prescribes that an ID should not have a pecuniary relationship with the company. But what about the pecuniary relationship that gets established post-appointment? When some one earns huge monies from a company as an ID, does he remain independent anymore? He would never dissent; he would always have the fear of being shown the door.

Then there are cases where an ID's earnings from a single company are as high as 50% of his total annual income from directorships. His independence in dealing with such companies would surely be under threat.

So is ID a service, a public service at that, as it is made out to be, or is it now a business?

Further compounded by lack of time...

Let us also look at the reality on how much can an ID do given the time he gets to interact with the company. At best, 4-6 meetings in a whole year lasting a few hours each!

Further compounded by lack of personal motivation...

IDs are supposed to protect other people's monies, not their own. It should, therefore, not be expected that they would watch over it with the same diligence and vigilance.

Finally compounded by the Indian culture...

IDs are invitees, they are guests. And guests who are also being paid. In the Indian culture, the guests will always be polite to their hosts, and in this case, such hosts who are also paying them!

As such, ID is a utopian idea

The first requirement of an ID is knowledge, and deep knowledge, not only of the business but also of corporate affairs. The second requirement is of independence. Regrettably, both are missing in a large majority of cases, making the entire concept of ID utopian.

The handful of people who are both competent and independent, unfortunately, cannot do much justice as they have too much of their own already on their table plus a horde of directorships! Moreover, a real ID, if any, would be in a dismal minority in the boardroom, and would be easily out-voiced.

SOME OTHER TRUTHS ABOUT IDs

Most Value IDs hold too many board positions

The directorsdatabase.com reveals that there are hundreds of individuals who hold directorships in a large number of companies (As many as 330 individuals hold 5 or more than 5 directorship positions in listed companies, and in addition, directorships of several unlisted companies). The Companies Act puts a ceiling of 15 directorships of public companies. However, among public companies, it is beyond debate that the listed ones demands a much greater degree of commitment from an ID, including attending at least four board meetings and several meetings of one or more of the many committees during a year. How many of such IDs can play an effective role in the listed companies is a moot question.

Propriety of related recently-retired government servants on being on boards

Several senior government officials have accepted ID positions post-retirement. Is there not a question of propriety in being a director of a company that one had regulated just some time back or which would get listed in the future? Should there be a cooling period of say at least 3 years, not only for becoming an ID but also accepting any full-time or advisory positions with the listed companies?

Very poor women representation

Women in India have made rapid strides in almost all walks of life, and have not only excelled but also demonstrated a higher degree of governance. But not when it comes to directorship positions. Only 2.5% of IDs are women (162 out of 6,443).

Many kids on the boards

The directorsdatabase.com had earlier revealed that many kids (even 18 year olds) were on boards of companies as IDs. While arguably the son of a promoter-director can be of such an age, some one so young surely cannot acquire enough experience to become an ID of another company. Prime had suggested a minimum age of at least 35 years for an ID. However, SEBI has now mandated 21 years; the logic being that one can contest the parliament election at that age. But then to become an MP, one has to at least get elected. It is true that the shareholders have to elect a director too, but the farce of shareholders' meetings is well known; the IDs are pure nominees of the promoters. Presently, there are as many as 245 IDs below the age of 35, with 20 being even less than 25!

Too many very old people too

On the other hand, many old people are IDs. A very high 3,033 individuals or 48% of the total IDs are above the age of 60, the typical retirement age. Significantly, of these, as many as 1,380 are above 70, as many as 199 are past 80 and 8 are even beyond 90! Are many of these fit enough, physically and mentally, for the onerous board positions?

Relationships among IDs

While the regulations prescribe that anyone related to the promoters cannot be treated as an ID, it overlooks the relationships among IDs, again a provision found to be widely misused.

Nominee directors as IDs

The regulations allow the nominees of specified shareholders/lenders to be treated as IDs. This is untenable. Such IDs at best would be focused only on protection of interests of their nominator and not of the minority shareholders.

Multiple committees/same day, many meetings

While IDs are mandated to be on some committees, they get on to various other committees as well. Pressure of time typically sees several committee meetings being held on the same day as the board meeting, resulting in little time for any serious deliberations.

The farce of audit committees

The audit committee is expected to deliver wonders. And to give a double sense of security, the chairman of the audit committee has to be an ID. However, given the knowledge base of most IDs and the fact that most of them are home directors, nothing meaningful should be expected from this committee. In any case, audit committee members should necessarily have a high level of competence in finance. On the other hand, regulations prescribe “financially literate” as the only eligibility requirement, which is too vague and unenforceable.

Continuing vacancies

There was no guideline prescribing a time limit for replacement of an ID in case there was a resignation, removal or death of an existing one. Many companies remained non-compliant, and took a plea that they have not been able to find a replacement, which could stretch for indefinite periods. Prime had suggested mandating a time limit of 60 days for replacement. However, SEBI has prescribed 180 days, which unfortunately is too long a period.

Too few IDs on some boards

Many companies have too few directors in number. As many as 21% companies have just one or two IDs on their boards.

Poor board practices

Many promoters purposely create voluminous agenda items, laying the critical ones at the end which would then get rushed through due to paucity of time. Moreover, the agenda is often sent very late and several items could actually be placed only at the table. Minutes of the meeting too are sent very late, and are drafted to suit the promoters' will.

Weak enforcement

A majority of the companies take compliance of Clause 49 very lightly. Forget about the quality of IDs and exploitation of the loopholes, many do not even have the requisite numbers on their boards. The casual approach is all-pervasive; as also demonstrated in a recent study done by directorsdatabase.com which revealed that many companies appointed new directors but did not fulfill their obligation to inform the stock exchanges about it.

The regulator also does not seem to take non-compliance very seriously. There appears to be no effective mechanism to ensure compliance on a continuing basis, even in letter. Like compliance and disclosures are better at the IPO stage but fall dramatically post listing, in the case of IDs too, compliance is fully ensured at the IPO stage but forgotten later on. Moreover, no action has yet been taken against the non-compliant companies, including the PSUs who plead helplessness as appointment of IDs is not in their jurisdiction. The only action, if it can be called one, has been putting up the names of such companies on the websites of the stock exchanges, and the recent list includes an astounding 1,317 cases.

WILL THE FOLLOWING SUGGESTIONS MADE BY EXPERTS WORK?

Make regulations principle-based

In response to the present crisis, some voices are emerging to suggest that regulation is not the answer, self-regulation is and, as such, we should not amend or enhance the regulations. This is unworkable. It is beyond debate that regulations are inevitable, given the increasing and larger frauds. Surely, good companies have to suffer because of increased regulations. But then what is the count of good companies?

IDs should now ask more questions

Some good IDs are now hoping IDs will become more vigilant and ask more and right questions. The reality is they would not. Simply because most of them are home directors and in any case are not even competent. Only a few of the few value directors, who are knowledgeable enough, may now ask more questions. But, as said earlier, this would not be for protecting the minority shareholders; it would be more to safeguard their personal credibility.

IDs should have access to more information

It has been suggested that IDs should have access to information other than that provided to them by the chief executive. This is easier said than done. In any case, the functional heads would be more loyal to their employer (promoter) than to the ID. Moreover, the functional heads could be suitably tutored by the promoters.

IDs should meet regularly with the functional managers

IDs are being suggested to meet independently with the functional heads to get into depth as also to obtain varied perspectives. However, in reality, when most IDs do not even have the time to attend the board and committee meetings, how will they find time to talk independently with the management team? Moreover, they would not like to be seen as intruders. In any case, the poor knowledge base of most IDs would make them incompetent to ask the right questions from the management team.

Tenures of IDs should be fixed

Many argue that IDs should compulsorily retire after 6 or 9 years as by then familiarity may breed complacency. It is true that many IDs have served on the boards for too long. Data shows that as many as 2,960 ID positions have been held for more than 6 years, out of which as many as 1,974 are for more than 9 years!

However, this argument is faulty and assumes that IDs do not connive with the promoters in the first 6 or 9 years. The problem is that familiarity has existed even before their appointment. Fixed tenure could have been valid in case an outsider, not known to the promoter, came on to the board as with the passage of time, there is a possibility that he could become friendly with the promoter. The fixed tenure proposition has some value only in case we can ensure that independence was ensured at the time of appointment.

Companies should be rated for corporate governance

Corporate governance is very subjective and cannot be measured through check boxes. Credit rating agencies, at best, can look at some visible aspects of CG-the quality of board members, their company/industry knowledge, the attendance records, quality of agenda items, minutes of the meetings, and other board room practices, but this is all about the letter and not the spirit.

CG rating was introduced in India almost 5 years ago on a voluntary basis. Only 19 companies opted for the same, and that too in the initial period. Since neither the companies nor the market has found value in CG ratings, this concept has been relegated to the shelves. It would be inappropriate in case CG rating is now made mandatory.

Quorum should be redefined

It has been suggested that the quorum of a board meeting should necessarily require presence of majority of IDs, or that for certain agenda items, the presence of all or at least two-thirds of all IDs should be mandated. This is again based on the wrong premise that IDs are independent and, as such, the suggestion would be of no help.

IDs should have their own budgets

Another suggestion demands a budget for the IDs which they can use to hire the services of outside experts like lawyers, accountants and consultants. However, since the funds would be provided by the company, there could be a conflict of interest. But more fundamentally, would the IDs, who have been appointed by the promoters, be interested or even dare to take the promoters' intentions for an outside opinion?

IDs should meet regularly without the promoter-directors

Some are suggesting that the IDs should meet independent of the promoters. Are they supposed to conspire in private against the promoters? What purpose would this serve given the truth that these people are really not independent? In any case, the hollow knowledge base of most IDs would make such meetings meaningless.

Audit committee should meet privately with the auditors

It is being suggested that the audit committee should independently meet with the auditors in order to extract the truth. First, almost all audit committees have promoters as members. Second, the IDs are not really independent. Third, what comfort would the auditor draw in talking to people against the promoter who has appointed him too in the first place? In any case, the shallow knowledge base of most IDs would make them incompetent to ask the right questions from the auditors.

Focus should be more on quality, and not quantity, of IDs

Some experts are suggesting that the 50 % clause should be dropped as the more important thing is to have good quality of IDs and not the number of IDs. They even argue that even if there is one good ID, that should be more than enough. The question is how would you get this one good ID, and will he be independent if the promoter is going to hire him.

IDs should bring diversified knowledge

A few people are suggesting that presently most IDs are from the field of finance, and they should actually be from diverse fields like finance, law, academics, humanities etc. The issue again is the dilution of the meaning of IDs. Is their primary role bringing value to the company or is it protection of minority shareholders. If value indeed is the requirement, then hire professionals, and not IDs.

Legal immunity should be provided to the IDs

New noises are being heard about the need for legal immunity to IDs. Clearly, IDs want only the upside-fee, commissions, ESOPs and the perquisites-but not any downside. Undoubtedly, IDs should not be responsible for every wrong in a company as they have no control over or knowledge of it. In case they are, we will only see a further exodus of IDs, at least of the value directors. However, the IDs need to be accountable for decisions that they were a party to, with negligence being also treated as connivance.

OR WILL MORE IDs NOW RESIGN?

The home and PSU directors would not. But many value and celebrity directors are now seriously worried. I have received several calls in the last 45 days from such people asking me for my insight into the companies on which they are on the boards ,so that they can take a preemptive action by resigning and not be caught napping later. (I actually ask them the reverse question: It is they who should know which the fishy companies are as it is they who are on their boards!) Many are worried that their life's reputation can be ruined overnight and they in fact not only become persona non-grata, but also invite media ridicule and government prosecution. Is the fee they earn enough for them to expose themselves to such risks, is a question many are asking? Many of them are also now doing soul searching, going back the memory lane....how many times did they proactively protected the minority or protested against the dominant owners?

Between 15 December 2008 and 1 March 2009, as many as 195 individuals had already resigned from ID positions, and the number is growing by the day. They are now admitting in private that they are resigning from such companies with whom they have not been very "comfortable"! The biggest casualty is the few competent value directors, which would then leave us mainly with the home directors as IDs!

WHAT IS THE WAY FORWARD?

Scrap mandatory ID, and make it voluntary

The mandatory requirement of ID should be scrapped, because IDs would always be insiders. On the other hand, corporates would neither accept outsiders nor should outsiders be imposed upon them. So the institution of IDs would always remain a farce, despite any number of loopholes that are plugged. Neither principle-based nor rule-based regulations will work. Let companies appoint them if they find it necessary and let investors see value in them. This way only quality IDs will get appointed, and investors will demand high quality IDs.

AND ALSO SEEK ANSWERS WHERE THEY LIE...

Review all regulations

There is already a plethora of regulations. The need is for a comprehensive review of all the regulations, making these meaningful and free of loopholes.

Mandate better corporate disclosures

There is already a huge amount of information that corporates have to disclose. The need is to review these requirements; the focus should be on quality and not quantity, and in making them meaningful for the investors. While the disclosure requirements for initial listing are very elaborate, the continuing disclosure regime is very weak and needs to be overhauled. Finally, severe punishment for non-disclosure should be mandated.

Most importantly, enforce compliance of regulations

Instead of depending upon the IDs, the regulatory agencies should strengthen their surveillance and enforcement functions to ensure compliance of all laws and regulations. Alongside, there is a need to develop a system for swift and adequate punishment to the offenders, which will also act as a deterrent. It is better not to have laws than to have one which are opaque or which cannot be enforced. It should be the job of the regulators to punish non-compliance and not the job of the IDs to ensure compliance.

BUT IDs ARE HERE TO STAY

It would politically be a controversial move to scrap the very institution of ID, as it has been invoked for the protection of minority shareholders. Moreover, it is now a universally acclaimed regulation. It would also require admission of having introduced a bad practice in the first place, as if without proper thought. So it appears to me that, despite its ineffectiveness, ID would stay as an institution. If that be so and if IDs are indeed expected to play their defined role, the way forward is to at least strengthen the entire system surrounding their appointment and functioning.

CAN WE FIRST LOOK AT A NEW PARADIGM?

Bring in demutualization

The functions of owner, chairman and CEO should ideally vest in three different persons, with the chairman being compulsorily an ID.

Relook at the uniform 50% requirement

One size fits all is not appropriate. The number of IDs, for example, could be related to the percentage of non-promoter holding, as against 50% across all cases.

Reconstitute the boards

1/3rd of the board should be of promoter-directors. Another 1/3rd should be of value directors, appointed by the management, who would not be deemed as IDs. The balance 1/3rd should be the real ID, who are necessarily qualified and have experience in corporate affairs, are picked up by the companies from a pool created by the regulator, and who are then subsequently trained and have a certification in directorship. If an auditor has to be compulsorily a member of ICAI, the people who are supposed to oversee, among others, the auditors themselves, should also have the requisite qualifications and be a member of an appropriate body. IDs can be brought in from outside as long as the process is transparent and fair. Though corporates may protest against induction of outsiders, the reality is that corporates do accept outsiders on their boards even now, though not by choice...this happens when a lender or a venture capitalist nominates their representatives.

Create the institution of lobbyists

Many countries in the world recognize the institution of lobbyists. Several Value Directors, in fact, play that role. It may be worthwhile to recognize this institution and allow many of the directors to play that role and charge their fee appropriately.

AND UNTIL THEN, AT LEAST REVISE CLAUSE 49

The regulations were written by good people in good faith. The corporates either found loopholes or implemented only in letter!

It may be reiterated that there cannot be IDs if they are going to be appointed by the owners. Moreover, if quality cannot be mandated, corporates would continue to comply only in letter and would keep finding new loopholes when the present ones are plugged. Yet, some progress can be made by implementing the following suggestions.

Revise definition of relatives

The term 'relatives' needs to be expanded, to include relatives from the mother's side as well as wife's side and, in fact, cover more relatives.

Recognize relationships among IDs

If IDs in a company are related to each other, only one of them should be deemed as an ID. SEBI, however, has prescribed only disclosures about the relationships, but would continue to deem these as IDs.

Do not treat nominee directors as IDs

The directors nominated by any outsider under a lenders' or a shareholders' agreement should not be treated as IDs. These are typically "persons acting in concert".

Mandate minimum qualifications and/or experience for IDs

SEBI has, upon my representation, issued only a non-mandatory guideline stating companies should ensure that the IDs should have the requisite qualifications and experience. This is too subjective. Some minimum qualifications and/or experience norms should be mandated.

Mandate a certificate course for IDs

In addition, there is a need to mandate, at the least, a certificate course for IDs.

Mandate minimum and maximum age for IDs

The minimum age for IDs should be 35 years, at the least, and the maximum age should be capped at 65 years. If most jobs face retirement at 58 or 60 or 65, there is logic to it. Physically old and mentally tired people cannot be expected to be vigilant (in fact, they are likely to often go off to sleep during the board meetings).

Limit the number of directorships

No person, including retired people, should be allowed to hold independent directorships in more than 3 listed companies. This number should be brought down to only 1 for persons who are also promoters of listed companies or who are full-time employees any where, as they have an existing huge responsibility on hand.

Introduce reporting of start/end time of board/committee meetings

Many of such meetings last but a few minutes. It may be worthwhile for recording and reporting of the start/end time of all board/committee meetings.

Put a cap on remuneration

A cap on remuneration may not be desirable, and should be left to each case. However, remuneration earned by an ID from any single company should not exceed 15% of his total annual income, in order to reduce his dependence.

ESOPs and commissions should not be granted to IDs. Incidentally, sharing of profits is banned in many countries, including the US and UK.

In fact, people who offer to become IDs should see it more of a public service. If they see it as a form of significant remuneration, they should join as consultants or as professional directors.

Mandate IDs for foreign unlisted subsidiaries

Clause 49 presently requires all domestic subsidiary companies of a listed company to also have IDs. This requirement should be extended to foreign unlisted subsidiaries of the Indian listed companies.

Greater focus on interests of non-promoter shareholders

The promoters/management should prepare, for each board agenda item, an impact analysis on minority shareholders. This would help draw specific attention of the IDs to any issues that unduly enrich the promoters or are against the interests of the non-promoter shareholders.

Punish the promoters for non-compliance

Non-compliance of Clause 49 needs to be punished. Putting up the names on the stock exchange websites is no punishment. Delisting the company works against the minority shareholders and in fact may encourage many companies to get delisted easily through this route. Suspension again harms the investors so does a penalty on the company. The only effective punishment is a significant fine on the promoters/managements in their personal capacities.

AND ALSO...

Grill the IDs who have recently resigned through exit interviews

There has been a spate of resignations of IDs in the recent times. Most would have cited personal or health or pre-occupation as the reasons. The regulator should find a way to convert these IDs into whistleblowers of sorts, and identify the ills affecting the companies from which they have resigned.

Prescribe/encourage greater role of institutional investors

Institutions would have to shed their passive, inactive roles and take proactive decisions on company agendas. They should also be required to publicly disclose annually all negative stances that they have taken. Retail investors would gradually give their monies to such institutional investors who are protecting their interests. Greater institutional investors' involvement shall also keep the IDs on their toes.

Institutional investors would also need to play an active role in appointment of IDs. Unless institutional investors attend AGMs and reject bad IDs, shareholders' endorsement shall remain a farce.

Mandate whistleblower policy

An effective whistleblower policy needs to be mandated for each listed company. Anonymous complaints should also be entertained.

Ban CG awards

The Satyam fiasco has clearly shown the CG awards in very poor light. Since such awards are very subjective and based on optical items, these do not capture the essence of CG. Contrary to expectations, these they may create wrong impressions on the investors.

WHAT SHOULD NOT BE DONE...

Election of IDs by non-promoter shareholders

Suggestions have been made that IDs should be elected by the non-promoter shareholders. This is fraught with unimaginable negatives. One could see all kinds of blackmailers, people propped up by the competition or simple hooligans coming on to the boards and destroying the companies.

A suggestion has also been made that the promoters should instead create a panel and the minority shareholders should vote their choice. However, the panel would still be made only by the promoters and as such would still include names of only insiders.

Nomination of IDs by the government/SEBI

Suggestions have been made that IDs should be appointed by the government or SEBI. This idea should be discarded in the bud itself; this would lead to nepotism, corruption and unnecessary political interference. A good example of this practice can be seen in the quality of several IDs that have been appointed to the boards of PSUs.

ULTIMATELY, CG HAS TO BE IN THE DNA

Too many expectations have been built from a body (IDs) that is not designed to deliver any thing worthwhile. We expect an ID to be a superman! The only serious voice of dissent has come from Mr. Prem Chand Gupta, the Minister of Corporate Affairs, who has all along questioned the wisdom behind this concept. His voice got subdued because scrapping of IDs would be perceived as anti-reformist and anti minority shareholders! In reality, the promoters themselves too realize that IDs are a myth, but they are happy in its present form of definition and compliance. Unfortunately, only they understand it, others either do not understand it or they pretend they do not understand it.

The regulators, world over, keep imposing new regulations, mainly after a major scam. The Sarbanes-Oxley Act was the answer to poor corporate governance. Did it help? Worse things have happened since then. More disclosures, of all kinds, are mandated. IPO prospectus has become a 300-page document, yet all experts believe that it hides more than it reveals. IPO grading was introduced, again to give small investors a sense of safety. This too has turned out to be a false protection, and is being questioned severely. *ID is yet again another instrument of false sense of security.*

IDs cannot be appointed by an outsider or a regulator. As long as IDs would be appointed by the promoters, the independence shall remain a myth. How can the master's actions be overseen by his very own appointees? Moreover, quality cannot be mandated and corporates would continue to comply only in letter and would keep finding new loopholes when the present ones are plugged. On the other hand, nominating IDs by an outside body will be counter-productive. Let us accept the reality. If qualified and statutory audit firms are failing to act as watchdogs, how can we expect IDs to perform this role?

Corporate governance ultimately is not a matter of regulation. It has to be in the DNA of the promoter. Good behaviour will be valued and respected by the market. We should stop expecting regulations to infuse morality into people. Emphasis should more be on meaningful and timely disclosures, and on severe punishment in case of non-compliance.

*Data Source:www.directorsdatabase.com, which profiles the directors on boards of 2,244 out of a total of 2,689 companies (83%) listed at BSE, as on 3 March 2009.

Prithvi Haldea is the Chairman & Managing Director of Prime Database. He can be reached at prithvi@primediatabase.com