

Independent directors or insiders?

Listed companies now have independent directors but only for namesake, and they obviously would not protect your interests as a minority shareholder

Many promoters are appointing their close relatives as independent directors

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Sebi's deadline for the induction of independent directors expired on 31 December 2005. Even today -- six months later -- no information is available to the public on how many companies have complied. But it makes sense to believe that at least all actively traded ones must have met the directive, as non-compliance would invite regulatory action. In any case, compliance is easy; the cost and effort of inducting independent directors is insignificant, especially if one gets on board his father-in-law or wife's brother or mother's brother, all of whom, interestingly, are excluded in the definition of relatives, both in the Companies Act and by Sebi.

Besides, there are no norms on age, qualifications or experience. Besides, several regulatory loopholes can easily be exploited. Little wonder, that a cursory discussion in the marketplace led to a belief that many companies complied only in letter, not in spirit.

The obvious way ahead is to identify and plug the loopholes, though this will still take care mainly of the quantitative issues. A more effective way is to pressurise companies into ensuring meaningful compliance by making information public on independent directors in various companies. The recently launched www.directorsdatabase.com (developed by my company, Prime Database for BSE) has been primarily designed toward this objective. The site recognises the need for investors, regulators and the market to know not only about directors at the helm of affairs of a company, but also about the independent directors who are supposed to foster corporate governance and protect the interests of minority shareholders.

At present, the only way to get just the names of board members of any company is to get hold of its annual report or visit its website, though many companies do not have websites. Obtaining the director's profiles is even more difficult. The notice to shareholders at the time of induction of new directors is the only means. Moreover, no profiles are provided in cases of reappointment. The new website provides not only a single-point access to information on the boards of listed companies, but also a profile with age, qualifications, experience and other directorships of each director. It is a free public service.

Clause 49 unplugged

An analysis of the database has already brought about several issues that need regulatory intervention. For example, Clause 49 says that if a company has a non-executive chairman, only a third -- and not 50 per cent, applicable to other cases -- of its board need consist of independent directors. This exemption has, however, been widely misused. Promoters and their relatives have designated themselves non-executive chairmen. The database shows as many as 292 cases in which promoter-directors have described themselves as such!

A non-executive chairman should neither be from the promoter group nor be related to any promoter director nor to any other director nor, in fact, to any key executive. Also the term 'relatives' needs to include, for example, close relatives from the wife's side and the mother's side.

On another front, while the regulations prescribe that anyone related to the promoters cannot be an independent director, it overlooks the relationships among independent directors. In an extreme case, it has been found that a company has eight directors, of which four have been shown as independent directors, all closely related to each other. More investigation may reveal that even these four independent directors are probably also related to the promoter directors.

Significantly, there is no guideline prescribing a time limit for the appointment of an independent director in case there is a resignation or removal or death of an existing one. Companies are exploiting this by taking a plea that they have not been able to find a replacement.

There is also some lack of clarity about the status of nominee directors. Nominees of institutional lenders are accepted as independent directors, but confusion remains about the status of nominees of private equity investors. Also, in the regulation, any shareholder with more than 2 per cent stake in a company is not deemed as an independent director. This is okay if the shareholder is a person but what if it is a company? As in the case of the auditor of the company where the regulation specifies its employees being ineligible, the regulation needs to specify that employees/nominees of QIBs will be eligible to be deemed as independent directors but not of non-QIB equity investors.

On a broader basis, it is generally true that independent directors are hired neither for better corporate governance nor for protecting minority shareholders' interests. They are hired either for compliance through the 'in letter' approach or for their help in the company's growth, networking or such other purposes. We need to find a way to get true independent directors, and to prescribe some entry norms for them.

The database provides information on the board of directors of each company on a current basis, and also as on 31 December 2005, being the last date of compliance of Clause 49. It is hoped this new website would generate public interest and create a platform for a substantive debate on the quality and role of independent directors.