In a first in 5 years, number of independent directors leaving exceeded new appointments

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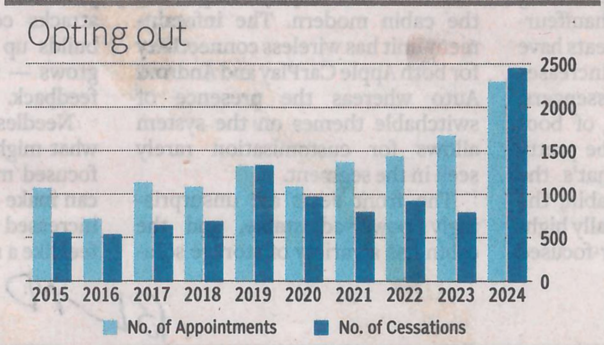
The terms of independent directors (IDs) coming to an end exceeded new appointments for the first time in five years.

Number of cessations last year stood at 2,465 against 2,311 appointments, according to primeinfobase.com. The terms of several independent directors who had signed up for five-year tenures in 2018-19 were up for renewal, which could have contributed to the high cessation numbers, said experts.

IDs can get a second term after approval by a special resolution. Individuals are getting more selective about joining the boards of companies, while basing their decisions on factors such as the track record of governance, litigation history, and if the company was promoter-driven or professionally run.



Source: primeinfobase.com

GOVERNANCE ISSUES

In June last year, shares of Suzlon Energy slid after one of its independent directors resigned, citing corporate governance issues. Another independent director cited differing views on leadership and succession planning as the reason for her decision to resign from the board of VIP Industries.

There have been instances of IDs quitting boards on grounds of non-compliance and doubtful corporate governance practices, M. Damodaran, Chairperson, Excellence Enablers and former Chairman of SEBI, said in a recent newsletter. Both in the case of Suzlon Energy and VIP Industries, he said, the reasons for resignation were explicit. However, not many details of specific non-compliances have come into the public domain.

"These are matters in which stock exchanges, as first level regulators, and SEBI, should do a deep dive, to determine whether there are serious transgressions, and if so, what corrective action, if any, needs to be taken. This will send a signal to IDs in other companies, who are experiencing a similar situation of unease," Damodaran said. Recently, eight individuals, including IDs, paid over ₹3.3 crore to settle regulatory violations pertaining to One97 Communications (Paytm) with SEBI.

"IDs are now under greater scrutiny by regulators. They need to be cognizant of fraud risks, especially with the froth in the market and a number of promoter-driven small and mid-cap companies that are over-leveraged. Stocks have corrected 20-30 per cent from their highs and the pain will slowly start spreading. If the benchmark indices correct further, promoters that have pledged their shares could face more trouble," said In-Govern's founder and MD Shriram Subramanian.

ROLE OF ID

The role of IDs in fraud detection has come into prominence as they, along with auditors, are the first line of independent authorities expected to question wrongdoing early in the day. IDs carry legal and regulatory obligations to record dissent on board matters. Directors are liable to class-action suits under the Companies Act, criminal misappropriation under the Indian Penal Code (IPC), and criminal breach of trust, also under the IPC.

"Having a strong board of directors, consisting of persons who are willing and able to ask the right questions, is a positive that entrepreneurs do not recognise as often, and as quickly, as they should. When directors resign, tough questions will get asked. Bringing a couple of high-profile advisors later in the day, in an effort to correct the mistakes that have crept in, and to address issues of credibility, is never going to be enough," Damodaran said.