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TIME TO BURY INDEPENDENT DIRECTORS?

Clause 49 of the Listing Agreement had mandated induction of independent directors by listed companies. After an initial extension of 6 months, the deadline for compliance was finally extended in March 2005 to 31 December 2005. On expiry of the deadline, it was made to believe that almost all companies had complied. That did not appear surprising, because it was easy to comply in letter, made easier by lack of eligibility norms and no costs.

Having created so much noise about non-availability of professionals, I grew suspicious of how easily the corporates had found them. It was obvious that quality had been sacrificed. However, as it would always be difficult to mandate quality, I felt that public disclosures of profiles of the independent directors would put sufficient pressure on companies to bring better people on their boards.

To do so, Prime conceived and implemented directorsdatabase.com, under the aegis of BSE, to host profiles of all directors. As expected, the database revealed that the quality was very poor. But what came as a painful surprise was that most corporates had dug up several regulatory loopholes to become compliant. These were promptly brought to the notice of Sebi in July 2006, along with remedial suggestions, and were also carried in this newspaper on 9 August 2006. Sebi has accepted some of the suggestions and have put these up now for public comments. I am slightly intrigued with Sebi's preface which mentions that these suggestions were received from several quarters.

Let me talk about some of the loopholes that are proposed to be fully or partly plugged.

The regulations stipulate that if a company has a non-executive chairman, only one third – and not 50 per cent -- of its board should consist of independent directors. This exemption has, however, been widely misused. Prime found that in as many as 30 per cent 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 such companies should not be allowed exemption. It is proposed to accept this suggestion.

While the regulations prescribe that anyone related to the promoters cannot be treated as an independent director, it overlooks the relationships among independent directors, again a provision widely misused. Prime had suggested that if independent directors in a company are related to each other, only one of them should be deemed as an independent director. However, the proposal is to only prescribe disclosures about the relationships.

There is no guideline prescribing a time limit for replacement of an independent director in case there is a resignation or removal or death of an existing one. Companies were found to be exploiting this, hiring one, removing him and then by taking a plea that they have not been able to find a replacement, which could stretch for indefinite periods. Prime had suggested a time limit of 60 days. The proposal is for 90 days.

Nominees of institutional lenders are accepted as independent directors. Prime had suggested that as all nnominee directors primarily represent the interests of their institution, be it a lender or an equity investor, these persons should not be considered as independent directors. The proposal is to not deem nominees of specified institutions as independent directors but it ignores nominees of other investing groups.

Many kids (even 18 years of age) were found to be on boards of companies as independent directors. While a son of promoter-director can be of such an age, some one so young surely cannot acquire enough experience to become an independent director of another company. Prime had suggested a minimum age at 30 years. The proposal is for 21 years.

Now to some other suggestions which presently have not been accepted, but going forwards, I hope would.

Prime found hundreds of independent directors without any noteworthy qualification and/or experience and had suggested that some qualification and/or experience should be prescribed.

According to the Companies Act, all relations from the wife's and mother's side are not considered as relatives. It was found that many companies had brought on their boards the promoter's father-in-law or wife's brother or mother's brother. Prime had suggested that the term 'relatives' needs to be expanded.

The database had revealed scores of individuals holding directorships in a large number of public limited companies. The Companies Act puts a ceiling of 15 directorships of public companies. However, among public companies, each of the listed ones demand a huge commitment from an independent director, including attending during a year at least four board meetings and meetings of one or more of the several committees. It may as such be difficult for these persons to play an effective role in the listed companies. Prime had suggested that no person should hold independent directorships in more than 7 listed companies.

On a broader level, it bothers me that corporates have been so blatant in misuse of regulations. The note put out by SEBI shames them in public and would undermine the confidence of the small investors, whose interests are to be protected by the institution of independent directors.

Going forwards, plugging of the loopholes would at best lead only to a slightly better set of directors, but that again would be compliance still only in letter. The spirit will still be missing. This is surely going to be a long haul for the regulator. But increasingly, a call would need to be taken about the concept of independent directors itself. World over, it is being now recognized that there cannot be an independent director if he is going to be appointed by the owners. Other means like election by shareholders or nominations by the regulator are fraught with dangers. If quality cannot be mandated, if corporates would continue to comply only in letter and even there keep finding new loopholes and if independent directors are going to be the appointees of the owners, is the time ripe to restart the debate on this institution?