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# ROLE OF INDEPENDENT DIRECTOR IN CORPORATE GOVERNANCE

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## I. ABSTRACT

This article aimed to identify the different concepts of IDs in corporate governance. The term "corporate governance" refers to the structure for managing and overseeing a company. “ID” refers to board members who are not directly affiliated with the company or its administration. In addition to balancing the board's authority with that of senior management, IDs are brought in to ensure that all board decisions are made from a fair and balanced vantage point. Particularly in publicly traded companies with ownership and control being kept separate, where IDs play a crucial role in corporate administration. In the backdrop of high-profile corporate scandals, the role and effectiveness of IDs in corporate governance have come under scrutiny in recent years. This research paper talks about the function of the ID in the context of corporate governance and its role, legal responsibility, and liabilities. The paper also discusses the challenges faced by IDs in carrying out their duties, such as the potential for conflict with other board members or the need to balance their obligations to different stakeholders, with a comparative analysis between IDs and Executive directors. Additionally, the abstract highlights the benefits that IDs bring to an organization, including increased transparency and accountability, improved decision-making, and enhanced investor confidence.

## II. KEYWORDS

ID, Corporate Governance, Board Members, Scandals

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# III. INTRODUCTION

## A. INTRODUCTION TO INDEPENDENT AND CORPORATE GOVERNANCE

Corporate Governance refers to the framework of a set of rules, practices, and processes by which a company is governed and managed. In today's world, corporate governance[2] has become an essential aspect of business operations. The role of IDs in corporate governance has been a subject of great importance and discussion in recent years. IDs are non-executive directors who are appointed to the board of a company based on their expertise and experience, with the primary objective of enhancing transparency and accountability in the company's management. The concept of IDs was introduced as a measure to address the issues of conflicts of interest, lack of transparency, and inadequate oversight in the decision-making process of the company's management. IDs bring an objective and unbiased perspective to the board, which is crucial in ensuring that the interests of all stakeholders are taken into account. The role of IDs has evolved over time, and they now play a critical role in the decision-making process of the company. They are responsible for monitoring the company's performance, assessing risks, and providing advice and guidance to the management. They are also accountable to the shareholders and other stakeholders for the company's overall performance.

In this context, the appointment of IDs has become a significant aspect of corporate governance. Companies are expected to appoint IDs who possess the necessary qualifications, expertise, and experience to provide effective oversight and guidance to the company's management. The role of IDs in corporate governance is critical in ensuring that companies operate in a transparent and accountable manner, thereby enhancing the trust of stakeholders in the company.

[2] M.P. Paridhi Selvan and M. Kannappan, A study on role of IDs in protecting the rights of Minority shareholders, Volume 119 No. 17, International Journal for Pure and Applied Mathematics, 839, 840, 2018

# IV. RESEARCH DESIGN

## A. STATEMENT OF PROBLEM

A company serves as a common platform for many different groups of people, including its customers, employees, stockholders, and investors. With companies now requiring access to global financial sources, vendor partnerships for large-scale projects, and maintaining societal harmony, this is more important than ever. All corporate decisions should be fair and transparent with all parties involved. Capital is more likely to flow into a company with competent leadership and well-established corporate policies. In order to ensure the board acts impartially and holds management to account, the independence of the board is crucial. According to standard procedure in most legal systems, the answer is to appoint an ID. Therefore, this paper aims to discuss the duties and obligations of IDs in corporate governance. This research paper has discussed various issues, like how independent, IDs are in India.

## B. LITERATURE REVIEW

- **ARTICLES**

1. Author Vikas Maheshwari in his article "Role of IDs in corporate governance", states that according to Clause 49, an ID of a Company must only invite other IDs to a meeting. A detailed analysis of the legal responsibility and liabilities of IDs in CG has been explained, and the difference between executive directors and IDs. The ID should work independently and should be unbiased for the best interest of stakeholders.
2. M.P. Paridhi Selvan and M. Kannappan, (2018) in his article "A Study on Role of IDs in Protecting the Rights of Minority Shareholders," explain the importance of the independence of directors that the board's independence is viewed as a crucial step in ensuring the IDs operate more effectively in corporate governance. A comprehensive analysis of the role of IDs and minority shareholders has been explained.

- **BOOKS**

1. EBC Company Law by Avtar Singh (17th Edition, 2022)[3] in his book has explained the very concept of corporate governance and who is an ID and, what is the role of an ID in corporate governance, clause 49 and IDs, and how Clause 49 provides that the ID of a Company shall hold a meeting by only inviting IDs. And also explains the concept of CG and the process by which it was implemented.
2. Taxmann's Company Law by G.k Kapoor, (24th Edition, 2019)[4] explains the concept of corporate governance and IDs in Indian companies and the legal responsibility of the ID. Appointment of IDs helps in the smooth functioning of companies without any conflicts. The recent high-profile fraud cases in India show the importance of IDs in tracking fraud cases and how their independence and being unbiased and loyal to the company is necessary to protect the rights of stakeholders.

### C. RESEARCH OBJECTIVE

- To introduce the concept of ID in corporate governance.
- To analyse the difference between executive and ID
- To examine IDs' roles, legal responsibilities, and liabilities of IDs in corporate governance.

### D. RESEARCH METHODOLOGY

This seminar paper is mainly a doctrinal research and analytical study. Keeping this in view, researchers have relied on the traditional approach of using primary sources such as journals, papers, and books. Sources such as Banking and Insurance law textbooks and new media such as online journals, various case laws, and blogs to gather information and resources were used to understand and further present the topic.

## V. ANALYSIS

### A. WHO IS AN INDEPENDENT DIRECTOR?

[3] Avtar Singh, Company Law, Publisher: Eastern Book Company Publication Private Limited, 2022
[4] G.K. Kapoor, Company Law and Practice, 452, Taxmann Private Limited 2019

An ID[5] is a member of a company's IDs who has no financial or substantial relationship to the company or its management. IDs are members of a company's BODs who are not directly associated with the company's administration but are still trusted for their knowledge and expertise. Due to their ability to provide an impartial view of the company's activities and strategic choices, IDs play a crucial role in corporate governance. They need to put their own money and personal interests aside to make decisions that benefit the company and its shareholders. Selection criteria for independent members often include work experience and education in fields like company, finance, accounting, law, or technology. They contribute to the board with a wide range of expertise and provide reliable guidance to the company's management. Stock exchanges and other governing organizations often stipulate the presence of IDs as a condition for listing a company. All three of the board's committees—audit, remuneration, and nominations—must include at least one independent member to ensure maximum transparency and accountability.

A member of the BOD who does not have a financial or other significant connection with the company or its management is considered to be "independent" in India. Appointing IDs to the board ensures that all opinions and recommendations regarding the company's operations and strategy decisions are based on principles of objectivity and independence.

All listed companies in India are obligated by law to have IDs on their boards. IDs must constitute a minimum of one-third of the BODs at publicly listed companies, per regulations set by the Securities and Exchange Board of India (SEBI). Companies with a paid-up share capital of Rs. 10 crore or more, as well as public companies, are obliged by the Companies Act, 2013 to have at least one ID. Certain eligibility requirements are set forth by SEBI and the Companies Act, 2013 for an applicant to be nominated as an ID in India. The applicant must have the knowledge, abilities, and experience essential to fulfill the role of an ID. They should also be trustworthy and knowledgeable about the company's operations, governance, and legal obligations. IDs in India are not only responsible for supervision and governance but also for

[5] G.K. Kapoor, Company Law and Practice, 452, Taxmann's 2019

participating in the board's meetings, such as the audit committee, nomination and remuneration committee, and partner relationship committee. IDs, in general, are crucial to promoting effective corporate governance and enhancing the company's position in India. By maintaining objectivity, IDs help to ensure that a company is doing what is best for each of its stakeholders and is to account for its conduct.

### B. APPOINTMENT AND RE-APPOINTMENT OF IDs

The term "corporate governance" refers to a framework of rules and regulations that govern how a company operates. Appointing and re-appointing IDs is a crucial part of maintaining good corporate governance. Directors who are "independent" do not have any relationships with the company, its management, or its significant stockholders. When operating with the BODs, they are expected to provide oversight and guidance to the company's management team from an impartial outsider's point of view. A company's BODs or is usually responsible for selecting and appointing[6] IDs. The first step is finding people with the right background and expertise to serve on the board committee with the right background and expertise to serve on the board is typically the first step. Applicants are assessed in several ways, including their knowledge of the company, their ability as a leader, and their capacity for impartial management.

An integral and essential part of corporate governance is ensuring that IDs are re-appointment. The IDs' re-appointment is governed by the performance evaluation report as per clause V of schedule IV[7]. IDs are typically appointed for a term of three years, after which they may be re-appointed for another term, subject to shareholder approval. Re-appointment provides continuity and stability to the board and ensures that IDs continue to provide effective oversight and guidance to the company. However, the re-appointment of IDs also raises questions about independence and objectivity. If an ID has served on the board for a long time, they may develop close relationships with the company's management or controlling shareholders, which

[6] G.K. Kapoor, Company Law and Practice, 454, Taxmann's 2019

[7] M.P. Paridhi Selvan and M. Kannappan, A study on role of IDs in protecting the rights of Minority shareholders, Volume 119 No. 17, International Journal for Pure and Applied Mathematics, 839, 842, 2018

could compromise their ability to provide independent oversight. To address this concern, some companies have implemented term limits for IDs or require a cooling-off period before an ID can be re-appointed.

In summary, the appointment and re-appointment of IDs is a crucial component of effective corporate governance. It ensures that the BODs have the necessary skills and experience to provide oversight and guidance to the company's management team and that IDs can provide an objective, independent perspective. However, it is important to balance continuity and stability with independence and objectivity, and companies should implement appropriate policies and procedures to address this concern.

### C. ROLE OF IDS

“IDs” play a crucial part in corporate governance by monitoring whether or not management is looking for stockholders' best interests first and foremost. IDs are not employed by the company, and they do not have any significant financial relationships with the company, its management, or its associates. An ID's role is to counterbalance management's authority and to ensure that board decisions are made fairly and thoroughly. Among an ID's many duties are ensuring that the company's management is following the law and looking out for the company's and its stockholders' best interests. The board relies on them for objective counsel and oversight on issues like strategy, risk management, and accountability. It is the duty of IDs to keep an eye on the company's leaders, hold them accountable for their actions, and keep tabs on their compensation. One of the responsibilities of IDs is to oversee the establishment of adequate internal controls and risk management procedures within the organization. They need to check if the company's risk management policies and processes are adequate to prevent possible problems. To further ensure that the company's audit and internal control functions are adequate to identify and prevent fraud and other financial misconduct, IDs may be tasked with monitoring these areas as well.

Finally, IDs play a critical role in promoting transparency and accountability within the company. They are expected to ensure that the company's financial reporting is accurate and reliable and that the company is complying with all relevant laws and regulations. They may also be responsible for overseeing the company's social and environmental policies and practices, ensuring that the company is operating sustainably and responsibly.

## D. LEGAL RESPONSIBILITIES OF IDS

IDs in a company have legal responsibilities that they are expected to fulfill in order to promote good governance, transparency, and accountability. These responsibilities are enshrined in corporate governance laws, regulations, and governance, and failure to fulfill them can result in legal and reputational consequences.

**Here are some of the key legal responsibilities of IDs in India:**

a. **Fiduciary duty -** There exists a fiduciary obligation on the part of IDs to the company, requiring them to prioritize the best interests of the company and its shareholders above everything else. Decisions must be made with ability, care, and effort and must avoid bias and conflict of interest.

b. **Oversight and monitoring:** The role of IDs is to oversee the management team and keep tabs on the company's activities and performance. They're responsible for ensuring the company follows all relevant rules and regulations.

c. **Audit and financial reporting:** Financial filing and audits are supervised by the board's audit committee, which is composed entirely of IDs. The financial statements and the effectiveness of the company's internal controls are their responsibility.

d. **Nomination and remuneration:** To ensure that the company’s IDs are competent and fairly compensated, the board has committees in charge of nomination and remuneration, both of which must be staffed by IDs.

e. **Risk management:** IDs are responsible for monitoring the company's risk management structure and ensuring adequate policies and processes are in place to deal with any potential threats.

f. **Disclosure and transparency:** IDs must ensure that the company provides accurate and timely information to its stakeholders and that the company's disclosures are transparent and complete.

### E. LIABILITIES IDs

Liabilities of IDs[8] refer to the legal obligations and responsibilities that IDs have towards the company, its shareholders, and other stakeholders. IDs are responsible for providing an objective and independent perspective to the BODs and ensuring that the company's decisions are in the best interest of all stakeholders.

**Some of the liabilities of IDs include:**

a. **Fiduciary Duty:** IDs owe a fiduciary duty to the company's shareholders and must act in their best interests. They must ensure that they exercise due diligence in their decision-making process and avoid any conflicts of interest.

b. **Legal and Regulatory Compliance:** IDs are responsible for ensuring that the company complies with all legal and regulatory requirements. They must stay updated with changes in regulations and laws that impact the company and ensure that the company follows them.

c. **Financial Reporting and Disclosure**: IDs must ensure that the company's financial statements and disclosures are accurate and transparent. They must review financial reports, audit findings, and other financial information to ensure reliability.

d. **Risk Management:** IDs are responsible for identifying and managing risks affecting the company's operations and reputation. They must ensure that the company has adequate risk management policies and procedures in place.

[8] Vikas Maheshwari, Role of ID in Corporate Governance, Volume 6 No. 7, EPRA International Journal of Multidisciplinary Research (IJMR), 203, 209, 2020

e. **Corporate Governance:** IDs must ensure the company follows sound corporate governance practices. They must ensure that the BODs have a proper balance of skills and expertise, that the company's internal controls are adequate, and that the company's executives are held accountable for their actions.

In summary, IDs have a significant responsibility towards the company and its stakeholders. They must exercise due diligence in their decision-making process, ensure legal and regulatory compliance, and manage risks effectively to protect the interests of shareholders and other stakeholders.

## F. REMOVAL OF IDS

IDs play a crucial role in corporate governance by providing an objective and unbiased perspective to the company's BODs. They are appointed to represent the interests of all stakeholders and ensure that the company's management operates in a transparent, ethical, and responsible manner. However, there may be instances where the removal of IDs becomes necessary. In this article, we will discuss the reasons why IDs may be removed and the implications of such removal on corporate governance.

**Reasons for removal of IDs[9]**

a. **Non-performance:** IDs are expected to contribute to the company's decision-making process and provide guidance on matters relating to governance, risk management, and compliance. If they fail to perform their duties effectively or consistently, the board may consider their removal.

b. **Conflict of interest:** IDs are expected to act in the best interests of the company and its stakeholders, free from any conflicts of interest. If they become involved in activities that compromise their independence or objectivity, they may be removed from the board.

[9] Melissa Cyrill, Appointment and Removal of IDs in India: Alternate Mechanism Notified, India Briefing, Mar, 3, 2023, 10:00 AM, https://www.india-briefing.com/news/appointment-and-removal-of-independent-directors-in-india-alternate-mechanism-notified-26474.html/

c. **Breach of confidentiality:** IDs are often privy to sensitive information about the company and its operations. If they breach this confidentiality by disclosing such information to unauthorized parties, they may be removed from the board.

d. **Legal or regulatory non-compliance:** IDs are expected to ensure that the company complies with all applicable laws and regulations. If they fail to do so, they may be held accountable for their actions, and their removal from the board may be necessary.

### G. Implications of removal of IDs

The removal of IDs can have significant implications for corporate governance. It can affect the board's ability to make informed decisions and ensure that the company operates responsibly and ethically. Here are some potential consequences of removing IDs:

a. **Loss of expertise:** IDs bring a wealth of experience and expertise to the board, which can be challenging to replace. Their removal can result in a loss of valuable insights and perspectives that are essential for effective decision-making.

b. **Risk of groupthink:** The removal of IDs can lead to a lack of diversity in the board's composition, which can increase the risk of groupthink. Groupthink occurs when members of a group conform to a certain mindset or perspective, leading to suboptimal decision-making.

c. **Damage to reputation:** The removal of IDs can be viewed as a sign of instability or lack of accountability, which can damage the company's reputation. This can result in a loss of stakeholder trust and confidence in the company's leadership.

In conclusion, removing IDs in corporate governance should be approached with caution and careful consideration. While there may be valid reasons for removing IDs, the board should ensure that such actions do not compromise the company's long-term interests or its commitment to transparency, ethical conduct, and responsible business practices.

## VI. CASE STUDY

The Satyam Computer Services scandal[10], also known as India's Enron, was a major corporate governance scandal that rocked the Indian business world in 2009. Ramalinga Raju, the company's founder and head, admitted to fabricating financial records over the years. The case study examines how IDs could have prevented the Satyam scandal. M. Rammohan Rao, a former head of the Indian School of Business, was one of the six independent members on the board of Satyam Computer Services. The IDs were responsible for ensuring that the company was run ethically and transparently and that its financial statements were accurate and reliable. However, the IDs failed to detect the fraud that was being perpetrated by Raju and his associates. In fact, they had approved the company's financial statements without raising any red flags or asking any probing questions. They also failed to ensure that the company's auditors were performing their duties properly. After the fraud was uncovered, the IDs came under intense criticism for their failure to detect the fraud. Many stakeholders, including shareholders and regulators, questioned their qualifications, independence, and commitment to their duties as IDs.

**Failure of Independence and Impartiality:**

- The case points out that despite having impressive academic and professional backgrounds, the IDs failed to act independently and impartially in the best interests of stockholders.
- Critique: This failure raises questions about the effectiveness of the selection process for IDs and whether personal or professional relationships may have influenced their ability to provide objective oversight.

**Lack of Proactivity and Vigilance:**

[10] Vikas Maheshwari, Role of ID in Corporate Governance, Volume 6 No. 7, EPRA International Journal of Multidisciplinary Research (IJMR), 203, 209, 2020

- The case suggests that the IDs approved financial statements without asking questions, indicating a lack of proactive oversight.
- Critique: This lack of proactivity can be seen as a failure on the part of IDs to fulfill their responsibility of ensuring the accuracy and reliability of financial records. They should have been more vigilant in their oversight duties.

**Ineffectiveness in Ensuring Auditor Accountability:**

- The text mentions that IDs failed to ensure that the company's auditors were performing their duties properly.
- Critique: IDs are expected to play a crucial role in overseeing the work of auditors to ensure transparency and accountability. Their failure in this aspect raises questions about the effectiveness of the ID's role in the audit process.

**Questionable Qualifications and Independence:**

- Stakeholders, including shareholders and regulators, questioned the qualifications, independence, and commitment of IDs after the fraud was uncovered.
- Critique: This suggests a lack of confidence in the ability of IDs to fulfill their roles effectively. It raises concerns about the selection criteria for IDs and the mechanisms in place to ensure their continued independence.

In summary, the case criticizes the role of Independent Directors in the Satyam scandal for their failure to act independently, proactively, and vigilantly. It raises concerns about their qualifications, independence, and the overall effectiveness of their oversight in preventing fraudulent activities. The Satyam case is presented as a cautionary tale, urging companies and regulators to ensure that IDs are more robustly fulfilling their duties.

## VII. COMPARATIVE ANALYSIS

In corporate governance, IDs and executive directors play essential roles in ensuring the effective functioning[11] of the company. Below is a comparative analysis of these two types of directors:

1. IDs
2. Executive Directors

| | **Independent Directors** | **Executive Directors** |
|---|---|---|
| **Definition** | IDs are individuals who do not have any direct or indirect interest in the company's management, and they are appointed to provide unbiased and impartial opinions on the company's operations. | Execution directors, on the other hand, are responsible for the company's day-to-day management and implementing the board's decisions. |
| **Responsibilities** | IDs are responsible for overseeing and providing guidance on the company's strategy, risk management, compliance, and performance evaluation. They also ensure that the company's actions are in | Execution directors, on the other hand, are responsible for implementing the company's strategy, managing |

[11] Vikas Maheshwari, Role of ID in Corporate Governance, Volume 6 No. 7, EPRA International Journal of Multidisciplinary Research (IJMR), 203, 207, 2020

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| | | |
|---|---|---|
| | the best interest of shareholders and other stakeholders. | operations, and achieving the company's goals and objectives. |
| **Appointment** | IDs are appointed by the BODs, and they must meet certain qualifications and independence criteria. | Execution directors are typically appointed by the CEO or BODs, based on their qualifications and experience. |
| **Compensation** | IDs are typically compensated with a fixed fee and may receive additional compensation for serving on committees. | Execution directors receive a salary and may also receive bonuses or other incentives based on the company's performance. |

| | | |
|---|---|---|
| **Conflict of interest:** | IDs are expected to be free from conflicts of interest and must disclose any potential conflicts to the board. | Execution directors may have conflicts of interest, but they must disclose them to the board and recuse themselves from decisions where there is a conflict. |
| **Liability** | IDs are not involved in the company's day-to-day management and are not typically held liable for the company's actions. | Executive directors are responsible for day-to-day management and are held liable for the company's actions. |

## VIII. CONCLUSION AND SUGGESTION

A company's governance relies on the choices taken by its IDs. The BODs rely on them for the smooth functioning of the company to look out for stockholder interests, and keep the company profitable. Companies that include IDs are better able to make decisions in the best interests of the company and its stakeholders because of the scope and depth of knowledge, perspectives, and experience they bring to the table. Promoting transparency, responsibility, and ethical conduct, IDs are essential to upholding high standards of corporate administration. They serve as a safeguard against potential conflicts of interest and make sure the board is always looking out for the best interests of the business and its shareholders. IDs play a crucial role in ensuring a company's long-term viability and success, making them a vital cog in any corporate governance structure. Their objectivity and objectivity boost the organization's image and value in the views of its stakeholders, who in turn, have more faith in the organization as a result of their increased confidence in it.

## IX. SUGGESTIONS

To further enhance the effectiveness of IDs in corporate governance, the following suggestions can be considered:

a. Clearly define the roles and responsibilities of IDs to avoid any confusion or conflict of interest.

b. Provide adequate training and support to IDs to enable them to understand the company's business and the regulatory environment in which it operates.

c. Encourage regular communication and engagement between the IDs and the company's management to ensure that they have access to all necessary information to make informed decisions.

d. Ensure that IDs are truly independent and not connected to the company's management or any other interested parties.

e. Encourage diversity among IDs to bring in different perspectives and skill sets to the board.

In conclusion, the presence of IDs on the board of directors is essential for effective corporate governance. By following the above suggestions, companies can ensure that their IDs are empowered to perform their roles effectively and contribute to the company's long-term success.

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