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IRRELEVANCY OF BOARD OF DIRECTORS.

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I. INTRODUCTION:

The Board of Directors are elected by the shareholders and are responsible for running the Company. The process works in the following way: shareholders contribute towards the capital of the Company and elect their Board of directors, while the Board appoints managers to handle the Company's day-to-day policies. It is their job to keep the Board of Directors informed about the work that they do. In India, there is generally a controlling/dominant/majority shareholder who monitors the Company's situation and this is where corporate governance steps in. Corporate governance aims to effectively monitor the management and aims to ensure that the majority shareholder acts in a manner that benefits the Company and not just him. It is the duty of the Board of directors to understand the best interests of the Company and its stakeholders, and thereafter, make policies for governance. Their incorporation is mandatory for every Company. But, the practical effects of recent corporate governance norms and policies have diminished their role and really leave the Board of directors no scope for performing their functions. This paper aims to understand the diminishing nature of their role and how they have slowly become irrelevant as the authority that they are given is simply never independent of the expectations of the majority shareholder.

II. ANALYSIS:

Whenever the topic of Company Law is discussed, the two scams of Enron and Satyam are spoken about since they paved the way for the legislative to understand the need for Corporate Governance. In a nutshell, both the Enron and Satyam scams were based on accounting fraud. Because of the fraudulent books of accounts, the entire public were misled at large. As a result, the accounting firms in both cases were also involved in the scams. However, the Enron scam was far more complex, involving the participation of financial institutions, setting up of companies outside the US and using fluctuations of prices in energy markets and using market derivatives to manipulate the market. On the other hand, the Satyam scam simply involved stating incorrect or inflated profits and assets in their books of accounts. Seeing the mammoth nature of their scams, a need to counter such practices was ascertained and the Sarbanes Oxley Act was drafted and it was taken as the guiding authority for the Companies Act (hereinafter referred to as "**the Act**"). The Act took this into consideration and imposed many additional obligations on the Board of directors for making policies for good governance.

But, this paper deals with the entire debate based on issues of corporate governance and whether the Board of directors are controlled by the shareholders or by the promoters. The promoters always focus on having a higher number of directors that favour them over the number of directors that favour the shareholders on the Board of directors to maintain their supremacy and ultimately control the Board of directors. They are bound to choose people who are in consort or owe their allegiance to them, while the shareholders want more of independent and small-shareholder directors so that their voices can be heard on the Board of directors and that any sort of minority oppression can be dealt with. And in furtherance to this dynamic problem, the Act tries to maintain a dynamic balance between both sides.

a) **RELATED PROVISIONS:**

Section 149 to 173 of Chapter XI of the Companies Act, deal with the appointment and qualifications of directors and covers all important provisions regarding the Board of directors. Section 149 deals with the appointment of directors and is a crucial administrative requirement. The section mandates that only an individual can be appointed as a director, which entails that no Board of directors corporate can be appointed as a director.[1] The Board of directors must have a minimum number of three directors in the case of a public Company; two directors in the case of a private Company and one director in the case of a One-Person Company.[2] To have more than fifteen directors, a special resolution is required to be passed.[3] Every listed Company and public Company shall mandatorily appoint one, woman director.[4] Each Company is needed to have a minimum of one director who has stayed in India for at least 182 days in the previous calendar year.[5] Lastly, every Company is mandated to have at least 1/3rd of the total number of directors as independent directors. Moving on, section 151 allows a listed Company to have one director elected by small shareholders. Small shareholders are people holding shares with a nominal value of not more than Rs. 20,000.

[1] Section 149(1), The Companies Act 2013
[2] Ibid.
[3] Section 149(1)(b), The Companies Act 2013
[4] Ibid.
[5] Section 149(3), The Companies Act 2013

The person appointed under this is also like an independent director since he caters to the shareholder part of the Board of directors. Apart from these, Section 161 allows the Company to appoint other directors such as additional, nominee and alternate directors. These are subject to the Articles of the Company. An additional director is a person appointed if he fails to get appointed as a director in a general meeting, if the Board of directors wishes to. A nominee director is appointed by an institution for a particular time because of a law in force or because of any agreement by the Central Government or the State Government by virtue of its shareholding in a Government Company. An alternate director is appointed if a director is absent from India for at least 3 months.

b) ISSUES WITH THE PROVISIONS:

The most basic problem with the appointment sections is that none of these provisions have been clarified in terms of being exclusive or inclusive of the other. Whether the woman director quota is to be part of the independent director quota isn't clear. Also, if woman directors can be made the promoters, what is to say that family members of the promoters won't occupy those positions? Coming back to the main issue of the directors being for a shareholder or the promoters? This question is the reason why corporate governance exists as the promoters always try and find loopholes in the Act to have more participation by people who are biased to them so that they can control the Board of directors and eventually concentrate on profits rather than cater to the needs of minority shareholders.

The second issue is that of the independent directors. Sub-section (6) of Section 149 deals with who can become an independent director. He[6] and his relatives[7] are excluded from having any pecuniary relationship with the Company. The section is worded in a way that clearly intends to remove any sort of conflict of interest the independent director would have and aims to ensure that he would be devoid of any bias with respect to the Company and would strive to bring integrity and honesty in the firm's dealings. [8] Not only is the section ambiguous, but it also fails to lay down any test through which it can be proven. From an objective standpoint, it would mean that an independent director must know what was going

[6] Section 149(6)(c), The Companies Act 2013.
[7] Section 149(6)(d), The Companies Act 2013.
[8] International Journal of Innovation, Management and Technology, Corporate Governance and Non-Listed Family Owned Businesses, M Awais Gulzar, Zongjun Wang.

on in the firm while through a subjective standpoint; the same situation might lead to a different conclusion.

The other inherent problem with this is that this conflicts with the rules of the listing agreement which specifies different levels of independent directors depending upon whether the Chairman is an Executive Director or Non-executive director and whether the Non-Executive Chairman is a promoter or not. Clause 49(II) of the Listing Agreement says that the Board of directors must necessarily have 50% non-executive directors. It mandates that if the Chairman of the Company is a non-executive director, 1/3rd of the Board of directors must comprise of independent directors. However, if the Chairman is an executive director half of the Board of directors must comprise of independent directors. The Act doesn't specify which one is to be followed and this conflict leads to a lot of misunderstanding. The Act plays here a balancing role to preserve the dynamic between shareholders and promoters.

With respect to the issue of the other directors, the problem here is that no check is put on Companies as they can appoint any director without giving any reason.[9] This is a loophole exploited many-at-times by the promoters in having a higher majority on the Board of directors. In spite of the provisions of the 'small shareholders director' and 'independent director', the cause of the small shareholders in terms of Board representation is not furthered. Since all the decisions of a meeting made by the Board of directors require a simple majority (fifty percent or more) or a special majority (seventy-five percent or more), the majority is easily attainable.

To bring this into point into context, the concept of independent directors worked well Abroad but doesn't seem to work in India. This is because in India there are a lot of Companies with consolidated shareholding. Now because of that, a majority is easily attainable since all the directors answer to the promoter, who is inherently responsible for their appointment. The mindset in India is different from that Abroad as the promoters look to their Board of directors and don't see representatives of shareholders, but see their representatives. This is because the majority of the directors are appointed by the promoters and majority shareholders themselves. Because of the consolidated holding with respect to a Company, all the votes of a meeting are pre-determined and not a lot of independence is given to the said, independent director. The vision with which the provisions were made was that minority shareholders would be able to appoint directors that would answer to their

[9] LIC v. Escorts, 1986 AIR 1370, 1985 SCR Supl. (3) 909.

voices and represent the interests of minorities in the Company, but in India, the lack of dispersed shareholding meant that independent directors were appointed at the choice of majority shareholders/ promoters which reduced the independence of the independent directors. This is because the majority shareholder would naturally appoint a person that was trustworthy and well known to them. This can also be interpreted as a person who had a bias to the needs of the majority and not the minority. Although this is morally wrong as all minority shareholders are denied representation on the Board of directors, it is a commonly adopted strategy to preserve the control of the Company with the promoter. Regardless of these issues, a lot of importance was given to the independent directors and the provisions were praised, but little did the legislature realise that it was merely a ticking time-bomb in India where the promoters and majority shareholders had the control of the Board of directors and took decisions as owners and not as a collective and thus, making these provisions seemingly unworkable in India.[10]

This entire dynamic problem has been exemplified in the recent firing of Cyrus Mistry by Tata. But, to understand this further let us understand the duties of directors first.

c) **ROLE OF DIRECTORS:**

Section 166 primarily deals with the duties of directors. The directors are to act in accordance with the articles of the Company; act in good faith to promote the objects of the Company for the benefit of its members; and exercise duties with reasonable care, skill and diligence. Directors are not to be involved in a situation in which they have a conflict of interest; where they achieve undue gains or advantages; and assign their offices. Apart from this section, directors have a duty to attend board meetings and play their part in policy making for the Company. They have to disclose any conflict of interest they have directly or indirectly with respect to any contracts or arrangements of the Company[11] and are bound to disclose their directorships in other companies within 20 days of appointment.[12] They are also bound to disclose their shareholding in the Company.[13] They are remunerated as per the provisions of the articles of the Company and are commissioned a fixed percentage of the profits of the Company.[14]

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[10] India's corporate governance challenge, Live-mint.
[11] Section 299, The Companies Act 2013 (India).
[12] Section 305, The Companies Act 2013 (India).
[13] Section 308, The Companies Act 2013 (India).
[14] Rights, duties and liabilities of directors, GS Rao.

While the Act lists out general duties of directors[15], they are practically very tough to follow as innumerable scams of insider trading, improper structures, collusion between companies and their accounting firms, presence of weak or ineffective internal audits, lack of required skills by managers, lack of proper disclosures, non-compliance with standards have cropped up.[16]

These are discussed in terms of the Board of directors because it is the duty of the Board of directors to stop such scams in their firm and seeing the recent standards in corporate firms, the public has made it clear that the status quo is unacceptable. Accountability, responsibility and regulatory systems are required for directors to be put in check. So much so that the issue of the independent director being absolutely not independent still pervades the corporate atmosphere.

d) SCOPE OF THEIR AUTHORITY:

In an ecosystem where the management derives its appointment and authority from the owners, disciplining the owners themselves is next to impossible. This is because any decision that marginally disciplines or is in the interest of the minority and not majority is dealt with strict action. Practically, this problem surfaced in the Tata-Mistry case. The whole problem essentially boiled down to what "acted diligently" meant. That was the terminology used in section 149. Schedule IV Part 1 required Independent Directors to "uphold ethical standards of integrity and probity." Clause 9 of the same part expected them to "assist the Company in implementing the best corporate governance practices." Schedule IV, Part II, Role and Functions, Clause 4 expected them to "satisfy themselves on the integrity of financial information."

The whole issue was that Ratan Tata's successor, Cyrus Mistry complained of mismanagement and corporate governance failures within the Company.[17] Thereon, he was fired and the reason given was of falling revenue and dried up funds for charitable work.[18] But in reality, the reasons are totally different. The point of why we discuss this is that we have been discussing how the majority shareholder tries to keep all powers with him and

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[15] The Role of government in corporate governance, Harvard Law Journal.
[16] Corporate Governance 2, Eravandi.
[17] How Tata Sons lost confidence in Cyrus Mistry: Full text of Tatas' statement, First-Post.
[18] Cyrus Mistry vs Ratan Tata: A guide to the key issues involved, Ravi Krishnan.

control the board of directors and this is exactly what happened here. Just before appointing Mistry as chairman, Tata Trusts gave Tata Sons the special power to nominate, approve and remove the chairman. A majority of the directors nominated by the trusts were given affirmative voting rights. This takes us back to the root of the issue, the unquestioned and boundless power of the majority shareholder and how he manoeuvres everyone around to keep the ring of power within him. That was the real reason, it was a boardroom battle for Mr. Mistry who struggled to keep the faith of the majority and was ousted. We don't discuss this to check the decision, whether it was wrong or right, we just believe that such limitless power on the majority shareholder leaves the independent director and other small shareholder directors no scope to exercise their authority in the Company. And in reality, it is just saddening to see this happen to one of India's most inspirational and well-governed corporate groups, but in retrospect the Act had it coming.

This glaring abuse of corporate governance is defended by people under the garb of shareholder democracy but frankly, it is time to accept that such norms simply don't work. If we look at this from a holistic perspective, the problem is not just with directors. The central problem goes much deeper as the mindset in the Indian business industry is a promoter-driven one.[19] The way we approach our businesses is how a manager would and think of it as under his ownership and driving it forward. This is the attitude that we operate by, for example, corporate governance arises in India in three large categories of Indian companies. First are the public-sector units (PSUs), where the majority shareholder is the government and the general public takes the form of the minority shareholder. Second are the multinational companies (MNCs) where the foreign entity is the majority shareholder. Third are the Indian business groups where the promoters are the dominant shareholders with large minority stakes, government-owned financial institutions hold a comparable stake, and the balance is held by the general public.

In PSUs, the Board of directors are totally irrelevant. Although on paper, they are very strong because many operating decisions come to the Board of directors but this envisions the Board of directors as an authority for managing and not directing because the decisions come only for approval. No strategic importance is given since all material decisions are taken by the Government, majority shareholder or through the puppet-directors appointed by him. Coming to MNCs, parent companies are able to pass resolutions with a considerable amount of

[19] Corporate governance and the Indian institutional context: Emerging mechanisms and challenges: In conversation with K.V. Kamath, Chairman, Infosys and ICICI Bank, N Balasubramanian.

majority and in the process, ignore the interests of the public. Even if residuary responsibilities are given to managers of subsidiaries, they aren't empowered enough to take such roles since they are answerable to the MNC's themselves.[20] Indian business groups have a similar story as they exercise influence over their companies. Promoters are in control of the resources and have superior information about the Company's day-to-day affairs that help them create a significant divide between them and minority shareholders.[21]

From a very positivist standpoint[22], one can argue that the law shouldn't prescribe governance strategies and should only prescribe punishment. This was the stance taken by JN Gupta, managing director of a proxy advisory firm Stakeholders Empowerment Services (SES). He said that independent directors take up their roles for monetary compensation and are rarely independent. He said that "independence is a character that the law cannot infuse. Law can only infuse fear."[23]

With these situations continuing, the Board of directors are becoming a completely irrelevant concept. If these situations continue and measures aren't taken to control this, their already diminishing authority shall leave them in a state of no-man's land where they will be responsible to their majority shareholders for simply ratifying their decisions and in a way helping them to oppress the minorities, which glaringly sounds like the times of Enron and Satyam. While corporate governance was looked at as a bridge to a better corporate world, these policies make it seem like a cycle back to the old Enron times.

III. CONCLUSION:

The three agency problems between the directors-shareholders; minority shareholder-majority shareholder and creditors-companies are the three foremost problems in the framework of Company Law.[24] Judging the dynamic between the management and the ownership in India, it is extremely visible that whence the management derives its power from the ownership, the management isn't really independent and an independent director is never really independent. Moreover, it is not clear whether the Board of directors are to act in the interests of the majority shareholders or pay heed to the voices of the minority. As seen

[20] Study on the State of corporate governance in India, evolution, issues and challenges for the future, Santosh Pande and Kshama V Kaushik.
[21] Getting the right architecture for corporate governance, Financial Express, 13 January 2009.
[22] Green, Leslie, "Legal Positivism", The Stanford Encyclopedia of Philosophy (Fall 2009 Edition), Edward N. Zalta (ed.).
[23] Seeking 'independent' directors, Khushboo Narayan.
[24] Reinier R. Kraakman, Et al., The Anatomy of Corporate Law: A Comparative and Functional Approach 22 (2004).

by the numerous examples in the abovementioned sections, it is clear that the Board of directors are unable to do justice to their existing roles. So, the role and scope of the authority of the Board of directors need to be clarified, so that they can operate within its framework.

To suggest, the first and foremost measure would be to implement the measures prescribed and work towards a corporate atmosphere that incorporates the needs of the minority shareholder.[25]

Second, would be a need for better awareness to be embarked upon for compliance related benefits and a need for it to be to enshrined upon private companies.

Third, the need for shareholder activism in India and fourth, for the investors to spend little time communicating their concerns to the Board of directors or the management of a firm.[26]

Apart from this, regulatory checks that have been put up are in the form of evaluation meetings, need stricter implementation. And this is the root of the problem, the best way to solve the problem is the implementation of the existing norms and standards. Without the implementation of norms and a gradual attitude shift towards the policies, no solution would be practically attainable.

[25] Companies Act, 2013: Rise of the Minority Shareholder, Indian Law Journal.
[26] Jayati Sarkar & Subrata Sarkar, Large Shareholder Activism in Corporate Governance in Emerging Economies: Evidence from India, 1:3 INT'L REV. FIN. 161 (2000).