



**INDEPENDENT FUNCTIONING OF DIRECTORS UNDER CORPORATE LAW:  
IMPACT ON CORPORATE GOVERNANCE**

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**ABSTRACT**

The implementation of corporate governance is of paramount importance in upholding transparency, accountability, and ethical behaviour within organisations. The notion of autonomous independent directors plays a pivotal role in ensuring efficient corporate governance. These directors are entrusted with the responsibility of providing unbiased supervision of management decisions. The present study delves into the importance of autonomous operation of directors in accordance with corporate legislation and its influence on the administration of corporations. The article commences by presenting a comprehensive outline of the legal framework pertaining to independent directors, accentuating the regulatory provisions and guidelines that delineate their duties and obligations.

Additionally, the article explores the diverse manners in which autonomous directorship contributes to enhancing corporate governance. The text examines the role of independent directors in promoting board diversity, providing varied viewpoints, and serving as a proficient counterbalance to management's judgements. The exercise of independent judgement by individuals aids in the prevention of conflicts of interest, the promotion of shareholder protection, and the mitigation of agency problems. Furthermore, the article analyses the difficulties and possible drawbacks linked to autonomous board members.

**Keywords:** Board, Independent, Director, Company, Governance.

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## **INTRODUCTION**

The effective functioning and sustainability of corporations are contingent upon the critical role played by corporate governance. The central component of corporate governance is the board of directors, who are charged with the duty of supervising the organization's administration and safeguarding the welfare of stakeholders. The significance of independent directors is emphasised in corporate laws worldwide as a means to uphold the integrity and autonomy of the board. The present article aims to examine the notion of autonomous functioning of directors in accordance with corporate legislation and evaluate its influence on corporate governance.<sup>1</sup>

## **ROLES AND RESPONSIBILITIES OF BOARD**

The primary responsibility of the Board of Directors is to safeguard the financial well-being of the organisation while also addressing the legitimate concerns of the shareholders. The jurisdiction of the board is contingent upon the restrictions imposed by the Memorandum of Association, Articles of Association of the corporation, and the pertinent provisions of the Companies Act, 2013. In the context of publicly listed corporations, the trading of securities in the public domain and the need to adhere to SEBI regulations and guidelines outlined in the listing agreement are important factors to be taken into account. Private limited companies are characterised by being closely held and managed by their directors. Annual general meetings are held in companies to facilitate discussions that are essential for providing specific directions. The directors of a company are responsible for managing its day-to-day operations in accordance with the regulations set forth in the Companies Act of 2013.<sup>2</sup> This is due to the impracticality of having the AGM oversee every aspect of the company's affairs.

The BOD focuses on four key areas:

- “by establishing vision, mission and values;
- by setting strategy and structure;
- by delegating authority and responsibility to management; and,
- by exercising accountability to shareholders and be responsible to relevant stakeholders.”

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<sup>1</sup> Reyes Calderon, Ricardo Pinero and Dulce M. Redin, ‘Understanding Independence: Board of Directors and CSR’ [2020] *Front psychol* 8.

<sup>2</sup> The Companies Act 2013.

## **DEFINING INDEPENDENT DIRECTORS**

Independent directors are those who hold positions on the board of directors without any significant financial or material ties to the company or its management. It is anticipated that they will adopt an unbiased viewpoint and employ their discernment in the optimal welfare of the organisation and its stakeholders, without being subject to any unwarranted influence or conflicting interests.

## **ROLE OF INDEPENDENT DIRECTORS IN CORPORATE GOVERNANCE**

The presence of independent directors in a board of directors facilitates objective decision-making by introducing diverse perspectives and experiences. The autonomy of individuals enables them to make judicious decisions for the benefit of the organisation, without being influenced by personal or professional affiliations. The implementation of this practise guarantees that the decisions made by the board are impartial and equitable, thereby fostering accountability and transparency.

The concept of checks and balances is upheld by the presence of independent directors who serve as a pivotal mechanism to oversee and regulate the power and influence of the executive management. Through the utilisation of inquisitive inquiries, self-governing evaluations, and the questioning of management's propositions, these individuals impede the consolidation of authority and promote a robust equilibrium between the board and management.

The bolstered sense of accountability within a company is facilitated by the presence of independent directors, who assume a crucial responsibility in this regard. The individuals in question oversee the conduct of the managerial staff, evaluate the organization's achievements, and enforce accountability upon the executive leadership for their actions. The contribution of their oversight and vigilance is instrumental in enhancing the governance framework as a whole and fostering trust among stakeholders..

Legal provisions have been established worldwide by corporate laws to safeguard the independence of independent directors, recognising their significance. Typically, these provisions encompass: The laws stipulate specific criteria for independence that directors must satisfy in order to be considered independent. Typically, the criteria utilised encompass various elements such as lack of association with the organisation, absence of significant financial ties, and restricted

duration of service to prevent potential conflicts of interest.<sup>3</sup> The appointment of independent directors necessitates that companies adhere to a transparent and objective process. The aforementioned procedure may encompass the submission of nominations by the Nomination and Remuneration Committee, endorsement by shareholders, and divulgence of pertinent details regarding the director's qualifications and autonomy.

The role of independent directors encompasses distinct duties and responsibilities that are delineated by corporate legislation. It is anticipated that individuals will conduct themselves with integrity, exercise reasonable care, uphold confidentiality, and divulge any potential conflicts of interest. In addition, they are bestowed with the responsibility of overseeing the managerial performance and ensuring adherence to lawful and moral principles.

### **ROLE OF B.O.D. IN UNITED STATES**

The United States is commonly perceived as having a liberal approach towards defining the responsibilities of directors, with a brief overview provided. In contrast, India has established comprehensive legal frameworks that outline the specific roles and duties of directors. In India, the Companies Act and SEBI regulations serve as the principal sources of rules and regulations, whereas in the United States, state corporate laws and federal securities laws are the primary sources. At the federal level in the United States, the Securities and Exchange Commission (SEC) possesses the authority to regulate and enforce the Securities Act.<sup>4</sup> Conversely, in India, the Ministry of Corporate Affairs (MCA) serves as the apex body, with the Securities and Exchange Board of India (SEBI) acting as the statutory body responsible for overseeing corporate governance.

At the state level, there does not exist any legally constituted governing body. In the United States, state corporation laws do not impose any restrictions on the maximum or minimum board size, resulting in a variation in the number of directors across different companies. Conversely, in India, every public company is mandated to have a minimum of three directors, while a private company must have at least two directors. The New York Stock Exchange (NYSE) listing standards mandate that a majority of directors of a listed company in the United States must be independent. In accordance with the Companies Act in India, it is mandated that every listed company must have a minimum of one-third of the total number of directors serving as independent directors.

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<sup>3</sup> ICSI, 'ICSI Recommendations to Strengthen Corporate Governance Framework' <[https://www.mca.gov.in/Ministry/latestnews/ICSI\\_Recommendations\\_Book\\_8dec2009.pdf](https://www.mca.gov.in/Ministry/latestnews/ICSI_Recommendations_Book_8dec2009.pdf)> accessed 31 May 2023.

<sup>4</sup> The Securities Act 1933.

The United States lacks explicit provisions that establish the duration of directors' terms, whereas in India, non-executive directors, specifically independent directors, are restricted to a maximum term of five years. In the United States, publicly traded companies are obligated to reveal their board leadership arrangement, regardless of whether the CEO and board chair positions are held by the same individual.

The issue of companies acting in accordance with Clause 49 in India is currently unaddressed. Typically, publicly traded corporations divulge their corporate governance framework within the board composition segment of their annual report. In the United States, there is no formal quota system in place to ensure female representation on corporate boards, however, there is a growing emphasis on promoting gender diversity. Conversely, in India, it is mandatory for companies to have at least one female director on their board. The corporate governance structure in the United States comprises three distinct committees, namely the audit committee, the nominating committee, and the compensation committee.<sup>5</sup> Conversely, India possesses an audit committee, shareholders committee, and remuneration committee. The Compensation Committee in the United States and the Remuneration Committee in India share a common objective of overseeing the compensation of corporate executives. India, akin to the United States, possesses inherent delegation powers that are not contingent upon shareholders. It can be posited that the variance between the two nations lies in the regulatory approach and stakeholder support pertaining to the implementation of the aforementioned.

## **IMPACT ON CORPORATE GOVERNANCE**

The bolstering of board independence through the inclusion of independent directors serves to mitigate the potential for conflicts of interest. Consequently, this results in enhanced decision-making efficacy, heightened transparency, and better corporate governance methodologies.

The presence of independent directors on a company's board has been shown to increase investor confidence. The existence of independent directors is frequently perceived by external investors and stakeholders as an indication of sound governance procedures, which enhances their confidence in the management of the firm and its prospects for sustained success.

The utilisation of independent directors is a pivotal strategy for mitigating risks. The user asserts that the identification of potential risks and prevention of unethical or illegal practises within a

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<sup>5</sup> OECD, 'OECD Corporate Governance Factbook 2021' (2021)  
<<https://www.oecd.org/corporate/corporategovernance-factbook.htm>> accessed 31 May 2023.

company is facilitated by the oversight and diligence of its personnel.<sup>6</sup> Through their role as gatekeepers, they decrease the probability of fraudulent activities, mismanagement, and other forms of corporate malfeasance.

The safeguarding of stakeholder interests is a crucial aspect of corporate governance, and independent directors are instrumental in fulfilling this responsibility. Specifically, they are tasked with ensuring the protection of the rights and welfare of diverse stakeholders, such as minority shareholders, employees, and creditors. The impartiality of decision-makers guarantees a balanced consideration of the interests of all stakeholders, thereby promoting long-term sustainability and equity.

## **CONCLUSION**

The principle of autonomous operation of directors in accordance with corporate law is a fundamental aspect of efficient corporate governance. The presence of independent directors in the boardroom is known to enhance objectivity, accountability, and diversity of perspectives. The inclusion of individuals not only serves to improve the quality of decision-making processes, but also plays a significant role in fostering trust among stakeholders. The adherence to the principles of independence, transparency, and ethical conduct by independent directors is crucial in guaranteeing the enduring prosperity and viability of corporations in the intricate contemporary business environment.

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<sup>6</sup> *Ibid.*