

BOARDS AND THEIR BURDEN

June 11, 2024

SUMMARY OF DISCUSSIONS

Background

The responsibility of the Board of Directors to provide superintendence, direction and control to the management of a company, has long been recognised. With the Board being at the apex of decision-making, it is fair to say, especially when things go wrong, that “the buck stops here”. From time to time, questions have been raised on the competence and the commitment of members of the Board to discharge their duties and to ensure that the Board is a performing entity. At the same time, there has been increasing focus on the liabilities attached to Board positions, arising from increasing instances of tough regulatory action in recent times. Even though the statute provides that Independent Directors (IDs) will be responsible for acts and omissions, when they are informed through Board processes or when they do not demonstrate due-diligence, the ecosystem seems to believe that they should be held guilty, unless they are able to establish their innocence. In this environment, not unexpectedly, some potentially good Directors are shying away from becoming members of the Board.

DISCUSSIONS

- **Expectations from the Board** - Boards cannot be wished away. However, with changing expectations, there is a need to reimagine the way Boards function. The world over, when there were no regulations, companies were run based on the value systems of the Board. Now that there is a plethora of legal and regulatory provisions, the expectations from the Boards have escalated to seemingly impractical levels.
- **Before accepting a Board position** - A Director should be careful while choosing a Board. It is important to have prior interactions with the Chair of the Board and the Chief Executive Officer (CEO), to understand the culture and the value system of the company.
- **New Director** - The role of a Director has nothing to do with the size of the company. A new Director on a Board should recognise that his/her role is one of improving the company’s governance and performance. For this, both intent and capability are important. He/she can view his/her role as one of responsibility, or one of burden. Awareness of one’s role, education and protection are all important for a Director.
- **Induction** - Directors must ensure that they get a proper induction when they join a company’s Board. If this is not provided by the company, they should ask for it. They should interact with the Chairperson, the CEO, the Chief Financial Officer and the Company Secretary.
- **Stakeholders of business** - Increasingly, society, as a stakeholder, is becoming demanding, and is questioning the purpose of a company. ESG is gaining importance, as a response to society’s expectations from the company and the Board. Directors should seek to serve society’s expectations, and not only those of the shareholders. They are, in some sense, custodians of what the company is doing for the

society at large. They should be aware that all stakeholders closely look at the affairs of the company. The concept of trusteeship is gaining importance.

- **Shareholders' interest** - Shareholders are becoming more demanding. "Majority of minority" concept is gaining importance. Over the years, some companies have abused shareholders rights. To protect minority shareholders and to address conflict of interests, laws and regulations have strengthened the provisions relating to Related Party Transactions (RPTs). SEBI's mandating response by companies to market rumours is also for promoting shareholders' interest.
- **Promoters** - A promoter may understandably promote his/her interest, but a good promoter will respect the interest of other shareholders too. An enlightened promoter would move one step further to respecting the interests of other stakeholders. There is an expectation that IDs should tame an errant promoter all the time. However, there is also a need to put a check on such promoters, both at the time of IPO and later. The view is now gaining ground that IDs exist to protect the promoter from herself/himself.
- **Definition of independence** - Independence is a state of mind. It is not possible to satisfactorily define it. What should be ensured is the absence of any conflict of interest.
- **Board composition** - It is increasingly being realised that the composition of Board is very critical. It is the starting point that influences the quality of deliberations and decisions. To ensure this, Nomination and Remuneration Committees (NRCs) have to play a much bigger and a more assertive role in selecting the right kind of Directors.
- **Role clarity** - Along with getting the Board composition right, there is also a need for role clarity for Executive Directors (EDs), including Managing Director, Nominee Directors and IDs. Non-Executive Directors must not be held accountable for executive action, which is the responsibility of EDs. There is also a need to define fiduciary relationships and the expectation from Directors. Increasingly, the role of all Directors, including IDs, is seen as similar to that of executive management, with even operational matters sometimes getting a Board nod. Boards must not be held accountable for operational actions, which are within the remit of management. Their role should be restricted to ensuring that implementation is consistent with the decision taken.
- **Diligent Directors** - Law requires Directors to be "diligent". A diligent Director should proactively seek information, when managements may not be forthcoming. He/she should also be well informed about the affairs of the company, from sources other than the company, such as media reports.
- **Role of Director** - A Director must ask himself/ herself whether he/she is diligent, whether he/she is applying best judgement, and where he/she should put down his/her foot. This depends on the boardroom culture, the Chairperson of the Board as also the ID himself/herself. Decisions brought for the consideration of the Board are proposed by management persons, who are experts in their domains. In some cases, Directors bring their expertise, and in other cases their judgement. Directors are not expected to be functional experts. While it is necessary to challenge management, second guessing management should not be the default option.
- **Time commitment and compensation** - Directors should be compensated for their time. However, for Directors to shy away from their responsibility citing time constraints is not correct. Once a person has

agreed to serve as a Director, he/she has to create the time for the affairs of the company. In case a Director feels that the duration of a meeting is not sufficient, he/she should ask for more time.

- **Information flow to Boards** - Schedule IV of the Companies Act, 2013 lays emphasis on flow of information to the Directors. There is an expectation that agenda items, complete with agenda notes, should come to Directors. However, in some instances, owing to concerns relating to Unpublished Price Sensitive Information (UPSI), or otherwise, agenda notes are sent later. It is not fair to expect Directors to contribute to discussions without giving them adequate time to read agenda papers. A related problem is one of data overload. A number of companies are struggling with what to send as agenda, how to present agenda items to the Board, including what content to include. Attaining a balance between receipt of agenda, volume of agenda, and reading time, is difficult.
- **Meetings other than Board meetings** - IDs must spend time together, outside Board meetings, so that they can discuss any concerns that they may have, and so that clearer views can emerge. IDs should also have one on one conversations with CXOs, and senior management persons, between Board meetings. This will help ensure that Directors and management persons will have a healthy working relationship.
- **Regulators' expectation** - Regulators are becoming more assertive, and less tolerant of deviations, and are holding Directors accountable. Liabilities for Directors have also increased. There is an increased expectation from Directors, especially IDs. NFRA too has become very active, and it expects Audit Committees (ACs) to get into more details. The continuing changes to law and regulations are a result of increasing expectations.
- **Continuing education** - There is a need for continuing education for Directors, including, but not limited to, on legal repercussions arising from actions of Directors.
- **Liabilities of Directors** - Increasingly, law agencies are coming after Directors, long years after he/she has ceased to be a Director. Some of them also file criminal cases against IDs in civil matters. It is important for a Director to ensure that he/she is diligent, and that there is a good D&O liability insurance policy. There also has been a recent case of clawback of commission from IDs. Unlike in some other countries, in India, Directors are not given benefit of care, diligence and loyalty. While Section 149(12) of the Companies Act, 2013 provides some relief, it is limited to the Companies Act, 2013, and not extended to other laws.
- **Quality of Directors** - There has been a spate of IPOs, including of SME companies. Some of these companies have first time Directors appointed as IDs. In the absence of a proper training programme or induction programme about the role, responsibility and duty of Directors, some of these persons will not be able to contribute immediately on appointment. In the event of any mishappening, the Regulator may decide to come down heavily on IDs of the companies.
- **Role of Proxy Advisory Firms** - Boards are accountable to the shareholders and stakeholders of the company, and for this purpose, they must comply with laws and regulations. However, at times, proxy advisory firms create negative perception by sticking to their own guidelines, which are over and above the prescribed regulations, without considering what is good for a company.

- **Are IDs needed?** - Is there a need for a category known as IDs, especially since the expectations from them have increased, and the liabilities have kept pace? These are two sides to this question. If there is no such category, the promoter can pack the Boards with “convenient” persons. If the category is to be retained, the IDs must be held accountable for only what they have got to know through Board processes. “Heads I win, tails you lose.”

EXCELLENCE ENABLERS

CORPORATE GOVERNANCE SPECIALISTS

ADDING VALUE, NOT TICKING BOXES

www.excellenceenablers.com

All rights reserved.

No part of this publication may be reproduced, stored in retrieval system or transmitted in any form or by any means, electro nic, mechanical, photocopying, recording or otherwise without the prior permission of Excellence Enablers Private Limited.

The views expressed in this report are the views of the participants at the roundtable and do not necessarily reflect the vie ws of Excellence Enablers Private Limited.