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## INDEPENDENCE – FACT, FICTION AND FANTASY

*Independence is, strangely, seen as a desirable attribute of only Independent Directors. We take a look at where else independence must manifest itself.*

What is independence? This is a question that surfaces in different forms, within and outside of boardrooms. History informs us that political independence is an event which liberates countries from a dominion status, from the stranglehold of other countries, and enables them to be the masters of their own destinies. In conversations in the corporate environment, independence assumes a different dimension. It is not about carving out one's own territory or flying a flag or working towards a concept of nationhood, with its own laws and rules. Independence in boardrooms is about each Director applying his/her mind to the facts in issue, and the information available, and contributing objectively to the process of decision-making. It is interesting to note that google defines independence as– *"Independence is the state or quality of being free from the control, influence or support of others. It refers to the ability to make your own decisions, govern yourself and act without relying on external assistance."*

Clearly this definition cannot, in its entirety, apply to independence in the boardroom. While one is expected to be free from the control and influence of others, the support of others is a necessary condition for participating in the deliberations, and the decision-making process, since it is premised on information that is provided by others within the organisation. Further, this definition does not address the possibility that one could be independent even as a member of a team working in pursuit of a common objective.

One of the questions which arise when independence is discussed is "independent of whom?". Is it independence from the promoter group or from any other significant group of stakeholders which influences the direction taken by the company? In the context of Independent Directors (IDs), there are those that believe that when the promoter group, or any other significant group in control, is associated with the appointment process, there cannot be any genuine independence. This leads to the somewhat facile conclusion that no one in a corporate environment can be independent of the controlling group. Yet the expectation is that those belonging to the category of ID act objectively and dispassionately, and in the process, ignore the interests of the controlling stakeholder or stakeholder group. Carried to the extreme, this independence would manifest itself as opposition to every proposal that management brings up for consideration, presuming that any such proposal will benefit the promoter directly or indirectly, and should necessarily be opposed. The unexpressed view is that IDs constitute the opposition party in the boardroom, and cannot, or should not, align with any decision that emanates from a management proposal. There are those that subscribe to the view that the promoter, having invested his/her resources, time, energy and reputation in setting up a company, will not act against its interests, and therefore, it would be fair to presume that by aligning with the promoter, the ID is acting in the interest of the company.

It reminds one of the old saying “I take all the major decisions in my house, and my spouse determines what is major.”

Independence is not an attribute expected only of Directors. The auditing profession is expected to understand and interpret all relevant information relating to the functioning of the company, so that a balanced, fair and correct view can be presented to the stakeholders. With that expectation, there have been questions raised on the independence of auditors, with even a regulatory body, such as National Financial Reporting Authority (NFRA), pointing out instances of the absence of independence in the conduct of some large audit firms. This gives rise to a related question. Auditors, as a part of their report, clearly state that they have relied on information provided by the management. There is no other source from which they can receive all the information that they would need. Will this, in some manner, impact on the independence of the auditor, considering that the information provided may fall short of what is necessary for a complete diagnostic study of the operations of the company? There are also aspects of the audit process in which auditors are expected to address the correctness of the judgement of management, and opine whether they are comfortable with those judgement calls. Does such agreement translate to a negative impact on the independence of the auditors?

There has been, for many years, the larger question, the elephant in the room, of income from non-audit services impacting on the rigour of the auditing process. A rough and ready test is to determine whether the non-audit income is significant in relation to the audit income. Pending a blanket ban on non-audit services being provided by auditors, it is for the Board to satisfy itself that the provision of any such service does not adversely impact on the independence of the audit process. In the present context, this is a very tall ask from Boards which are struggling to face the reality that they are the persons primarily tasked to ensure corporate governance.

Internal Audit (IA) constitutes the best instrument for undertaking a diagnostic study of the functioning of any organisation. It helps to identify substantive and procedural shortcomings which could lead to major setbacks. It is universally accepted as arguably the best instrument of risk management. It stands to reason that anything that adversely impacts on the independence of the IA function should be identified, and taken out of the system. One major problem noticed in many entities is that the IA function reports to a member of the senior management, namely the CEO or the CFO, and this prejudicially affects the ability of the Internal Auditor to comment freely on what is observed. The IA function, while relying on management for logistic support, should functionally report to the Audit Committee (AC), and to no one else. A similar requirement exists in regard to the Compliance function, which should not be weighed down by the administrative control exercised by senior management functionaries, on account of considerations of rank.

The working of the committees of the Board also required to be taken note of. On some occasions, statements have been made to the effect that the AC of the Board should be independent of the Board. This has met with opposition from persons who believe that being a committee of the Board, the AC, as also other committees, should be subordinate, if not subservient. The expectation from the AC is that the correctness of decisions being taken by management will be examined, and where necessary, commented on. This aspect of

functioning of AC should not be adversely impacted by non-AC members at the Board level influencing the decision-making of the AC. Similar is the situation with regard to the Nomination and Remuneration Committee (NRC). In rightly constituting the Board, and compensating Directors as well as Key Managerial Personnel (KMPs), and other senior personnel, as well as in ensuring the identification of successors for Board members and senior management persons, the NRC has to function objectively, without fear or favour. It follows that the independence of the NRC should be respected and ensured.

Independence is also a term that is bandied about when discussing regulatory organisations. Some context is necessarily in order. Regulatory organisations have been set up to provide a level playing field to all participants in the regulated universe, whether publicly owned or privately owned. The fact that public sector enterprises, either wholly or majority owned by the Government, compete in the same space as privately owned entities, made it necessary for regulation to be taken out from the Government, and entrusted to a body constituted for this purpose. The question arises therefore whether regulatory organisations act independently to further public interest. Looking at the area of Securities Market Regulation, it is fair to say that on some occasions, public sector enterprises have got away with transgressions that private sector entities have been punished for. There is also the question of special dispensations being given to public sector enterprises in matters such as Minimum Public Shareholding, proper constitution of Boards, and the like. Differential treatment by a Regulator is not evidence of independent conduct. It might well be argued that Regulators operate as a part of the larger ecosystem, and therefore, what they need is functional autonomy, as distinct from independence, properly so-called. Be that as it may, the question remains whether regulatory conduct is always objective, impartial and even-handed.

The overriding question is in whose interest should the corporate ecosystem work? When it comes to Directors, the Companies Act, 2013 (the Act) is very clear. Section 166(2) of the Act clearly states that all Directors are to act in the interest of the company, as well as of the other stakeholders that constitute the company. If for arguments sake, the interests of the company are not identical with those of the country, should Directors look only at the company's interest, or see themselves as part of the larger entity? If there is clarity in regard to this seeming contradiction, there would be less instances of companies being ranged against the Government for judicial determination of seemingly contentious issues.

This brings us to a somewhat slippery surface, namely the independence of the Judiciary. The Constitution clearly provides that the Judiciary is one of the 3 organs of the Government. It is expected to act independent of the executive wing of the Government, and to determine the correctness, or otherwise, of legislative or executive action. Is the Judiciary structurally enabled to meet this expectation? This is no reflection on the functioning of the Judiciary, which is the last resort of hapless individuals seeking justice, when ranged against large institutions, or even the Government. The question is whether the procedure for appointing Judges, in any manner, gives rise to the possibility that independent judgement might be adversely impacted. Members of the higher Judiciary are selected by a collegium comprising Judges, with the process ending with the Government approval. The National Judicial Accountability Bill has not survived judicial scrutiny, and therefore questions continue to be raised on whether, given the selection process, Judges can be expected to be fair and impartial at all times. It is to the credit of the Judiciary that there is significant evidence of

impartiality and objectivity in the judgements delivered, but the discomfort arising from the selection process refuses to go away.

The media is an important element in any civilized society. It follows that a free media should ensure balanced reporting, leading to its readers and viewers being fed complete and correct information, to enable them to exercise their judgement in an informed manner. Even senior personages and influential voices from within the media have been heard to state that the performance of the media, by and large, has fallen significantly short of expectations. Persons whose rights and reputations have been adversely impacted as a result of irresponsible reporting, do not have a forum that they can easily access in search of justice. The Press Council, which meets infrequently, does no more than administer a slap on the wrist, even in the cases of serious misreporting. The Broadcasting Council, which is a later phenomenon, has also not demonstrated any significant clout. Self-regulation, which media houses talked about at a point of time, seems to have fallen by the wayside. The ownership pattern of media houses also does not generate confidence that free and frank reporting will be the rule, rather than the exception. Some of them have experimented with creating an office of Ombudsperson, but the impact, if any, has been minimal, and the post hoc corrections have not added up to much. The question to be asked is whether the media is the fourth estate or the fifth wheel in the coach.

Conventional media has been seriously challenged by the emergence of what passes for social media. This is the platform that a large number of persons, both young and old, use to transmit information, share opinions, and sit in judgement, with no care in the world. Freedom of speech seems to have become a license, in the absence of regulation, to take potshots at any person or institution, knowing that no harm will be done to the originators of such thoughtless endeavours. Social media has also gained a legitimacy of its own, with even Governments and organisations communicating to their stakeholders through social media, rather than through the old conventional instruments of communication. A consequential danger is that a seriously threatened conventional media is also seen to be resorting to shortcuts, and expediency, and to put out stories that are neither verified, nor have any basis. The social media is truly independent, but that independence does not seem to partake of the rudimentary requirements of ensuring correctness, fairness and objectivity.

Technology and transparency should lead to trust. However, in a world that worships speed, and gives short shrift to accuracy, is independence too much to ask?

Independence is premised on the absence of conflict of interest, the latter being a red rag to an honest decision-making process that serves the interests of all stakeholders. However, while conflict of interest can be addressed through law and regulation, the efforts to deal with independence similarly have fallen flat, with all attempted definitions throwing up loopholes, rather than providing comprehensive solutions. Alan Greenspan, who reached the ripe old age of 100, before calling it a day a couple of weeks ago, famously said “you cannot legislate for honesty”. Much the same can be said of independence.