Towards affirmative boardrooms

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Accountability, fairness, transparency and independence are the cardinal principles of corporate governance, which has become the buzzword because of the inflow of foreign investments into India.

To alleviate the concerns of foreign investors about efficient management and transparency, the Securities and Exchange Board of India (SEBI) has placed corporate governance high on its agenda and requires listed companies to provide a separate report on corporate governance pursuant to Clause 49 of the listing agreement.

Maintaining independence

Clause 49-I (A) mandates an optimum combination of executive and non-executive directors, with at least 50% comprising the latter.

Such an optimum mix provides a check on the management and also ensures effective performance when the members are not either a part of the management, or financially obligated in some way to the management.

The number of independent directors depends upon whether the chairman is executive or non-executive. In the former instance, at least half the board and in the latter instance, at least one-third must be independent.

Independence is lost if, besides other things, a director has any material pecuniary relationship or transaction other than his remuneration (including sitting fees, commission and stock options) influencing his independence, which must be disclosed in the annual report.

The aforesaid relationships and transactions, though not defined, can be with the company, its promoters, directors, senior management and even other group companies.

Accordingly, Clause 49-I (A)(iii)(f) requires that a director who holds substantial shareholding (i.e. owning 2% or more of the block of voting shares) will not be considered independent.

Further, an independent director must not be related to the promoters or persons occupying management positions, either at the board level or at one level below it - ("*management group*"). Independence is, therefore, the cornerstone of qualitative governance.

Recent changes

The induction of independent directors is emphasized in the listing agreement, since it encourages objectivity and fair decision-making.

In an attempt to further these objectives, SEBI has tightened the compliance norms linked to Clause 49, bringing greater transparency and efficiency in boardrooms. The new changes, introduced on 8 April 2008, are more in the nature of addition than alteration.

Among the mandatory requirements and as a move towards board independence, SEBI has clarified that at least half of the board must be independent where a non-executive chairman is a promoter, or is related to the *management group*.

Further, to keep shareholders well-informed, SEBI has made the disclosure of relationships between the directors inter se mandatory in annual reports, prospectus and other requisite filings.

SEBI has also stipulated that the gap between the resignation or removal and appointment of another independent director must not exceed 180 days.

However, this does not apply where a company fulfils the minimum requirement of independent directors on its board (one-third or one-half as the case may be) even if the vacancy created has not been filled.

These requirements will prevent non-compliance and will eliminate the possibility of not finding the right candidate by the company.

The only non-mandatory requirement stipulated is that individuals possessing requisite qualifications and experience that will be of use, and will contribute effectively to the company, should be appointed.

Expectations

Spectacular performance, enhanced profits and expanded reach: nothing safeguards a company when good governance and ethics take a back seat.

The aforesaid changes are a step towards developing an antidote for imperfect governance.

Further changes may be introduced based on evolving business trends and practices, however, without a strong enforcement mechanism – both at the regulatory and corporate mindset level – any change is meaningless.

Consequently, Indian corporate houses need to transform from family-owned businesses to those run by professionals so that implementation is in the hands of those who will be impartial, without any vested interests, and in the best interests of the company.

SEBI also needs to be proactive in its approach towards addressing such issues, and in its pursuit to meet global competition.

Since foreign investors demand greater disclosure, transparent explanations and better shareholder value, it will be essential for Indian corporates to abide by the provisions of effective corporate governance and display their commitment to ethical success.

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