

**BOARD OF DIRECTORS – A  
POWERFUL INSTRUMENT IN  
GOVERNANCE**

# OBJECTIVES

- Board of directors of a corporation - most important instrument that would make it or break it.
- If corporation a role model or a beacon - due to its CEO and a proactive board
- While many corporate failures and scams point out to an inactive or 'obedient' board
- We will look at what goes in depth into all these issues, as well as positive and negative elements connected to the board of directors.

# Outline

- **Introduction**
- **The Role of the Board in Ensuring Corporate Governance**
- **Governance Issues Relating to the Board**
- **The Role of Directors**
- **Independent Directors**
- **Directors' Remuneration**
- **Family-owned Businesses and Corporate Governance**
- **Some Pioneering Indian Boards**

# Introduction

- **Separation of ownership** from active direction and management-essential feature of the company form of organisation.
- To manage affairs of the company, shareholders elect their representatives called the “Directors” of the company.
- A number of such directors constitutes: “Board of Directors”. The board generally has only part-time directors.

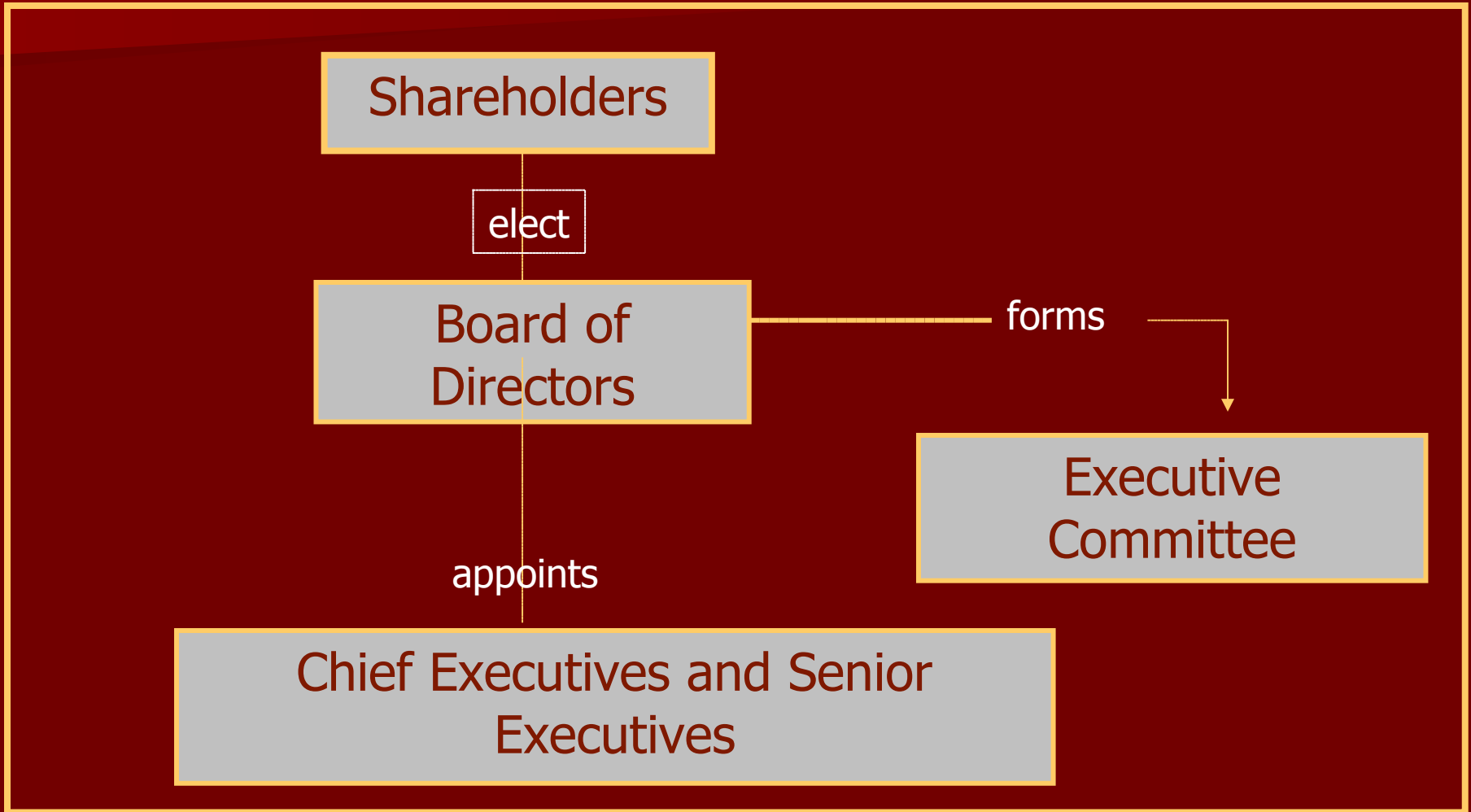
# Corporate Management Structure

**Expected *to lay down policies, procedures and programmes,*  
but may not be able to secure their implementation under  
their guidance and continuous supervision, or communicate  
their decision to the rest of the staff**

# **Corporate Management Structure (contd.)**

**The CEOs who include Managing Directors and managers receive instructions from the board and disseminate them to executives in charge of various departments.**

# Fig 1 : CORPORATE MANAGEMENT STRUCTURE



# Company Director and the Board

In the eyes of law, a company is an artificial person, who however has no physical existence and has neither a body nor soul.



# Company Director and the Board (contd.)

In many countries, as in India, it is mandatory for a public limited company to have directors and in practice *“the identities of directors and those of their companies are inseparable for good or bad”*.

# Who is a Director?

Section 2 (13) of the Companies Act defines a director as follows: "A director includes any person occupying the position of director by whatever name called. The important factor to determine whether a person is or is not a director is to refer to the nature of the office and its duties. It does not matter by what name he is called. If he performs the functions of a director, he is a director"

# Who is a Director? (contd.)

Section 2(6) of the Companies Act states that directors are collectively referred to “Board of Directors” or simply the ‘board’.

# **Kinds of Directors**

- **A director may be a full time working director, namely, managing or whole time director covered by a service contract.**
- **A company may also have non-executive directors who do not have anything to do with the day-to-day management of the company.**

# Kinds of Directors (contd.)

We can recognise another category of directors as per certain provisions of the (Indian) Companies Act **“Shadow Directors”**. These so-called “deemed-directors” acquire their status by virtue of their giving instructions (other than professional advices) according to which “appointed” directors are accustomed to act.

# Directors' Appointment

- The Articles of Association of a company usually name the first set of directors by their respective names or prescribe the method of appointing them.

# Directors' Appointment (contd.)

- Certain provisions of the Companies Act in India govern the appointment or reappointment of directors by a company in general meeting.

# Legal Position of a Director

- They have been described variously as agents, trustees, or managing partners of the company.
- The legal position of the directors as agents and trustees emanate from the fact that a company being an artificial person cannot act in its own person.
- It has become a well-settled fact now that directors are not only agents but also act as trustees as a result of several court decisions in India and England.



# Duties and Responsibilities of Directors

- Fiduciary duties
- Duties of care, skill and diligence
- Duties to attend board meetings
- Duties not to delegate their functions except to the extent authorised by the Act or the constitution of the company and to disclose his interest

# Qualifications and Disqualifications of Directors

- No body corporate, association or firm can be appointed directors of a company.
- A director must
  - be an individual
  - be competent to enter into a contract
  - hold a share qualification if so required by the Articles of Association

# Qualifications and Disqualifications of Directors (contd.)

- ❑ The following persons are disqualified for appointment as directors
  - ❑ A person of unsound mind
  - ❑ an undischarged insolvent or one whose petition for declaring himself so is pending in a Court
  - ❑ a person who has been convicted by a Court for any offence involving moral turpitude
  - ❑ a person whose calls in respect of shares of the company held for more than six months have been in arrears

# Qualifications and Disqualifications of Directors (contd.)

- ❑ a person who is disqualified for appointment as director by an order of the Court on grounds of fraud or misfeasance in relation to the company
- ❑ directors can be removed from office by
  - (i) the shareholders
  - (ii) the Central (Federal) Government
  - (iii) the Company Law Board

# Board of Directors

- The Board of Directors which includes all the directors elected by shareholders to represent their interests is vested with the powers of management.
- The board has extensive powers to manage the company, delegate its power and authority to executives and carry on all activities to promote the interests of the company and its shareholders, subject to certain restrictions imposed by public authorities.

# Board of Directors (contd.)

- The board of directors of a company is authorised to exercise such powers and to perform all such acts and things as the company is entitled to.
- Subject to two conditions:
  - The board shall not do any act which is to be done by the company in general meeting of shareholders
  - The board shall exercise its powers subject to the provisions contained in the Articles or the Memorandum or in the Federal Acts concerned with companies or any regulation made by the company in any general meeting.

# Powers of the Board

**Board of directors shall exercise the following powers**

- (a) make calls on shareholders in respect of money unpaid on their shares;
- (b) issue debentures;
- (c) borrow moneys otherwise (For example, through public deposits);
- (d) invest the funds of the company; and
- (e) make loans.

**BOD can exercise other powers as listed below with the consent of the company in general meeting, as in the case of an amalgamation scheme:**

- (a) to sell, lease or otherwise dispose of the whole or substantially the whole, of the undertaking of the company;
- (b) to remit or give time for repayment of any debt due to the company by a director except in the case of renewal or continuance of an advance made by the banking company to its director in the ordinary course of business



## The Board of Directors (contd.)

- (c) to borrow in excess of capital
- (d) to contribute to charitable and other funds not relating to the business of the company or the welfare of its employees beyond a specified amount
- (e) to invest, compensation amounts received on compulsory acquisition of any of company properties
- (f) to appoint a sole selling agent

# Nominee Directors

- Appointed to ensure that the affairs of the company are conducted in a manner dictated by the laws governing companies and to ensure good corporate governance.
- As an affiliated director, nominated to ensure that the interests of the institution which he or she represents are duly or effectively safeguarded.

## Nominee Directors (contd.)

- Kumar Mangalam Birla Committee on Corporate Governance suggested that financial institutions should not have their representatives on the boards of *assisted companies*.

# Liabilities of Directors

- (1) Directors of a company may be liable to third parties in connection with the issue of a Prospectus, which does not contain the particulars required under the Companies Act or which contains material misrepresentations;
- (2) Directors may also incur personal liability under the Act

# Liabilities of Directors (contd.)

- (a) on their failure to repay application money if minimum subscription has not been subscribed;
- (b) on an irregular allotment of shares to an allottee (and likewise to the company) if loss or damage is sustained;
- (c) on their failure to repay application money if the application for the securities to be dealt in on a recognised Stock Exchange is not made or refused ;and
- (d) on failure by the company to pay a bill of exchange, hundi, promissory note, cheque or order for money or goods wherein the name of the company is not mentioned in legible characters.

# The Directors' Liability to the Company

## **(1) Ultra vires Acts:**

Directors are personally liable to the company in matters of illegal acts.

## **(2) Negligence:**

A director may be held liable for negligence in the exercise of his duties.

# **The Directors' Liability to the Company (contd.)**

## **(3) Breach of Trust:**

They are liable to the company for any material loss on account of the breach of trust.

## **(4) Misfeasance:**

Directors are liable to the company for misfeasance, i.e, wilful misconduct.

# Liability for Breach of Statutory Duties

The Companies Act imposes penalty upon the directors for not complying with or contravening the provisions of the Act, which include sections on criminal liability for mis-statements in Prospectus, penalty for fraudulently inducing persons to invest money, purchase by a company of its own shares, concealment of names of creditors entitled to object to reduction of capital, penalty for default in filing with the Registrar for registration of the particulars of any charge created by the company.



# Liability for Acts of his Co-directors

- A director is not liable for the acts of his co-directors provided he has no knowledge and he is not a party.
- When more than one director is alleged to have neglected his duties of care, all the directors are jointly and severally liable.

# Directors with Unlimited Liability

- In a limited company ,the liability of all or any of the directors may ,if so provided by the Memorandum is unlimited.

# Disabilities of Directors

- In order to protect the interest of a company and its shareholders, the Companies Act has placed the following disabilities on the directors:

- (1) Any provision in the Articles or an agreement which exempts a director (including any officer of the company or an auditor) from any liability on account of any negligence, default, misfeasance, breach of duty or breach of trust by him shall be wholly void.

- (2) An undischarged insolvent shall not be appointed to act as director of any company or in any way to take part in the management of any company.

# **Disabilities of Directors (contd.)**

- **(3) No person shall hold office at the same time as director in more than 15 companies.**
- **(4) A company shall not without obtaining the previous approval of the Central Government in that behalf, directly or indirectly make any loan to**

# Disabilities of Directors (contd.)

- (i) any director of the lending company or of a company which is its holding company or any partner or relative of any such director;
- (ii) any firm in which any such director or relative is a partner;
- (iii) any private company of which any such director is a director or member;
- (iv) any body corporate at a general meeting of which not less than 25 per cent of the total voting power may be exercised or controlled by any such director; or
- (v) any body corporate, the board of directors, managing director, or manager whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors of the lending company.

# Disabilities of Directors (contd.)

- Except with the consent of the board of directors of a company, a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner, in such a firm, or a private company of which the director is a member or director, shall not enter into any contract with the company.
- (a) for the sale, purchase or supply of any goods, materials or services; or
- for underwriting the subscription of any shares in, or debentures of, the company.
- (6) A director shall not assign his office. If he does, the assignment shall be void.

# **Prevention of Management by Undesirable Persons**

**An undischarged insolvent cannot**

- (1) act as, or discharge any of the function of, a director or manager of any company, or**
- (2) directly or indirectly take part or be concerned in the promotion, formation or management of any company.**

# **Fraudulent persons**

- (1) a person who is convicted of any offence in connection with the promotion or management of a company; or**
- (2) a person who in the course of winding up of a company**
  - (i) has been guilty of fraudulent conduct of business; or**
  - (ii) has otherwise been guilty, while being an officer of the company, of any fraud or misfeasance in relation to the company or of any breach of his duty to the company.**



# **Effectiveness of the Board of Directors**

**Though the board is recognised legally as the top layer of management with the responsibility of governing the enterprise, yet, in actual practice, the board of directors delegates most of its managerial power to chief executives- say, the managing director or manager. In many cases, the board appoints many committees and clothes them with its power.**

# **Effectiveness of the Board of Directors (contd.)**

**The realistic functions of the board may, therefore, be enumerated as follows:**

- (a) Confirming management decisions on major changes in objectives, policies, and those transactions which will have a substantial effect on the success of the company;**
- (b) Providing constructive advice to the executives through discussion on important matters such as business outlook, new governmental legislation, wage policy, etc., with a view to guiding the executives when the policies are still in the process of formation;**

# **Effectiveness of the Board of Directors (contd.)**

- (c) Selecting the chief executives and confirming the selection of the other executives in the company made by chief executives; and**
- (d) Reviewing the results of current operations.**

# **ROLE OF BOARD IN ENSURING CORPORATE GOVERNANCE**

## **Role of the Board**

- **The quality of directors, their competence, commitment, willingness and ability to assume a high degree of obligation to the company and its shareholders as members of the board alone drives the value of any board. A strategic board with broad governing responsibilities rather than one that acts in response to the demands of the CEO has become the need of an intensely competitive world.**

# **ROLE OF BOARD IN ENSURING CORPORATE GOVERNANCE (contd.)**

**Susan F. Shultz, founder of SSA Executive Search International, author of several best sellers on the subject and a member of several boards of directors condenses her experiences and research in the following summation**

# SNAPSHOT

- 1. The smaller the board, the greater the director's involvement.**
- 2. The essence of strategic boards is independence.**
- 3. Diversity (of Board) means that a company has access to the best. It also means that the company is not arbitrarily limited to a single subset of its global constituency.**
- 4. If the board is not informed appropriately, intelligently and comprehensively, it cannot function. In simple words, the output is only as good as the input.**
- 5. The board has a broader responsibility to long-term shareholder value than the CEO, who is necessarily focused on day-to-day operations.**

**(1) Small Size of the Board**

**(2) Independence of the Board**

**(3) Diversity of the Board**

**(4) A Well – informed Board**

**(5) The Board should have a Longer Vision and Broader Responsibility**

**FIG 2: DYNAMICS OF CORPORATE GOVERNANCE AND BOARD OF DIRECTORS**





# **I. THE ROLE OF DIRECTORS**

- (1) An efficient and independent board should be conscious of protecting the interests of all stakeholders and not concerned too much with the current price of the stock.**
- (2) Another important function of the director is to set priorities and to ensure that these are acted upon.**

# I. THE ROLE OF DIRECTORS (contd.)

- (3) A director is also expected to have the courage of conviction to disagree.
- (4) Directors have great responsibility in the matter of employment and dismissal of the CEO.
- (5) One of the toughest challenges confronted by boards arises while approving acquisitions.

# I. THE ROLE OF DIRECTORS (contd.)

- (6) An efficient board should be able to anticipate business events that would spell success or lead to disaster if proper measures are not adopted in time.
- (7) The directors have a duty to act *bona fide* for the benefit of the company as a whole.

# I. THE ROLE OF DIRECTORS (contd.)

- (8) In recent times, those who advocate reform of laws governing corporate practices stress the importance of reformulation of the concepts behind these laws.

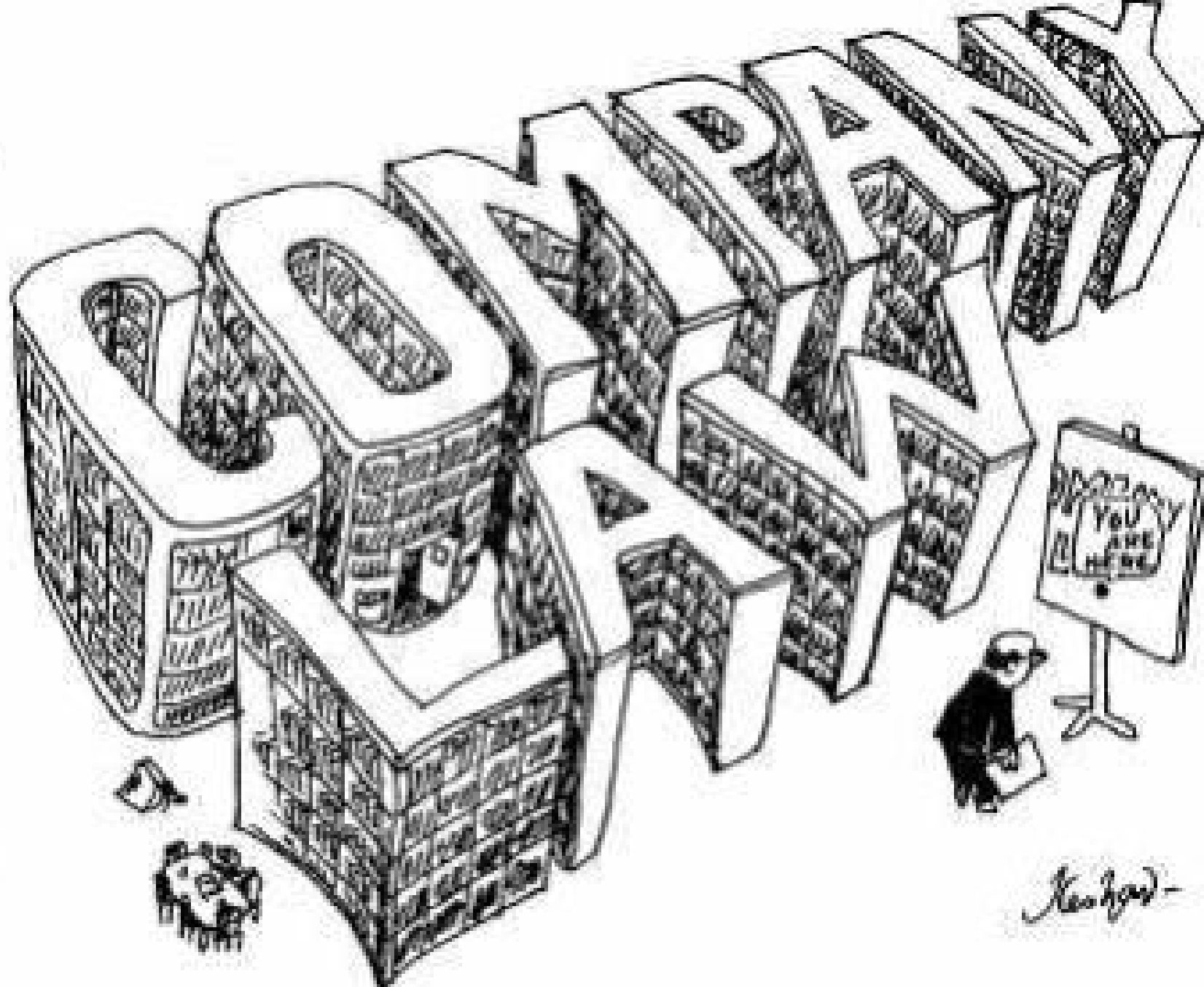
# **II. INDEPENDENT DIRECTORS**

- **Who is an Independent Director?**
- **Desirability of having Independent Directors**
- **Views of Promoters**

**SEBI directions are meant only for listed companies Recommendations of Irani committee apply both to the listed & non-listed companies**

# JJ Irani Committee Report

- SET UP to structurally evaluate the views of several stakeholders in the development of company law
- movement to create better frameworks of corporate governance.
- Report has made suggestions to reform and update the basic corporate legal framework essential for sustainable economic reform.
- Since a board of directors is seen as a primary source of creating competitive advantage and, in turn, shareholder value in the global marketplace, the quality of corporate governance has been rightly stressed in the report.
- Calls for a significant shift from a `government approval' regime to a `shareholder approval and disclosures' regime.
- This is commendable more so as the committee recognizes the key role of the triumvirate of CEO, CFO and Company Secretary. The burden of responsibility and accountability to all stakeholders will vest on the shoulders of this trio.



*Keenan*



# **Independent Director – Clause 49**

**Definition of 'Independent Director' is now wider and includes a Non-Executive Director (NED), who**

**Does not have any material pecuniary relationships or transactions with the company's associates**

**Is not related to promoters or persons occupying management positions at the Board level or a level below**

**Has not been a company executive in past 3 years**

**Is not/was not in last 3 years a partner or executive of the statutory audit/internal audit/consulting firm**

**Is not a material supplier, service provider, customer, lessor or lessee of the company**

**Does not own 2% or more of voting shares**

# **Role & Responsibilities**

- **At least one Independent Director to be present on the Boards of all material subsidiaries**
- **Minutes of the Board meeting of a subsidiary to be tabled at board meeting of parent company**
- **Significant transactions or arrangements entered into by each subsidiary to be reported to the Board periodically**
- **Audit Committee to have minimum of three directors as members, of which two-thirds must be Independent Directors**
- **Independent Director to be Chairman of Audit Committee and be present at AGM to answer shareholders queries**
- **A minimum of two Independent Directors to be present at AGM**

# Remuneration of Independent Directors

- **Prior approval of shareholders required in a general meeting for all fees and compensation paid to NEDs**
- **Maximum number of stock options for NEDs including independent directors in a financial year to be specified in shareholders' resolution**
- **Criteria of making payments to NEDs to be disclosed either in the annual report or on the website**
- **Number of shares and convertible instruments held by NEDs to be disclosed in Annual Report**
- **Shareholding of persons proposed to be appointed as NEDs to be disclosed in the notice if the general meeting called for appointment of the directors**

# Challenges for Independent Directors

- Formulation and execution of strategy
- Audit and assurance process
- Shareholder and stakeholder communications
- Legal and regulatory compliance
- Enterprise risk management
- Organisational ethics, brand loyalty, and employee retention

**An organization must manage a host of governance related activities and expectations that affect its ability to create and sustain value**

# **III. DIRECTORS' REMUNERATION**

- **Executive Pay, an Unsettled Issue**
- **Emphasis on Transparency and Disclosure**
- **Pay as a Reward for Performance**
- **Performance Hurdles**
- **Remuneration Committee**
- **Severance Payments**
- **Other Remuneration Packages**

# Directors' Remuneration in India

Remuneration shall include,

- (a) any expenditure incurred by the company in providing any rent free accommodation, or any other benefit or amenity in respect of accommodation free of charge, to any director or manager;
- (b) any expenditure incurred by the company in providing any other benefit or amenity free of charge or at a concessional rate to any of the person aforesaid;

# **Directors' Remuneration in India**

- (c) any expenditure incurred by the company in respect of any obligation, or service, which but for such expenditure by the company, would have been incurred by any of the persons aforesaid; and**
- (d) any expenditure incurred by the company to effect any insurance on the life of, or to provide any pension, annuity or gratuity for, any of persons aforesaid or his spouse or child.**

# Prohibition of Tax-free Payments

**According to Section 200 of the Companies Act:**

- (1) No company shall pay to any officer or employee thereof, whether in his capacity as such or otherwise, remuneration free of any tax, or otherwise calculated by reference to, or varying with, any tax payable by him, or the rate or standard rate of any such tax, or the amount thereof.**



## **IV FAMILY-OWNED BUSINESSES AND CORPORATE GOVERNANCE**

The board of directors, including chairmen and managing directors, consisted of family members with a couple of directors from funding financial institutions and perhaps a couple of outside passive directors.

**Prof.N.Balasubramanian in his article: “Economic Reforms,Corporate Boards, and Governance” provide a profile of the post-reforms corporate board.**

- (a) Family concerns will turn professional in order to face successfully competition and market forces.**
- (a) Members of the board will be persons with technical and managerial capabilities “Who can guide and oversee operating management in the discharge of their functions”.**

- (c) The practice of one person combining in himself both the positions of Chairman and CEO will sooner rather than later, come to an end.
  
- (c) Rubber stamp boards will be a relic of the past, prompted and goaded by SEBI and its guidelines, board members would be expected to devote more time and show commitment.

- (e) Boards delegating specific tasks such as audit, remuneration and appointments to committees with members having professional expertise will be a normal phenomenon.
- (e) Transparency in reporting and full disclosures will be norms.
- (e) Guidelines on corporate governance all over the world insist on independence of audit, and this will be observed by boards in India too. Boards will have to ensure unattached and professionally competent auditors audit the company's accounts.

- (h) The highest priority of the boards would be to ensure long-term maximisation of shareholder value and wealth. Better corporate performance through legitimate and transparent policies will enrich shareholders. Accountability to shareholders does not mean, that other stakeholders such as customers and employees would have to be excluded, as the respective objectives are not naturally exclusive.**
  
- (h) Since boards will have to shoulder greater responsibility, bear risk and manage uncertainty with a great deal of pressure on them to perform, their members would have to be compensated adequately and appropriately.**
  
- (h) Corporate social responsibility would become part and parcel of the duties of boards of directors.**

- (k) Companies in India emulating the examples of Western countries, would have their own corporate governance rules that clearly describe their vision, value systems and board responsibilities.
  
- (k) Companies would in due course put in place an appropriate whistle blower policy enabling both the board and senior management take corrective measures to stem the rot.

# Some Pioneering Indian Boards

1. The foray of Infosys Technologies into consultancy and Business Process Outsourcing (BPO) from its original profile of just a services company was prompted by its proactive board.
2. The Industrial Credit and Investment Corporation of India (ICICI), has an active board. The board initiated and helped actively the merger of the ICICI and its banking arm. . The ICICI Bank also insists that its middle level managers make presentations to the board regularly.

- (3) The board of the fast-growing Chennai-based pharmaceutical company, Orchid Chemicals and Pharmaceuticals Ltd, directed its Managing Director to seek the advice of the international consultant, Mckinsey and Co. on his growth strategy for the company.**
  
- (3) The board of Chennai-based Polaris Software Lab. forced its Chairman and Managing Director not to acquire any new business at the peak of dotcom boom, but instead to consolidate the company's business.**
  
- (3) Godrej Consumer Products consulted the Confederation of Indian Industry (CII) for forming its board. The CII advised the company to choose independent professionals and not industrialists.**



# CONCLUSION

- In the new era, the board of directors has to shoulder larger responsibilities to meet the increasing demand of the market place.
- The Board of Directors expected to play a powerful role in such a metamorphosis the world is waiting to see happen.