A Study on Role of Independent Directors in Protecting the Rights of Minority Shareholders

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Abstract

The section 149(4) of the Companies Act, 2013 states that every listed public company must have at least one-third of the total number of directors as Independent Directors. The role of the independent directors in Corporate Governance has recently come into scrutiny. The emergence of the concept of Independent Directors has improved the conditions of the boardroom according to some. It has been considered as an effective deterrent to fraud and mismanagement by some. The Independent Directors are not appointed by any specific shareholder and their first allegiance is to the welfare of the company. In theory, the Independent directors do not have any specific interest in the company and hence, they present a neutral view in their voting and other affairs of the company. However, the Independent director can be subject to dismissal by voting by a majority shareholder. The powers held by Independent directors can also be used by them in protecting the rights of minority shareholders by objecting to policies which are only in favour of one side. The role of the Independent Directors has become very important in Corporate Governance and their role in protecting the rights of minority shareholders is discussed in research paper.

Key Words: Independent, minority, shareholders, company, voting.
1. Introduction

The section 149(4) of the Companies Act, 2013 states that every listed public company must have at least one-third of the total number of directors as Independent Directors(Singh 2015). The increase in the number of minority shareholders has increased the need for the Independent directors. The corporate governance has gone over many changes in the recent years and the concept of Independent Directors is one of the most important changes among those. In 2009, the role of Independent Directors took a huge dent both in India and overseas after the Satyam scam. Large number of Independent Directors resigned the post which highlighted the powerless state of the Independent directors in the Indian Corporate Governance. The position of Independent Directors in a corporate governance dominated by promoters and controllers was very weak. According to the definition by International Finance Corporation, Independent directors must fulfill certain minimum requirements. The standard must be maintained in appointing the Independent directors to ensure integrity of decision making. The Independent directors must be unhampered by the circumstances to ensure their decision making is neutral.

The main objective of this research paper is to explain the role of the Independent Directors in the Corporate Governance at present and also explore their role in protecting the rights of the minority shareholders. There have been some research papers done on the role of independent directors after the events in 2009 but the main focus of this research paper is to study the role of independent directors in protecting the rights of minority shareholders.

Objectives

- To explore the duties of Independent Directors in Corporate Governance.
- To analyse the role of Independent Directors in protecting the rights of minority shareholders.
- To suggest measures to protect the rights of minority shareholders.

Hypothesis

The Independent Directors are not equipped with enough powers to protect the rights of minority shareholders.

2. Review of Literature

The board Independence is thought to be an important step in ensuring the better functioning of the Independent Directors in Corporate Governance (Gupta). The Liberalisation Privatisation and Globalisation of 1991 played a vital role in the emergence of Independent directors in India(Koshy). The

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1 Avtar Singh, Company Law, Eastern Book Company, 2016
2 (n.d.). Indicative Independent Director Definition - IFC. Retrieved June 1, 2018, from https://www.ifc.org/wps/wcm/connect/9d10d4804091a9a7b3f4b3cdd0ee9c33/Independent+Director+IFC+Definition+2012.pdf?MOD=AJPERES
presence of Independent directors improves the quality of Corporate Governance (Lawrence and Stapledon). The independent director has to make the declaration of his independence at first meeting of the board and subsequently during every financial year the company and the independent director must abide by the provisions of Schedule IV (Mittal). Thus, the Independent Director cannot be held accountable for matters outside his purview and knowledge (Clarke). Clause 49 provides that the Independent Director of a Company shall hold a meeting by only inviting independent directors (Singh 2015). The recent exposure of high-profile cases of fraud in India shows that the Independent Directors are taking interest in reviewing fraud risk management framework which was drafted to mitigate the risk of fraud (Ringe). The wealth maximisation has become the key corporate objective of the shareholders, legislators all over the world have understood the role the independent directors can play in protecting the rights of minority shareholders (Iwu-Egwuonwu 2010). Companies may bear the fruit of independent directors by having a same person as an Independent directors of all those companies, it may help in smooth functioning of all those companies without conflicts (Ferrarini).

**Methodology**

Narrative and Descriptive methodologies are used by the researcher for the study.

**Sources of Study**

Only Secondary sources are referred for this research paper.

Secondary sources are in the form of Books and Articles

**3. Powers and Duties of Independent Directors**

The concept of “Invisible hand” (Smith, Adam) proposed by Adam Smith cannot be applied to the work of Independent Directors as their main role is in making sure that they use their utmost powers for the welfare of the company and the minority shareholders. The Independent Director is required to hold a very neutral view and should not have any interest in the company to function effectively and in the same time looking out for the welfare of the company. The Liberalisation Privatisation and Globalisation of 1991 played a vital role in the emergence of Independent directors in India (Koshy). The presence of Independent directors improves the quality of Corporate Governance (Lawrence and Stapledon). The board Independence is thought to be an important step in ensuring the better functioning of the Independent Directors in Corporate
Governance(Gupta). Thus, the need for Independent directors has increased to maintain the neutral functioning of the company. The Companies Act, 2013 has provisions for the Independent Directors. Section 149(4) of the Companies Act, 2013 talks about the Independent Directors. Every listed Public Company is required to have at least one-third of its total number of directors as Independent Directors. The central government may prescribe the minimum number of independent directors in class or classes of public companies(Arindam).

The independent director, must be in the opinion of the board, a person of integrity, must possess relevant expertise and experience as per section 149(4)(a), he should not be a promoter of the company or of the holding or subsidiary company. He should have no pecuniary relations with the company and he should also not have relatives who have pecuniary relationships with the company. The independent director has to make the declaration of his independence at first meeting of the board and subsequently during every financial year the company and the company and the independent director must abide by the provisions of Schedule IV(Mittal).

**The Role of Independent Directors**

The role of an independent director is of great importance to the company and its stakeholders. Schedule IV of the Act puts down certain functions for the Independent Directors like protecting the interest of stakeholders mainly the minority holders, bringing together and harmonising the conflicting interest of the minority shareholders, analysing the management’s performance, Resolving in situations where the management and shareholders are in conflict. The Independent Directors must keep themselves updated about the position, activities of the company and the external environment in which it operates. They should not reveal confidential information of the company unless approved by board or permitted by Law. They must actively participate in the committees of the board as Chairpersons or members. They should keep on refreshing their skills, knowledge and familiarity with the company, regularly attending the General Meeting of the company, among many other duties. The familiarization programmes have been introduced whereby the directors would be know with their role and functions in the company(Khanna).

Clause 49 provides that the Independent Director of a Company shall hold a meeting by only inviting independent directors(Singh 2015). Analysing the performance of the other directors, assessing the quality and quantity of

5 (n.d.). Indepency of Independent Directors in Corporate Governance - ICSI. Retrieved June 1, 2018, from (M. Gupta)


information exchange between the Company and the Board are the objectives of
the meeting. The Act requires them to meet at least one time a year to evaluate
the performance of the chairperson of the company. This would aid immensely
in ensuring proper and smooth functioning of the Board of Directors of the
Company (Geof).10

The 2013 Act limits the liability of the independent directors to matters relatable
to them. Section 149 (12) limits the liability of an Independent Directors “only
in respect of acts of omission or commission by a company which had occurred
with his knowledge, attributable through board processes, and with his consent
or connivance or where he had not acted diligently” (Bath). Thus, the
Independent Director cannot be held accountable for matters outside his
purview and knowledge (Clarke).11

Independent Directors help in fraud prevention and detection. The recent
exposure of high-profile cases of fraud in India shows that the Independent
Directors are taking interest in reviewing fraud risk management framework
which was drafted to mitigate the risk of fraud (Ringe). Thus, the Independent
Directors are vested with many powers which help them in smooth functioning
of the company and at the same time protect the interest of the stakeholders
(Clarke; Abdullah). This puts them in the position where they must
protect the interest of the shareholders.12

4. Independent Directors and
Minority Shareholders

The wealth maximisation has become the key corporate objective of the
shareholders, legislators all over the world have understood the role the
independent directors can play in protecting the rights of minority shareholders
(Iwu-Egwuonwu 2010).

Clause 49 of the Listing Agreement in India expects the boards to have at least
one-third of independent directors in listed companies which have non
executive chairman. If the board has an executing chairman, then the
independent directors must be half of them.13

11 (n.d.). Independent Directors After the Crisis | Corporate Governance | Board .... Retrieved June 1, 2018,
12 (n.d.). Exploring the Motives of Appointing Independent Directors .... Retrieved June 1, 2018, from
In theory, this is a great idea, to have independent directors who voice the rights of the minority shareholders and the common interest of the company, but practically it is impossible as most of the independent directors are in favour of the management and remain loyal to them as they get their jobs because of them. The independent directors who vote against the interest of the majority shareholder risks losing their job. In many cases, the directors appointed may be very neutral and just, but may not be competent enough to run the company smoothly or may not have enough knowledge in corporate affairs, even though, there is no direct link between the financial status of a company and the number of independent directors, it is important that they function properly to run the company smoothly and without major conflicts. Those Directors who are competent mostly stay loyal to those who appointed them (Fogel).

A company which appoints more independent directors after disappointing performances cannot be expected to improve overnight. The independent directors may not sometimes have sufficient knowledge about the company as there are appointed in terms and suffer from having no continuity in a particular company (Qing). The Independent directors can be directors at many companies at the same time when it is seen as a prestigious position and thus, it may affect their knowledge about the functioning of the company (Dube).

The financial situation of a company, in connection with the independent directors is directly connected to the qualities of the independent director. A person can be Independent director only in 20 companies as per section 164 of the companies Act, 2013. The talented people are appointed by top companies and can simultaneously manage the affairs of all these companies, however some companies are stuck with non competent directors who cannot manage efficiently and their involvement may not have any impact on the performance of the company Group. Companies may bear the fruit of independent directors by having a same person as an Independent directors of all those companies, it may help in smooth functioning of all those companies without conflicts (Ferrarini).

**Protection of Rights of Minority Shareholders**

In a democracy, there is always a group of persons who are affected by the decisions by the other group or the majority. In a governance of a country, it is balanced by having an opposition party to voice the opinion of those who voted against the ruling party. In corporate governance, it can only be balanced if the independent directors decide to voice their opinion for the rights of minority shareholders. It is not the primary job of the independent directors to fight for the rights of minority shareholders, the first allegiance of an independent director is to the company. The director must put the interest of the company first, rather than individuals or the minority. However, it does not release the independent directors from the job of protecting the rights of minority. The majority rule prevails in all companies and the tribunal has the power to control it in certain circumstances. Only in exceptional cases, the tribunal steps in. It is
the duty of these directors to look after the interest of minority shareholders (Hora). The independent directors must work as vigilant watchdogs. The independent directors must have increased responsibility for the better functioning. The role of independent directors is to provide a balance of power in board and management structure (Pritchard). The independent directors must use this power provided to them to attain justice for the shareholders who are affected by the decision of the majority (Bebchuk). The principle of independent directors has been universally accepted as the right model for running a company (Davies). The independent directors are accountable to public investors and effectively in protecting the rights of the minority shareholders. However, they have not been effective enough in protecting their rights and the concept of independent directors is something that needs reform for better functioning (A. Gupta).

In the daily operating of an organization, bound choices ought to be taken relating to the management of the corporate and these choices square measure typically taken by the bulk members. during this method of decision-making, there could arise bound occasions whereby the interests of the bulk shareholders could be available conflict therewith of the minority shareholders. In such a case, if the choices taken, aren't within the larger interest of the corporate as a full, however solely caters to the interest of 1 specific cluster, the minority cluster whose interest could be profaned will raise its voice against such an action.

The protection of minority shareholders in the domain of company activity constitutes one of the foremost issues facing fashionable companies Act. The aim should be to strike a balance between the effective management of the corporate and also the interest of the little individual shareholders. It is solely right to expect that in matters of an organization, any choices that square measure taken square measure done thus to keep with principles of natural justice and honest play. just in case of failure to try and do so, it is necessary that the interest of minority shareholders be protected. within the gift analysis paper, the target of the scientist is to appear into the topic of the protection of the interest of minority shareholders. On doing thus, The rights of the majority shareholders and minority rights throughout the history of common law can be examined. The rule relating to the majority rule and minority rights shall be examined. Even though the courts have mostly dominated in favour of the majority rule, there square measure bound things but, whereby this rule might

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15 (n.d.). Monitoring of Corporate Groups by Independent Directors. Retrieved June 1, 2018, from https://repository.law.umich.edu/cgi/viewcontent.cgi?article=2722&context=articles
not be applicable. The rule ordered down in Foss v. Harbottle extends to cases wherever the companies square measure competent to formalize social control sins. Exceptional cases but, could exist wherever no majority shareholders will approve or affirm. In such cases each stockholder could sue to enforce obligations owed to the corporate. Herein, the stockholder becomes a representative of the “corporate interest”. Following square measure the exceptions to the rule of majority: Acts ultra vires – A stockholder will bring an action against the corporate in matters that square measure ‘ultra vires’ and that no majority shareholders will sanction. The rule from Foss v. Harbottle isn't applicable in cases wherever the corporate exceeds its powers. This was seen within the case of Bharat Insurance Co. Ltd v. Kanhaiya Lal, wherever the litigant, who was a stockholder of a respondent company, complained regarding many investments being created by the corporate while not adequate security, that was contrary to the note and so, sought a enjoining against the corporate creating any such more investments. The court ruling for the litigant same that even if in matters of internal management, the corporate was the simplest choose and also the rule was that the court mustn’t interfere, application of assets of an organization wasn't just a matter of internal management, within the instant case, the corporate administrators were acting ultra vires and so, one stockholder was eligible to bring an action against the corporate. It is necessary to notice but, that the plaintiff’s own conduct ought to be right once suing the corporate, within the event of a minority stockholder suing the corporate, there’s the question of procedural device, and so for the sake of doing justice to the corporate that is being controlled by offender administrators, the court could step in to verify whether or not the litigant is that the correct person to sue the corporate. If the plaintiff’s conduct could imperil just relief from being allotted to the corporate or if there’s an undue delay in transportation an action, the court could refuse to just accept the plaintiff’s action. A majority completing a fraud on the minority is additionally an exception to the bulk rule. A discontent minority shareholder has three general statutory remedies against unfairness on the part of people who manage the corporate beneath the amended firms Act of 1985. These square measure as follows: Firstly, it provides minority shareholders a special remedy in things wherever they need bee treated below the belt and detrimentally. Secondy, minority shareholders square measure permissable to enforce bound claims of the corporate free from the restrictions obligatory by the rule of majority once the corporate is aroused. Lastly, the minority shareholders square measure permissable to get remedies indirectly through an investigation of the company’s affairs by the inspectors appointed by the Secretary of State for Trade and trade, who could follow up the inspector’s report by taking remedial action. With regard to unfair treatment, an aggrieved member will gift a relief petition to any court, (in follow, all petitions square measure given to the businesses Court, which might order for the effecting of the corporate, on the bottom of conduct that has well-tried to be unfair and

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detrimental to the interest of the members normally or a minority of the members, as well as the petitioner. In the second case, of effecting an organization, an application could also be created to the court by the official receiver, the liquidator or by any someone of the corporate or with leave of the court, by any gift or past member of the corporate, for an order against any gift or past officer of the corporate, anyone who has acted as a liquidator, administrator or body receiver of the corporate or the other one that has been involved or taken half within the promotion, formation or management of the corporate, and who within the case of any such person has misapplied or preserved or become in command of any cash or property of the corporate, or has been guilty of any actusreus or breach of any fiduciary or alternative duty in regard to the corporate. Finally, beneath the third remedy on the market to the minority shareholders, the Secretary for Trade and trade could appoint one or additional inspectors to research the affairs of the corporate. The Secretary of State has the liberty to appoint inspectors beneath any of the on the market grounds of appointment while not having to specify that of the bottom has been relied on. Moreover, he's beneath no obligation to disclose the proof or info that initiated the investigations or the explanations for ordering the investigations. With these statutory rights, the minority has been given additional power than before to hunt remedy for any violation of their rights by the bulk. The minority will currently ask for redressal type the court for any violation of their rights and square measure punctually protected beneath the laws governing the functioning of firms.

The rule regarding protection of minority shareholder’s interest has evolved through a protracted method since the bulk rule was ordered down in Foss v. Harbottle beneath common law. From the rule that minority or one stockholder might not ask for any relief for a right violation, we’ve seen the varied exceptions to the bulk rule that are developed through the varied case laws over the years. The rule stands modified currently and so, minority rights square measure finally protected beneath the law. In fact, the courts dominated that the rule out can't be applied automatically in Asian countries. The courts taking in thought, the actual fact that monetary establishments offer finances to the corporate, although their share-holding could also be tiny, dominated that they must lean a say within the matters of the corporate. In such a scenario applying the bulk rule would be unjust and unworkable. The majority rule was applicable in Asian country from 1843-1956. when the enactment of the Indian firms Act, minority was given bound protections, including protection against oppression and direction, as we’ve already mentioned. On a closing note, it’s fascinating to understand, that in European nation, the law has modified drastically since 1980. Now, just in case of oppression, the minority needn't prove actual oppression however it's spare to indicate unfair prejudice. this is often not the prevailing follow in Asian country, however, it'd be helpful

19 ibid
modification to create more the reason behind protection of interest of minority shareholders.

5. Conclusion and Suggestions

The independent directors play an important role if they can ensure the protection of the interests of minority shareholders. The concept of Independent directors has been recognised by India only in this century whereas countries like America started to follow it in mid 20th century. To improve the situation of the independent directors, the maximum number of companies, a person can be employed as Independent director must be reduced. Currently, a person can be an independent director for 20 companies, it should be reduced so that these people can focus their work on less number of companies which can increase efficiency and their commitment to the cause of the betterment of the company and the rights of the majority shareholders. This may affect the smaller companies who may be left with less number of experienced and efficient independent directors to appoint. To tackle this problem, the awareness of the need for independent directors must be increased, so that it is not viewed as a job for people who are experienced and the young people start to prepare themselves for a job like this and view this as a profession. The independent directors must be given full freedom to express their independent views and they should not be mere watchdogs against the majority or loyal to one group. The main interest of the independent director must be of the company and not anyone else. Interest of the company is of utmost importance. In a democracy, there are always dissenters whose rights are affected. Everyone’s right cannot be protected by independent directors. So, it must be accepted that the interest of the company comes first. Thus, this research shows that the Independent directors are not equipped with enough powers to protect the rights of minority shareholders.

References


