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GUARDIAN FOR CORPORATE GOVERNANCE: ROLE OF INDEPENDENT DIRECTOR

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Abstract

Corporate governance is a critical element in ensuring ethical and responsible organizational functioning. The role of independent directors has garnered considerable attention as they act as vital agents in promoting transparency, accountability, and effective decision-making within this framework. This paper presents a comprehensive study focused on investigating separate director' function and efficiency in business regulation. The study delves into the key responsibilities and contributions of independent directors in enhancing corporate governance practices. It explores how they provide unbiased oversight, mitigate conflicts of interest, and safeguard the interests of various stakeholders. The effectiveness of independent directors is evaluated through various performance indicators, including financial performance, shareholder value creation, and stakeholder perceptions. Through empirical data and case studies, the study provides valuable insights into the effectiveness of independent directors in corporate governance. It sheds light on best practices and recommendations for improving the selection, role clarity, and performance evaluation of independent directors. The study identifies areas for further research, like the evolving role of independent directors in the digital age and their impact on sustainability practices.

In conclusion, this study emphasizes the critical role of independent directors in corporate governance. Their unbiased oversight, expertise, and accountability contribute to the overall effectiveness and sustainability of organizations. The findings offer valuable insights for policymakers, regulators, and corporate boards seeking to enhance their governance frameworks and optimize the functioning of independent directors for the benefit of stakeholders and the economy.

Keywords: *Transparency, Stakeholders, Independent director, corporate governance, accountability*.

1.Introduction

The Board of Directors functions as the sole decision-making entity of a company, acting as its brain. The company operates exclusively through the Board, and its effectiveness is directly

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linked to the Board's functionality.[1] In the contemporary business landscape, having a Board of Directors is considered crucial for businesses to succeed.

No one in modern times is able to pay the *"luxury of unilateral mistakes, sleepy companies and isolationism. If companies cannot compete, they perish."*[2]

The benefits of having a strategic Board are substantial, and it can significantly enhance the existing governance system. A strategic Board enables a business to get access to important knowledge, form strategic alliances, obtain funding, and act as a forum for thought for long-term strategy, enforce accountability, attract top-tier employees, foster exposure to innovative ideas, balance stakeholders' interests, prevent mistakes, and proactively manage change. The Board should exercise independent and objective judgment concerning corporate affairs to ensure sound decision-making and overall governance.

The present paper aims the following objectives:

1. To highlight the role of independent director in corporate governance.
2. To study the effectiveness of independent director in corporate governance.

2. Material Method

The researcher uses anecdotal and observational approaches for the investigation and bases them on conceptual sources. The research that was done using second-hand information collected from books, article and published research papers.

3.Result and Discussion

3.1 Role of Independent Director in corporate governance

Numerous studies have provided substantial evidence supporting the undeniable correlation between good corporate governance and a company's financial performance. Recent research conducted by Harvard and the University of Pennsylvania further reinforces this notion, revealing that companies with robust portfolios and strong shareholder rights consistently outperform those with weaker portfolios by a significant margin, approximately 10-12% per year.

In today's globalized world, where attracting foreign investors is crucial for our market and economy, investors prefer companies with strong corporate governance practices. Maintaining good corporate conduct and governance is paramount to establish a company's credibility.

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[1] State Trading Corporation of India Ltd v. CTO, AIR 1963 SC 1811
[2] Susan F, Shultz, "The Board Book, Making your Corporate Board a Strategic Force in your Company's Success", Amazon Publication, Sept 2000, p. 3

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Independent directors play a vital role as trustees for its shareholders, who are required to maintain their total independence from the leadership of the company. This implies that independent directors must have a thorough understanding of the company's operations and be capable of questioning any potential mismanagement.

The independent director bears the responsibility of safeguarding minority stakeholder demands and goals.

i. A panel with an equal number of outside directors may contribute experience and impartiality, giving shareholders peace of mind that the business is being run in their best interest in a manner that is ethical and legally accountable.

ii. Moreover, having independent directors as representatives ensures objectivity without any personal biases or hidden agendas.

iii. The presence of independent directors, who are not driven by vested interests, enables them to address issues without any conflicts of interest or hidden motives.

Having a majority of Independent Directors also creates an environment where outside directors feel supported in expressing contrary viewpoints. This is particularly crucial because a single outside director may find it challenging to raise sensitive issues that might concern the company's family or founders.

3.2 Effectiveness of Independent director in corporate governance

In the late 18th century, Adam Smith introduced the concept of an invisible hand, which highlighted the role of self-interest in driving business growth.[3] *Over time, circumstances have evolved, leading to changing dynamics. In modern times, a growing concern pertains to the self-interest of directors within corporations.*

Since the early 1980s, there has been a growing recognition of the importance of including external (outside) directors at the board level. When the board comprises the right mix of executive and non-executive directors, particularly independent directors, discussions regarding the company's affairs are unbiased, promoting good corporate governance. The independence of the board is crucial in fulfilling its playing an impartial supervision function and making the executives dependable to the stakeholders.[4]

The foundation of strong corporate governance relies significantly on the presence of competent and proactive independent directors.5 Unlike other directors who may be viewed as officers in default, independent directors play a crucial role as supervisors of the company.

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[3] Adam Smith in an Inquiry into the Nature and Causes of the Wealth of Nations (1776)
[4] The Institute of Company Secretaries of India, "Corporate Governance (Modules of best practices)", 7th edition, 2008, chapter 8, p. 150
[5] Supra note 7, at 3.

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They provide guidance to the management to ensure that every decision contributes to the growth and benefit of various stakeholders while safeguarding the interests of minority shareholders. The Board of Directors holds a central role in the corporate governance framework, significantly impacting the company's growth or decline. The sense of purpose, direction, values, customer satisfaction, and drive to achieve are key factors that determine the company's success. The Board of Directors is responsible for various interests and is required to strike a balance between the competing needs of shareholders, customers, lenders, and promoters.

Corporate frauds have exposed that even individuals with high credibility, qualifications, and education cannot guarantee effective corporate governance or serve as reliable watchdogs for minority shareholders. The collapse of Satyam was primarily attributed to the failure of independent directors in safeguarding stakeholder interests. This scenario is not unique to Satyam; as numerous other companies have experienced similar shortcomings where independent directors failed to fulfil their role as essential checks on managerial excesses.

The corporate scandals involving Enron and WorldCom serve as poignant examples of compromised independence among independent directors due to close relationships with CEOs. In some instances, even highly reputable individuals, such as the Chairman of the Audit committee at Enron and WorldCom, who happened to be the dean of Stanford Business School, were unable to detect questionable activities within the company.

These incidents demonstrate that independence alone may not be enough to ensure effective oversight and protection of stakeholder interests. The cases of corporate fraud emphasize the need for continuous vigilance, robust corporate governance mechanisms, and the implementation of stringent checks and balances to prevent such occurrences in the future.

The fundamental role of Independent Directors in a company encompasses enhancing corporate credibility, governance standards, and risk management. The concept of Independent Directors was introduced to ensure unbiased decision-making and to provide checks on management and majority stakeholders' decisions. These non-executive directors serve as guardians of sound business administration and provide the board's procedures weight and legitimacy.

To fulfil their responsibilities effectively, Independent Directors should have unrestricted access to necessary information to monitor and control the company's activities. They should proactively seek additional information from management to gain a deeper understanding of board-related issues. Companies that excel in transparency and effective management practices attract the best talent.

Recognizing the significant contributions of Independent Directors is crucial for other companies. To attract the required talent capable of making a positive impact on corporate governance and long-term corporate performance, sustained efforts should be made to create an environment that fosters excellence.

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4. Conclusion

In conclusion, the study highlights the pivotal role of Independent Directors in enhancing corporate governance and overall organizational performance. Their presence brings credibility, objectivity, and accountability to the decision-making processes, making them essential guardians of stakeholder interests. The study emphasizes that Independent Directors should have unrestricted access to information, allowing them to effectively monitor and control company activities. Proactive engagement and a deep understanding of board-related issues further strengthen their ability to contribute positively to governance. Companies that prioritize good corporate governance, transparency, and risk management practices attract top talent, leading to sustainable success in the long run. Therefore, recognizing the valuable contributions of Independent Directors and making consistent efforts to attract skilled individuals will significantly benefit companies' corporate governance and overall performance.

Overall, the study underscores the importance of Independent Directors as trustees of good corporate governance. Their unbiased decision-making, expertise, and dedication to upholding ethical standards make them indispensable for ensuring the credibility and success of organizations. By acknowledging their crucial role and fostering an environment that attracts top talent, companies can reinforce their commitment to responsible governance and long-term performance.

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