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REVIEW ARTICLE

COMPANIES ACT 2013- AN INDEPTH ANALYSIS

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ABSTRACT

The Companies Act 2013 regulates incorporation of a company, responsibilities of a company, directors and dissolution of a company. The Act has replaced The Companies Act, 1956. The 2013 Act is divided into 29 chapters containing 470 sections as against 658 Sections in the Companies Act, 1956 and has 7 schedules and came into force on 12 September 2013. The new act has comprehensive provisions related to corporate governance and independent directors. The requirements regarding independent directors prescribed under the Companies Act 2013 are much more stringent than that of the listing agreement. The present paper focuses on the various provisions relating to independent directors as contained in the Companies Act, 2013. Further it also critically analyses these provisions and addresses various concerns regarding board independence. The Companies Act 2013 that replaced the old Companies Act 1956 has been landmark change in the Indian corporate world after almost six decades. The new act has comprehensive provisions related to corporate governance and independent directors. The Companies Act 2013 was passed by the parliament on 29th August, 2013 and was made partially effective by implementing 98 Sections w.e.f. 12th September 2013.

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INTRODUCTION

Section 149(4) of The Companies Act 2013 states that every listed public company shall have at least one-third of the total number of directors as independent directors and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies.

Section 149(6) states that an independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director,

- who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;
- (i) who is or was not a promoter of the company or its holding, subsidiary or associate company
(ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company
- who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

- None of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;
- who, neither himself nor any of his relatives—
 - (i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;
 - (ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—
 - (A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or
 - (B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;

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- (iii) holds together with his relatives two per cent. or more of the total voting power of the company; or
- (iv) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or
- f) who possesses such other qualifications as may be prescribed.

Thus, under the Act, 2013, strict eligibility criteria have been laid down for the appointment of an Independent Director. An Independent Director should not be related to the company or its holding or its subsidiary or its associate company, he himself or his relatives should not have or had any pecuniary relationship or transaction with the company or its holding or its subsidiary or its associate company during the current financial year.

Appointment and Remuneration of Independent Director

The process of identification and appointment of an Independent Director has emerged as an important factor that decides the true independence of the directors. Haldea (2007) in a survey conducted by Prime, found that the Independent Director were mostly handpicked by the shareholders and hence were mere puppets in their hands. Thus a good way to identify and appoint an Independent Director could be to involve a nominations committee that would ensure that biasness and proximity to management, or a majority shareholder, does not influence the selection of Independent Director. Section 150 of the Companies act 2013 states that an independent director could be selected from a data bank maintained by anybody, institute or association, as may be notified by the Central Government and having expertise in creation and maintenance of such data bank. It shall contain names, addresses and qualifications of persons, who are eligible and willing to act as independent directors. Such data bank could be The data bank is required to create and maintain data of persons willing to act as independent director in accordance with such rules as may be prescribed and put on their website for the use by the company making the appointment of such directors. Responsibility of exercising due diligence before selecting a person from the data bank referred to above, as an independent director would however lie with the company making such an appointment. The appointment of independent director shall be approved by the company in the general meeting of the company. The Central Government may prescribe the manner and procedure of selection of independent directors who fulfil the qualifications and requirements as specified. Section 161(2) further provides that no person shall be appointed as an alternate director for an independent director unless he is qualified to be appointed as an independent director under the provisions of this Act.

Declaration of Independence by Independent Director

According to **Section 149(7)** every independent director shall give a declaration that he has met the criteria of independence as provided in the above definition Section 149(6), at the first board meeting in which he participates as a director and thereafter at the first board meeting in every financial year. He

is required to declare to the board that he is independent at the time of his appointment and also whenever there occurs any change that may affect his independence. Both the company and the Independent Director shall abide by the provisions of the act. Also the appointment of Independent Director shall be approved at the meeting of the shareholders and the explanatory statement attached to the notice of the meeting for approving the appointment of an Independent Director shall include a statement that in the opinion of the Board, the Independent Director's proposed to be appointed fulfils the conditions specified in the Act, 2013 and the Rules and the proposed director is independent of the management.

Tenure and remuneration of Independent Directors

Section 152 of the act limits the tenure of an Independent Director by stating that an independent director shall hold office for a term up to five consecutive years on the Board of a company, but shall be eligible for reappointment only on passing of a special resolution by the shareholders. No independent director shall be allowed to hold office for more than two consecutive terms, but such independent director shall be eligible for appointment after a cooling off period of three years. During these three years the concerned director should neither be appointed nor be associated with the company in any other capacity, either directly or indirectly.

Section 197(7) provides that an independent director may receive remuneration by way of sitting fees, reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members but shall not be entitled to any stock option.

Meetings and Committees

Section 173(3) states that a meeting of the Board may be called at notice shorter than seven days if any urgent matter is to be transacted. In such a case at least one independent director should be present at the meeting. In case all the Independent Director's are absent from such a meeting then decisions taken at such a meeting shall be final only on ratification by at least one independent director. The Act, 2013, also requires all the Independent Director's to meet at least once in a year, without the presence of the non-independent directors and members of the management. All the independent directors of the company should try their best to be present at such meetings. The main purpose of such meeting would be to evaluate the performance of the chairperson of the company and review the performance of the non-independent directors and the Board as a whole of the company. The Independent Director's will also be required to assess the quality, quantity and timeliness of flow of information between the company management and the Board for effectively and reasonably performing their duties. These measures would help in ensuring smooth and proper functioning of the company. The Act, 2013 has also emphasized on the appointment of an Independent Director as a member or as a chairperson in various committees. The Companies Act 2013 has mandated the presence of independent directors in certain board committees to overlook the workings of these committees in an unbiased manner.

Section 177(2) provides for the constitution of an Audit Committee of the company which shall consist of a minimum

of three directors with independent directors forming a majority.

Section 178(1) recommends companies to constitute Nomination and Remuneration Committee consisting of three or more non-executive directors out of which not less than one-half shall be independent directors.

Section 135(1) of the act suggests that every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the consisting of three or more directors, out of which at least one director shall be an independent director.

Maximum directorship

Section 165(1) has limited the number of directorships of a director by stating that no person shall hold directorship in more than twenty companies at the same time, provided that maximum directorship in public companies shall not exceed ten. For calculating the limit of public companies, directorship in private companies that are either holding or subsidiary shall also be included. Members of a company may specify a lesser number of companies in which a director can hold directorship by passing a special resolution.

Roles and duties of independent directors

Schedule IV of the companies act lays down a code for independent director's which provides a guide to their professional conduct. Adherence to these standards by independent directors and fulfilment of their responsibilities in a professional and faithful manner is expected to promote confidence of the investment community, particularly minority shareholders, regulators and companies in the institution of Independent directors. The role of an Independent Director is considered to be of a great significance. The guidelines, role and functions and duties and etc are broadly set out in a code described in Schedule IV of the Companies Act, 2013. The code lays down certain critical functions like safeguarding the interest of all stakeholders, particularly the minority holders, harmonizing the conflicting interest of the stakeholders, analyzing the performance of management, mediating in situations like conflict between management and the shareholder's interest and etc. The code also lays down certain important duties like keeping themselves updated about the company and the external environment in which it operates, not disclosing important and confidential information of the company unless approved by the board or required by law, actively participating in committees of the board in which they are chairperson or members, keeping themselves update and undertaking appropriate induction and refreshing their knowledge, skills and familiarity with the company, regularly attend the general meetings of the company and etc. There are certain guidelines laid down for the independent directors that expect them to uphold ethical standards of integrity and probity and act objectively while exercising his duties. The independent directors are required to devote sufficient time and attention towards the company and exercise his responsibilities in a bona fide manner in the interest of the company. The Independent Director is expected not to abuse his for personal advantage or advantage for any associated

person whether direct or indirect. He should refrain from any activity that would lead to loss of his independence and should always strive to assist the company in implementing the best corporate governance practices.

Evaluation mechanism of independent directors

The act also provides for performance evaluation of independent directors by the entire board of directors, except the director being evaluated. On the basis of the report of performance evaluation, it shall be decided whether or not to extend the term of appointment of the independent director.

Resignation or Removal of Independent directors

The Act states in the code that resignation or removal of an independent director shall be in the same manner as is provided in sections 168 and 169 of the Act. An independent director who resigns or is removed from the Board of the company shall be replaced by a new independent director within a period of not more than one hundred and eighty days from the date of such resignation or removal, as the case may be. If the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply. As per section 161(2) no person shall be appointed as an alternate director for an independent director unless he himself is qualified to be appointed as an independent director.

Liability of Independent directors

The Act, 2013, has sought to balance the wide nature of the obligations, functions and duties imposed on an Independent Director. The Act, 2013, restricts and limits the liability of Independent Director's to the matters which are directly relatable to them. Section 149(12) states that an independent director shall be held liable, only in respect of such 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. Nominee directors, despite not being considered as 'independent' under the new definition, would nevertheless be eligible for immunity, as long as they are non-executive. The new concept of having Independent Director is a welcome step for corporate governance in India. The Act, 2013 has conferred greater empowerment upon Independent Director's to ensure that the management and affairs of a company are run in a fair and smooth manner. But, at the same time, greater accountability has also been placed upon them. The Act, 2013 has empowered the Independent Director's to have a definite 'say' in the management of a company, which would thereby immensely strengthen the corporate governance. However it is also important to keep in mind that good corporate governance cannot be achieved by only appropriate selection and effective functioning of Independent Director's. Every director, whether independent/non independent, executive/non-executive has a distinct role in the functioning of the company. It is only when the entire board functions effectively it results into good corporate governance and benefits all stakeholders including minority as well as majority shareholder. This also helps in maintaining a good corporate image in the market thereby leading to increased investor confidence.

Critical Analyses of Companies Act 2013

It is evident from the provisions of the act that high importance has been placed on ensuring greater independence of independent directors. However, while the new act required an independent director to be a person of integrity, relevant expertise and experience, it failed to intricate on the standards required for determining such a criteria. The act has stated that the individual should possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company's business to be an Independent Director in a company. This means that listed companies will be required to exercise their own judgment in the appointment of independent directors. Thus shareholders can no more appoint friends or distant relatives, as directors. Companies need to find independent directors with varied skills and experience. Moreover, the universe of companies that is required to appoint Independent Director's has also increased. Apart from all listed companies, unlisted public companies with either share capital of Rs 10 crore or more, or turnover of Rs 100 crore or more, or outstanding loans/debentures/deposits exceeding Rs 50 crore are also required to appoint at least two independent directors. Even in case of listed companies that were already having right mix of independent directors, the requirements of the new act have become far more stringent that may lead to disqualification of some of the existing independent directors.

Apart from the fact that companies are required to test persons against all the criteria laid down in the act to ensure that they qualify as 'independent directors', it will be difficult to convince people to become independent directors on the Boards of companies in light of the stringent and onerous responsibilities, duties and penalties associated with the position of independent directors. The act has restricted the company to allot stock options to independent directors. There are people who feel that the remuneration drawn by directors is less as compared to the risk associated with it. These people will further be demotivated to accept directorship positions if ESOP's are banned. Secondly, Independent directors can be held liable for wrong deeds of a company, if it's proven they had not objected to those deeds or decisions or that they had not exercised due diligence. Thus this would further demotivate them towards accepting independent directorship positions. Thus, while companies have been scrambling to find fit candidates for board positions, risk aversion on the part of individuals has prompted many to turn down the proposition. The demand for independent directors in India is set to increase and its supply limited. These harsh and inflexible provisions will deter people from becoming independent directors, creating a scarcity of persons interested in being appointed on Boards as independent directors. Another drawback of the act relates with the provisions regarding the tenure of independent director.

Though the act restricts the tenure of directors to two terms of five years but Independent directors need not resign from the boards of the companies where they are serving as independent directors from many years as the Act does not apply retrospectively. Thus if the existing Independent Director's on the board satisfy rest of the qualifications and conditions for appointment of independent directors they can enjoy two more terms of five years and serve on the board for another ten years before being disassociated from the company for a cooling off period of three years.

Thus it is seen that corporate governance norms are dynamic in nature and require reconfiguration periodically to keep pace with the changing climate. While several concerns regarding board independence have been addressed in the act, some areas require refining and the implementation could give rise to various difficulties.

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