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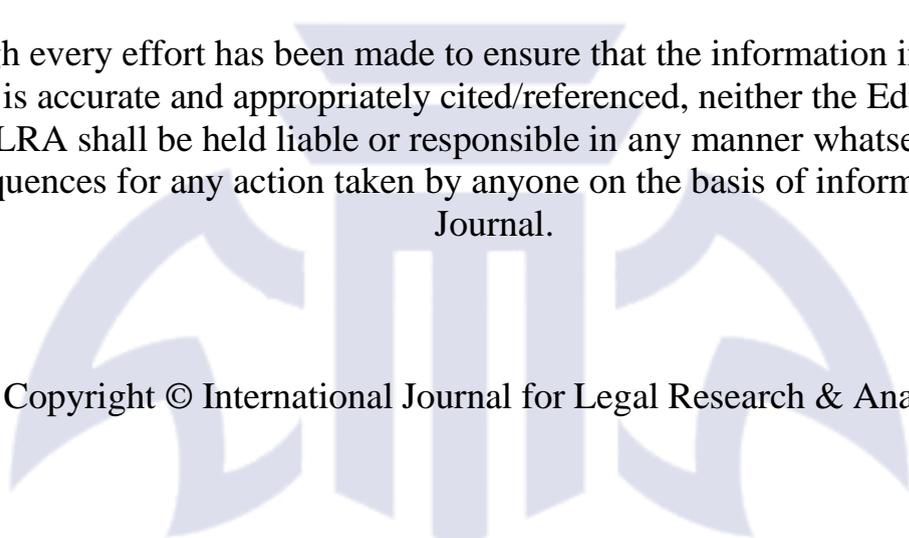
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# **INDIAN FAMILY MANAGED COMPANIES:** **THE CORPORATE GOVERNANCE** **CONUNDRUM-**

AUTHORED BY - GOPIKA BANSAL

## **ABSTRACT:**

Approximately one-third of the Sensex enterprises are pushed, controlled, and managed by family members<sup>1</sup>. These are large Indian corporations that must have expanded beyond the family's control and bounds by their size. However, there are still many organizations in the industrialized world that have been founded and managed by family members, and a significant number of them have accomplished separating management from ownership. Unfortunately, the scenario in India is far from ideal. Even though their stake is small in contrast to other holdings, the promoters are closely engaged in the day-to-day operation and manage the businesses as their private property. As a result, this research paper recognises that there are numerous aspects to consider concerning the role of the board of directors, selection criteria, and independent director independence with the help of various case studies. Furthermore, it proposes that specific efforts be taken to avoid any instances of governance failures in the Indian sector by being proactive and implementing "best" and "next" practices.

## **RESEARCH PAPER:**

Corporate governance, as a subject, has been into recognition in the corporate world and businesses globally. In India, overwhelming attention is being given to it. Corporate governance is of utmost importance as a system of rules, practices, and processes is formed through which a company is controlled and governed. Balance of interest is maintained between the shareholders, suppliers, executive management, administrative members, customers, and the community, and it promotes

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<sup>1</sup> Sathesh Kumar, 'Indian Family Managed Companies: The Corporate Governance Conundrum' (Research Gate, 2022)

<[https://www.researchgate.net/publication/313564124\\_Indian\\_Family\\_Managed\\_Companies\\_The\\_Corporate\\_Governance\\_Conundrum](https://www.researchgate.net/publication/313564124_Indian_Family_Managed_Companies_The_Corporate_Governance_Conundrum)> accessed 6 May 2022.

ethical business practices further toward financial viability<sup>2</sup>. The listed companies must comply with the SEBI deadline and fulfil the criteria/requirements given under Clause 49 of the listing agreements<sup>3</sup>.

With the corporate governance scenario at Indian family-managed companies, the organizational structure and its governance give an appearance of complication. Countries like the United States and the United Kingdom have successfully delineated management from ownership. However, India is yet to cover the grounds in this regard. The feud between the known entity of Reliance, the Ambani brothers, is one example that opens the floor for debate on governance issues and family-managed companies. On the board, multiple positions are allotted to the family members at the same time when management positions are held, arising as a cause of conflict of interest.

In an Indian family-managed business, when business expansions start, the structure of power, ownership, and process should be formalized as a priority to promote professionalism. Thus, separation of management from the control of ownership is imperative to corporate governance to maximize the benefits pertaining to it and assure sustainability in business.<sup>4</sup>

Thus, this paper addresses the issues pertaining in family managed businesses in India related to corporate governance and classifies such problems broadly into two-

- Has the board of directors in Indian family-managed companies been constructive in promoting corporate governance?
- Whether the appointed independent directors are truly independent and problems of finding the right calibre of independent directors in required numbers.

Thus, this paper raises the concerns that need immediate attention in Indian family-managed companies on corporate governance and suggests specific steps to secure a better corporate world.

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<sup>2</sup> James Chen, 'What Corporate Governance Means For The Bottom Line' (*Investopedia*, 2022) <<https://www.investopedia.com/terms/c/corporategovernance.asp>> accessed 7 May 2022.

<sup>3</sup> Clause 49 of "Listing agreement" deals with the complete guidelines for corporate governance.

<sup>4</sup> Rishabh Shroff and Saloni Shroff, 'Opinion: Corporate Governance In Family Businesses' (*mint*, 2022) <<https://www.livemint.com/opinion/online-views/opinion-corporate-governance-in-family-businesses-1551117458528.html>> accessed 7 May 2022.

## BOARD OF DIRECTORS AND THEIR ROLES:

The Indian Family system, a cohesive force, usually binds individuals to run business with families. Surprisingly, many corporates are managed and promoted by family, yet news of corporate failure because of lack of corporate governance and poor results are minimal to none<sup>5</sup>. The chief reasoning for this must be the promoters who bring the family having enlightening behaviour of considering themselves at the position of trustees of public wealth even when holding huge shareholding in the company.

Family-run businesses are not limited to India. It is to be noticed that initially, developed nations also promoted and managed companies in a family setup. Later, segregation between management and ownership was encouraged in family-owned companies to willfully utilizes all the benefits of ownership and minimize conflict of interest and intrusion in decision-making. While in India, the promoters are proactively part of the daily functioning and management of the company.

It leads us to the question- *who are the ones who manage a company?* It is the directors whose job is to manage and control the affairs of a company. A group of these directors in a company is called the Board of Directors. Collectively, it is the responsibility of this group of directors or board of directors to manage and protect the interest of its stakeholders.

The next question is, *what happens when ownership is not separated from management in the family-managed businesses?*

We all are aware that India is an emotionally driven society, especially when it comes to families. It is not easy to demarcate these lines. One major drawback of not separating ownership from management in a family-managed company is the high probability of making corporate decisions influenced by family emotions.<sup>6</sup> Another issue is that for non-family member employees, the working environment is not very pleasing as they could be treated differently from other family members and

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<sup>5</sup> Soutik Biswas, 'Why Indians Continue To Live In Joint Families' (*BBC News*, 2022) <<https://www.bbc.com/news/world-asia-india-54053091>> accessed 11 May 2022.

<sup>6</sup> Core.ac.uk. 2022. [online] Available at: <<https://core.ac.uk/download/pdf/213958222.pdf>> [Accessed 10 May 2022].

the growth prospects for them are limited. All this combined makes it a hindrance in the growth and development of these companies.

The governance system is not in its best position in India and is suited to be explained with the example of **Reliance Industries Ltd., (RIL)** the most significant private-sector enterprise. As per the relevant information available through the issuance of a report from the media made public, the case raised the question of whether one person could only take an essential decision as of demerger or restructuring of the company on behalf of the company. Even though the disagreement was amicably settled between the Ambani brothers, Mrs Kokilaben, the family's head holding 34% of the RIL shareholding, the decision to demerge the company was in question; that it was in the interest of the remaining shareholders holding 66% or not?

The board of directors in any company hold specific fiduciary duties that need to be complied with, which consist of the duty of trust, legitimacy, care, upholding the corporate governance values, critical review, and independent thoughts, upholding primary loyalty to the director's position, delivering primary tasks and roles of the board, corporate responsibility, protecting the interest of the minority owners, and learning, communicating, and developing. In this case, none of the board of directors during the whole episode took the duty of exercising their authority and power by putting forth the more significant number of shareholders' interests.

Not only this, but even the shareholders were missing in raising the question of the absence of the board of directors in decision making.

To figure out in the Company Act, 2013, Section 166 talks about the duties of the directors which acts as safeguards.

It provides that directors carry the duty of care for their shareholders. It is their responsibility to take care that they are taking care of their actions carefully, and importantly, they should be making independent judgments. Moreover, they should perform their duties as well as obligations effectively. It is also the responsibility of the directors to think about the shareholders as a whole. It should take

care of the benefits of the company, employees, and shareholders.<sup>7</sup>

When we talk about the RIL board of directors performing their fiduciary duty, glaring omissions have been found and revealed. RIL has been in the news multiple times for breaching the governance, and allegations of their practices have been put forth throughout these years of financial success and rewards.

A general thought has been built upon corporate governance among the existing experts; **Dr Ram Charan's** beliefs are considered to be prominent, stating that no positive change in results could be found in governance through structural changes as even now, many family managed companies in India are not complying with the objective criteria.<sup>8</sup>

As per Clause 49 of the listing agreement, companies that are listed have an obligation to form a report based on corporate governance. Through the analysis of these reports, one can easily find out that the intention of these companies rather than being on performance is based on conformance. One such example is **Mr. M.L. Bhakta**, who has been an independent director since 1977 on the RIL board, meeting all the requirements for being an independent director.

In 1977, RIL went public, and there are total chances of him also being a promoter nominee. His independence at his job remains a mark, as when the Ambani brother's dispute on ownership was going on, his resignation was taken as the answer. He is also seen to be a partner at RIL's Solicitors and Advocates, **M/S Kanga & Company**.

Another famous example of an independent board of directors is **ACC Limited**. **Mr. A.L. Kapur** and **Mr. N.S. Sekhsaria**, independent directors of ACC, were also the whole-time director and managing director respectively of **GACL**, which held approximately 14% of ACC by **Ambuja Cement India Ltd.**, which was its subsidiary. This raised the question of how the directors could be

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<sup>7</sup> Companies Act 2013, s (166)

<sup>8</sup> Charan, Ram, *Boards At Work: How Corporate Boards Create Competitive Advantage*, San

Francisco, Jossey-Bass, 1998, Charan, Ram, *Boards That Deliver: Advancing Corporate Governance From Compliance to Competitive Advantage*, San Francisco, Jossey-Bass, 2005.

classified as independent on the board in 2003-04 of ACC.

**Mr. Nusli Wadai** is another example, being a part of three Tata company boards, including **Tata Chemicals, Tata Motors, and Tata Steel**. Holding the position of independent director in all three companies raises suspicion.

Moving back to Reliance Industry Limited, the board of directors could have been more proactive in taking the stand of solving the dispute between the Ambani brothers as they held a fiduciary role to take care of the interest of the remaining shareholders and outsiders who held 66% shares and not leaving it on the family to settle it.

Thus, it is time to realize that family-managed companies in India and their board understand that their responsibility is constructive and rigorous and performing in a passive role is not sufficient. The duty lies with the management and the board to be responsible for the money put by the shareholders. If the failure is on the side of the corporation to create reform and possess improved behaviour, then the regulators or government will have no choice but to enforce stricter laws and conditions.

Even when every expert agrees that board structure modifications will have no significant influence on governance, no necessary steps have been taken by the family-managed companies to establish trust in the eyes of investors and the general public. According to a quick check, three out of the four Tata businesses in the Sensex are seen to have promoter nominations on their audit committees. Furthermore, in the case of the fourth business, one member's independence (Mr J.K. Setna, who sits on the Tata Motors board, as mentioned before) is in question. The Tatas is seen to be at the frontline of upholding strong standards based on sound business ethics. On the surface, all these corporations have quite enough independent directors to staff their audit committees. The audit committee is the only group meant to be completely independent of management. Thus, Indian family-managed companies are implied to play a constructive role.

## - ISSUES RELATED TO INDEPENDENT DIRECTORS:

Talking about the second issue of independent directors, their independence, and the problems of finding the right calibre candidate for such a position required numbers, we need to understand that the board of directors is the most critical and powerful decision-making bod, and its independence is required to ensure good corporate governance standards. The rising number of corporate frauds in India and the increasing number of resignations of independent directors necessitate a welcoming change by reworking existing independent director models. For the first time, the Companies Act of 2013 (new act) provides guidance on the functions and standards that independent directors must strive for and maintain.<sup>9</sup>

The notion of the independent directors and its origins under the current corporate framework is based on recommendations and proposals made by various committees, including the **Kumar Mangalam Birla committee (1999)** and the **Naresh Chandra committee (2002)** as well as the **Narayana Murthy committee (2003)**. The Securities and Exchange Board of India (SEBI) coined the phrase "independent director" by introducing Clause 49 into the Listing Agreement in India.<sup>10</sup>

*"For the purpose of this clause, the expression 'independent directors' means directors who, apart from receiving director's remuneration, do not have any other material pecuniary relationship or transactions with the company, its promoters, its management, or its subsidiaries, which in the board's judgement may affect the independence of judgement of the directors,"* according to clause 49 which provides a comprehensive definition of the independent director<sup>11</sup>. It mandates that at least half of the board shall be independent when an Executive Chairman is available for the company. When a non-executive Chairman is available, the independent directors should make up at least one-third of the board of directors. The non-executive chairman is the only one with which the company, management, promoters, or subsidiaries have a meaningful monetary tie that could impact the judgment's independence. By being the company's considerable shareholders, independent directors

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<sup>9</sup> Vrajlal Sapovadia, 'Corporate Governance Issues In Indian Family-Based Businesses' (Core.ac.uk, 2022) <<https://core.ac.uk/download/pdf/213958222.pdf>> accessed 5 May 2022.

<sup>10</sup> Shinoj Koshy, Preetha S and Vandana V, 'The Responsibilities, Rewards And Liabilities Of Independent Directors Will Be Transformed By The New Companies Act' (Nishithdesai.com, 2022) <[http://nishithdesai.com/Content/document/pdf/ResearchArticles/New\\_directions.pdf](http://nishithdesai.com/Content/document/pdf/ResearchArticles/New_directions.pdf)> accessed 4 May 2022.

<sup>11</sup> Clause 49, Listing Agreement

cannot have the capacity to own 2% or more of the voting shares. They are, however, eligible for remuneration with shareholder approval prior to the decision of the board<sup>12</sup>.

There lies an underlying problem with complying with the independent director's "independence". The subject is an Indian family-run business that requires financing as its growth speeds, resulting in rise in the number of outside owners who may not be family members. This contributes to a focus on management and ownership separation, which stresses professional management and lays the groundwork for corporate governance requirements. Independent directors are selected with the goal of improving good governance. Nonetheless, it remains a "process" because no guarantee exists through any administrative technique. The obligation should use the independent director's fearlessness and openness in calling out those in positions of power to accomplish responsibilities and fulfil the fiduciary duties entrusted to them. Going back to the example of Reliance Industry Limited's board of directors, there existed six of them out of twelve were independent directors at that point in time and even though it occurred to none that the fiduciary duty towards the shareholders should be ensured by keeping the company's future health into mind while taking any decisions.<sup>13</sup>

Independence and governance are not backed by verification of strong corporate governance. It is important to emphasize that trustworthiness cannot be assured by following rules, despite the fact that compliance is required. "*The culture of a corporation dictates how individuals behave when they are not being monitored,*" remarked **Tom Tierney**, former Managing Partner of **Bain & Co.**<sup>14</sup> Companies like **Parmalat, WorldCom, and Enron** have failed due to intolerable cultural crises created and driven solely by their CEOs.

Clause 49 currently stipulates the minimum percentage of independent directors necessary, based on whether the chairman is executive or non-executive. In an Indian family-owned business, this provision is a recipe for disaster. One such example to consider is **Tata Motors**, a subsidiary of the

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<sup>12</sup> Meenu Gupta, 'Independency Of Independent Directors In Corporate Governance' (Icsi.edu) <<https://www.icsi.edu/media/portals/86/Independent%20Directors.pdf>> accessed 7 May 2022.

<sup>13</sup> Satheesh Kumar, 'Indian Family Managed Companies: The Corporate Governance Conundrum' (Research Gate, 2022) <[https://www.researchgate.net/publication/313564124\\_Indian\\_Family\\_Managed\\_Companies\\_The\\_Corporate\\_Governance\\_Conundrum](https://www.researchgate.net/publication/313564124_Indian_Family_Managed_Companies_The_Corporate_Governance_Conundrum)> accessed 6 May 2022.

<sup>14</sup> Tierney Tom, When Something Is Rotten (2002).

**Tata Group. Mr. Ratan Tata** maintained the role of Executive Chairman for almost 65 years. He resigned from his previous position as Non-Executive Chairman due to the popular retirement policy of Tata Group devised by himself for the directors.

It is worth noting that Clause 49 of the listing agreement distinguishes between the executive and non-executive chairmanships, forming an independent component. Nevertheless, Mr Ratan Tata's post-movement from executive chairman to non-executive chairman raised the issue of looking for a shift in the power dynamic within the corporation. It is also worth noting that the company had never had a CEO or Managing Director until **Mr. Ravi Kant** was recently hired. Many family-owned businesses will use this outline. As a result, it is necessary to determine if having independent directors should need to be independent of the chairman would be considerably more widely used than the present Clause 49 provision.<sup>15</sup>

There have also been various market complaints about competent, independent directors not being available. The issue, however, is well within the sector. The reason for this is that because the expectation of finding well-trained and groomed director material available for Indian organizations is there, it needs to be seen that if someone like **Mr. Nusli Wadia** has worked for three major Tata firms for over thirty years, it eliminates the opportunity to give someone else a shot. Companies used to have a bad practice of overburdening strong director candidates with several directorships, which must change. Companies need to look for board members underneath the board level, including vice presidents, general managers, and so on, and focus on finding the "functional and right" match rather than someone who is "known and famous."<sup>16</sup>

Expectations should be reasonable and commensurate to the time frame. The notion of becoming valuable and productive right away is unrealistic. The members under consideration have a history of demanding core managers who should be given the opportunity to grow as directors to improve

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<sup>15</sup> Satheesh Kumar, 'Indian Family Managed Companies: The Corporate Governance Conundrum' (Research Gate, 2022) <[https://www.researchgate.net/publication/313564124\\_Indian\\_Family\\_Managed\\_Companies\\_The\\_Corporate\\_Governance\\_Conundrum](https://www.researchgate.net/publication/313564124_Indian_Family_Managed_Companies_The_Corporate_Governance_Conundrum)> accessed 6 May 2022.

<sup>16</sup> Satheesh Kumar, 'Indian Family Managed Companies: The Corporate Governance Conundrum' (Research Gate, 2022) <[https://www.researchgate.net/publication/313564124\\_Indian\\_Family\\_Managed\\_Companies\\_The\\_Corporate\\_Governance\\_Conundrum](https://www.researchgate.net/publication/313564124_Indian_Family_Managed_Companies_The_Corporate_Governance_Conundrum)> accessed 6 May 2022.

performance through orientation and training<sup>17</sup>. The immediate result is unlikely to demonstrate its worth, and such a person should be given ample opportunity to contribute. A senior independent director must supervise such kinds of independent directors to ensure effective leadership. This aspect of director development is a grey area in our boardrooms. In this arena, none of the corporations has taken any steps. Training and development are essential for directors because their talents differ significantly from those of managers.<sup>18</sup>

## - FUTURE STEPS AND PRACTICES SUGGESTED:

Particular suggestions should be taken into consideration to build a setup in Indian family-managed companies where corporate governance is of utmost importance, and the practices followed are instrumental.

- ***True independence must be achieved-*** Independent directors should not own any firm shares. They, too, will not be given options. It is unethical to compensate them with choices under the guise of aligning oneself with the shareholders. The overall response to shareholding by independent directors is ironic. Because authorities believe that independence would be lost (or that they might align more often with shareholders with reasonable percentages and therefore acquire vested interests), the current legislation stipulates those independent directors own no more than 2%. Simultaneously, authorities have agreed with the corporate argument that independent directors will be much more united with other shareholders if they own stock in the company, questioning the sanctity of the 2%.
- ***Independent Directors should be adequately compensated-*** Independent directors should not take up too many directorships, as this will dilute their engagement. CEO of Genpact, Mr Pramod Bhasin, recently brought this up at the CII Corporate Governance Series in Delhi<sup>19</sup>.

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<sup>17</sup> Role Of Independent Directors In Family Business Governance' (Newsletter, 2022)

<<https://newsletters.isb.edu/FamilyBusiness-Newsletter/File/RoleofIndependentDirectors-issue12.pdf>> accessed 4 May 2022.

<sup>18</sup> Jyoti Bowen Nath Nath, 'Ind Directors On Board Can Help Family-Run Cos Take Off - Times Of India' (The Times of India, 2022) <<https://timesofindia.indiatimes.com/business/india-business/ind-directors-on-boardcanhelp-family-run-cos-take-off/articleshow/91295790.cms>> accessed 6 May 2022.

<sup>19</sup> Real Estate and others, 'Is The Board Preparing Your Company For The Future?' (*Thehindubusinessline.com*, 2022) <<https://www.thehindubusinessline.com/specials/new-manager/is-the-board-preparing-your-company-for-the-future/article64547371.ece>> accessed 11 May 2022.

If independent directors wish to contribute to any business, directors should limit their directorships to three to four. However, there is currently one issue. Directors who are not elsewhere employed must take on multiple directorships to maintain an acceptable quality of life that they were accustomed to when in executive positions, as even giant corporations pay them a pittance. For example, in a business-like RIL, the most significant salary an independent director (who also serves on a few committees) earns is Rs.0.58 million, compared to Rs.217.2 million for the CEO. The compensation must be commensurate with their efforts. Assuming that the average CEO works at least 14 hours per day, the independent director will be paid around the same hourly basis as the CEO for the estimated number of hours he will spend preparing for and attending board/committee meetings.

- Examine the performance-. The board will be subjected to a performance evaluation. A method of self-evaluation for the board as a whole and individual directors will be implemented. At least once a year, evaluations should be conducted. The approach will also include peer review.<sup>20</sup>
- A sharp divide between business and emotions- Division between emotions and business is necessary for the effective operation of the company. At the end of the day, the business should be about competing on a worldwide level with other businesses, not internal conflicts among members of the same firm, therefore the obligation of explaining every member's clearly defined tasks to them falls on the shoulders of the family's leader.
- Clarity and transparency in leadership- After the death or incapacity of the former leader, a clear process for selecting the next-of-kin to transmit the baton must be established. When no such strategy is in place, it could lead to confusion and anarchy, putting the company's foundations at risk.
- Democracy- A healthy and disciplined business practice requires participatory decision-making and a democratically elected board of directors. Particularly in the case of family

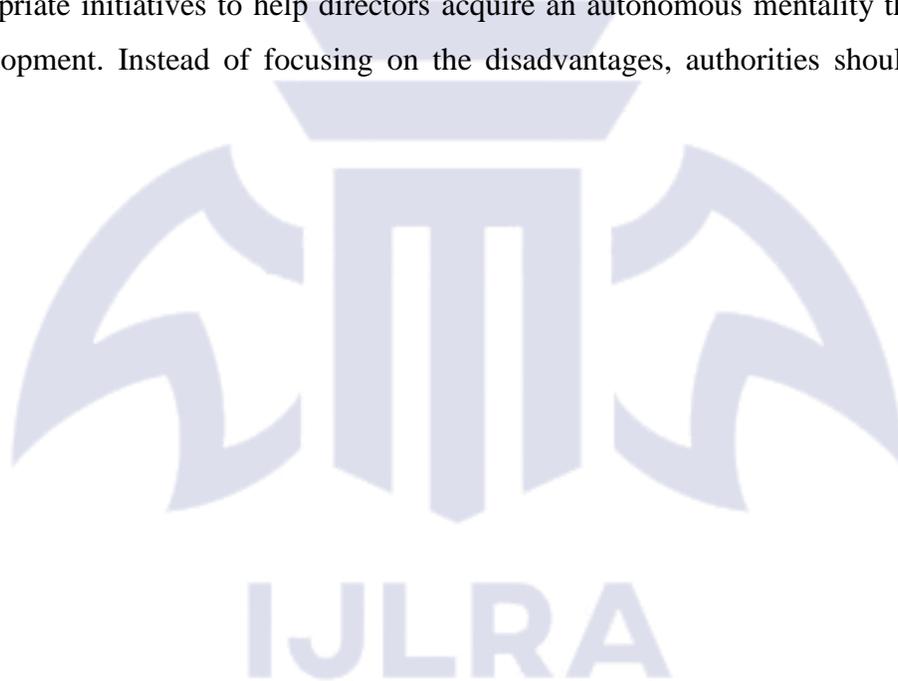
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<sup>20</sup> Meenu Gupta, 'Independency of Independent Directors In Corporate Governance' (Icsi.edu) <<https://www.icsi.edu/media/portals/86/Independent%20Directors.pdf>> accessed 7 May 2022.

enterprises, which are prone to nepotism and favouritism.<sup>21</sup>

## **- CONCLUSION:**

Although there have been no known corporate collapses due to inadequate corporate governance, and several significant instances of family-owned businesses with visionary leadership, current revelations have unlocked Pandora's box regarding corporate governance practices in India. FMCs in India have a long road ahead to implement the best and following practices to establish a new paradigm. Changes will be made voluntarily by corporations and boards of directors. They must employ appropriate initiatives to help directors acquire an autonomous mentality through ongoing director development. Instead of focusing on the disadvantages, authorities should focus on the positives.



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<sup>21</sup> Meenu Gupta, 'Independency Of Independent Directors In Corporate Governance' (Icsi.edu) <<https://www.icsi.edu/media/portals/86/Independent%20Directors.pdf>> accessed 7 May 2022.