

The Trilemma of Indian Independent Directors: Concerns and Directions for Reform

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Abstract

Independent Directors (IDs) have long been hailed as the ‘monitors’ of India Inc. As the Covid-19 pandemic brought about an unprecedented environment of uncertainty, the risk of unethical conduct on corporate boards also increased manifold. During these times, the monitoring role of IDs gained even more significance. However, studies show that in the year 2020, there was a 45 per cent increase in the rate of resignations by IDs from companies listed on the National Stock Exchange (NSE) as compared to 2019 and an 80 per cent increase when compared to the rate of resignations in 2018. Why are IDs abandoning India Inc.? Is India heading towards another corporate governance crisis? Can the amendments have introduced by the Indian Ministry of Corporate Affairs in 2021 resolve this impending crisis? This paper aims to tackle these questions by analysing the reasons behind this alarming rate of resignations, studying the effects of the same on the share market and discussing a way forward. To do so, this paper examines whether this impending crisis is a result of (1) the gaps in the legislative drafting for the protection of IDs; (2) negative corporate attitude towards ID; (3) or both. The article also undertakes empirical legal research by analysing the fluctuation in share prices of the top 50 companies in India listed on the NSE (by market capitalisation) in response to the announcement of their IDs’ resignation. In doing so, we study the nexus between IDs’ resignation, the reasons thereof, the fluctuation in share price, and trading volume. In the third section, it examines the avenues for averting this crisis of resignation by IDs. The findings of this study indicate that there is a pressing need to reevaluate the legal

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position of IDs in India Inc. Finally, it highlights the avenues for averting this crisis.

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I. Introduction

The Covid-19 pandemic shook India's corporate environment at its core. In such a precarious situation with an increased risk of unethical conduct on boards, the role of Independent Directors (IDs) gains significant importance as they are hailed as the 'watchdogs' of the corporate landscape.³ However, between 2018-2020 there was an 80 per cent increase in the rate of resignations by IDs from companies listed on the National Stock Exchange (NSE).⁴ This steep rise in resignations by IDs in India becomes especially problematic when we compare it to the position of the United States of America (USA) in 2020, where the average tenure of IDs was 12.7 years.⁵

In this context, this paper raises the following research questions: what is the reason behind this stark difference? Considering that the very concept of IDs has

³ Rica Bhattacharyya, *Covid-19 crisis increases risk of unethical conduct in corporate India : EY survey* THE ECONOMIC TIMES, (June 25, 2020,3:35 PM) <<https://economictimes.indiatimes.com/news/company/corporate-trends/covid-19-crisis-increases-risk-of-unethical-conduct-in-corporate-india-ey-survey/articleshow/76623451.cms>. (Last visited on January 26, 2021).

⁴ Kala Vijayaghavan, Maulik Vyas & Lijee Philip, *Why are Independent Directors Resigning in Drove* THE ECONOMIC TIMES, (7THSEPTEMBER,2020) <https://economictimes.indiatimes.com/markets/stocks/news/exodus-of-ind-directors-gains-pace-on-reputational-and-legal-concerns/articleshow/77966601.cms?from=mdr> (Last visited on January 26, 2021).

⁵ SPENCER STUART, 2020 U.S. SPENCER STUART BOARD INDEX (2020) <https://www.spencerstuart.com/-/media/2020/december/ssbi2020/us_spencer_stuart_board_index_2020.pdf. (Last visited on March 26 2021)

been adopted from the west,⁶ why are Indian IDs resigning in such high numbers while IDs in the USA serve long tenures? Further, while such a steep rise in resignations by IDs poses concerns for Indian regulators, should individual companies also be concerned? This paper aims to analyse and answer these questions in the following manner:

First, this study will undertake a three-fold analysis of the reasons behind IDs' resignations by identifying the three Phases in which their efficacy in India has been compromised. *Second*, this study analyses the effect of IDs' resignation on the company's performance in the secondary market. *Third*, we put forth some suggestions for developing the position of IDs in the legal and corporate landscape of India Inc.

II. Three Reasons Behind Increasing Resignations by IDs

IDs, like all economic entities, are rational actors in the market. Their actions and inactions are motivated by the rational choice theory, which dictates that every economic actor will undertake their own cost-benefit analysis to determine whether a task is worth pursuing.⁷ Thus, to determine the reasons behind the mass exit of IDs in India, we shall conduct a cost-benefit analysis from the point of view of IDs. Cost-benefit analysis is the process by which a rational economic actor (here, an ID) measures the benefits associated with taking an action against the costs associated with the same and undertakes a balancing exercise to decide whether that act must be done.⁸ This analysis shall be conducted across the three phases of operation that impact the position of IDs in India. These are: (1) India's corporate shareholding structure, (2) legislative provisions, and (3) corporate environment & attitude.

⁶ Umakanth Varottil, Evolution and Effectiveness of Independent Directors in Indian Corporate Governance 6(2) HASTINGS BUSINESS LAW JOURNAL (2010)

⁷ Gary Browning, Abigail Halcli & Frank Webster, Understanding Contemporary Society: Theories of the Present (2012).

⁸ Rodreck David, Patrick Ngulube & Adock Dube, A Cost-Benefit Analysis of Document Management Strategies used at a Financial Institution in Zimbabwe: A Case Study, 15(10) SA JOURNAL OF INFORMATION MANAGEMENT, 1, 1-10 (2013).

A. The Incapacitation of IDs in India's Corporate Shareholding Structure

To appreciate the role of IDs in the business and regulatory landscape of India, its legal framework must be looked at in the context of the agency theory.⁹ As postulated by Berle and Means, the agency theory states that the company's separation of ownership and management creates two distinct groups in the company: the shareholders and the management.¹⁰ As the shareholders' and managers' interest in the company differs in nature, their interests may conflict in certain scenarios. In such cases, the shareholders have to incur 'agency costs' to ensure that the managers don't favour their own personal interest and are responsive to the shareholders' interests.¹¹

Further, in companies with concentrated shareholding, a second agency problem arises between the controlling and minority shareholders.¹² By virtue of their voting power, controlling shareholders enjoy a level of control over the company's decision-making.¹³ In such cases, 'agency costs' are incurred to ensure that the majority shareholders don't expropriate the minority shareholders.¹⁴

Agency theorists argue that a company's 'agency costs' can be effectively mitigated through good corporate governance,¹⁵ which largely depends on the

⁹ See: Haslinda Abdullah & Benedict Valentine, *Fundamental and Ethics Theories of Corporate Governance*, 4 MIDDLE EASTERN FINANCE AND ECONOMICS (2009); Shann Turnbull, *Corporate Governance: Theories, Challenges and Paradigms* 1(1) GOUVERNANCE REVUE INTERNATIONALE (2000)

¹⁰ Adolf A. Berle & Gardiner Means, *The Modern Corporation and Private Properties* (Macmillan 1932).

¹¹ John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems, Legal Strategies and Enforcement*, Oxford Legal Studies Research Paper No. 21/2009 (2009)

¹² BERLE AND MEANS, *supra* note 8.

¹³ BERLE AND MEANS, *supra* note 8.

¹⁴ Armour, Hansmann & Kraakman, *supra* note 9.

¹⁵ BERLE AND MEANS, *supra* note 8; Eugene Fama & Michael Jensen, *Separation of Ownership and Control*, 26(2) JOURNAL OF LAW AND ECONOMICS (1983).

See also: PRASANNA KRISHNA. CORPORATE GOVERNANCE: INDEPENDENT DIRECTORS AND FINANCIAL PERFORMANCE: AN EMPIRICAL ANALYSIS (Indian Institute of Capital Markets 9th Capital Markets Conference 2006) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=877807 (Last visited on March 21, 2021)

efficacy of the role of IDs.¹⁶ However, it is imperative to note that the role of IDs originated in the USA only to tackle the first agency problem and monitor the constituency of managers in the context of the country's dispersed shareholding patterns.¹⁷ On the contrary, Indian listed companies tend to have concentrated shareholding patterns and suffer from the second agency problem highlighted above.¹⁸ The controlling shareholders (who are often the promoters) of such companies not only have the power to 'hire and fire' directors,¹⁹ but also hold the loyalty of domestic financial institutions.²⁰ As a result, it becomes difficult for the board to challenge the controlling shareholders or go against their interests.

In this context, the exploitation of minority shareholders to serve the interests of controlling shareholders becomes a serious concern for corporate governance,²¹ and Indian IDs are expected to safeguard the minority's interests.²² However, as discussed above, controlling shareholders hold the power to remove any director from the board. This creates a peculiar position wherein Indian IDs are subject to the control of the very constituency that they are expected to monitor.²³ Thus, the concentrated shareholding pattern of India Inc., incapacitates its IDs and limits their efficacy.

¹⁶ MEENU GUPTA, A STUDY ON INDEPENDENCY OF INDEPENDENT DIRECTORS IN CORPORATE GOVERNANCE, (ICSI) <https://www.icsi.edu/media/portals/86/Independent%20Directors.pdf>. (Last visited on March 23, 2021)

¹⁷ Shweta Mehrotra, *Corporate Board Structure in the United States and India: A Comparative View*, 8(2) INDIAN JOURNAL OF CORPORATE GOVERNANCE, 166, 166–186 (2015); VAROTTIL, *supra* note 4.

¹⁸ Arjya Majumdar, *Convergence in corporate governance: the case of China and India*, 7(1) BRICS LAW JOURNAL, 59, 59-90 (2020).

¹⁹ BERLE & MEANS, *supra* note 8; MAJUMDAR, *supra* note 19; VAROTTIL, *supra* note 4.

²⁰ Neeti Shikha, *Corporate governance in India – a paradigm shift*, 8(2) INTERNATIONAL JOURNAL OF CORPORATE GOVERNANCE, 81, 81–105 (2017).

²¹ Neeti Shikha & Rishika Mishra, *Corporate Governance in India – Battle of Stakes*, 10(1) INTERNATIONAL JOURNAL OF CORPORATE GOVERNANCE (2019) 1; VAROTTIL, *supra* note 4; MAJUMDAR, *supra* note 16; María Gutiérrez & Maribel Sáez, *Deconstructing Independent Directors*, 13(1) JOURNAL OF CORPORATE LAW STUDIES, 63-94 (2013)

²² Companies Act, 2013, Schedule IV § II (5), No.18, Acts of Parliament (India).

²³ VAROTTIL, *supra* note 4.

While this peculiarity can be resolved by adapting the office of IDs to meet the needs of the Indian position, we shall see in phase two, how the law fails to address the concerns of phase one and continues and further compromises the efficacy of IDs in India.

B. Legislative Provisions and their Effect on IDs

As a result of the second agency problem in India, IDs face the additional obligation to protect minority shareholders from the majority. However, we argue that the Indian law does not provide IDs with equivalent protection, incentives, or statutory powers to carry out these obligations. In this section, we will discuss this imbalance by highlighting the various facets of Indian law that have failed to account for the power held by controlling shareholders and the legal risks associated with the post of IDs.

i. Power of Controlling Shareholders to Control the Appointment and Removal of IDs.

According to *Section 150(1)* of the *Companies Act, 2013*, IDs should be selected from a data bank of eligible individuals. However, studies have found that the most common practice of appointing IDs is to hire the people recommended by the promoters.²⁴ Such widespread disregard for legal provisions points towards a clear difference between prescription and practice in India Inc.

Moreover, *Section 178* of the *Companies Act, 2013* suffers from grave practical oversight. The Section requires a Nomination and Remuneration Committee (NRC) to be formed for the identification and recommendation of qualified individuals for the post of IDs. These recommendations are made to the board, and after their approval, the candidate's appointment is put to vote in the General Body Meeting (GBM). This process is flawed due to the following reasons.

The NRC is formed by directors currently working at the company,²⁵ whose removal is in the hands of the controlling shareholders. Additionally, the

²⁴ INDIAN INSTITUTE OF CORPORATE AFFAIRS, RESEARCH REPORT ON 'DISCIPLINE OF INDEPENDENT DIRECTORS: FROM CODE TO CONTRIBUTION (2019) https://iica.nic.in/images/ID%20Research%20Report%2013_03_19.pdf . (Last visited on April 18, 2021)

²⁵ Companies Act, 2013 s 178, No.18, Acts of Parliament (2013) (India).

independence of such committees must be looked at in the context of the practical realities of India Inc. As business connections are the “steppingstones to success” and “give and take is the norm” in India’s corporate world,²⁶ there is little chance of the NRC recommending candidates that the controlling shareholders disapprove of.

Even if the NRC is assumed to be free of the controlling shareholders’ influence, the candidates will ultimately have to be voted upon in a GBM, where the controlling shareholders have the power to block the candidate’s appointment.²⁷ Therefore, the NRC is compelled to function in the shadow of the controlling shareholders’ decisions.

To address these shortcomings, The Securities and Exchanges Board of India (SEBI) released a consultative paper in March 2021, recommending IDs to be appointed by a special resolution with a majority of non-promoter shareholders approving the appointment.²⁸ These changes were partially implemented in August 2021 through amendments made to the *SEBI (Listing Obligations and Disclosure Requirements) Regulation, 2015* wherein the appointment and removal of ID can only happen through a special resolution passed by the members of the company.²⁹ However, the amendment fails to protect IDs from the influence of controlling shareholders because of three reasons. *First*, it entails that three times of the votes cast against are required in the GBM to appoint an ID. Thus, it becomes easier for controlling shareholders to only appoint candidates who are loyal to them and veto the others. *Second*, the amendment fails to account for the first drawback of the appointment process discussed

²⁶ Shital Jhunhunwala, *Are Committees Independent?*, 10(1), INDIAN JOURNAL OF CORPORATE GOVERNANCE (2017)

²⁷ Umakanth Varottil, *Appointment and Removal of Independent Directors: Need for Reform?*, INDIA CORP LAW, (December 25, 2016) <https://indiakorplaw.in/2016/12/appointment-and-removal-of-independen.html>. (Last visited on April 29, 2021)

²⁸ Securities and Exchanges Board of India, *Consultation Paper on Review of Regulatory Provisions related to Independent Directors (2021)* https://www.sebi.gov.in/reports-and-statistics/reports/mar-2021/consultation-paper-on-review-of-regulatory-provisions-related-to-independent-directors_49336.html. (Last visited on May 2, 2021)

²⁹ SEBI (Listing Obligations and Disclosure Requirements) Regulation, Regulation 25(2A) (2015) (India).

above. As a result, candidates who are not loyal to the controlling shareholders may not even be recommended by the NRC, let alone be appointed as IDs of the company. *Third*, even if the controlling shareholders do not have 75 per cent of the total votes, it must be noted that the minority shareholders are usually diffused and passive.³⁰ As a result, the controlling shareholders' influence at the GBM far exceeds their total voting capacity, and they might still be able to remove IDs who are not loyal to their interests.

Further, the reputational harm caused to an ID by a company voting upon their removal in the General Body Meeting warrants serious consideration by the regulators.³¹ This reputational harm is a significant factor in the cost-benefit analysis that an ID undertakes while deciding whether to resign from a company. This cost-benefit analysis will be discussed in greater detail in section II(D) of this paper.

The case of *Cyrus Investments v Tata Sons (2019)*³² highlights the extent of power the controlling shareholders have in practice over the removal of IDs and the resultant reputational harm caused to them. In 2016, Tata Sons removed its Chairman, Cyrus Mistry. When Nusli Wadia, an ID of various Tata Group companies, spoke in support of Cyrus Mistry, he was also removed from the board for 'acting in concert with Cyrus Mistry against the interest of principal shareholder'.³³ Subsequently, Nusli Wadia was removed from all Tata Group company boards wherein he served as an ID.³⁴ An ID from one of the Tata Group companies also alleged that the Tatas shared a note seeking the expulsion of Nusli

³⁰ Indian Institute of Corporate Affairs, *supra* note 22.

³¹ Albert Cannella, Jr., Donald Fraser, D. Scott Lee & Matthew Semadeni, *Fight or flight: managing stigma in executive careers*, 29(5) STRATEGIC MANAGEMENT JOURNAL, 557, 557–567 (2008)

³² *Cyrus Investments Pvt. Ltd. v. Tata Sons Ltd.*, 858 SCC NCLAT (2019).

³³ Cyrus Mistry complained of mismanagement within the company. He attributed his ouster to the corporate governance issues within the company, especially concerning the separation of powers between the promoters and the management. See: Shital Jhunjhunwala, *Tata Sons and the Mystery of Mistry*, 45(3) VIKALPA: THE JOURNAL FOR DECISION MAKERS (2020)

³⁴ *Nusli Wadia voted out of all Tata Group company boards* HINDU BUSINESS LINE, (January 16, 2018, 2:37AM) <https://www.thehindubusinessline.com/companies/nusli-wadia-voted-out-of-all-tata-group-company-boards/article9443531.ece> (Last visited on May 5, 2021)

Wadia because he “did not serve the interest of the group”.³⁵ The ID who divulged this Information chose to remain anonymous, which points towards the fear of apprehension that IDs face on their boards.³⁶

The severe and constant attacks from the media and the Tata group following Nusli Wadia’s removal as an ID led him to file a defamation case against the Tata group, but the supreme court asked the parties to talk amongst themselves and ‘reach an amicable solution’.³⁷ This inaction of the court can be attributed to the ‘business judgement rule’ in corporate law that leads the judiciary to incline towards upholding business decisions unless the contrary is proven by concrete evidence.³⁸ This defamation was an opportunity for the Supreme Court to address the severe risk of reputational harm to IDs that has been identified by various Indian studies to be a strong motivator for IDs’ resignations.³⁹

ii. Legal Risks Associated with the Post of an ID

The duties of Indian IDs are listed under Section 166 read with Schedule IV of the *Companies Act, 2013*. While studies have successfully shown that legal

³⁵ Shally Seth Mohile, *Is Tata Sons Right in Seeking Nusli Wadia’s Expulsion*, LIVEMINT, (November 17, 2016, 3:47AM) <https://www.livemint.com/Companies/gAKkMI6ycCoArsnaYfs7xJ/Is-Tata-Sons-right-in-seeking-Nusli-Wadias-expulsion.html>. (Last visited on May 15, 2021)

³⁶ *Id.*

³⁷ *You both are leaders in the industry, why don't you talk and resolve the issue', Supreme Court tells Ratan Tata, Nusli Wadia*, FIRSTPOST, January 6, 2020 <https://www.firstpost.com/business/you-both-are-leaders-in-the-industry-why-dont-you-talk-and-resolve-the-issue-supreme-court-tells-ratan-tata-nusli-wadia-7866241.html>. (Last visited on June 6, 2021)

³⁸ SHIKHA & MISHRA, *supra* note 19.

³⁹ Bhumes Verma, *MCA Breather for Independent Directors*, SCC ONLINE BLOG, (July 18, 2020) <https://www.sconline.com/blog/post/2020/07/18/mca-breather-for-independent-directors/> (Last visited on June 16, 2021); Arunima Haldar *Assessment of the Role of Independent Director and its Effectiveness for the Growth and Development of Shareholders’ Value of the Firm*, S.P. JAIN INSTITUTE OF MANAGEMENT AND RESEARCH (2017); Vikramaditya Khanna & Shaun Mathew, *The Role Of Independent Directors In Controlled Firms In India: Preliminary Interview Evidencer*, 22(1) NATIONAL LAW SCHOOL OF INDIA REVIEW (2010).

liability deters individuals from serving as IDs,⁴⁰ we shall discuss in this section how Indian laws disregard this consideration by imposing onerous obligations on IDs, that increase the level of legal risks they face.⁴¹ We will highlight these legal risks by discussing the shortcomings of the legal protection granted to IDs to fulfil their obligations.

a) *Inefficacy of the ‘Safe Haven’ Provision under Section 149(12) of the Companies Act, 2013.*

Under *Schedule IV* of the *Companies Act, 2013*, IDs are required to monitor the performance of the board, scrutinise the ‘integrity of financial statements’ and ensure that there exist robust financial controls in the company.⁴² If an ID overlooks financial any ‘red flags’ or fails to ask appropriate questions, it would lead to the facilitation of false and misleading disclosures.⁴³ However, it is imperative to note that despite the above-mentioned obligations being placed on IDs, they don’t have any ‘independent’ source of information within the company.⁴⁴ IDs are not involved in day-to-day functioning or operations of the company and they ultimately rely on the information provided by the management to satisfy their obligations. Thus, there is an information asymmetry that the IDs must tackle to fulfil their duties.⁴⁵

⁴⁰ Lakshmi Naaraayanan & Kasper Nielsen, *Does Personal Liability Deter Individuals from Serving as Independent Directors?*, 140(2), JOURNAL OF FINANCIAL ECONOMICS, 621, 621-643 (2021)

⁴¹ Umakanth Varottil, *Director Liability Under the New Regime*, INDIA CORP LAW, June 16, 2014 <https://indiacorplaw.in/2014/06/director-liability-under-new-regime.html>. (Last visited on June 17, 2021)

⁴² Companies Act, Schedule IV (2013) (India).

⁴³ Venkatesh Vijayaraghavan & Akshaya Iyer, *India: Independent Directors: Staying Mindful Of Liabilities*, MONDAQ, (March 20, 2019) <https://www.mondaq.com/india/directors-and-officers/873426/independent-directors-staying-mindful-of-liabilities> (Last visited on July 15, 2021).

⁴⁴ GUTIÉRREZ & SÁEZ, *supra* note 19.

⁴⁵ Kala Vijayaraghavan, Maulik Vyas & Rica Bhattacharyya, *More independent directors take the exit fearing legal scrutiny*, THE ECONOMIC TIMES, (June 21, 2019, 3:17PM) <https://m.economictimes.com/news/company/corporate-trends/more-independent-directors-take-the-exit-fearing-legal-scrutiny/articleshow/69883746.cms>. (Last visited on July 25, 2021).

To account for this information asymmetry, a safe haven for IDs is found in Section 149(12) of *the Companies Act, 2013* which provides that IDs are only liable for those acts or omissions that occurred

- With their knowledge (which is attributable through board processes) or
- With their consent or connivance, or
- Where they did not act diligently.

While this provision intends to safeguard the IDs from being liable for activities outside their purview, in practice, it is riddled with limitations.⁴⁶ By attributing knowledge through board processes, the *Companies Act, 2013* effectually puts IDs in the same position as other directors who attend the meetings.⁴⁷ Additionally, Section 2(60) of the *Companies Act, 2013* entails that even if IDs merely receive minutes of the meetings, they cannot claim lack of knowledge or consent if they have failed to record their reservations/objections against the same.⁴⁸ Thus, the ‘safe harbour’ provision for IDs punishes them not only for their errors but also for their passive negligence, in contrast to the gross negligence standard applied in the US.⁴⁹

To address the above-mentioned limitations, the Ministry of Corporate Affairs issued a Circular in March 2020, stating that no criminal or civil proceedings should be initiated against IDs and Non-Executive Directors (NEDs) of a company unless there is sufficient proof of complicity in the act of fraud/default

⁴⁶ DEBANSHU MUKHERJEE & ASTHA PANDEY, *THE LIABILITY REGIME FOR NON-EXECUTIVE AND INDEPENDENT DIRECTORS IN INDIA: A CASE FOR REFORM* (2019) <https://vidhilegalpolicy.in/research/the-liability-regime-for-non-executive-and-independent-directors-in-india-a-case-for-reform/>. (Last visited on July 25, 2021).

⁴⁷ Lok Sabha Standing Committee on Finance, *The Companies Bill, 2011: Fifty-Seventh Report* (2012) (India)

⁴⁸ ASTHA PANDEY, *SEBI’S CONSULTATION PAPER ON REGULATION OF INDEPENDENT DIRECTORS: AN ASSESSMENT* (2021) <https://vidhilegalpolicy.in/blog/sebis-consultation-paper-on-regulation-of-independent-directors-an-assessment/>. (Last visited on July 25, 2021).

⁴⁹ Brian Cheffins & Bernard Black, *Outside Director Liability Across Countries*, 84 *TEXAS LAW REVIEW*, 1401 (2006).

on their part.⁵⁰ It must be noted that this Circular merely clarifies the interpretation of Section 149(12) of the *Companies Act, 2013* by introducing a principle-based standard operating procedure to be followed by Registrars before indicting IDs. The standard of what constitutes knowledge, consent or connivance remains unchanged. Thus, the shortcomings of Section 149(12), as highlighted above, remain unresolved.

Additionally, the above-mentioned safeguard applies only to proceedings under the *Companies Act, 2013*. There are certain Acts that put IDs on the same level of liability as other directors without any safe haven provisions.⁵¹ Such provisions that hold the IDs personally liable can be seen in the *Income Tax Act, 1961*, *Prevention of Money Laundering Act, 2002*, and the *Black Money Act, 2015*.⁵² The standard of attributing liability under these Acts is much lower than the standard of consent or connivance; if a director is merely negligent and the commission of the offence is attributable to his negligence, he will be held liable under the above-mentioned Acts.⁵³ Further, certain statutes like the *Prevention of Money Laundering Act, 2002*, have stringent conditions for bail and provide for the reversal of the burden of proof,⁵⁴ which results in IDs being indicted even when there is no substantial evidence against them.⁵⁵ Such a fragmented and inconsistent framework of regulations shows a lack of shared understanding amongst regulators on how to adequately protect IDs. Thus, India's safe haven provisions fail to protect IDs from onerous obligations.

b) Overzealous Interpretation of the Law

⁵⁰ Ministry of Corporate Affairs, Clarification on Prosecutions Filed or Internal Adjudication Proceedings initiated Against Independent Directors, Non-Promoters and Non-KMP Non-Executive Directors, GC No. 1/2020 https://www.mca.gov.in/Ministry/pdf/Circular_03032020.pdf. (Last visited on August 1, 2021)

⁵¹ PANDEY, *supra* note 46.

⁵² DEBANSHU MUKHERJEE & ASTHA PANDEY, THE LIABILITY REGIME FOR NON-EXECUTIVE AND INDEPENDENT DIRECTORS IN INDIA: A CASE FOR REFORM (2019) <https://vidhilegalpolicy.in/wp-content/uploads/2019/09/Final-Director-Liability-Report-September-19-2019.pdf>. (Last visited on August 2, 2021)

⁵³ *Id.*

⁵⁴ Prevention of Money-laundering Act, s 24 and s 45 (2002) (India).

⁵⁵ PANDEY, *supra* note 46.

In addition to the inefficacy of safe haven provisions, IDs are at a disadvantage due to the over-zealous interpretation of laws by courts. Even though IDs are not involved in the day-to-day operations of a company, a 2019 report by Vidhi Centre for Legal Policy found that in practice, all directors of a company are incriminated and summoned in complaints of dishonour of cheques.⁵⁶ This is in stark contrast to the rule laid down in *KK Ahuja v VK Vohra* (2009), according to which a ‘specific averment,’ stating that the person was ‘in-charge’ of or ‘responsible’ for the company’s conduct of business, must be made to incriminate or summon IDs.⁵⁷ This striking gap between prescription and practice has been seen in several interim orders issued since 2017 because of the above-mentioned principle being either ignored or wrongfully applied.⁵⁸

The courts have narrowly applied the rule laid down in *KK Ahuja* to allow IDs to be implicated without any particulars to support the ‘specific averment’ against them.⁵⁹ One such case is *Somendra Khosla v State* (2017), where the Delhi high court allowed the complaint and ordered summons to be issued against an ID.⁶⁰ The court’s ruling wholly relied on one statement in the complaint, that alleged (without any particulars to support the averment), that the ID was responsible for the business's day-to-day functioning. Such decisions set a dangerous precedent as they fail to account for the information asymmetry discussed above.⁶¹ This disproportionate involvement of IDs causes them severe inconvenience and reputational harm while placing an unfair burden on them.

⁵⁶ MUKHERJEE & PANDEY, *supra* note 50.

⁵⁷ *KK Ahuja v. VK Vohra*, Criminal Appeal Nos.1130-31 of 2003 (2009).

⁵⁸ *Usha Anantha Subramanian v. Union of India*, 4 SCC 122 (2020); *Chitra Sharma v. Union of India W.P (Civil) No. 744 of 2017* (2017); *Bikram Chatterji v. Union of India W.P (Civil) No. 940 of 2017* (2017).

⁵⁹ *KK Ahuja v. VK Vohra*, Criminal Appeal Nos.1130-31 of 2003 (2009).

⁶⁰ *Somendra Khosla v. State* Criminal Miscellaneous Case 3982 of 2017 (2019).

⁶¹ Kala Vijayraghavan, Maulik Vyas & Rica Bhattacharyya, *More independent directors take the exit fearing legal scrutiny*, THE ECONOMIC TIMES, (June 21, 2019,3:17PM) <https://m.economictimes.com/news/company/corporate-trends/more-independent-directors-take-the-exit-fearing-legal-scrutiny/articleshow/69883746.cms>. (Last visited on August 10, 2021)

C. Corporate Behaviour towards IDs

The onerous obligations and legal risks faced by IDs are matched with a controlling corporate behaviour against them in India Inc. Studies have shown that outside directors do not significantly increase the performance of family-run businesses in India.⁶² This finding can be attributed to the trend of ‘symbolic governance’ prevalent in India wherein IDs are employed to merely satisfy the regulatory requirements and act as puppets of the majority shareholders.⁶³

An IICA study conducted in 2019 revealed that IDs are more concerned with saving themselves from any future implications rather than adding value to the board.⁶⁴ Another study by Tonk showed that 70 per cent of IDs themselves agree that IDs do not regularly seek information on reasons for non-performance.⁶⁵ Such findings point towards the troubling internalisation of passiveness by IDs. The ill-effects of such passiveness were highlighted in the *IL&FS* case, where IDs did not flag any concerns against the group's numerous malfeasances, despite being aware of the same.⁶⁶

This internalisation of passiveness by IDs can be ultimately attributed to the tendency of controlling shareholders to silence or remove IDs who try to flag

⁶² Shireenjit Johl, Beverley Jackling & Mahesh Joshi, *Family Generation, Leadership, and Performance: The Role of Outside Directors in Indian Family Firms*, 8(1) *Corporate Ownership and Control* (2010) <https://virtusinterpress.org/family-generation-leadership-and.html> (last visited on August 10, 2021)

⁶³ GUTIÉRREZ & SÁEZ, *supra* note 19.

⁶⁴ GARIMA DADHICH & VAISHALI ARORA, *RESEARCH REPORT ON DISCIPLINE OF INDEPENDENT DIRECTORS: FROM CODE TO CONTRIBUTION* (2019) <https://iica.nic.in/images/ID%20Research%20Report%2013_03_19.pdf>. (last visited on August 12, 2021).

⁶⁵ Mohinder Tonk, *Independent Directors in Listed Indian Public Sector Enterprises: An Analytical Study*, 3(2) *IJRCM* (2013).

⁶⁶ Rashmi Rajput, *IL&FS case: SFIO files first Chargesheet*, *THE ECONOMIC TIMES*, (May 31, 2019, 8:00AM) <https://economictimes.indiatimes.com/industry/banking/finance/ilfs-case-sfio-files-first-chargesheet/articleshow/69590260.cms>; IANS, *MCA Wants to Question Erstwhile IL&FS 'Independent Directors*, *MONEYLIFE*, (May 14, 2019) <https://www.moneylife.in/article/mca-wants-to-question-erstwhile-ilfs-independent-directors/57156.html>. (Last visited on August 15 2021).

governance concerns with the company.⁶⁷ A 2019 IICA study confirmed this trend by finding that the most common repercussion of expressing dissent during board meetings is their tenure not being extended.⁶⁸ Thus, the overall corporate attitude of India Inc. has reduced IDs to a meaningless symbol of compliance.

D. Cost-Benefit Analysis Undertaken by IDs Before Resigning from a Company

In cases where the IDs sense the possibility of legal non-compliance by the company, they undertake a cost-benefit analysis to determine their course of action vis-à-vis their membership on the board. The benefits associated with directorship include the monetary benefit of remuneration, business relationships as well as building reputation.⁶⁹ On the flip side, the costs associated with directorships are the time commitment, legal risks, and reputational concerns.⁷⁰ When an ID senses the possibility of legal non-compliance by the company, there are three courses of action that they can take: *first*, they can go against the interests of the controlling shareholders, *second*, they can act as per the wishes of the controlling shareholders, and *third*, they can resign.

If the ID opts for the first option and decides to go against the interests of the controlling shareholders, they run the risk of being removed from the board and facing substantial reputational harm.⁷¹ On the contrary, if the ID decides to act as per the whims of the controlling shareholders, they will have to violate their legal obligations and face consequent legal repercussions. The third option for the IDs is to resign from the company and retain their reputation while abandoning their legal obligations. Such abandonment is supported by the finding of the study conducted by Barhava, Huang, Segal, and Segal, which shows that reputational concerns for IDs cause their interests to diverge from that of the shareholders of

⁶⁷ SHIKHA & MISHRA, *supra* note 19.

⁶⁸ DADHICH & ARORA, *supra* note 62 at 47.

⁶⁹ Ronald Masulisa & Shawn Mobbs. Independent Director Incentives: Where do Talented Directors Spend their Limited Time and Energy?, 111(2), JOURNAL OF FINANCIAL ECONOMICS, 406, 406-429 (2014).

⁷⁰ *Id.*

⁷¹ Keren Barhava, Sterling Huang, Benjamin Segal & Dan Segal, *Do independent directors tell the truth, the whole truth, and nothing but the truth when they resign?* JOURNAL OF ACCOUNTING, AUDITING AND FINANCE (2018).

the company.⁷² However, it must be noted that in case of the third option, the compliance requirements, i.e., reasons to be given for an IDs' resignation under Schedule III Part A in Para A, clause 7B(i) of *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015* must also be followed.

Thus, when the ID senses the possibility of a corporate governance crisis, the option that will reduce his cost the most is the third option as they are not violating any legal provisions (given that the compliance requirements under *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015* as discussed above are satisfied) and neither do they face the risk of suffering reputational harm.

Furthermore, the third option benefits the ID while simultaneously reducing his cost, i.e., resigning from the board before he is faced with information that can lead to him being complicit in the wrongdoings of the company/management. Thus, in the current legal and corporate landscape of India, an ID acting as a rational economic entity will choose to resign from the company rather than facing the risk of being removed from the company or prosecuted for the company's wrongdoings.

When seen in the context of the severe and consistent surge in resignations by IDs in recent years, the conclusion arrived at above can be seen as the IDs' version of the 'Wall Street Walk'.⁷³ The problem that arises from this exit haste is that the IDs are bound to be caught in a labyrinth of 'Wall Street Walks' if the trend continues. If IDs continue to exit companies when the going gets rough, rather than making attempts to voice/prevent the wrongdoings, there will always be a possibility of the same dilemma resurfacing, albeit in a different company. Thus, resulting in a constantly increasing rate of resignation by IDs much similar to the trend India has been experiencing in the recent years.⁷⁴ As resignations by

⁷² *Id.*

⁷³ The 'Wall Street Walk' is a common trend amongst retail investors who seek to exit companies when they are unhappy with the company's management/functioning rather than making attempts to impact decision-making within the company through their voting power. See: Anat Admati & Paul Pfleiderer, *The "Wall Street Walk" and Shareholder Activism: Exit as a Form of Voice*, 22(7), THE REVIEW OF FINANCIAL STUDIES, 2645-2685 (2009).

⁷⁴ Vijayraghavan, Vyas & Philip, *supra* note 2.

IDs act as a signalling mechanism for the stakeholders to show that the cost of serving on the concerned board exceeds the benefit therefrom, in the next section, we shall study the effect of such resignation on shareholder confidence in the secondary market.

III. The Effect of IDs' Resignation on Shareholder Confidence

IDs are seen as a fundamental tool for effective corporate governance that, in turn, is aimed at, *inter alia* promoting shareholders' interest. This section aims to study the effect of IDs' resignations on shareholder confidence and company performance in the secondary market with the following objectives:

- To identify the effect of resignations by IDs on the share prices and trading volume of companies.
- To study the variation (if any) in the effect of IDs' resignation on share prices and trading volume in the context of promoter shareholding patterns of the concerned companies.
- To analyse whether the reasons given by IDs for their resignation impact the effect of said resignations on the company's share prices.

Resignations by IDs are seen as a 'signal' that the cost of serving on the concerned board exceeds the benefit therefrom.⁷⁵ Samontaray has shown that there is a significant relationship between the share prices and corporate governance scores of an Indian company.⁷⁶ Gupta and Fields' study on the United States' stock exchanges shows a negative effect of stock price when outside directors resign from boards.⁷⁷ Our motivation to conduct this study comes from the absence of literature in the Indian landscape concerning the effect of resignations by IDs on the share prices and trading volume of the concerned companies in India.

⁷⁵ BARHAVA et al, *supra* note 69.

⁷⁶ Durga Prasad Samontaray, *Impact of Corporate Governance on the Stock Prices of the Nifty 50 Broad Index Listed Companies*, 41 INTERNATIONAL RESEARCH JOURNAL OF FINANCE AND ECONOMICS (2010).

⁷⁷ Manu Gupta & Paige Fields, *Board Independence and Corporate Governance: Evidence From Director Resignations*, 36 (1-2) JOURNAL OF BUSINESS FINANCE AND ACCOUNTING (2009)

Further, Schedule III Part A in Para A, clause 7B(i) of *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015* mandates the disclosure of reasons behind resignations by IDs in listed companies. This part aims to analyse whether the kind of reasons given by IDs for their resignations alter the effect such resignations have on a company's performance in the secondary market. The secondary market performance of a company in terms of share prices and trading volume can be an important indicator of investor/shareholder confidence.⁷⁸ The results of this study will highlight the importance of corporate governance for individual companies, as shareholder confidence and factors affecting the same form the basis of many management decisions in a company.⁷⁹

This part involves a study of the Share-Price data of fifty companies included in the NSE *Nifty-50* index. The 50 companies indexed on NSE Nifty-50 Index account for more than 67 per cent of the free-float market capitalisation of all the stocks listed on NSE.⁸⁰ As the NSE *Nifty-50* index is a barometer for India's stock market,⁸¹ we believe that the findings based on these 50 companies can throw light on the share market's overall situation.

For the purposes of this study, the independent variables have been identified as (i) the date of resignation by IDs, (ii) the reasons given for their resignation, and (iii) promoter shareholding for each of the concerned *Nifty-50* indexed companies. The dependent variables have been identified as the (i) Effect on Share Price of the company and (ii) Effect on Total Traded Quantity of Shares.

⁷⁸ Austin Murphy & Lian Fu, An Empirical Analysis of Investor Confidence Incorporated in Market Prices, 20 (3) *JOURNAL OF BEHAVIORAL FINANCE* (2019).

⁷⁹ Elvira Bocskei & Vencel Kis, *Interplay of ERP and Controlling: Future Business Skills of Entrepreneurship Education*, 23(2) *JOURNAL OF ENTREPRENEURSHIP EDUCATION* (2020); See also: Tibor Bíró, Peter Kresalek, József Pucsek, & Imre Sztanó, *A Vállalkozások Tevékenységének Komplex Elemzése* (2016).

⁸⁰ NSE Indices, *Nifty 50 The torch bearer of Indian equities market for last 25 years*, NSE INDIA, (April,2019) https://archives.nseindia.com/content/indices/Whitepaper_NIFTY50.pdf (Last visited on September 25, 2021)

⁸¹ Oommen Ninan, *Rebranding NSE indices will increase user confidence*, *THE HINDU*, (November 08, 2015, 10:57 PM) <https://www.thehindu.com/business/markets/rebranding-nse-indices-will-increase-user-confidence-chitra-ramkrishna/article7858480.ece>. (Last visited on October 6, 2021).

Data on these variables have been collected and analysed for the years 2015-2021.

The Annual reports, Annual General Meeting (AGM) Reports, public disclosures, and statutory filings made by the *Nifty-50* indexed companies were collected and analysed for the years 2015-2021. The total number of resignations tendered by IDs for each *Nifty-50* indexed company and the date of announcement of such resignations were collected.

For the second independent variable, i.e., the reasons for the resignation of IDs, reasons for resignation given by IDs were divided into four categories; (i) Detailed Reasons: where the reason of resignation is explained albeit briefly, (ii) Vague/Indefinite Reasons: where the reason of resignation is open-ended and ambiguous, e.g., personal reasons/personal commitments (iii) No Reasons: where no reason has been provided by the company for the IDs' resignation and (iv) Negative Reasons: where the reasons for resignation highlight bad corporate governance or poor management in the company. For the third independent variable, i.e., promoter shareholding patterns were collected for each *Nifty-50* indexed company as on 31st March 2021.

For the dependant variables, the share price of the chosen companies and the total traded quantity of shares before and after the announcement of IDs' resignations was collected to calculate the effect on share price and total traded quantity.

A. Effect on Share Price and Total Traded Quantity

The effect on share price of the chosen companies has been taken as one of the dependent variables in this study. Thus, to ensure that the appropriate share price value is taken for the analysis, the closing share price for each company was taken before the announcement of IDs' resignation, and it was compared to the closing share price after the announcement of said resignation.

The Effect on Share Price was calculated as:

$$\text{Effect on Share Price} = \text{Closing Share Price before the day of announcement of IDs' resignation} - \text{Closing Share Price on the day of announcement of IDs' resignation}$$

For the purpose of analysis, the Effect on Share Price for all the resignations tendered by IDs in each *Nifty-50* indexed company was calculated, and the mean value of the same was calculated for each individual company.

Aggregate Effect on Share Price was calculated as:

Aggregate Effect on Share Price = Sum of Effect on Share Price due to all resignations by IDs in a company / total number of resignations by IDs in a company.

The Effect on Total Traded Quantity of Shares is calculated as:

Effect on Total Traded Quantity of Shares = Total Traded Quantity of Shares before the day of announcement of IDs' resignation – Total Traded Quantity of Shares on the day of announcement of IDs' resignation.

Aggregate Effect on Total Traded Quantity of Shares is calculated as:

Aggregate Effect on Total Traded Quantity of Shares = Sum of Effect on Total Traded Quantity of Shares due to all resignations by IDs in a company / total number of resignations by IDs in a company.

B. Methodology

This study employs descriptive statistics, i.e., mean and percentage of the tabulated data to study the relationship between dependent and independent variables.

To achieve the objectives of this study, *first*, the relationship between the resignation of IDs and the Effect on Share Price (as calculated above) is measured. *Second*, the relationship between the resignation by IDs and the Effect on Share Price is studied in the context of varying promoter shareholding patterns of the companies. *Third*, the relationship between the IDs' resignations and the Effect on Total Traded Quantity of Shares is calculated. *Fourth*, the relationship between the resignation by IDs and the Effect on Total Traded Quantity of Shares is analysed in the context of varying promoter shareholding patterns of the concerned companies. *Fifth*, the change in Effect on Share Price is measured in the context of the reasons given for IDs' resignation. The data so procured is analysed to study the signalling effect (if any) of the resignation by IDs and the

reasons given for the same, and its impact on the company's liquidity and future cost of capital. In doing so, we also evaluate the responsiveness of Indian Investors to the disclosure mandate under Schedule III Part A in Para A, clause 7B(i) of *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015* vis-à-vis the resignation of IDs from public listed companies in India and the reasons for the same.

Table 1: Total resignations by IDs from *Nifty-50* indexed companies during the period 2015-2021 and its effect on share price vis-à-vis majority and minority promoter shareholding patterns

	Resignations by IDs from NSE <i>Nifty-50</i> indexed companies having minority promoter shareholding (as on 31st March 2021)	Resignations by IDs from NSE <i>Nifty-50</i> indexed companies having majority promoter shareholding (as on 31st March 2021)	Total
Resignations by IDs resulting in a Negative Effect on Share Price	15	21	36
Resignations by IDs resulting in a Positive Effect on Share Price	24	21	45
Total	39	42	81

During the period 2015-2021, total 81 IDs resigned from boards of 38 NSE *Nifty-50* indexed companies. On aggregate, resignations by IDs had a negative Effect on Share Price 48 per cent of the time, i.e., almost five out of ten times. However, the data varies when we account for the shareholding patterns of individual firms.

On companies with minority promoter shareholding (i.e., promoter shareholding <50 per cent), resignations by ID negatively impacted share price 38.4 per cent of the time. On the other hand, for companies with majority promoter shareholding (i.e., promoter shareholding > 50 per cent), resignations by ID negatively impacted share price 50 per cent of the time.

This data suggests that companies with majority promoter shareholding are at higher risk of being faced with a negative Effect on Share Price in response to resignation by IDs. This finding highlights the culpability of companies with majority promoter shareholding to face erosion of investor confidence and shareholder wealth as a consequence of IDs' resignations.⁸²

Table 2: Average Share Price fluctuation in *Nifty-50* indexed companies post-resignation by IDs between 2015-2021 vis-à-vis promoter shareholding patterns

Sr. No.	Company Name	Aggregate Effect on Share Price due to resignation by the Company's IDs	Promoter Shareholding of the Company (as on 31 st March 2021) (per cent)
1.	TCS	-6.52	72.2
2.	WIPRO	5.37	73.03
3.	CIPLA	-2.65	36.66
4.	ICICI Bank	12.8	0
5.	ONGC	6.3	60.41
6.	HDFC Bank	10.2	25.97
7.	Adani Ports	1.75	63.73
8.	Hindalco	-1.21	34.65
9.	BPCL	2.22	52.98
10.	Asian Paints	13.6	52.79

⁸² E Welch, Grant Fleming and RA Heaney, *The Shareholder Wealth Effects of Director Departure Announcements*, (Australian National University Working Paper Series in Finance 00-08, 2000) <<https://openresearch-repository.anu.edu.au/bitstream/1885/40674/2/Workingpaper00-08.pdf>>. (Last visited on April 6, 2022)

11.	Power Grid	0.8	100
12.	Ultra Tech Cement	-89.75	59.96
13.	Eicher Motors	-120.9	49.23
14.	HCL technologies	11.10	60.33
15.	Tata Consumer	-3.66	34.68
16.	Hero Motocorp	5.35	34.76
17.	NTPC	1.7	51.1
18.	Maruti Suzuki	-40.15	56.37
19.	Bajaj Auto	0.51	53.7
20.	Dr Reddy	13.10	26.76
21.	UPL	17.05	27.95
22.	ITC	4.12	0
23.	Sun Pharma	-21.4	54.47
24.	Britannia	-4.21	50.55
25.	SBI Life	-6.83	55.7
26.	HDFC Limited	0.03	0
27.	IOC	-1.78	51.5
28.	Titan	1.95	52.9
29.	Divis Lab	15.12	51.95
30.	LT	-65.15	0
31.	Bharti Airtel	-5.8	55.85
32.	Grasim	63.65	41.83
33.	Infosys	16.10	12.95
34.	IndusInd Bank	56.12	16.74
35.	Axis Bank	-26.42	13.25
36.	HDFC Life	0.95	58.86
37.	Reliance	50.07	50.58
38.	SBI	2.6	57.63

Table 3: Aggregate Effect on Share Price of *Nifty-50* indexed companies during the period 2015-2021 vis-à-vis the companies' promoter shareholding pattern

	Combined Aggregate effect on Share Price due to resignations by IDs
NSE <i>Nifty-50</i> indexed companies having minority promoter shareholding (as on 31st March 2021)	-1.34
NSE <i>Nifty-50</i> indexed companies having majority promoter shareholding (as on 31st March 2021)	-2.83

During the period 2015-2021, IDs resigned from the boards of 38 NSE *Nifty-50* indexed companies. Out of these, 22 companies had majority promoter shareholding, and 16 had minority promoter shareholding. For companies with minority promoter shareholding, all resignations by IDs had an aggregate negative effect of Rs. 1.34. On the other hand, for companies with majority promoter shareholding, all resignations by IDs had an aggregate negative effect of Rs. 2.83.

This data must be looked at in the context of Table 1, which highlights that for all companies, the share price was negatively impacted only 48% of times, which indicates that there were fewer instances of fall in share price in response to resignations by IDs as compared to a rise in share price. Despite the fewer instances of negative Effect on Share Price, the Aggregate effect on Share Price for all NSE *Nifty-50* indexed companies is negative. This suggests that the *quantum* of negative Effect on Share Prices is significantly *higher* than the quantum of rise in share price in response to resignation by IDs.

Further, on average, the quantum of negative Effect on Share Price is higher in the case of companies with majority promoter shareholding than for those with minority shareholding patterns.

Table 4: Total resignations by IDs from *Nifty-50* indexed companies during the period 2015-2021 and its effect on trading volume vis-à-vis majority and minority promoter shareholding pattern

	NSE <i>Nifty-50</i> indexed companies having minority promoter shareholding (as on 31st March 2021)	NSE <i>Nifty-50</i> indexed companies having majority promoter shareholding (as on 31st March 2021)	Total
Resignations by IDs resulting in a Negative Effect on Total Traded Quantity	22	22	44
Resignations by IDs resulting in a Positive Effect on Total Traded Quantity	17	20	37
Total	39	42	81

During the period 2015-2021, on average, resignations by IDs had a negative Effect on Total Traded Quantity 54.3 per cent of the time, i.e., five out of ten times. However, the quantum of negative effect varies when we account for the shareholding patterns of individual firms. On companies with minority promoter shareholding, resignations by IDs negatively impacted total traded quantity 56.4 per cent of the time. On the other hand, for companies with majority promoter shareholding, resignations by IDs negatively impacted total traded quantity only 52.3 per cent of the time.

This finding suggests that while companies with majority promoter shareholding are at higher risk of being faced with a negative Effect on Share Price in response

to resignation by IDs, the risk of negative impact on total traded quantity is higher for companies with minority promoter shareholding.

Table 5: Effect on Total Traded Quantity vis-à-vis reasons given for resignation of IDs

	Resignations by IDs resulting in a Positive Effect on Total Traded Quantity	Resignations by IDs resulting in a Negative Effect on Total Traded Quantity	Total
Detailed reasons for resignation given by IDs	14	17	31
Indefinite / Vague reasons for resignation given by IDs	15	19	34
No reason for resignation given by IDs	7	8	15
Negative reasons for resignation given by IDs	1	0	1
Total	37	44	81

Table 6: Reasons given by IDs for their resignation from *Nifty-50* indexed companies with minority promoter shareholding during the period 2015-2021.

	Resignations by IDs resulting in a	Resignations by IDs resulting in a Negative	Total

	Positive Effect on Share Price	Effect on Share Price	
Detailed reasons for resignation given by IDs	12	3	15
Indefinite / Vague reasons for resignation given by IDs	6	7	13
No reason for resignation given by IDs	5	6	11
Negative reasons for resignation given by IDs	0	0	0
Total	23	16	39

Table 7: Reasons given by IDs for their resignation from *Nifty-50* indexed companies with majority promoter shareholding during the period 2015-2021.

	Resignations by IDs resulting in a Positive Effect on Share Price	Resignations by IDs resulting in a Negative Effect on Share Price	Total
Detailed reasons for resignation given by IDs	11	5	16
Indefinite / Vague reasons for resignation given by IDs	8	12	20
No reason for resignation given by IDs	2	3	5
Negative reasons for resignation given by IDs	0	1	1
Total	21	21	42

The results show that majority of the IDs (50 out of 81) gave vague reasons or no reasons for their resignations. This finding aligns with previous findings of directors being hesitant to disclose the true reasons behind their resignations as it jeopardizes their relationship with the company and negatively impacts their business dealings and future appointments.⁸³ It has been found that such hesitation is especially prevalent when the reasons for resignation pertain to the company's future performance or conduct.⁸⁴

In this context, the findings of this study show that investors are vigilant about the possibility of future concerns in case of vague/no reasons for resignations by IDs. The data shows that in case of indefinite reasons for resignation and in cases where no reasons were given at all, there was a negative Effect on Share Price 58.8 per cent and 50 per cent of the time respectively. On the other hand, when detailed reasons were given for IDs' resignation, there was a negative Effect on Share Price only 26.6 per cent of the time, and in case of negative reasons for resignation, there was a negative Effect on Share Price 100 per cent of the time.

This finding can be explained by the weightage of information asymmetry in investment decisions.⁸⁵ Less information asymmetry and timely public disclosure of information results in investors being more willing to trade in the said shares, thus increasing stock market liquidity. However, more information asymmetry results in the investors perceiving the stock trade as 'risky' and consequently reduces stock market liquidity of the concerned shares.⁸⁶ Thus, there exists a strong signalling effect of reasons given by IDs for their resignation.

⁸³ Cassandra Marshall, *Are dissenting directors rewarded?* (Indiana University, Working Paper, 2010)
<https://business.uc.edu/content/dam/business/departments/finance/docs/Cassandra%20D.%20Marshall%20Are%20Dissenting%20Directors%20Rewarded.pdf>. (Last visited on May, 7, 2022)

⁸⁴ BARHAVA et al, *supra* note 69.

⁸⁵ Tom Berglund, *Liquidity and Corporate Governance*, 13(54) JOURNAL OF RISK AND FINANCIAL MANAGEMENT (2020).

⁸⁶ *Id.*

C. Results

The findings of this study suggest that companies with majority promoter shareholding are at higher risk of being faced with a negative Effect on Share Price in response to resignation by IDs. As capital appreciation is one of the most significant factors of consideration for investors,⁸⁷ this negative Effect on Share Price points towards a possible investing chill in companies after resignation by IDs.

Additionally, the quantum of negative Aggerate Effect on Share Price is higher in the case of companies with majority promoter shareholding than for those with minority shareholding patterns. However, the risk of negative impact on total traded quantity is higher for companies with minority promoter shareholding.

As in majority of the cases, IDs' resignation negatively impacts the total traded quantity; it can be inferred that resignations by IDs have a high risk of negatively affecting a company's stock market liquidity. Studies have shown that any fall in a company's liquidity on the stock market can lead to an increase in the company's cost of capital.⁸⁸ Thus, the current crisis of resignation by IDs is an alarming scenario for Indian companies. Further, stock market liquidity is an important factor for consideration in investment decisions.⁸⁹ Thus, the detriment caused to the liquidity of a company's share in majority of the companies points towards a grave concern for the future performance of the company on the stock exchange and the shareholders' wealth.

In total, most of the companies with minority promoter shareholding have a positive Effect on Share Price coupled with a negative Effect on Total Traded Quantity in response to resignations by IDs. Studies have shown that an upward movement of share prices coupled with a decrease in total quantity of shares traded points towards a general lack of confidence in the market and indicates a

⁸⁷ Surendar Gade, *Equity Investment Strategies: A Study on Retail Investors In India*, 2(6) SCHOLEDGE INTERNATIONAL JOURNAL OF MANAGEMENT & DEVELOPMENT (2015)

⁸⁸ Abdul Rahman & Prabina Rajib, *Index Revisions, Stock Liquidity and the Cost of Equity Capital*, 19(4), GLOBAL BUSINESS REVIEW (2018)

⁸⁹ INSTITUTE OF COMPANY SECRETARIES OF INDIA, FINANCIAL AND STRATEGIC MANAGEMENT

,<<https://www.icsi.edu/media/webmodules/Financial%20and%20Strategic%20Management.pdf>> (Last visited on June 7, 2022)

price reversal in the future.⁹⁰ Thus, in the case of minority promoter shareholding, the study reveals that resignation by IDs' negatively impacts the companies' liquidity and may be detrimental to its future share price. This impact on future share price must be seen in the context of the directors' fiduciary duties not just towards existing shareholders but also the prospective shareholders of a company.⁹¹ Therefore, to protect the shareholder value and wealth of present and future investors, Indian boards must take cognizance of the negative impacts of resignations IDs. Additionally, in case of majority promoter shareholding, both total traded quantity and share price were negatively impacted 52.3 per cent and 50 per cent of the time, respectively which shows a significant relationship between the variables.

Furthermore, the data for reasons of resignation by IDs suggest that the shareholders take into account the reasons for resignations while making investment decisions in response to resignation by IDs. Thus, the disclosure mandate under Schedule III Part A in Para A, clause 7B(i) of *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015* is an important tool in the hands of IDs and the shareholders to analyse the corporate governance standards of a company and make corresponding investment decisions. However, it must be noted that the overwhelming presence of vague reasons / no reasons given during resignations by IDs points towards the inefficient implementation of this regulation in India Inc. Even though this study suggests that vague reasons or absence of reasons for resignations by ID have given rise to a negative reaction by investors in the stock market, such a negative effect is merely incidental to the purpose behind the disclosure mandate under *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015*. The ultimate purpose of the said disclosure mandate is to ensure transparent public disclosure of the reasons for resignations by IDs which, as suggested by the findings of this study, is yet to be achieved in India Inc.

⁹⁰ Prabakaran & Krishnaveni, *DOW Theory in Assessing Equity Share Price Movement*, 6(10), *ASIAN JOURNAL OF RESEARCH IN SOCIAL SCIENCES AND HUMANITIES*, 1326, 1326-1336, (2016).

⁹¹ Arjya Majumdar, *The Fiduciary Responsibility of Directors to Preserve Intergenerational Equity*, 159(1), *JOURNAL OF BUSINESS ETHICS*, 149, 149-160, (2017)

In the context of the ill-effects of resignations by IDs on individual companies, investors, and the overall corporate governance regime of India, the next section of this paper discusses the way forward for India Inc. to tackle the above-mentioned concerns.

IV. The Way Forward

Our study has shown that mass resignation is detrimental, not just to India's overall Corporate Governance structure, but also to individual firms on the stock market. By giving IDs the title of the 'flagbearers of Corporate Governance', the Indian legal regime creates a sense of false security among the stakeholders of a company who are unaware of the onerous nature of IDs' obligations. This alarming scenario warrants the reconsideration of legal policy surrounding IDs in India. In this section, we shall discuss the viability of certain suggestions to improve the position of IDs in India while keeping in mind the ultimate purpose of their position; the agency problem between the management and minority shareholders.

A. The Legal Landscape Surrounding IDs and the Regulatory Trilemma

The current regulation surrounding IDs follows the traditional structure of 'command and control'.⁹² However, academicians have widely criticised the effectiveness of such state-centred regulation in modern times.⁹³ The ill-effects of such regulation were studied by Teubner, who found that any regulation that aims to change the existing social institutions and practices will be faced with a 'regulatory trilemma', i.e., the above-mentioned regulation will struggle to achieve 'effectiveness, responsiveness, and coherence.'⁹⁴ The regulation surrounding IDs faces this 'regulatory trilemma' when we look at the laws in action.

With regard to the first prong of effectiveness, researchers have found that loopholes in legal text and a general lack of enforcement may point towards the

⁹² Christine Parker & John Braithwaite, Regulation: The Oxford Handbook of Legal Studies (Mark Tushnet and Peter Cane 2018).

⁹³ *Id.*; Gunther Teubner, Juridification: Concepts, Aspects, Limits, Solutions: Juridification of Social Spheres: A Comparative Analysis of the Areas of Labor, Corporate, Antitrust and Social Welfare Law (Gunther Teubner ed. 1987).

⁹⁴ *Id.*

regulation being passed only to pacify public concerns as the regulators do not possess adequate resources or mechanisms to enforce the same.⁹⁵ As discussed in section II(B)(2)(b), the courts' overzealous interpretation and incompletion of laws relating to the protection of IDs, is widely prevalent in India Inc. Thus, the effectiveness of the 'command and control' regulation adopted by Indian regulators is significantly compromised.

Further, studies have shown that any state-centred regulation that does not account for the 'non-legal normative' order of its target population (here, IDs), will not be able to accomplish its goals in the long term due to the lack of responsiveness.⁹⁶ One reason for such lack of responsiveness is that it is overly legalistic, which dissipates voluntary responsibility in the minds of its target population.⁹⁷ On the contrary, laws that enable private regulation in the form of self-regulation or incentive-based and third-party accreditation schemes are more effective in evoking responsiveness in the case of business regulation.⁹⁸ As discussed above in section II(C), the present regulation on IDs does not account for the existing negative corporate attitude towards IDs which reduces them to a mark of compliance with no value addition to the board process and simultaneous onerous legal obligations. Thus, the current regulations fail to achieve responsiveness from India Inc.

This 'regulatory trilemma' can be solved by creating a shared understanding of regulatory goals among the regulators and the target population (here, IDs), which will become the basis of the formation and enforcement of regulations. In the context of IDs, this shared understanding will tackle the uncertainty and lack of uniformity in the enforcement of the law by authorities who interpret regulations such as the *Negotiable Instruments Act, 1881* and the *Prevention of Money Laundering Act, 2002*. Further, the habitual compliance to regulations can be achieved when a shared commitment to regulatory goals is created through

⁹⁵ *Id*; Doreen McBarnet & Christopher Whelan, *Creative Compliance and the Defeat of Legal Control: The Magic of the Orphan Subsidiary: The Human Face of Law* (Keith Hawkins ed. 1997).

⁹⁶ PHILIP SELZNICK, *THE MORAL COMMONWEALTH* (University of California Press 1992).

⁹⁷ Parker & Braithwaite, *supra* note 90.

⁹⁸ Neil Gunningham & Peter Grabosky, *Smart Regulation: Designing Environmental Policy* (1998).

continuing relationships and discussions between the stakeholders. While it may be argued that the SEBI seeking public inputs on its consultative papers or amendments is a way of cultivating discussion to create a shared understanding, the power dynamics in the process of public inputs is fixed and hierarchical wherein the regulatees' (i.e., the IDs as well as the companies) suggestions *may* be adopted as per the regulators' discretion. To create shared commitments, the power dynamics must be rebalanced to give the regulatees appropriate say in the process.

B. Artificial Intelligence: A Solution to the Indian Agency Problem?

While shared commitments can pave the way for more effective regulations by tackling the legal and practical incapacitation faced by IDs in India, recent studies are promoting a way to eradicate these incapacitations altogether through the use of Artificial Intelligence (AI) as a substitute for IDs.⁹⁹

To analyse whether AI can substitute IDs in the Indian legal landscape, we shall look at the qualification requirements for IDs. Rule 5 of the *Companies (Appointment and Qualification of Directors) Rules, 2014* provides that an ID must possess 'appropriate skills, experience, and knowledge' in one or more of the fields identified therein. However, no quantifiable standard has been set to measure such skills the *Companies Act, 2013* or the corresponding rules. Thus, IDs are not required to possess any specific certification or educational degree. In 2020, the MCA introduced an Online Proficiency Self-Assessment test that must be taken by IDs for their name to be included in the database of eligible IDs in India.¹⁰⁰ These requirements can be satisfied by AI through programming the required level of information and data analysis algorithm. Further, the requirement of Independence under the *Companies Act, 2013* are also satisfied as an AI does not have pecuniary or personal relationships with the company and/or the promoters.¹⁰¹ However, Section 149 of the *Companies Act, 2013* requires directors to be 'individuals', and the Indian courts have interpreted the

⁹⁹ Akshaya Kamalnath, The Perennial Quest for Board Independence: Artificial Intelligence to the Rescue? 83(1), ALBANY LAW REVIEW, 43-60, (2020)

¹⁰⁰ Companies (Appointment and Qualification of Directors) Rules, Rule 6, 2014 (India).

¹⁰¹ Companies Act, 2013, § 149 No.18, Acts of Parliament, 2013 (India).

same to require directors to be a natural persons.¹⁰² Thus, AI can possess the required qualifications to replace IDs in India only if the regulators and courts include artificial persons under the definition of Directors. This move also provides the following benefits:

In the current legal framework, IDs face the problem of information asymmetry, which significantly impacts their ability to carry out the onerous obligation placed on them by law. For e.g., the *Companies Act, 2013* expects IDs to monitor the board's performance, scrutinise the 'integrity of financial statements' and ensure that there exist robust financial controls in the company.¹⁰³ If an ID overlooks financial 'red flags' or fails to ask appropriate questions, it would amount to the facilitation of false and misleading disclosures.¹⁰⁴ However, AI can solve this problem as it does not face the same time constraints faced by IDs due to their involvement on multiple boards. Further, AI can identify 'red flags' more effectively by analysing large sets of data in a fraction of time.

Furthermore, unlike IDs, AI does not have to worry about its individual prospects if it goes against the wishes of the majority shareholders. Studies have shown that AI is not susceptible to human biases unless the same has been programmed into its system.¹⁰⁵ Thus, the individual cost-benefit analysis undertaken by IDs will be eliminated. As Akshaya Kamalnath has rightly pointed out, 'it will not be afraid to upset its friends' (or foes).¹⁰⁶

Further, there are three broad functions that IDs must perform: monitoring, advisory, and networking.¹⁰⁷ In practice, there has been a growing focus on the advisory function of 'value addition' carried out by IDs after the advent of the Covid-19 pandemic and the accompanying corporate uncertainty.¹⁰⁸ As

¹⁰² *Oriental Metal Processing Works Ltd v. Bhaskar Kashinath Thakur*, (1961) AIR SC 573.

¹⁰³ *Companies Act, Schedule IV* (2013).

¹⁰⁴ Vijayraghavan & Iyer, *supra* note 41.

¹⁰⁵ KAMALNATH, *supra* note 97.

¹⁰⁶ *Id.*

¹⁰⁷ GUTIÉRREZ & SÁEZ, *supra* note 19.

¹⁰⁸ Namrata Singh, Covid forces companies to relook at board mix, *TIMES OF INDIA*, (20th July 2020, 7:00PM) <https://timesofindia.indiatimes.com/business/india-business/covid-forces-cos-to-relook-at-board-mix-assess-independent-directors-value-addition/articleshow/77055857.cms>. (Last visited on October 24, 2022)

postulated in the resource dependence theory, IDs provide ‘value addition’ through the external resources, knowledge, and experience they bring to the board.¹⁰⁹ These skills play a crucial role for creative strategy building in times of unprecedented events or corporate, legal, and environmental uncertainty.¹¹⁰ In this context, the IDs’ role of ‘value addition’, could be reserved for humans. Such a limitation in obligations will allow boards to utilise the invaluable experience of IDs by freeing them from the onerous legal obligations of a ‘watchdog’.

However, the integration of AIs on corporate boards raises a crucial question about liability; who should be held accountable for the AI’s shortcomings; the developers of the AI or the board of directors who provide day-to-day information to the AI and rely on its analysis? In our view, a shared understanding between regulators, developers, and corporate India is required vis-à-vis the functioning of AI on corporate boards. By formulating a clear demarcation of liability on the part of the boards which use the AI and the developers, AI can successfully carry out the obligations of IDs.

V. Conclusion

The legal and practical reasons discussed in this paper for the incapacitation of IDs depict the gross control that controlling shareholders have over IDs in India. While the law fails to address the exact problem of undue control by majority shareholders, the corporate attitude has reduced IDs to a mere symbol of regulatory compliance. These multifaceted dilemmas faced by IDs have resulted in IDs internalising passiveness in their functioning.

The study undertaken in relation to fluctuations in share price and traded quantity of shares of a company in response to the resignation of IDs from *Nifty-50* Companies shows that the shareholders consider the reasons for resignations

¹⁰⁹ Amy Hillman, Albert Cannella & Ramona Paetzold, The resource dependence role of corporate directors: Strategic Adaptation of Board Composition in Response to Environmental Change, 37 (2) JMS, 235, 235–256 (2000).

Jonathan Johnson, Catherine Daily & Alan Ellstrand, Boards of Directors: A Review and Research Agenda, 22(3) JOURNAL OF MANAGEMENT, 409 409–438 (1996)

¹¹⁰ John Pearce & Shaker Zahra, Board composition from a strategic contingency perspective, 29(4) JMS 411, 411–438 (1992).

while making investment decisions in response to resignation by IDs. However, the overwhelming presence of vague reasons / no reasons given during resignations by IDs points towards the inefficient implementation of the disclosure mandate under Schedule III Part A in Para A, clause 7B(i) of *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015*. The negative effects of IDs' resignation on a company's performance on the stock market suggest that individual companies may face tangible losses due to bad corporate governance practices vis-à-vis the functioning of their IDs.

By highlighting the pressing concerns with the position of IDs in India in 2022 and the effect of their resignation on Individual firms, this study brings to light further avenues of research in the matter of law and policy. How can the concept of IDs be adapted to suit the Indian corporate environment? How can IDs in India effectively carry out their obligations towards the minority shareholders and other stakeholders? These are the questions that need to be asked to improve corporate governance in India. Further, technological developments have opened new avenues to solve the agency problems faced by India Inc. In light of these developments, urgent changes must be made to India's corporate governance regime. Focussed policy and legal developments of this nature will free IDs from the three phases of suffocation they are subjected to in India Inc.