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## Role of Independent Directors in Corporate Governance

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### *Abstract*

*Independent directors have emerged as a cornerstone of modern corporate governance, particularly in listed and large public companies. In India, the introduction of independent directors into company boards was seen as a significant reform to enhance corporate governance align Indian practices with international standards. They are tasked with safeguarding the interest of various stakeholders, management, including shareholders, employees, and the boarder community, while ensuring that organization decisions align with ethical and legal standards. The multifaceted role of independent directors, examining their legal responsibilities, the challenges they face, their overarching impact on organizational transparency and accountability. The effectiveness of independent directors is evaluated through various performance indicators, including financial performance, shareholder value creation and stakeholder perceptions. By promoting ethical practices and fostering a culture of integrity, independent directors help reinforce investors' confidence and contribute to long-term sustainability of businesses. It shed light on best practices and recommendations for improving the selection, role clarity, and performance evaluation of independent directors. In companies act 2013 mandates that each public company's boards of directors shall consists of at least one-third of independent directors. The position of independent directors is critical in ensuring strong corporate governance. This paper examines the legal framework, responsibilities, and evolving challenges of independent directors, with a focus on*

*India's companies act 2013 and SEBI regulations. It also explores best practices for enhancing their effectiveness in corporate governance.*

**Keywords:** *Independent directors, SEBI, corporate governance, companies act, transparency, accountability*

### **Introduction**

Corporate governance refers to the system of the rules, practices, and processes by which company is directed and controlled. It encompasses the relationships between a company's management, its boards of directors, its shareholder, and other stakeholders. Effective corporate governance ensures transparency, accountability, and fairness in decision-making which is crucial for sustainable growth and success of businesses. The system serves a vital role in ensuring that the firm acts ethically and transparently, fulfils its goals, and safeguards the interests of shareholders and other stakeholders. The Securities and Exchange Board of India (SEBI)<sup>1</sup> included independent directors in the 2013 Companies Act in India to improve corporate governance. Independent directors are non-executive directors who provide an objective perspective on the company's operations and serve as a check on the board and management's decision-making.

### **What is independent director? why is there a need for independent directors in companies?**

Boards of directors are the main players in setting strategies, controlling implementation, and reporting to shareholders and other stakeholders in a modern business environment. Independent directors within this setting have become a major tool for raising the quality of corporate governance and solving agency problem. Independent directors are those who sit on boards as nonexecutive members and who are not only free from any material pecuniary relationship with the company, promoters, or management but also from any undue influence. In India, Companies Act, 2013<sup>2</sup> and SEBI (Listing Obligations and Disclosure Requirements) Regulations are mandating that listed companies and big public companies appoint a minimum number of such independent directors to maintain an outside perspective. The rationale behind having independent directors stems from large-scale corporate reorganizations, the dilution of owners' direct control over companies, and the potential abuse of power by promoters. Independent directors are able to offer a disinterested viewpoint during boards' discussions, they review management's decisions, they check controls, and they give more trust to the finance report. They do management oversight, minority shareholders' defence, and ensure that corporate governance is - transparent and responsible. Within the above

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<sup>1</sup> The Securities and Exchange Board of India Act,1992, Act No.15 of 1992

<sup>2</sup> The Companies Act 2013, Act no.18 of 2013

context, this paper discusses the nature functions difficulties, and level of performance of independent directors in Indian corporate governance

### **Research question**

- How do independent directors contribute to board effectiveness, transparency, and accountability in corporate governance?
- How can the effectiveness of independent directors be strengthened in Indian corporate governance architecture?
- What is the legal and regulatory framework governing independent directors under the companies act 2013 LODR in India?

### **Research objective**

- Evaluating the theoretical and practical impact of independent directors in directing board effectiveness.
- Examining how board independence is helpful in reducing agency problems.
- Pinpointing the systemic barriers that hinder the performance of independent directors.
- Suggesting policy changes to improve the selection and functioning of IDs in the contemporary corporate world.

### **Literature review:**

Academic work on independent directors spans several academic disciplines law, economics, finance, and organizational behaviour and can be broadly grouped into two strands: agency theory and stewardship theory. Agency theory as conceived in the seminal work of Jensen and Meckling (1976) suggests that the separation of ownership and management in the contemporary corporation creates a structural conflict of interest between shareholders and managers.

Managers, as rational carters, who pursue their own interests may have incentives to advance goals harmful for the interests of shareholders. from an agency view independent directors are role of supervisor agents who are, on account of financial and structural separateness from the management, supposed to be effective Board overseers.

An alternative to agency theory stewardship theory a more optimistic view advanced by Donaldson and Davis (1991), offers a different approach that "established the basis for reconceptualising the

power of independent directors to prevent self-interested managerial behaviour in terms of the quality of advice and counsel they offer as opposed to the disciplinary mechanisms they afford.

Recent, research has been focusing on the difficulties that independent directors face in ownership structures featuring concentration of control through major shareholders a mode of corporate structure, which is prevalent in India, where promoter families quite often keep significant shareholdings. Chakrabarti, Megginson, and Yadav (2008) maintained that the success of governance measures in India heavily depends on the enforcement mechanisms and the quality of institutions in place. This worry has been brought back into the spotlight following the IL&FS crisis (2018) and the Satyam scandal (2009) that both showed that the independent directors, though formally appointed, were not able to perform effectively their monitoring responsibilities.

### **Evolution of corporate governance in India ;**

The essential principles of corporate governance are not contemporary constructs but extend back to ancient Indian treaties like Kautilya's Artha shastra, which stressed notion of accountability, ethical leadership and organised administration. But corporate governance in India in its modern sense emerged largely as a response to economic liberalisation in the early 1990s. opening the state-run economy meant Indian companies faced investment criteria from an international community of investors, necessitating associated change in transparency, accountability and shareholder rights.

The earliest of formal regulatory initiatives was SEBI's introduction of clause 49 of the listing agreement in 2000, which provided the groundwork for board structure, audit committees, disclosures. This regulatory drive was further enhanced by the introduction of companies Act, 2013, which codified the principles of corporate governance and made the inclusion of independent directors across certain categories of companies a statutory requirement.

The Act requires that under section 149(4), every public company would be required to fill at least 1/3<sup>rd</sup> of the board with independent directors. The criteria for independence is further defined in section 149(6) where it is stated that a person shall be considered independent if he is not having any pecuniary relationship, familial or material interest in the company or has not been associated with the promoters. Coupled with additional statutory requirements regarding the maintenance of a directors (section 150) and requiring shareholder approval for appointments (section 152), these provisions created a framework for the independence and the autonomy of the board.

The Satyam fraud of 2009, which revealed that a company, supposedly with good governance, operated a ten-year accounting scam became the immediate institutional trigger for the Act's stricter governance provisions. The Court's intervention and the subsequent re-organisation of Satyam identified the threat of board capture and failed formal compliance.

Over, the last decade the regulatory fine-tuning SEBI (LODR) Regulations, 2015 and the subsequent amendments thereto (2021 & 2025) appears to have set new expectation standards from independent directors-like new criteria for appointment/re-appointment, containment of multiple approval route, increased disclosure obligations and ESG-related governance tasks. Despite these developments, the practical import of independent directors continues to vary significantly by sectors, and their formal independence remains constrained by some internal forces and non-transparent nomination processes and legal doubt.

### **Background of independent director:**

The concept of the independent director a board member who is structurally detached from the company's management, The notion of independent director denoting a director who is formally independent from the management of the company and ownership of the controlling shareholders derived largely from the Anglo-American paradigm of corporate governance. In the United States, the New York Stock Exchange had by 1978 mandated that listed corporations establish audit committees of outside directors; the Securities and Exchange Commission (SEC) was equally eager to promote directors outside the management.

The idea initially became part of Indian regulation through the Kumar Mangalam Birla Committee on Corporate Governance (1999), set up by SEBI, which advised that listed companies should appoint directors who did not have significant financial relationships with the company, its promoters, or management so as to be able to bring neutrality and control to the boardroom. This suggestion was turned into action by Clause 49 of the SEBI (Listing Agreement), that required a minimum number of independent directors to be present on the boards of listed companies. The Confederation of Indian Industry (CII) governance codes and subsequently the Naresh Chandra Committee (2002) (2003) gave more reasons for having independent directors by highlighting their functions in audit supervision, risk management, and shareholder minority interest protection.

The turning point was the Satyam Indoors scandal (2009) that exposed huge governance violations and brought the role of independent directors back to the limelight. The Companies Act, 2013 which was enacted later on acknowledged the concept by giving a formal definition to the term "independent directors", setting statutory maximum tenure for their appointment, and issuing a Code for Independent Directors in Schedule IV, thereby transforming them into a mandatory element of the Indian corporate governance framework, and not just a soft-law advisory.

The evolution of independent director regulation in India therefore mirrors a consistent trend of gradually intensifying demands that are motivated by a mix of global corporate governance standards, local institutional weaknesses, and the increasing awareness of institutional investors.

### **Role and Responsibilities of independent director in corporate governance:**

Independent director s plays a crucial role in enhancing corporate governance and disclosure practices in Indian companies. They are appointed to the broad of directors to bring objectivity, independent judgement, and diverse perspectives. Unlike executive directors who are involved in day-to-day management, independent directors are expected to provide unbiased oversight, protect the interests of minority shareholders, and ensure ethical conduct within the organization. The independent director has specific responsibilities listed in schedule IV of the act, including safeguarding stakeholders' interests, particularly those of minority shareholder bringing together and harmonising the competing interests of minority shareholder evaluating the management's performance and resolving conflicts between management and shareholder.

They shouldn't divulge sensitive corporate information unless the board has given the go-ahead or the law permits it. They must serve as "chairpersons" or active members of boards committees. Among many responsibilities, they should regularly attend the business's general meeting in order to maintain their knowledge, abilities, and acquaintance with the company up to date.

Independent directors are not given a unique duty or function. Independent directors are treated the same as other directors for the reasons role and decision-making.

Independent directors play a significant role in corporate governance since they act as the board's unbiased and nonexecutive members. Their function is to shield the interests of shareholders and other stakeholders while not becoming involved in the management of the company. Firstly,

independent directors are given the role of supporting good corporate governance, supervising executive management's work and conduct, and ensuring the reliability of financial reporting and internal controls. They are expected to provide the board with new insights on discussions related to plans risks resources, key appointments, and ethics; they also are required to review related-party transactions, audit quality, and compliance with laws and regulations. For listed companies, independent directors are required to have a significant level of involvement in key committees such as audit, nomination, and remuneration, where they participate in the selection and appraisal of management, determination of executive compensation, and governance-risk-compliance system. By restricting the control of the promoters or majority shareholders, making sure the rights of minority shareholders are preserved, and enhancing transparency as well as accountability, independent directors become the guardians of corporate honesty. They help in building investor confidence and sustainable success of Indian corporate governance.

### **Challenges in the effectiveness of independent directors:**

The largest structural problem facing the efficacy of independent directors in India is the concentration of corporate ownership in the hands of promoters. In most Indian listed companies, the shareholding of promoter families or founding groups is sufficiently high to secure the necessary number of votes at meetings of the company to elect or remove independent directors. Hence, a fundamental paradox exists wherein independent directors are elected by shareholder voting that is dominated by the group of promoters whose conduct they are supposed to oversee.

Independent directors frequently operate with incomplete or delayed information, as they are not directly involved in day-to-day operations and rely on data and management briefings filtered through executives. This lack of information may entail that directors may be willing to examine the details but they simply will not have the perspective of related-party transactions, risks that have just been identified or internal control failures that would allow them to raise the warning signs in time.

India's regulating authority has made it a rule that independent directors attend orientation and training programs which are offered by Indian Institute of Corporate Affairs (IICA) besides tightening the disclosure requirements about directors' other commitments. Yet, the fundamental issue of balancing the benefits of having the best and most sought-after professionals as independent directors with the time of genuine board activities has emerged as the main point of disagreement. The Indian regulator has spawned mandatory orientation and training programmes for independent directors through Indian Institute of Corporate Affairs (IICA) and has also raised disclosure

requirements about directors' other commitments. But the crux of the matter is that the structural tension between the advantages of having experienced and in-demand professionals serving as independent directors and the time-consuming nature of genuine board activities remains to be the main point of disagreement.

A Significant and underappreciated challenge is the growing personal liability risk faced by independent directors in the aftermath of corporate failures. The Companies Act, 2013 holding directors and even independent directors liable with both civil and criminal penalties for a very wide range of corporate breaches. Sections 149(12) and its proviso try to restrict the responsibility of independent directors only for the cases where they had knowledge or consent or were party to the wrongdoing. But the way these limitations are being implemented hasn't completely followed these restrictions. Independent directors are being implicated in proceedings and complaints in which they have not been actively involved.

As a result, this risk of liability has clearly driven away many qualified professionals from becoming independent directors, particularly in those companies that have complex regulations or where promoter governance practices cause fear. The fact that several independent directors have quit the boards of these troubled companies, this is actually a governance signal which means that they consider the reputational and legal risks are turning high and outweigh the benefits of continuing to serve as a director.

More corporate governance research has acknowledged that formal requirements on board composition, no matter how strict, are only able to reflect to a limited extent the governance results that rely on informal board culture the norms, relationships, and power dynamics that really characterize how boards operate... In numerous Indian boardrooms, the informal culture is such that it even weakens the independent judgement of directors who are formally independent due to the permitted deference to the chairperson, the unwillingness to silence one's disagreement, and the social uneasiness of confrontational situations with promoter-directors.

#### **Legal framework governing independent directors in India:**

The companies Act 2013 provided the primary statutory foundation for the independent director regime in India. Section 149 (4) mandates that every listed public company must have at least one-third of its board comprising independent director. Section 149(6), an independent director is defined

as a non-executive director who is not involved in any material financial relationship with the company, its promoters or management, and whose independent judgment is believed to be trustworthy. Six cumulative conditions covering shareholding, relationships, and transactions with the company or its group entities are laid down for the purpose.

In fact, if the chairperson of the board is an executive or whole-time director, the requirement gets strengthened to at least half of the board being independent directors. On the other hand, unlisted public companies that exceed any one of the three thresholds: 10 crore paid-up share capital, 100 crore turnover or 50 crores in aggregate outstanding loans, debentures, and deposits will be required to appoint at least two independent directors. Section 149(9) Independent directors are elected by shareholders and usually, based on the nomination and remuneration committee's proposal, are limited to serving in office for continuous five years that can only be extended by a further term of five years, after which a three-year cooling off period is required. Besides this, their removal in case of listed companies is generally done via a special resolution (75% majority) to protect them from arbitrary removal. The Code for Independent Directors found in Schedule IV includes a code of conduct that requires them to act with integrity, independence and due diligence, to regularly attend board and committee meetings, to maintain confidentiality and to disclose.

SEBI's Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015, extend and supplement the Companies Act requirements for listed companies. Regulation 17 requires listed companies to have a board of which not less than one-half comprises independent directors (where the chairman is an executive director) or not less than one-third (where the chairman is non-executive). Regulation 17A limits independent directors to a maximum of seven listed company directorships.

This amendment also required that at least one independent director on the board of a listed holding company serve on the board of a material listed subsidiary.

The companies Amendment Act of 2017 has a profound impact on Independent Directors of India. Thus, the companies Amendment Act of 2017 further strengthened the notion that the purpose of Independent Directors is to look into the affairs of the company independently, objectively and without bias'. The role, function and scope of the Independent Directors had been redrafted based on the recommendations of the two Committee reports. Other specific implications of the companies Act are Defining of Independent Director, Accountability to the Board of Directors, non-co-operation of Independent Directors can be an additional reasons for disqualification of Directors (including

Independent Directors), Means of appointment of independent Directors, Perk of being a Director. Clarifying the role and scope of Independent Directors in the companies. Limiting Independent Director to two consecutive terms of five years each, in order to introduce a fresh view and new perspective.

A Code for Independent Directors under Schedule IV outlines their professional conduct, role, and duties.

### **Case laws:**

#### **Satyam computer service limited vs Union of India (2009)<sup>3</sup>: -**

Satyam Computer Services Limited (2009): The Satyam fraud in which the founder and Chairman, B. Ramalinga Raju, confessed to cooking the account books of the company over a period of nine years, is the Indian corporate governance failure par excellence and the regulatory tipping point behind the Companies Act, 2013. The Central Government, under powers granted by the Indian Companies Act 1956 assumed control of the company through the appointment of a government designed Board of Directors. In this case, it was apparent that the independent directors' oversight of the accountant's presentation to them had been lacking, that they had approved major transactions based on management information without directing substantiation, and that a sparse profile of active, effective oversight had been exercised. The consequences of the Satyam case led to re-thinking of whether a formal test of Board independence could, without the support of genuine director engagement and formalised accountability processes, provide the governance virtue it sought to justify.

#### **Tata Sons Ltd. v. Cyrus Investments Pvt. Ltd. (2021)<sup>4</sup>: -**

The Supreme Court of India, in a case which garnered frontpage headlines, examined the removal of Cyrus Mistry as Chairman of Tata Sons and the alleged oppression and mismanagement of Tata Sons by the majority shareholders and the board.

While the proceedings, the case was primarily framed as a case of oppression and mismanagement under Section 241 of the Companies Act, 2013 and concerning the constitutional basis of Tata Sons as a private company and had broader implications for corporate governance in India. The Court

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<sup>3</sup>Satyam computer service limited vs Union of India (2009), January 9 2009 by the company law Board, Principal Bench, New Delhi (2009) law suit (Trib) 1041 (India)

<sup>4</sup>Tata Sons Ltd. v. Cyrus Investments Pvt. Ltd. (2021), (2021)11 SCC 1 (India)

found that the dismissal of the Chairman by the board was no more than following the Articles of Association and internal parliamentary machinery of the company. In arriving at this conclusion, the Supreme Court restated the primacy of board-room decision-making and the limitations to the meddling of the courts in internal matters of the corporation.

It also clarified the scope of majority power of shareholders visive minority protection. The case has become the leading authority of the doctrine of directors' authority and duties and the constitutional documents of the companies.

**SEBI v. Price Waterhouse & Co. (SAT 2010 later confirmed on appeal by the Supreme Court)<sup>5</sup>**

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In the Satyam proceedings, it was SEBI in the proceedings against Price Waterhouse & Co. (Satyam auditors) for not catching the reason that the scam was so huge.

The case, even if it was mainly about auditor liability and SEBI's jurisdiction over auditors of listed companies, also touched upon the new area of overlap between the work of audit committees and statutory audits, over which independent directors have control. This case demonstrated that the strength of the audit committee's independence and capacity depends on the extent of its knowledge of the company's affairs and the level of interrogation to which it subjects such knowledge.

If the committee (which may be a predominantly or wholly independent body) bases its assessments on false premisses or approaches the task without the necessary professional scepticism, good governance is not assured, despite adherence to prescribed rules. The Satyam Price Waterhouse episode thus becomes a lesson for independent directors in particular as to where structural independence must end and why they need to ensure that their oversight is based on not just formal but real independent action.

**Conclusion:**

The institution of independent directors, as constituted under India's corporate governance framework, represent one of the most significant structural innovations of the post-liberalisation legal order. Grounded in the logic of agency theory and information by the accumulated experience

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<sup>5</sup> SEBI v. Price Waterhouse & Co. (SAT 2010 later confirmed on appeal by the Supreme Court), 9 September ,2019 (Appeal no. 6 of 2018) (India)

of global governance reform, the independent directors is conceived as a principle, expert, and disinterested overseer the embodiment of the board's accountability to its shareholders and its obligations to broader stakeholders.

India has actually made significant legal as well as regulatory advancements towards institutionalising this concept. The Companies Act, 2013 in conjunction with the SEBI<sup>6</sup> (LODR) Regulations, 2015 and subsequent amendments provides a rather elaborate structural framework regarding selection, qualification, tenure, duties and liabilities of independent directors. The 2021 SEBI amendments especially the need for minority shareholder approval of independent director appointments in large, listed companies is a substantive step towards breaking this pervasive structural promoter control which has repeatedly threatened the independence of Indian boards.

The background of independent director in India reflects a gradual evolution from soft recommendation under clause 49 of the SEBI listing agreement to a fully codified regime under companies Act ,2013. This transition was largely influenced by corporate scandals such as Satyam and other governance related disputes like Tata Sons Ltd. v. Cyrus Investments Pvt. Ltd. These events reveal that independent directors cannot simply be considered as papers and compliance driven people; they are the "moral conscience" of the board. They are the ones willing to dissent, the ones with the courage to speak the truth, and the ones who by their position have access to accurate and reliable information ("layers of truth"). Besides the aforementioned, judgement and regulatory measures (e.g. the SEBI action against auditors and directors in the Satyam case) have shed light on a sensitive issue i.e. balancing the accountability of directors and the preservation of their independence in a manner that undue legal risks do not discourage their directorial functions.

The future reform lines should flash point be strengthening the functional independence\_ of independent directors rather than just increasing their numerical extension by various means. Several ways to transform independent directors into truly functional directors include: - the redesign of nomination mechanisms- the provision of sufficient information rights- the setting-up of safe channels for dissent- the devising of clear liability standards so that independent directors are not passive rubberstamp members on the one hand, and not unfairly penalised scapegoats for management driven misconduct on the other hand When these requirements are accomplished, independent directors are much become more dependable in executing the role to which they were intended by being the protective of corporate integrity which in turn, producing more transparent, accountable, and sustainable corporate governance in India and beyond.

Several directions for reform merit serious consideration.

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<sup>6</sup> The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, were notified on September 2, 2015, under notification, No. SEBI/LAD-NRO/GN/2015-16/013

Therefore, the role of independent directors in enhancing corporate governance and disclosure practices in Indian companies cannot be overstated. Their influence extends to board independent, diversity and effectiveness, as well as transparency, accurate reporting and compliance with regulatory requirements. By embracing their responsibilities and addressing the challenges they face, independent directors can continue to drive positive change and contribute to the sustainable growth and success of Indian companies.