Role of Independent Directors in Family Business Governance

The corporate landscape in India is transforming towards a more transparent and accountable governance. Corporate governance abuses that have come to light in the recent past have alarmed both the investors and the regulators about the manner in which corporate boards function. Public scrutiny has grown immensely on how the promoters govern their businesses, be it - structuring of businesses and transfer of assets between group companies, preferential allotments of shares to the dominant shareholder, payments for "services" to closely held group companies and so on. In this back drop, inclusion of experienced professionals as independent directors on the board has gained importance not only for the stakeholders or minority shareholders but also for the promoters.

Though having independent directors on a company's board has always been considered a best practice, it has not had the desired effect in real terms. Independent directors have largely been passive and at times even riddled with conflicts of interest. In the present times it is paramount upon family businesses to induct 'truly' independent directors on their boards to allow objective evaluation of the management's performance and well-being of the company without any conflict of interest or undue influence of interested parties. Family members on the board must let their executive actions open to scrutiny. They must be willing to be questioned on their business proposals and decisions

Need for Independent Directors

Family owned businesses have many good reasons to bring on board independent directors other than to fulfill the regulatory requirements. If inducted in the right spirit, Independent directors add a lot of value to the company.

- **Enrichment of Talent Pool**: Independent directors bring in ***expertise and diverse knowledge pool*** to the business thereby improving quality of boardroom decisions.

- **Mentoring**: Independent directors can be extremely valuable for their role of mentoring the family members. Depending on their area of expertise, independent directors can ***coach and counsel*** the family members on legal, technical, financial or leadership issues. Instead of merely following the words of an external consultant in such matters, an 'in-house' mentor in the form of the independent director is much more dependable.

- **Objectivity in Business**: They challenge management decisions and question their actions. They bring a '***voice of reason***' that counterweighs family factionalism and historical bias. They voice concerns over vested interests and serve as spokespersons of minority interests. These measures ensure that the business is run objectively and not on personal whims.

- **External Perspective**: They bring an ***outside perspective on strategy and control***. Independent directors can help others view new strategic dimensions, opportunities and risks for a business. This challenges the 'status quo' in the way business is conducted by the family and drives improvement in business practices.

- **Oversight:** Independent directors ***keep a vigil*** on the management and financial performance of the company. This contributes to improvement in corporate governance thereby enabling the business to gain all-round respect.

- **Bridge family branches:** Power struggles in the family often cloud judgment leading to poor business decisions. Without direct family ties to any one group or individual, independent directors can bring ***balance and clarity*** to resolve boardroom conflicts. They can also help improve succession planning by being a neutral and objective voice.

Family businesses can benefit by inducting distinguished qualified professionals in the capacity of independent directors on their boards as this would help their businesses to **–**

- Demonstrate to shareholders, customers and other stakeholders that their organisation is professional and successful.
- Operate at a strategic and tactical level to create and sustain growth.
- Appreciate all facets of effective business leadership and good corporate governance.
- Improve the board's effectiveness.

Desirable Qualities for Independent Directors

Law requires independent directors to be free from any material relations with the company's management, promoters and others that might interfere with the independent exercise of his/her best judgment for the exclusive interest of the company. In practice, however, for this 'legal' independence to get transformed into 'true' independence, the independent directors must not have any conflicts of interest and must voice their legitimate concerns whenever required. In order to rightfully discharge their duties, independent directors must be -

- **Knowledgeable**: Possess expertise in a desired domain and the required business / industry context within which the firm operates.
- **Sensitive**: Empathetic to a family's long-held beliefs and values (with respect to the way in which business is conducted), yet being able to see and voice concern when they are getting in the way of the company's growth and profitability.
- **Objective:** Impartially analyse business situations/decisions on their own merit. Must think and act without bias, fear or favour.
- **Inquisitive**: Vigilant and curious to know 'what' and 'why' decisions are being taken.

- **Forthright**: Ask hard questions and challenge management decisions / underlying assumptions. Candidly voice a concern or disagreement.
- **Available:** Devote quality time to oversee company affairs and be available when needed
- **Prepared:** Prepare for and attend board/committee meetings.
- **Good Team-workers**: Work well with others and bring people with divergent interests to work together towards a common business goal.

Family businesses often need a more nuanced set of behaviour and people skills in independent directors. On the one hand, they need empathy and patience in dealing with family members but on the other they need to have an ability to be "super"-independent and offer candid opinions about board and management decisions.

The Way Forward

Sound corporate governance ingrains the principles of transparency, ethics and accountability into the day-to-day business operations. Family businesses need to bring forth an environment that empowers their boards and facilitates professionalism. Independent directors can be made more effective if the company –

- Has a diversity policy
- Appoints directors through an independent and objective process
- Establishes appropriate board committees
- Shares information in a timely fashion, especially with independent directors
- Develops and follows a code of conduct
- Adopts a consultative approach in setting meeting agendas
- Records and shares minutes of the meeting

Family businesses must aim to bring independent voices on board, be open to debate and welcome alternative suggestions. They must establish individual accountability and a climate of transparency, trust and candidness in the board. Managements of family businesses need to genuinely believe that institutional sustainability is paramount. The keys to that are boardroom relationships based on integrity.

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