

INCORPORATING THE INDEPENDENT-DIRECTOR CONCEPT INTO THE NIGERIAN COMPANY LAW: CHALLENGES AND PROSPECTS*

Abstract

The purpose of identifying and appointing independent directors is to ensure that the board includes directors who can effectively exercise their best judgement for the exclusive benefit of the company, judgment that is not clouded by real or perceived conflicts of interest. The paper therefore analyses the challenges and prospects of incorporating the independent director concept into the Nigerian Company Law. The doctrinal method of legal research was adopted. The Paper found out that there was no provision on the roles of independent directors under Nigerian Company Law and therefore recommended the need to strengthen the independence of independent directors and enhance their effectiveness in the protection of shareholders' interests especially the minority shareholders by making provision on the roles played by independent directors. The appointment of independent director should be rotated periodically to ensure the transparency and fairness in their decision. Legal protection should also be provided to independent directors so that they can raise their voice against the management and force their views in the interest of shareholders.

Keywords: Independent Director, Board of Directors, Nigeria, Challenges and Prospects

1. Introduction

The independence of the board of directors of a company is fundamental to good corporate governance and in a bid to ensure independence of company board, credence has been given to the need for independent directors especially in public companies. Indeed, the necessity for an independent director on the board of directors of a company arises from the need for a director who has no personal interest to protect and can take unbiased decisions for the sole benefit of the company.¹ The presence of independent directors on the board who are capable of opposing the decisions of the management therefore plays a significant role in protecting the interests of shareholders. Because of this very reason, the word 'independence' has become such a critical issue in determining the constitution of any board and being a huge helping hand in the area of corporate governance. Thus, the need for Independent directors has increased to maintain the neutral functioning of the company.² Accordingly, the Companies and Allied Matters Act, 2020³ introduced the concept of independent directors and the requirement that at least three persons of the total directors in every public listed company are independent directors and it also laid down requirements for their appointment. The paper therefore analyses the challenges and prospects of incorporating the independent director concept into the said Nigerian Company Law.

2. Concept of Independent Directors

Independent directors are directors who apart from receiving directors' remuneration do not have any other material pecuniary relationship or transaction with company, its promoters, its management or its subsidiaries, which in the judgment of the board may affect their independence of judgment.⁴ Principle 7.2 of the Nigerian Code of Corporate Governance 2018, referred to independent director as a non –executive director who does not possess a shareholding in the company, the value of which is material to the holder, such as will impair his independence or in excess of 0.01% of the paid up capital of company; is not a representative of a shareholder that has the ability to control or significantly influence management among other things. The writer is of the view that an independent director does not only mean a non-executive director⁵ but also someone who does not have any direct interest⁶ in the company. Thus, in the case of *Longe vs First Bank of Nigeria Plc*,⁷ Salami JCA attempted to draw a distinction between the executive and non-executive directors when he stated that non- executive directors are not employees of the company as they do not have contract of employment and do not draw salaries and classified the executive directors as employee who owes their tenure of office to their contract of service. However, on appeal, Ogundare JSC

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¹ E Pichet, 'Defining and Selecting Independent Directors', (2017) 6 (3) *Journal of Governance and Regulation*, 41.

² V Maheshwari, 'Role of Independent Director in Corporate Governance', (2020) 6 (7) *International Journal of Multidisciplinary Research*, 205.

³ Hereinafter referred to as 'CAMA'.

⁴ K Ravindranadh, 'Role of Independent Directors in corporate Governance', (2015) 5 (11) 375, *Indian Journal of Applied Research*. 375.

⁵ Ie one who does not exercise any management functions in the company or group

⁶ Significant shareholdings, employee status etc.

⁷ (2006) 3 NWLR (pt 967) p 228.

after explaining the position of the law stated that all directors whether executive or non-executive are the same as long as they are all engaged to direct and manage the business of the company.⁸ Similarly, the Securities and Exchange Commission's Code of Corporate Governance for Public Companies 2011, defined an independent director as a director who is not a substantial shareholder of the company (holds less than 0.1%); is not a representative of a shareholder who has the ability to control management; had not previously been employed by the company *inter alia*.⁹

The Securities and Exchange Commission's Code of Corporate Governance for Public Companies also stipulates that an independent director should be free of any relationship with the company or its management that may impair or appear to impair the director's ability to make independent judgement.¹⁰ Along the same line, section 275(3) of CAMA provided that an independent director mean a director of a company who or whose relatives either separately or together with him or each other, during the two years preceding the time of appointment as director:

- (a) was not an employee of the company;
- (b) did not make to or receive from the company payments of more than N20million and own not more than 30% interest in the company;
- (c) was not engaged directly or indirectly as an auditor for the company.

Independent director is therefore a director who does not have any kind of relationship with the company that may affect the independence of his/her judgement. Thus, a director who owns more than 30% interest in the company's shares or who receives payment of up to N20 million from the company cannot be considered independent.

3. Independent Directors under CAMA 2020

In Nigerian corporate history, there is more than an even chance that 2020 will go down as a watershed year in terms of corporate governance reforms as it was the year a path breaking new CAMA found its way into the statute book. The new Act, 2020 has brought in a lot of revolutionary changes addressing wide variety of issues which among them is the introduction of the concept of independent director. A public company registered in Nigeria is mandated under section 275(1) of CAMA, to have at least three independent directors. Specific criteria must be met before person can qualify for appointment as an independent director. As such, in order to qualify for appointment as an independent director, the relevant director and/or such director's relative(s) must not in the two years preceding his appointment to the board have:

- (a) Owned directly or indirectly more than 30% of the shares of the company.
- (b) Been employed by the company
- (c) Acted as an auditor of the company; the 30% shareholding threshold mentioned above differs from the requirement of Securities and Exchange Commission Code of Corporate Governance which states that an independent director should not hold more than 0.1% of the paid-up share capital of the company.¹¹
- (d) Paid or received from the company sums exceeding N20 million or held up to 30% of the shares (or acted as a partner, director or officer) of an entity that received or made such a payment to the company.

Directors are usually appointed at the annual general meeting of the company¹². The power to appoint independent directors is vested in the shareholders. Section 275(2) of the CAMA¹³ makes it obligatory for any person who nominates candidates for the board who would comprise a majority of the members of the board of directors to nominate at least three persons who would be independent directors. This is unlike, the Securities and Exchange Commission Code of Corporate Governance for Public Companies that provides that companies should have a minimum of one independent director.¹⁴ Again, the 30% shareholding threshold contained in CAMA differ from the provision of the Nigerian Code of Corporate Governance 2018, which stipulates that an independent director should not hold more than 0'01% of the paid up share capital of the company.¹⁵ The writer is of the view that by virtue of the provision of section 275 of CAMA,

⁸ Per Ogundare JSC.

⁹ 5.5 (a).

¹⁰ 5.5 (b).

¹¹ 5.5(a) (i).

¹² CAMA, s 273 (1).

¹³ *Ibid*, 2020.

¹⁴ SEC Code of Corporate Governance 2011, Rule 5.5(c).

¹⁵ NCCG 2018, Principle 7.2.

it then means that persons holding not more than 30% of the shares of a public company could still qualify for appointment as independent directors notwithstanding the requirements of the Nigerian Code of Corporate Governance. As CAMA is a statute and takes precedence over the provisions of subsidiary legislation such as the Nigerian Code of Corporate Governance.¹⁶

4. Challenges and prospects of Independent Directors in Nigeria.

One major challenge in relation to the provisions of independent directors is in the area of their roles. CAMA 2020, did not provide some roles for independent directors. The role of independent directors is of great importance to the company and its shareholders. Much as CAMA does not specify to whom the independent directors owe their allegiance, it does not contemplate any specific role for them. There is no separate task or function assigned to independent directors. Independent directors under CAMA are treated like any other director for purposes of role and decision making and there is neither a specific privilege conferred nor a specific duty or function imposed on independent directors. Securities and Exchange Commission Code of Corporate Governance and the Nigerian Code of Corporate Governance are also silent when it comes to the roles and responsibilities of independent directors. One may believe their role to be one of advising management from a business or strategic standpoint rather than to act as monitors of management or the controlling shareholders. The writer is therefore of the view that in the absence of any such clarity in CAMA, one cannot expect any meaningful level of monitoring from independent directors. It is not clear if they are to be involved in strategic advisory functions or monitoring functions. It is also not clear if they are to owe allegiance to the shareholder body as a whole, to the minority shareholders specifically, or to other stakeholders. For good corporate governance, it is very important to have clear direction, ie what is the role of independent directors. Such lack of clarity in their roles could result in less desirable outcomes from independent director action. Independent directors should be key members of the board, they should bring independent judgment as well as necessary scrutiny to the proposals and actions of the management and executive directors such as issues of strategy, performance, evaluation and key appointments.¹⁷

Moreover, the appointment of independent directors is still in the hands of shareholders of the company. Independent directors are therefore subject to appointment at the hands of the majority shareholders, and hence may be subject to influence by the majority shareholders. This mode of appointment therefore raises the question of the independence of the independent directors. The writer is of the view that as long as independent directors are appointed by the majority shareholders, the concept of independent directors in Nigeria is a myth. Indeed, director's independence is undermined if an independent director is appointed by majority shareholders. The process of appointment of independent director has a great bearing on independence. This is unlike in India where nomination committees are responsible for identifying and recommending independent director, after consideration of their relevant skills and experiences among other factors.¹⁸ CAMA did not provide for nomination committee that could have potentially brought the appointment outside the purview of the management and majority shareholders. The writer is therefore of the view that the absence of a nomination committee presents a significant obstacle to the protection of minority shareholders interest as majority shareholders are able to determine the identity of individual who occupy the position of independent directors and they are likely to ensure appointment of such individuals who will be sympathetic to the perspectives of the majority shareholders with complete allegiance in fact towards them.

Again, there is no specific period on the number of years that a person can serve as an independent director on a board. Thus, CAMA is silent on tenure of independent director. Also, it did not prescribe a time limit for replacement of an independent director in case there is a resignation or removal or death of an existing one and the company may be taking a plea that they have not been able to find a replacement which could stretch for indefinite period. The writer is therefore of the view that a fixed tenure is key to sustaining the independence of the independent directors and that the provision on the tenure of independent director is based on the assumption that familiarity impairs the independence of an individual as it is deemed a difficult task to maintain a forceful degree of objective oversight and rationality to examine the plans and proposals of management at arm's length when close friendships and long-term association have been developed. CAMA also fails to provide for the procedure for the removal and resignation of the independent directors.

¹⁶*NNPC v. Famfa Oil Ltd* (2012) 17 NWLR (Pt 1328) 148; *NNPC & Anor vs Famfa Oil Limited* (2012) LPELR-1812 SC.

¹⁷A A Afolabi, 'Examining Corporate Governance practices in Nigerian and South African Firms', 2015, 3(1) *Journal of Accounting Auditing and Finance Research*, 16.

¹⁸ India Companies Act 2013, s 152.

Notwithstanding the shortcomings of the concept, the value of the independent directors on company board cannot be overemphasized.¹⁹ Principle 1 of the Nigerian Code of Corporate Governance 2018 accentuates the importance of an effective board in ensuring the sustenance of the propriety of the company. Independent directors act as a watchdog to ensure that the promoters and executive directors of a company carry on the activities of the company in accordance with the interests of the company. Also independent directors act as advisors to the board, critical to maximizing revenue and overall value of the company.

5. The Relationship between Independent Directors and Corporate Governance

The presence of independent directors on the board is considered to be a major corporate governance mechanism as they can improve supervision of the management theme.²⁰ The board of a company is vital to the proper management of the company and consequently an effectively functioning board is the prerequisite of a successful corporate governance model. Independent directors are charged with the mandate of bringing objectivity to the oversight function of the board and critical in the performance evaluation of the board and management and the inclusion of the appointment of the same in the CAMA and various codes of corporate governance in Nigeria is laudable. Independent directors are important component in the overall framework of corporate governance.²¹ Independent directors are expected to hold a very neutral view and should not have any interest in the company to function effectively and protect the right of the minority shareholders and the interest of the company. Apart from this, independent directors try to improve board processes and bring in specialist knowledge, they provide continuity, help identify alliance and acquisition. Moreover, independent directors help lend credibility to the organization and also send a message that an organization is open to scrutiny and value independent thinking thereby improving corporate governance.²² As such, board independence is pivotal to corporate governance.

6. Conclusion and Recommendations

Independent Directors are charged with the mandate of bringing objectivity to the oversight function of the board and critical in the performance evaluation of the board and management and the inclusion of the appointment of the same in CAMA is laudable. Nevertheless, the provisions of CAMA on independent directors have shortcomings as highlighted above, noteworthy is the question of the true independence of the independent directors, as well as the failure of CAMA to provide for the roles of independent directors. Indeed, the continuous independence of the independent directors remains immensely indispensable to the protection of shareholders' interests and as such, principle 7.4 of the Nigerian Code of Corporate Governance compels the board to annually ascertain and confirm the continued independence of each independent director of the company. Thus, there is the need to strengthen the independence of independent directors and enhance their effectiveness in the protection of shareholders' interests especially the minority shareholders. As such, the writer recommends that CAMA specify the roles played by independent directors. The writer also recommends the broadening of the eligibility criteria for appointment of independent directors to include the exclusion of persons who have been employees of not only the company but its holding and subsidiary. There should also be provision on the process of re-appointment, removal of independent directors, resignation and also provisions on casual vacancy arising in case of death, resignation and removal. Provision for removal gives the independent director a right to response and he could use this to defend himself in the event that he is being removed on account of his stance with respect of an unethical issue. Again, the independent directors are appointed by majority shareholders, this system of appointment may be influenced by the management. Moreover, considering that the primary duty of independent directors is to protect the interest of minority shareholders, there is a need for minority shareholders to have greater say in the appointment of independent directors by making the appointment to be subject to approval of shareholders through ordinary resolution thereby giving minority shareholders greater say in the appointment of independent directors. The writer also recommends that proper induction and orientation programme should be conducted to acquaint the independent directors with their responsibilities and with the operations of the company. The writer further recommends that CAMA should provide for a clearly laid out provisions on the tenure, age limit and qualification of independent directors. The person must be well educated with required experience so that he can justify the role of an independent director. The appointed independent director should be rotated periodically to ensure the transparency and fairness in their decision. Legal protection should also be provided to independent directors so that they can raise their voice against the management and force their views in the interest of shareholders.

¹⁹O A Yahaya and J apochi, 'Board of Directors and Corporate Social Responsibility Reporting of Quoted Companies in Nigeria', (2021) 7(2) *Journal of Accounting, Finance and Auditing Studies*, 42.

²⁰AR Khan, 'Corporate Governance and Corporate Social Responsibility Disclosures: Evidence from an Emerging Economy', (2013) 114 (2) *Journal of Business Ethics*, 211.

²¹ W Wang, 'Independent Directors and Corporate Performance in China: A Meta-empirical Study', (2014) 2(3) *International Journal of Business and Management*, 146.

²² M Jarfarli, 'What Factors Prevent Independent Directors from Protecting Interests of Shareholders in Cases of Conflict of Interest?' (2020) 5(3) *Journal of Awareness*, 265.