

# New Norms for Compensating Professional Directors



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**H**istorically, a large number of Indian companies have been managed and controlled by Promoter-Directors or their associates. However, globalisation and liberalisation have created new competitive pressures that make it necessary to bring experienced Professional Directors with subject-area expertise into the Boardroom. Unlike Independent Directors, such individuals have overarching and full-time responsibility for particular functional or operational areas, and they therefore expect to be compensated in line with industry/market norms. The Companies Act and its subsidiary rules and schedules restrict the overall compensation to Directors to 11 per cent of the company's net profit; anything above that requires Central government approval. On the other hand, the Act provides certain relaxations to companies which make no profit, or which do not make enough to adequately compensate their Professional Directors. Recently, the rules concerning the appointment and remuneration of Directors have been amended – and this deserves attention

### Appointment

One of the prerequisites for appointing a Director without Central government approval is that the appointee should not have been sentenced to imprisonment for any period, or to a fine exceeding Rs 1,000, for any offence under the Companies Act. Previously, this stipulation only covered offences under the new Act, but a recent amendment rightly extends this to cover any existing or previous company law. This brings greater uniformity to the appointment rules.

### Remuneration

Earlier, a Professional Director could be paid remuneration up to the higher of either the applicable effective capital and the relevant remuneration as prescribed in the Schedule, or 2.5 per cent of the current profit of the company. This 2.5 per cent cap has been removed by doubling the remuneration as applicable to the company's effective capital.

### Interest in Holding and Subsidiary Companies

The revised rules have tightened the definition of 'interest' as it applies to Promoter-Directors. Earlier, such interest was restricted only to companies in which he is a Professional Director, but it has been now extended to holding and subsidiary companies. This means that, for a Director's compensation not to require Central government approval, that individual can have no



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the shares held through ESOPs or qualification shares cannot exceed 0.5 per cent of the paid-up share capital. While the concept of qualification shares has been discontinued under the new Act, those who already hold such shares can continue to do so, but new qualification shares cannot be issued. Further, the term ‘securities’ has been replaced by the word ‘capital’, which means that debentures and bonds are not covered.

### Qualification of Professional Directors

A new requirement has been introduced wherein, to be paid the appropriate remuneration (as defined above), Professional Directors must hold at least graduate-level qualifications, and have expertise and specialised knowledge in the field in which the company operates. Earlier there was no such requirement concerning qualifications or expertise.

### Summing up

The recent amendments have relaxed certain rules around the remuneration of Professional Directors – and in a nutshell, this is generally beneficial to them. At the same time, keeping in mind the interests of various stakeholders, including the company’s management, the rules concerning the appointment of Directors who have been convicted of any violation of company law, have been tightened. In sum, these changes should help build a stronger consensus within the organisation for shareholders and Directors to work together for the betterment of the company. Power, though, will continue to lie in the hands of shareholders – who, being the owners of the company, must decide how much to pay their Directors for their valuable inputs and hard work. ■

interest, either directly or indirectly, in the firm’s capital, or in any of its holdings and subsidiaries through any statutory structures. Further, the Director should not have had any direct or indirect interest in the company, the holding company, or any of its subsidiaries, at any point in the two years before or after the date of appointment.

### Shareholding Criteria

Another change relates to the securities holdings norms for Professional Directors. Earlier such individuals hold securities that are nominally valued at Rs 5 lacs or more, but now