A STUDY ON CORPORATE GOVERNANCE PRACTICES

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ABSTRACT

Mergers and Acquisitions scenario started changing in India after the introduction of liberalization process in 1991.The policy initiatives of the Government led to a structural transformation in the Indian industries. This industrial transformation has provided a launch pad for the corporate to grow and expand through Mergers and Acquisitions strategy. Corporate governance broadly refers to a set of practices that are designed to govern the behaviour of corporate enterprises. In the backdrop of several American corporate debacles, corporate governance has been increasingly seen as a means to promote healthier corporate practices and to check the errant enterprises. In this context, Mergers and Acquisitions serves as a vital instrument of corporate governance to increase corporate efficiency.

Corporate governance in the context of a company, deals with laws, procedures, practices and implicit rules that determine a company's ability to take managerial decisions vis-a-vis its stakeholders. In this paper, an attempt has been made to present the relationship between corporate governance and mergers and acquisitions. Further, an exploratory attempt has been made to analyse the impact of Mergers and Acquisitions on share price behaviour to identify the important issues, which could improve the corporate governance practices of enterprises.

***Keywords**:* Mergers, Acquisitions, Restructuring, Corporate Governance

INTRODUCTION

In the recent past, some corporate actions have proved that hostile Mergers and Acquisitions front prevailing in the Indian corporate front. Many companies are also playing safe by shoring up their holdings through buy-back of shares to thwart hostile corporate raids. In this backdrop, better corporate governance practices have become more essential.

The impact of mergers and acquisitions on corporate performance could be measured in several ways. One way of analysing is to evaluate the impact of Mergers and Acquisitions in terms of various measures of profitability before and after mergers and acquisitions. There are two sets of arguments. One set of arguments hold that significant improvement in profitability after Mergers and Acquisitions and vice-versa. Another aspect relating to the performance analysis is that many firms engaged in a series of Mergers and Acquisitions activities over a time as has been observed in the present study. Thus, it is difficult to isolate the influence of a single acquisition event. Thus, the best course of action is to investigate each of the pre and post-merger acquisitions events to analyse impact, which has been followed in this study.

The other way to measure the performance is to monitor the share prices after the merger or acquisition deal is struck, which assumes that stock markets are efficient. Empirical studies of this type indicate that a target firm's shareholders benefit and the bidding firm's shareholders either gain or do not lose. An exploratory attempt has been made here to investigate the impact of Mergers and Acquisitions on share price behaviour of the acquiring firms. This study concentrated only on acquiring firms, as relevant data is not available for target firms because either they are merged or taken over by the acquiring firms.

It is observed that in majority of the cases acquiring company's shareholder's gain due to the Mergers and Acquisitions. This also in consistent with the literature that Indian stock markets do take a positive view of M&A strategies being adopted by the Indian companies. As has been stated in the research findings, the reasons for appreciation may be related to the anticipated value enhancement of the merged entity as a result of expected increase in cash flows from the Mergers and Acquisitions.[i], This is in tandem with the arguments that the shareholders might have taken into account the expected increase in performance due to better profitability, market leadership, new growth prospects and cost efficiency. It has also been found from the literature that takeovers are motivated by expectations of improved performance due to the realization of synergistic benefits, which reflected in the share prices. This has been reflected in motives of Indian Mergers and Acquisitions which might have caused the share prices appreciation. A Strong R&D and Strategic alignment has also emerged as important motive of Indian M&As which may have influenced the share price behaviour of the Indian enterprises. However, there are some important issues, which needs to be taken care of for better corporate governance practices when corporate enterprises indulge in mergers and acquisitions.

ISSUES AFFECTING CORPORATE GOVERNANCE PRACTICES

Below mentioned are top ten issues affecting corporate governance practices in India

1. Getting the Board Right

Enough has been said on board and its role as the cornerstone for good corporate governance. To this end, the law requires a healthy mix of executive and non-executive directors and appointment of at least one woman director for diversity. There is no doubt that a capable, diverse and active board would, to large extent, improve governance standards of a company. The challenge lies in ingraining governance in corporate cultures[ii] so that there is improving compliance "in spirit". Most companies' in India tend to only comply on paper; board appointments are still by way of "word of mouth" or fellow board member recommendations. It is common for friends and family of promoters (a uniquely Indian term for founders and controlling shareholders) and management to be appointed as board members. Innovative solutions are the need of the hour - for instance, rating board diversity and governance practices and publishing such results or using performance evaluation as a minimum benchmark for director appointment.

2. Performance Evaluation of Directors

Although performance evaluation of directors has been part of the existing legal framework in India, it caught the regulator's attention recently. In January 2017, SEBI, India's capital markets regulator, released a 'Guidance Note on Board Evaluation'. This note elaborated on different aspects of performance evaluation by laying down the means to identify objectives, different criteria and method of evaluation. For performance evaluation to achieve the desired results on governance practices, there is often a call for results of such evaluation are made public. Having said that, evaluation is always a sensitive subject and public disclosures may run counter-productive. In a peer review situation, to avoid public scrutiny, negative feedback may not be shared. To negate this behaviour, the role of independent directors in performance evaluation is key.

3. True Independence of Directors

Independent directors' appointment was supposed to be the biggest corporate governance reform. However, 15 years down the line, independent directors have hardly been able to make the desired impact. The regulator on its part has, time and again, made the norms tighter: introduced comprehensive definition of independent directors, defined a role of the audit committee, etc. However, most Indian promoters design a tick-the-box way out of the regulatory requirements. The independence of such promoter appointed independent directors is questionable as it is unlikely that they will stand-up for minority interests against the promoter. Despite all the governance reforms, the regulator is still found wanting. Perhaps, the focus needs to shift to limiting promoter's powers in matters relating to in independent directors.

4. Removal of Independent Directors

While independent directors have been generally criticised for playing a passive role on the board, instances of independent directors not siding with promoter decisions have not been taken well - they were removed from their position by promoters. Under law, an independent director can be easily removed by promoters or majority shareholders. This inherent conflict has a direct impact on independence. In fact, earlier this year, even SEBI's International Advisory Board proposed an increase in transparency with regard to appointment and removal of directors. To protect independent directors from vendetta action and confer upon them greater freedom of action, it is imperative to provide for additional checks in the process of their removal - for instance, requiring approval of majority of public shareholders.

5. Accountability to Stakeholders

Empowerment of independent directors has to be supplemented with greater duties for, and accountability of directors. In this regard, Indian company law, revamped in 2013, mandates that directors owe duties not only towards the company and shareholders but also towards the employees, community and for the protection of environment. Although these general duties have been imposed on all directors, directors including independent directors have been complacent due to lack of enforcement action. To increase accountability, it may be a good idea to require the entire board to be present at general meetings to give stakeholders an opportunity to interact with the board and pose questions.

6. Executive Compensation

Executive compensation is a contentious issue especially when subject to shareholder accountability. Companies have to offer competitive compensation to attract talent. However, such executive compensation needs to stand the test of stakeholders' scrutiny. Presently, under Indian law, the nomination and remuneration committee (a committee of the board comprising of a majority of independent directors) is required to frame a policy on remuneration of key employees. Also, the annual remuneration paid to key executives is required to be made public. Is this enough? To retain and nurture a trustworthy relationship between the shareholders and the executive, companies may consider framing remuneration policies which are transparent and require shareholders' approval.

7. Founders' Control and Succession Planning

In India, founders' ability to control the affairs of the company has the potential of derailing the entire corporate governance system. Unlike developed economies, in India, identity of the founder and the company is often merged. The founders, irrespective of their legal position, continue to exercise significant influence over the key business decisions of companies and fail to acknowledge the need for succession planning. From a governance and business continuity perspective, it is best if founders chalk out a succession plan and implement it. Family owned Indian companies suffer an inherent inhibition to let go of control. The best way to tackle with this is widen the shareholder base - as PE and other institutional investors pump in capital, founders are forced to think about a succession plan and step away with dignity.

8. Risk Management

Today, large businesses are exposed to real-time monitoring by business media and national media houses. Given that the board is only playing an oversight role on the affairs of a company, framing and implementing a risk management policy is necessary. In this context, Indian company law requires the board to include a statement in its report to the shareholders indicating development and implementation of risk management policy for the company. The independent directors are mandated to assess the risk management systems of the company. For a governance model to be effective, a robust risk management policy which spells out key guiding principles and practices for mitigating risks in day-to-day activities is imperative.

9. Privacy and Data Protection

As a key aspect of risk management, privacy and data protection is an important governance issue. In this era of digitalisation, a sound understanding of the fundamentals of cyber security must be expected from every director. Good governance will be only achieved if executives are able to engage and understand the specialists in their firm. The board must assess the potential risk of handling data and take steps to ensure such data is protected from potential misuse. The board must invest a reasonable amount of time and money in order ensure the goal of data protection is achieved.

10. Board's Approach to Corporate Social Responsibility (CSR)

India is one of the few countries which has legislated on CSR. Companies meeting specified thresholds are required to constitute a CSR committee from within the board. This committee then frames a CSR policy and recommends spending on CSR activities based on such policy. Companies are required to spend at least 2% of the average net profits of last three financial years. For companies who fail to meet the CSR spend, the boards of such companies are required to disclose reasons for such failure in the board's report.[iii] During the last year, companies which failed to comply received notices from the ministry of corporate affairs asking for reasons why they did not incur CSR spend and in some cases questioning the reasons disclosed for not spending. In these circumstances, increased effort and seriousness by the board towards CSR is necessary. CSR projects should be managed by board with as much interest and vigour as any other business project of the company.

CONCLUSION

As far as structural and regulatory changes are concerned, India has witnessed several enactments - the Companies Act, 2013 and SEBI's listing obligations and disclosure requirements regulations, which have contributed significantly in strengthening governance norms and in increasing accountability by way of disclosures. Interestingly, these changes have been inspired by the Anglo-Saxon model of corporate governance, which is probably one of the key reasons behind current practices of corporate governance not achieving the desired level of fruition. For achieving desired results, it is important that regulatory measures are modelled based on the practices and business environment in India. To state the obvious, this should be coupled with the board and the promoters' embracing such reforms - in form and spirit.

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