CORPORATE GOVERNANCE: A GAME CHANGER FOR M&A

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ABSTRACT

Corporate governance has emerged as a pivotal factor influencing the landscape of mergers and acquisitions (M&A) in contemporary business environments. This paper explores the transformative role of effective corporate governance practices in shaping the outcomes and dynamics of M&A activities. By analyzing case studies, empirical research, and industry trends, the study underscores how robust corporate governance structures enhance transparency, accountability, and stakeholder engagement, consequently mitigating risks and enhancing value creation in M&A transactions. The abstract further delves into the intricate interplay between corporate governance mechanisms, board oversight, executive leadership, and shareholder activism, illustrating their impact on M&A decision-making processes and post-transaction integration. Through a comprehensive analysis, this paper demonstrates how corporate governance acts as a game changer in M&A, fostering sustainable growth and competitive advantage for organizations in today's ever-evolving business landscape.

Keywords: Corporate Governance, Mergers and Acquisitions, M&A, Transparency, Accountability, Stakeholder Engagement, Value Creation, Risk Mitigation, Board Oversight, Executive Leadership, Shareholder Activism, Decision-making, Integration, Sustainable Growth, Competitive Advantage, Business Landscape.

INTRODUCTION TO CORPORATE GOVERNANCE AND ITS ROLE IN M&A TRANSACTIONS

Few decades ago, business practices were not complicated as they are now, and the employees and other people of the firm were much devoted and reliable. And so there was not much need to focus on various stakeholders and their practices or to come with a specific set of rules and regulation for the purpose of regulating their conduct. With advent of time, practices within a company have changed. Businesses have become more complex and so is the relationship between company and its management/employees. Also, with the advent of globalization, competition in the commercial world has increased wherein every company strives to perform better than the other. For this, they adopt various practices, within the company as well as with the outside environment so as to achieve their goals. These practices and trends keep on changing and firms have to adopt the same in order survive the competition. One such crucial practice is of corporate governance that ensures survival, growth, and success of any company. The concept of 'Corporate Governance', over the years, has gained wider meaning and is an essential component for functioning of very organisation. It is a set of rules and practices that regulates corporate behaviour. It controls and directs the firm's behaviour and helps balance the interests of various stakeholders of the company.

At the same time, after globalisation, companies started merging or acquiring other companies so as to grow, diversify and reach global markets. M&As involve two countries coming together with the common motive of achieving success and securing maximum profits. But, as no two companies follow common set of principles, practices and work ethics, their mode of achieving this goal might also be different. This is where corporate governance comes to play. How the companies work together in synergies so as to take maximum benefit of the transaction is essential and this is reflected by their governance practices.

Corporate governance practices play a crucial role in any scheme of merger or acquisition. Corporate governance and M&A transactions share an inter-dependant relationship. Good corporate governance practices followed within a company ensure the success of any M&A transaction and at the same time, a carefully planned and well-analysed M&A transaction ensures good governance practices within an organisation. Good corporate governance practices are essential before any M&A activity as well as post such arrangement.

The impact of M&A transactions on corporate governance practices or vice versa can be witnessed in various different situations. It can be any M&A activity resulting in the company performing better corporate governance practices or it could be good corporate governance practices being followed by a company that induces other company to acquire or merge with it. Or there could be instances where companies adhere to good corporate governance practices so as to avoid being acquired. Whenever companies plan to enter into any M&A transaction, they automatically would tend to have good corporate governance practices so as to ensure the success of such a transaction. Also, if one of the two party companies if have better corporate governance practice than the other, it would induce the other company to enhance their corporate governance practices as well.

Sometimes, developed and credible companies tend to acquire not so well-to-do companies, who are poorly governed thinking that their management is strong and efficient enough so as to absorb the other company and run it better. Whenever a company acquires a poorly governed company, they get an opportunity to remove the inefficient managers and employees, which helps in better management and working of the resultant company and also creates better synergies. Professor Henry Mane, in his works, has argued that companies that are poorly governed are better targets for acquisitions. It is obvious that a poorly governed and mis-managed company will have a relatively lesser share value in the market. This lower price becomes an incentive for the large companies, who think that they can run the company better, to acquire the other firm. Acquiring such companies and managing them better could yield enormous profits to the acquirer company. On the other hand, the companies that are poorly governed often become target of successful companies, and if they are acquired by developed companies, their management, employees, and other stakeholders would be negatively affected. So to avoid being targets or to avoid being acquired, they tend to adopt better corporate governance practices

Although target companies have the threat of being acquired and losing its structure due to which they tend to increase its corporate governance practices. But an argument in favour of such takeovers can be that such an acquisition will help improve the internal mechanism of the poorly governed company, which eventually will benefit all the stakeholders; and will also ensure that assets of the company are utilised to its maximum potential. The theory that in order to avoid being targets, firms might adhere to better corporate governance practices is not always true. The theory can be other way round as well. A company following good corporate governance practices can be good targets as such companies become value-addition for the other company and also enhances the value of the M&A activity.

It is a fact that good corporate governance practices followed by the companies helps in ensuring success of the M&A transaction. But this success in not achieved instantly. Initially, the companies may not respond to the said transaction or may even face difficulty in coping up with the new arrangement. In cases of acquisition, the acquirer company who has invested whooping amount in acquiring the other company may not be able to earn the amount what has been invested or may even face some losses initially. Various scholars are of the opinion that in any M&A transaction, on an average, it is the shareholders of the acquiring or target company that gain initially whereas shareholders of the acquirer company do not gain anything, or sometimes even witness a decrease in their share value initially. At first instance, it sometimes becomes difficult for the acquirer company to gain potentially out of the said transaction. Whenever companies enter into any M&A transaction, there are a number of factors that affect the resultant transaction at first instance, like overconfidence that the CEO or the management shows while investing in a company may lead him paying more than what ought to have been paid, which initially can lead to decrease in value of shares of the acquirer company and may disappoint various stakeholders.

Creating value in any M&A transaction, for the acquirer company is tricky. The shareholders of the acquirer company often get no returns or sometimes even face losses initially. Usually, in short term, a company gets only the amount that it had paid for the transaction. Initially, the acquirer company can gain only if it has paid very less for the deal or if it works more than what is expected, which practically is difficult.

Theories of Scholars

Corporate governance does have a significant impact on the M&A transactions and various scholars have propounded different theories explaining the inter-relationship between the two concepts. Scholars Byrd and Hickman, in their research have propounded that M&A is a significant decision that significantly affects the company and its stakeholders. It directly affects the shareholding and monies of the shareholders. Hence being decision makers, it is the responsibility of the board to exercise due diligence and ensure that the said M&A deal is entered into considering interests of all the stakeholders and specifically to the benefit of the shareholders. Some scholars like Zhang, FengGenfu and WuJianglin have analysed the impact of corporate governance practices on the performance of the firms. They state that usually the decision making power lies in few hands, which creates a dominance power in their favour and may result in them taking M&A decisions that are against the interests of the stakeholders. Role of Board of Directors, composition of the board, its size, etc are crucial here. Another scholar Jensen, in his research has presented a co-relation between size of the board and efficiency of the deal. He states that the larger is the size of the board making decisions, the difficult it is to co-ordinate and communicate effectively, which in turn leads to poor decision making and poor corporate governance.

An Enlightened shareholder theory as also propounded by Pichet on the basis of the 'Enlightened Partnership Theory' propounded by scholar Jensen. This theory suggests that while taking any M&A related decision, interests of all the stakeholders must necessarily be considered. This approach plays a significant role in success of the M&A transaction. Considering shareholders interests while making decisions helps benefit shareholders, this in turn results in better profits to the company as well. Amongst all other stakeholders, this theory gives preference to shareholders.

Stewardship theory was also propounded by various scholars who suggests that stewards, i.e, the management of the company works with the primary aim of achieving organisational objectives. Their main aim is to increase benefits for shareholders as this in turn would automatically benefit them as well as the company. Managers are the ones that help maintain relationship between various stakeholders. This theory reflects a strong relationship between the mangers and the firm and suggests that managers play a key role in ensuring success of any M&A transaction.

ROLE OF STAKEHOLDERS IN M&A TRANSACTIONS

Mergers and Acquisitions have become a significant part of business transactions since past few decades and much of its success depends upon environment surrounding the two companies involved in it. Such transactions requiring high investment also carries with it huge risks, not only in terms of making profits out of it, but also ensuring synergies between the stakeholders of both the party companies. Stakeholders play a crucial role in managing the working of the company and the working of the stakeholders or the relationship between stakeholders directly affects the success of the company.

Stakeholders are individuals or group of individuals who having an interest in the company. Stakeholders can be internal or external stakeholders. Internal stakeholders are those who have direct relationship and interests in the company, like management, employees, investors, etc. External stakeholders do not have a direct relationship with the company, but are affected by the outcomes and decisions of the company, like government, community, consumers, trade associations, etc. Both these groups of stakeholders are essential for efficient working of any company and work hand-in-hand. Without one, the other cannot function.

The interests of stakeholders, the structure of the board of directors and the management of the company, the powers of shareholders, expectations of different stakeholders, dues from stakeholders like shareholders, creditors, etc are some key factors that helps a company take decision with respect to any M&A transaction. And whenever a company enters into any M&A transaction, the relationships between stakeholders are affected. To not only make a correct decision with respect to such transaction, but to also ensure its success, companies must take into account the interests of all stakeholders, their position and influence over the organisation. It has been witnessed at various instances that a number of merger or acquisition activities have completely failed due to poor relationships between the stakeholders or due to inefficient working of the internal stakeholders of either of the companies. For instance, in M&A transaction between Apollo Ltd. and Cooper Tire & Rubber Co., former acquired the latter but over a period of time, this acquisition proved to be a big failure. This acquisition would have first instance resulted in loss of revenue, and as soon as the management and the employees of the firms came to know about it, they stopped working. Also, as it was the Indian management managing and controlling Chinese workers, this created a lot of conflicts due to cultural differences between them. Here, the entire transaction failed as there was no synergy between the management of workers of the two companies. Due to this, it becomes necessary to have good corporate governance practices followed in both the companies so as to ensure success of the transaction and also for the survival of the company.

Role of some of the stakeholders have been analysed here-

Internal stakeholders

Employees- Usually, decisions in a company are taken by the top-level management and employees do not have any say in the decision making process. Similarly, whenever a company negotiates any M&A deal, it is the top level management who takes the decision and other stakeholders like employees, who although are significantly affected by the transaction, cannot have any say in the same. Employees are an important part of any M&A deal as they are the ones working from the ground-level, responsible for enforcement of all the decisions and for effective working of a company. If a company fails to look into the interests of the employees while entering into such a transaction, employees would resist and oppose the decision, which can even lead to failure of such a deal. Workforce is an essential component of working of any company and if their interests are not taken care of, it would hinder the entire working of the company and could lead to the company losing its workforce, and subsequently, the deal. For instance, if a company A acquires another company B wherein company A would absorb all the employees of company A and would also increase their salary to the standards of what they generally pay to their own employees. In such a situation, employees of firm B would strongly support the deal. But suppose if company A invests majority of its funds in the said acquisition, absorbs employees of firm B and so due to insufficiency of funds, reduces the salary of its employees. Or for instance company A refuses to absorb employees of company B and company B also fails to make an alternative arrangement for the same. In such a situation, employees would oppose the transaction. Here is where role of corporate governance comes to play. If a company, while entering into any M&A transaction, duly considers the interests of the employees as well, they would support the deal and work efficiently, which in turn would contribute to the success of the transaction.

Shareholders- After any M&A transaction, the share prices of both the companies involved in the transaction are differently affected. Although this transaction would lead to an increase in the share prices of both the companies in long term, but the general trend suggests that the shareholders of the acquiring company gain initially whereas the shareholders of the acquirer company may even face certain losses at the initial stage. Also, as after M&A, the number of shareholders of the resultant company increases, it even dilutes the voting powers of the shareholders. Shareholders holding minimal or a small value of shares may not even have any say in the resultant company. So if the shareholders feel that they can benefit or increase their shareholding and returns from the transaction, they would support the same and in case they are of the opinion that the transaction could dilute their shareholding and even lead to long-term losses or decrease in the value of their shares, then they would oppose the same. At many instances, after the announcement of the M&A deal, if shareholders are of the opinion that the transaction could lead to losses for them, they may even exit from the same in large numbers, which could significantly affect the share value. Or for instance if the shareholders are not offered fair prices for their shares, they may oppose the entire M&A deal or can file a suit before courts. All this can affect the M&A deal and may even contribute to the downfall of the deal.

Board of Directors- Board of Director's role is very significant in any M&A transaction as they are the ones who negotiate the deal and enter into compromise between stakeholders. The primary responsibility of director in any M&A transaction is ensuring synergies between stakeholders, managing risks and the performance of the firm, and all of it can be achieved only when good governance practices are being followed. The board of directors, being the decision makers are responsible for managing risks, ensuring value maximisation for shareholders, ensuring fair terms and conditions of the deal, strategic management of the company, etc that directly affect the success or failure of any M&A transaction. For instance, in the M&A transaction between Sprint and Nextel Communications, the two firms merged to form a different entity. But soon after the merger, there arose cultural clash between the executives of both the companies. The management of both the companies had different motives and rationale for decision making. The main focus of Nextel was to ensure best services to customers while Sprint did not consider consumer satisfaction at all while taking decisions. This led to conflicts, executives left the company and so the entire deal failed. Hence, Board of Directors, holding a key position in the company is responsible for taking decisions related to every aspect of any M&A transaction and can ensure success of the transaction by taking decisions strategically and adhering to good corporate governance practices. Taking another instance reflecting the key role the BOD have to play in decision making process in any M&A transaction, is that when board decides to merge or acquire a company or get acquired by another company, they should consider the impact that the transaction would have on shareholders. If the transaction would maximise returns for the shareholders, not in short run but in long run, then BOD should proceed further with the transaction. But if the transaction could lead to share value and share holding being diminished, causing losses to the shareholders, then board must not proceed with the transaction as opposition from any of the stakeholder can significantly affect the working of the company and can contribute to failure of the M&A transaction.

External stakeholders

Government- One of the obstacles that a company faces while entering into any M&A transaction is government intervention. Government intervenes when it thinks that the M&A deal could negatively affect the consumers, the market or any other significant group of people, or poses a threat to the security or integrity of the country or is likely to affect the economy of our country, etc. for instance, when AT&T was to acquire Time Warner, it was opposed by the US government as the said M&A deal was in contravention of the U.S. anti-trust laws. Or for instance, Tianqi Lithium, a Chinese company decided to acquire a Chile company, but the same was objected by the government as this acquisition posed threat to other competitors in the market.

Consumers- Consumers form the focal part of a company. All the work that a company does, i.e, from production, to selling, taking decisions, diversifying, merging, etc, is done to satisfy consumers in the market, which in turn yields profits and growth. Relationship of the company with the consumers indirectly affects all the decisions that a company makes. Many a times, companies involve in M&A activity only to have better consumer base and to enhance its relationship with the consumers. But at the same time, it is necessary that the company exercises due diligence while entering into any M&A transaction because if proper governance practices are not followed within an organisation, it could lead to failure of merger or acquisition, and would result in company losing its customer base.

For instance, two companies, New York Central and Pennsylvania Railroad merged wherein they dealt in the business of long distance shipment of commodities through waterways. But subsequently as the time passed, consumers started preferring highways and short distance transportation. The customer base started shifting to other modes of transportation. The only way left with the company to attract consumers was to decrease rates and charges, but due to some strict government regulations, they could not do the same. This resulted in the companies losing all their customers and hence failure of the said merger. Consumer preferences significantly affects the companies and if the companies fail to respond to the same, or if the merger or acquisition is such that it is not suitable for them to change according to the preferences of the consumers, then they would end up losing all their consumers and would also lead to failure of their M&A deal.

Trade unions- Trade Unions are important external stakeholders, especially in cross-border M&A transaction. The foreign company is bound to respond to the demands of the trade unions of the country of the other company. If they do not do so, the trade unions would oppose the deal, which can subsequently contribute to failure of such a transaction. Often employees are the ones who losses the most in any cross-border merger and so they tend to make stronger unions so as to be able to respond to the M&A deals that affects their employment or their wages. One such corporate governance practice that helps maintains relationship between trade unions and company during any M&A transaction is Collective Bargaining. Collective bargaining helps solve issues between the company and its employees/workforce. It ensures flexibility, protection of the workforce, their employment, etc.

Other Authorities and Departments- Some transactions require approvals of various sectoral heads or departments and often these sectoral head or the department does not approve a M&A transaction if it violates any of the sectoral regulations or limits or may even take longer time to give approval. This can cause hindrance in the success of the M&A deal. A merger was proposed between HDFC, a banking company and Max life, an insurance company. Insurance Regulatory and Development Board, which is the sectoral authority, did not approve the said transaction because as per section 35 of the Insurance act, a merger between an insurance company and a non-insurance company is prohibited. Similarly, the merger between RCOM and Aircel failed as the said merger required approval from a lot many authorities which took a lot of time and the said merger could not be enforced.

GOOD AND BAD CORPORATE GOVERNANCE PRACTICES AND AGENCY PROBLEM

Bad Corporate Governance Practices

M&As are a significant business transactions that must be entered into carefully and only after exercising due diligence. But sometimes, issues like managerial hubris, overconfidence of the CEO or managers in the deal, winner's curse, etc motivates the company to enter into M&A deals that should have been avoided.[i] Or at instances, the overconfidence of the CEOs or managers in the deal makes them pay much more than what ought to have been paid. This affects the shareholders as well as other stakeholders, who are left with no other option but to comply with the hasty decision of the top management. Management must avoid hasty decisions and must consider interests of all the stakeholders before entering into any transaction significantly affecting them.

Snapchat and Flipkart merger- Snapdeal is a company incorporated in India. Some of the investors of snapdeal alleged that the company is involved in mismanagement which can be witnessed from the fact that they have acquired few other companies in past and have later sold them at very low prices. Snapdeal entered into a merger with Flipkart. The investors of snapchat and other minority shareholders opposed this deal as it involved differential payouts to different investors. The employees of the companies were also disappointed due to differential remuneration system. The structure of the resultant merger was so complex that it kept on adding liabilities for the investors of the companies. Due to these various reasons, the merger was later called off. This clearly suggests that how poor corporate governance practices can lead to failure of the entire transaction.

Any cross-border M&A deal fails because of the reason that such company was ignoring any of the five principles of corporate governance, i.e., fairness & integrity, transparency & disclosures, accountability, equitable treatment to all shareholders and social responsibility.[ii] The most common reasons for corporate failures and scandals were lax board, fraud, lack of transparency and inadequate disclosure, failure of internal/external audit and unethical business conduct. For instance, an acquisition took place between Sun Pharma and Taro. Sun Pharma did not make certain disclosures at the time of acquisition, due to which dispute arose between the parties at later point of time and thus resulted in end of this transaction.

Merging the management and operations of the two companies can be a difficult task. As M&A involves coming together of two different companies having different management, work culture, operations, etc, conflicts are bound to arise. If these two companies are able to integrate well in short time, it ensures success. But practically, it becomes really difficult for management and operations of the companies to integrate as many times, the people of the company are not willing to adjust to each other's work culture or they are not able to communicate well. There are a number of people managing the companies and communication problems are bound to happen. This causes misunderstandings and disagreements, which contributes to the failure of the M&A transaction. For instance, in merger between Bank of America and Merrill Lynch, the management of the companies took a long time to combine their assets and to decide the top-management positions in the company. The lack of communication between the companies led to a number of important decisions being delayed, due to which a number of bankers left the company few months after the merger.

Many a times, the decision makers of the company become over-confident in a deal that they end up paying more than what ought to have been paid for it. Or a company, thinking a deal to be very profitable, bids much higher than the fair price. Many a times, the results are not so profitable as anticipated or the company might not be able to earn as much as it has paid for the deal. For instance, a drug manufacturing company acquires a scientific research company so as to assist the former in testing drugs manufactured by it, by paying a whooping amount. The acquirer company manufactures a drug, send it for testing to the acquired company, but due to inefficiency of the research company, they could not study the side-effects of the drug and the drug was sent out in market for sale. The drug turns out to be a huge failure due to its side effects. Now, the acquirer company incurs huge losses, due to the drug failure and also as it had paid a whooping amount in acquiring an inefficient company.

In acquisition between Quaker Oats and Snapple, Quaker Oats ended up paying $1.7 billion to Snapple despite getting warnings from various sources that that Quaker Oats is paying too much for the deal. Subsequently, due to corporate cultural differences between the two companies, the resultant transaction could not prove beneficial and Quaker Oats ended up selling Snapple with a loss of $1.6 million.

M&A transactions involve integration of two different companies having different work ethics, culture, management, etc. many a times, M&A deals fail due to cultural clashes between the management of the companies. For instance, in the merger between Daimler Benz and Chrysler, there were two different entities belonging to different sectors being merged. Chrysler had a traditional management style whereas Daimler had a very structured, decentralised and carefully planned management. The different management structures led to corporate cultural conflict between the management of the two companies, resulting in failure of the transaction. Similarly, the merger between Apollo and Cooper Tire & Rubber Co. failed because the management of the merged company comprised of Indians whereas the workers were Chinese, which led to conflicts due to cultural differences between them.

Good Corporate Governance Practices

A common practice that firms across the globe resort to, in order to respond to the increasing competition and growth in the market is Mergers and Acquisitions. Mergers and acquisitions help companies tap new opportunities, better resources, better profits, and better positions in the market. M&A also helps managers and owners to achieve growth and credibility in a shorter span of time. M&A does guarantee better synergies and growth, but at the same time it can even fail if there is mismanagement in either of the company or if efficient governance practices are not followed within the firm.

Firstly, both the firms should be clear with the objective of the transaction and must have a plan to achieve the same in synergy. For instance, if the parties merge with the aim of increasing their consumer base, it is suggested that they have a clear plan regarding their target markets, target consumers, their demands, supply in relation to demand, etc, which will act as a blueprint for the firms to achieve their target. Or if the merger is to change the shareholding patterns of the shareholders, then a clear plan is to be drawn out for providing exit option to the existing shareholders, regarding their dividend policy, voting rights, etc.

While making decisions, interests of all the stakeholders must be considered and they must be actively involved in decision making process. It also becomes the responsibility of the management to ensure that all aspects of the negotiations are properly documented so as to avoid conflicts.

In majority cases, M&A transaction changes the composition of the board and the management. It absorbs the most efficient directors and managers to form a newly constituted board, which would be responsible for taking all decisions post-merger and will pay a key role in ensuring success of the transaction. Every member of the board must act diligently and perform their roles with utmost efficiency with the motive of achieving the objective of the M&A transaction. They must ensure that interests of all the stakeholders are taken care of. They must work in synergy and must regularly hold board meeting so as to ensure proper working of the company. Many companies also appoint an Independent director that reviews the performance and working of the board and being the neutral party, also helps resolve conflict between the management. This ensures transparency and good corporate governance practices.

Agency Problems

Corporate governance is an essential element of any M&A transaction. Good Corporate governance practices help increase efficiency and ensure success of any transaction. At the same time, if good corporate governance practices are not followed by management of both the companies, it can lead to various problems like hubris, empire building, agency problem, and much more, or can even lead to failure of the entire transaction.

Agency problem is a situation of conflict of interest between management of the company, who are considered agents of the company, and other stakeholders. Some scholars suggest that the main or primary reason for agency problems arising within a firm is expropriation of shareholder’s funds. Mergers and Acquisitions significantly affect the funds and equities of various stakeholders and might even create a situation of conflict within the firm. For instance, a company A wants to merge with company B, but shareholders of company A disapprove of the same as the resultant merger would significantly affect their shareholding and can even lead to decrease in the value of shares they hold. These kinds of agency problem often arise between the management and the shareholders. It can worsen the situation and can even lead to failure of any such M&A transaction.

It is often said that the primary objective of a company is maximisation of shareholders wealth. Management is considered to be the agent of a company that performs its functions in a way that leads to increase in profits for the principal, i.e., the shareholders. It is when the agents diverge from this primary objective, it leads to agency problems and in any M&A transaction. This divergence at first instance is bound to happen. If agents constantly focus on the objective of maximising wealth for shareholders, they then can never take risks like entering into any M&A transaction, wherein huge risk is involved. But if good corporate governance practices are followed, it can prove to be beneficial for agents as well for other stakeholders. Agency problem is nothing but a disagreement between two different stakeholders of the company and a strong and effective corporate governance policy or practice within a company can help avoid such situations.

To mitigate this issue, scholars like Stephen Ross and Barry Mitnick have developed the 'agency theory'. Agency theory helps solve the issue between management, as the agent of the company, and the shareholders. In general, agency theory is the fundamental theory of corporate governance that states that in modern companies, managerial action often diverges from the main objective of constant maximization of shareholder return.[iii] According to this theory, Board of Directors plays a significant role in maintaining relationship between owners and the agents/managers. And so bigger and better the board, there are of agency problems arising within the company. Agency theory helps mitigate 'agency loss', which is the difference between the returns that shareholders would have obtained had they directly exercised control over the company and the actual returns. Agency theory principally helps decrease agency loss by providing better incentives to the management/ agent so that they increase returns for the shareholders and work considering the shareholders interests as well. Many companies do so by providing opportunity to the senior executives to buy shares at a lower price, compensating executives in proportion to the returns that shareholders get, etc.[iv]

There are two theories on the basis of which this agency theory works. Firstly, there are two different groups in a company, one is the agents, i.e., the management of the company and other is the shareholders, who are the owners of the company. The second factor is that these agents must work in a manner so as to protect interests of the owners. It also suggests that all the stakeholders, whether external or internal must work in integration so as to ensure best interest of the company, which in turn would also help reduce the agency cost. Directors herein also play a crucial role in rectifying the decisions made by the managers in a manner that they are in the interests of the shareholders. The primary focus of this theory is the principal-agent relationship wherein the goal must be to maximise profits for shareholders.

CORPORATE GOVERNMENT TRENDS IN CROSS BORDER M&A TRANSACTION

With the increase in globalisation, operations of companies are no longer restricted to their own countries. The trend of cross-border merger has rapidly increased since past few years and companies now prefer making investments through mergers and acquisitions rather than investing in shares or creating a subsidiary in other country. Cross border M&As help companies get advantage of the resources and workforce of the other country. It also helps in strengthening its marketability and competitiveness, securing more consumers, accessing better technology, R&D, services, etc. Both the party companies can take advantage of the resources available with each other. But for a particular company entering into any M&A transaction with a company belonging to a foreign country, the driving factor/ motive could be anything. For instance, an Indian company might want to merge with a US company so as ensure easy availability of capital. Or for instance, a Japanese company enters into an M&A deal with an Indian company so as to take advantage of cheap unskilled labour available in India.

Cross border M&As can be between two developed companies, two developing companies, between a developed and a developing company, etc. It has been witnessed since a decade that new multinational companies from developing nations tend to acquire and make investment in large firms in developed countries. This helps the company in the emerging market to take advantage of the resources and expertise of the developed firm. But in cross-border M&As, apart from considering factors like better opportunities and synergies, that are anyways going to benefit the company, the companies must also carefully analyse the impact that such a transaction will have on the stakeholders and corporate governance practices of the company. It is an established fact that any M&A activity affects the governance practices of both companies, but in cases where an emerging company from an emerging or developing market acquires a company from a developed market, it is the governance practices of the target company that affect and control the acquirer company. Usually, such kinds of arrangements result in better corporate governance practices being followed overall, resulting in success of the M&A transaction. For instance, in the Mittal-Arcelor merger, a company from an emerging market acquired a company from a developed market and took benefit of the good corporate governance practices that was followed in the developed markets, contributing to the success of this deal. Also, as a large amount of funds are being diverted from the emerging company to a developed company in the developed market, the board of directors and the management becomes extra vigilant and exercises due diligence at every stage. This increases governance practices within the firm.

But so is not true every time. In such transactions, the difference between the governance practices of both the countries, especially in less-developed countries, may act as a hindrance in the success of the transaction. When an emerging firm in a developing company acquiring a company in the developed market, they are subjected to the laws, regulations, governance practices, compliances of the target county, which significantly affects them and their stakeholders. Emerging market companies sometimes may even be the reason for failure of the transaction due to lack of experience, not having international governance practices, etc. A good corporate governance practice is that such an emerging firm considers interests of all its stakeholders and take their approval before entering into such a deal as it subsequently affects the acquirer company more than it affects the target company.

The best option for emerging market companies is to adopt and take advantage of the corporate governance practices of the target firm in the developed market, which reduces risks, increases efficiency and helps ensure success of such a transaction.

Board of directors play the most important role in ensuring success of the M&A transaction through effective corporate governance practices. They help mitigate risks associated with the transaction. In cross-border transactions, companies are exposed to different work environment, different culture, different regulations, etc. For instance, suppose an Indian company wants to merge with a US company, but the strict corruption laws and compliances regarding the environment in US can be a matter of concern for the Indian company. But if the management has known the rules and regulations of the other country and is well-prepared to work in compliance with the regulations and working system of the other country, the risks associated would automatically be absorbed.

Corporate Governance in India

Corporate governance as a concept was not prevalent earlier in the corporate world. Subsequently, companies started taking advantage of the loopholes and flaws in the Indian legislations. Board of Directors starting escaping from their primary responsibility, there was lack of transparency and disclosures, which led to diminishing market value of the firms. Hence need to have a governance mechanism to regulate the working of the firms and its management was felt in India. Since liberalisation, government has attempted to amend Companies Act and also so give powers to certain regulators like SEBI, RBI and various other departments so as to ensure transparency and accountability in the governance structure.

As the number cross-border M&A transactions are Increasing, SEBI has timely attempted to come up with better regulations so as to ensure transparency and to protect interest of the investors. After conducting numerous studies, one such attempt was made in 2004 wherein SEBI modified a clause in the Listing Agreement between a company and the stock exchanges.[v] This clause specifically addressed the corporate governance issue and is commonly known as 'Clause 49 '. This provided for comprehensive lists of corporate governance practices that are necessarily to be followed by the Indian companies. All the listed companies, coming under the threshold as provided by the regulation, were required to comply with the said clause. Studies show that there was a significant improvement in the corporate governance practices and success rates of M&A deals post introduction of this clause.

CONCLUSION

With the advent of globalisation, what companies primarily aim for is growth. The growth of a company can be achieved either organically, i.e, the company performing better and increasing its size, and the other way could be through mergers and acquisitions. Often, companies prefer mergers and acquisitions as a better option to grow as it yields faster results and also help companies take advantage of the reduced resources available with the other company. But ensuring the success of any M&A transaction is a difficult and crucial step for a company. M&A involves the integration of two different companies with different work environments, work ethics, corporate culture, management styles, etc. These differences often leads to conflicts, hence it becomes essential for the companies to take M&A-related decisions carefully and with due diligence so as to avoid conflicts and ensure the success of the M&A transaction. Corporate Governance practices of the companies ensure this and contribute significantly to the success or failure of the M&A transaction.

The present research focuses on two important topics of corporate practice, i.e., corporate governance and Mergers and Acquisitions. The inter-relationship or the intersection of the two concepts was never been discussed since past few decades when the world started globalising. Corporate governance and M&A share a significant inter-relationship in various ways. Firstly, a good M&A deal becomes an incentive for the companies to enhance their corporate governance practices. And secondly, at the same time, it also suggests that good corporate governance practices being followed in a company induces or acts as an incentive for the other company to enter into any M&A deal with such a company.

Generally when any M&A activity takes place, there arise a lot many issues, like a decrease in value for the Acquirer Company, a lack of co-operation and understanding between the management of the two entities, hubris, empire building, agency problems, and much more. There is also a risk of failure of such an arrangement. One of the most basic problems is the agency problem, which is the conflict of interest between the management and other stakeholders of the two entities that may arise after any merger or acquisition. Good corporate governance practices help mitigate agency problems. If the agent, i.e, the management exercises due diligence while taking M&A-related decisions and considers the interests of the principal, i.e, the shareholders, it would ensure good corporate governance practice and would contribute to the success of the transaction. And poor governance practices on the part of agents, where they neglect the interests of the shareholders contributes to the failure of the transaction. For instance, one of the reasons why the deal between IDFC and Shriram Finance failed was that the agents, i.e., the management failed to provide any value to the shareholders after the merger.

A better corporate governance practice enhances the effectiveness of M&A and creates a value for all the stakeholders. Efficient corporate governance reduces the risks involved in M&A to a great extent.

Where an emerging company acquire a large company from a developed market by investing millions of rupees, they are very careful, they analyse all the aspects and take decisions judicially. In such situations, the companies in the emerging market benefit potentially from the resources, customer base, assets, services, expertise etc of the company in the developed market that it is acquiring. It was hypothesized that the environment in target firm's countries affects the corporate governance practices of the acquirer company drastically and hence results in better corporate governance and yields positive returns to the companies. It is true that if the target company, i.e., the company in the developed market follows good governance practices, it will give the acquirer company an insight into the good corporate governance practices that are generally followed by large companies in developed nations and will also induce the acquirer company to ensure that such practices are also followed in their company. In such kind of M&A deals, it is the acquirer company that tends to follow the corporate governance practices of the acquired company.

Corporate governance is an essential element for a growth and development of a company. Whenever a merger or an acquisition takes place, the success or failure of the said agreement depends, to a great extent, on the corporate governance practices of the companies. Having a good corporate governance regime is important while the scheme of arrangement is taking place and also equally important post-arrangement. Weak Corporate governance practices could lead to failure of the new arrangement between companies. M&A activities are such that it could be very beneficial for both the companies in long run, or it could be disastrous to both the companies. The result depends on how good the corporate governance of the companies is.

ENDNOTES

i Richard Roll, Empirical Evidence of Overbidding in M&A Contests [2016] CIT https://authors.library.caltech.edu/78846/1/sswp1426.pdf.

ii Dr. Nayantara Padhi and Dr. Kamal Vagrecha, "A Study on Corporate Governance Practices of Indian Financial Sector Companies" [2017] IGNOU 14.

iii Lex Donaldson & James Davis, "Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns" [1991] AJM.

iv Maxim Sevastyanov,"The role of corporate governance in mergers and acquisitions: how board structure affects M&A performance" [2016], <https://dspace.spbu.ru/bitstream/11701/5192/1/Master_thesis_Maxim_Sevastyanov.pdf>.

v Burcin Col, "The Role of Corporate Governance for Acquisitions by the Emerging Market Multinationals: Evidence from India" NSEIndia, < https://www.law.ox.ac.uk/sites/files/oxlaw/oscola_4th_edn_hart_2012quickreferenceguide.pdf >.