

Corporate Governance During the Covid-19 Pandemic

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Abstract

The purpose of this article is to present some of the challenges that companies faced during the Covid-19 pandemic and how corporate governance practices helped them or not in adapting to the new business environment.

Boards of directors apply market defense tactics to avoid hostile bids. Various takeover defenses were shown for Standard & Poor top 500 companies in 2020 and a qualitative analysis was performed on these defense takeover tactics.

This study contributes to present literature on market reactions to Covid-19 outbreak in terms of corporate governance responses and emphasize key guidelines of good practice in takeover defense.

Key words: corporate governance, corporate citizenship, COVID-19, takeover defense.

J.E.L. classification: G32, G34, O16.

1. Introduction

Corporate governance provides a greater degree of assurance that at company level is implemented an effective control system that guarantees that the business is conducted in the interest of shareholders and stakeholders. The agency theory points out that corporations' act like agents for the shareholders. The shareholders give custody of their resources to the officers or board of directors of the company. The theory agency explains also the relationship between the agency in which one party, the principal, appoints another party, the agent, to perform a particular service. The agency problem rises when both parties seek to maximize their benefits and the agent – officer, director, disengages from the shareholders' interests.

Corporate governance establishes a framework assembling the agent-principal relationship. The set of rules care to line up the incentives of principals with those of shareholders, preventing disruptions of corporate interest from officers and directors, so the agency theory grants the principals' duties owned to the corporation.

2. Theoretical background

With the global public economic and health crisis commenced, companies had to intensify their preoccupations more than measuring the impact on operations. The valuations generally decreased as Covid-19 impacted market volatility, inevitably attracting disruptions in credit markets, whilst partial market dislocation engaged an increase of controversial situations of mergers and acquisitions (M&A). Nonetheless, as the initial disturbance of COVID-19 and the turmoil on health and economic started to diffuse, well-resourced bodies draw their attention on identifying and seeking opportunities. Lead bidders had a multitude of factors to adopt more often hostile tactics than in recent years. Consequently, this trend raises new challenges for boards and executives as companies are more vulnerable to potential attacks compared with the *ordinary course of business* (Webster, 2021).

Like in every other crisis, there are winners and losers, and companies used these special circumstances to grow and gain new markets using takeovers. Whenever the acquiring procedure is accomplished with the management support of the target company, it's the case of a friendly takeover. Else, when the acquirer undertakes it against the will of management, bidders might consider more valuable to make a proposal directly to shareholders, resulting in a hostile takeover. The companies are mitigating this risk using strategies termed as takeover defense measures or antitakeover defense provisions.

The Covid-19 crisis offered the opportunity to analyze how different governance methods influence corporate governance. Studying and capitalizing on the pandemic outrage will make a clear image in research and practice on which corporate mechanism and why they can safeguard companies on worse crisis consequences and can support them in their rehabilitation.

In the first half of 2020, in Romania, the M&A market recorded significant increase of 28% transactions compared with the precedent year, according to Deloitte Romania, valuing around 1.2 billion Euro. Investors focus on companies that came through the Covid-19 pandemic, adapting their activities, developing new technologies and increased their performance, particularly technology companies, renewable energy sources, healthcare and real estates (Deloitte, 2021).

The main objective of the article is identifying different corporate governance measures that companies adopted in 2020 highlighting the challenges on corporate level, mainly the takeover defense measures that companies opted for in the course of the last year.

3. Research methodology

The research analysis was made on the takeover defense strategies applied by the Standard & Poor's 500 large companies listed on United States stock exchanges, divided into economic sectors. Data was accessed from Eikon Reuters Database, using an academic subscription account, selecting from the Environment Social Governance Data, the data concerning the Takeover Defense referring to the American current fiscal year (1 October 2020-30 September 2021)

4. Findings and discussions

The research refers to the *Takeover Defense Market View*, using the S&P 500, for ten types of industries, calculated for the year of 2020. Data was collected from Eikon Reuters database, a platform with subscription request access. the reason of using this population is the availability of data.

2020 was a difficult year for everybody and companies were not excepted. In times of crises there are losers and winners. To avoid hostile takeovers, companies choose to adopt various strategies to the corporate charter that will financially impact the shareholders of the target companies. The *shark repellent tactics* and *poison pill strategies* are effective in counteracting a takeover but they also translate into decline of shareholder value.

There are three categories of measures taken to avoid hostile takeovers of companies: provisions in force, board structure and the voting provisions.

- **Provisions in force**

Poison pill is the name of a defensive method that target companies might use that will increase the cost of takeover further than the acquirer wanted to pay and discourage the takeover pursues. The tactic also reduces considerably shareholder value (Malatesta et al., 1988). Only in two economic sectors, consumer cyclicals and technology, the drastic tactic was adopted for the American public companies from the S&P 500 top.

With *Staggered board of directors'* tactic, the election time for directors will be different on multiyear terms, the goal is taking much longer time to vote and will discourage the potential raider to control the company and lose interest. Company management benefits from staggered board of directors but shareholders will not have any benefit from it. There were companies in every analysed sector to adopt this tactic.

Golden parachute was one of the favourites tactics in mergers and acquisitions for the top companies analysed and refers to a very high compensation or financial benefits guaranteed to the executive of a company that is overtaken and loses job. This tactic makes the company less interesting for the bidder (Brown, 2002).

Unlimited authorized capital or blank check is a stock method in which shareholders pre-approve new classes of favoured stocks to be issued in the future whenever the board of directors considers. The new stock can also be created by public companies in case of a hostile bid for the company as a takeover defense and it was mostly used by the S&P 500.

Limited Shareholder Rights to Call Meetings – the members representing 5% of the share capital, entitled to vote in the general meetings of the company can call a general meeting, according to Companies Act 2006. The majority of the meetings are called by directors.

Limitations on Removal of Directors The shareholders of a company can remove the director of the company or replace the director before term though an ordinary resolution, according to Companies Act 2013.

Limitation of Director Liability – personal liabilities of a director to the company or its shareholders counteracts with its fiduciary duty, acting in good faith and integrity (Lawinsider).

Shareholders have the right to act under their *written consent* instead of meetings with no or little notice to the company.

The goal of a *Fair Price Provision* refers to mandating a 80% vote to approve certain transactions so it protects the shareholders against a hostile takeover when an acquirer buys the majority voting interest and then achieves the remaining shares by a coercive fusion paying the an amount lower than the fair value. The price is a multiple of the target company’s price-to-earnings ratio (Forexbite).

The *pre-emptive rights* clause refers to the right of shareholders of a company to acquire the new issued stock before going on the market, with the intention to protect their ownership stake in the corporation.

Company Cross Shareholding happens when a publicly traded company owns stakes in another company of the same kind.

The *Constituency Provision* statute offers the directors of companies the right to balance interests of stakeholders instead of focusing only on shareholders value maximization in a way that would affect the long-term sustainability of the corporation.

All tactics taken by corporation in specified industries are shown in the following table.

Table no. 1 Takeover Defense - Provisions in Force, S&P 500

| Index: S&P 500 | Industrials | Healthcare | Consumer Cyclicals | Technology | Utilities | Financials | Basic Materials | Consumer Non- Cyclicals | Energy |
|---|-------------|------------|-----------------------|------------|-----------|------------|--------------------|-------------------------------|--------|
| Historical Poison Pill | 0% | 0% | 9.7% | 2.9% | 0% | 0% | 0% | 0% | 0% |
| Staggered Board Structure | 23.4% | 35.3% | 22.4% | 17.3% | 4% | 10.7% | 17.4% | 7.9% | 13% |
| Golden Parachute | 98.4% | 98% | 98.7% | 94.7% | 100% | 94.6% | 100% | 94.6% | 87% |
| Unlimited Authorized Capital or Blank Check | 92.1% | 98% | 92% | 93.5% | 83.3% | 96.4% | 90.9% | 89.2% | 100% |
| Limited Shareholder Rights to Call Meetings | 98.4% | 100% | 100% | 100% | 100% | 100% | 100% | 97.4% | 100% |
| Limitations on Removal of Directors | 53.6% | 59.1% | 62.5% | 44.9% | 75% | 44.2% | 71.4% | 33.3% | 47.4% |
| Limitation of Director Liability | 100% | 100% | 100% | 100% | 100% | 100% | 95.7% | 100% | 100% |
| Written Consent Requirements | 52.5% | 53.1% | 57.6% | 42% | 75% | 48% | 50% | 69% | 27.3% |
| Fair Price Provision | 83.3% | 60% | 78.6% | 64.3% | 83.3% | 93.3% | 83.3% | 63.6% | 57.1% |

| | | | | | | | | | |
|--|------|------|------|------|------|------|------|------|------|
| Pre-emptive Rights | 5.6% | 0% | 5.7% | 6.1% | 4.3% | 0% | 0% | 3.1% | 0% |
| Company Cross Shareholding | NA | NA | 0% | 0% | NA | NA | NA | NA | NA |
| Advance Notice for Shareholder Proposals | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |
| Advance Notice Period Days | 89.9 | 88.8 | 89.2 | 88.7 | 80.9 | 92.5 | 82.8 | 90.3 | 94.2 |
| Expanded Constituency Provision | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |

Source: Authors' selection from ESG Eikon Reuters Database, 2021

• **Board Structure**

The board of directors is the executive committee and represents the utmost authority in the management structure of a corporation or public traded company that supervises the activities of the company. The board controls and monitors the performances of the management and acts in the best interest of the company and of shareholders. Its size, composition, diversity, duties and powers are important corporate governance tools.

Table no. 2 - Takeover Defense - Board Structure, S&P 500

| Index: S&P 500 | Industrials | Healthcare | Consumer Cyclical | Technology | Utilities | Financials | Basic Materials | Consumer Non-Cyclical | Energy |
|--------------------------------------|-------------|------------|-------------------|------------|-----------|------------|-----------------|-----------------------|--------|
| Board Size | 10.8 | 10.8 | 10.8 | 10.3 | 12 | 12.8 | 10.7 | 11.9 | 9.9 |
| CEO Board Member | 98.6% | 98.3% | 95.1% | 96.5% | 100% | 100% | 100% | 95% | 100% |
| Number of Board Meetings | 7.8 | 8.5 | 8.1 | 9.1 | 9.3 | 9.9 | 7.5 | 7.7 | 8.4 |
| Female on Board | 25 | 27.7 | 28 | 27.2 | 28.4 | 29.2 | 27.1 | 29 | 23.8 |
| Audit Board Committee | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 95.7% |
| Nomination Board Committee | 78.3% | 75% | 88.9% | 88.4% | 57.1% | 82% | 80.8% | 70% | 78.3% |
| Compensation Board Committee | 100% | 95% | 96.3% | 97.7% | 82.1% | 95.1% | 96.2% | 92.5% | 100% |
| Corporate Governance Board Committee | 97.1% | 96.7% | 97.5% | 100% | 100% | 98.4% | 100% | 95% | 87% |
| CSR Sustainability Committee | 65.2% | 78.3% | 63% | 79.1% | 96.4% | 68.9% | 96.2% | 92.5% | 95.7% |
| Highest Remuneration Package | 13.8 | 18 | 19 | 28.6 | 13.4 | 14.6 | 13.4 | 16.2 | 18.8 |
| Total Senior Executives Compensation | 32.7 | 42 | 41.8 | 53.6 | 29.6 | 40.5 | 31.6 | 40.9 | 45.2 |
| Board Member Compensation | 2.9 | 3.7 | 2.9 | 3.2 | 3.1 | 3.8 | 2.9 | 3.4 | 3 |

Source: Authors' selection from ESG Eikon Reuters Database, 2021

- **Voting provisions**

Voting rights plan is a company clause that the board of directors add to the charter to regulate or restrict the voting rights of shareholders on issues if their ownership surpasses 20% of shares. Management can use the rights plans in takeover defense, preventing potential acquirers from voting pro or against of a takeover bid.

Table no. 3 - Takeover Defense -Voting Provisions, S&P 500

| Index: S&P 500 | Industrials | Healthcare | Consumer Cyclical | Technology | Utilities | Financials | Basic Materials | Consumer Non-Cyclical | Energy |
|--|-------------|------------|-------------------|------------|-----------|------------|-----------------|-----------------------|--------|
| Supermajority or Qualified Majority Vote Requirements | 61.9% | 59.2% | 63% | 52% | 52.4% | 64.3% | 56.5% | 29.4% | 63.6% |
| Significant Company Transactions (M&A) Shareholders Approval | 92.5% | 95.2% | 70.7% | 90.9% | 71.4% | 86.4% | 100% | 73.1% | 88.2% |
| Elimination of Cumulative Voting Rights | 95.7% | 93% | 100% | 96.7% | 86.4% | 86.7% | 94.1% | 96.2% | 100% |
| Confidential Voting Policy | 91.2% | 95.2% | 86% | 88.4% | 100% | 91.4% | 83.3% | 95.5% | 100% |
| Shareholders Vote on Executive Pay | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |

For Telecommunications Services industry - N/A

Source: Authors' selection from ESG Eikon Reuters Database, 2021

5. Conclusions

Although corporate governance cannot be an evident spotlight during a pandemic, the corporate governance structures are tested for their strengths and weaknesses and make the difference in the long term for their stakeholders.

Capital management – In the Covid-19 context, there were changes within workforce and shareholders experience. The remuneration schemes were brought into discussion, like pay ratios decreases to adapt to the workforce and compensations plans and other remuneration characteristics. Shareholders would hold a higher attention to remuneration proposals for 2022, ensuring a compensation program adjusted to company’s strategy and commitments to stakeholders.

Board structure – the pandemic was a great opportunity to evaluate the boards in terms of structure, size and diversity, for board of directors respectively. The diversity of the executive teams has to be assessed and especially the directors that are involved in multiple boards and have a weaker capacity of appropriate supervision in times of uncertainty. Governance and oversight processes need to perform effectively, with good attendance rates at meetings and strong planning capacity.

Risk management is another process that needs close examination for a transparent communication, together with business continuity planning and crisis management. Companies must ensure their supply chain risks are safe and respond in such environments where lockdowns and border closures can block their supply chains.

Information technology risks are a constant concern point, tough in times of crisis risks are getting greater. The internal control function and cyber security systems are vital for business continuity. Risk management and cyber governance defense framework are mandatory in times of remote work and business disruptions (FraudWatch International, 2020).

We align to the opinion of Araujo et al. (2020) considering there are three key action items to be considered in preparing for unsolicited bids. First is about a comprehending the intrinsic value of the company. Second is about evaluating the factors that might drive the company vulnerable and prepare response strategy addressing the weaknesses and emphasizing the strengths of the company. Third action is about the continuous and efficient engagement and communication with shareholders.

In a changed world, due to COVID-19 pandemic, it is needed a more complex takeover defense although boards have the same duty, responding in a clear and steady manner, taking key decisions, protecting best the interests of shareholders.

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