

THE INFLUENCE OF BOARD DIVERSITY IN M&A DECISION-MAKING

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ABSTRACT

This paper mainly focuses on board diversity and M&A decision-making. Apart from that the paper also covers the concept of dimensions of diversity, M&A transactions, challenges faced in the diversity in the boardroom, and corporate governance in terms of adopting the diversity in the boardroom of the company. It elaborates on the impact that occurs in the mergers and acquisition decision-making through the diversified board members. The board of directors is the decision-maker to achieve the goals and objectives of the company and diverse board varied opinions and insights would arise in the meeting, different perspectives help to analyse the best idea and implement it in the company. Though the Companies Act had given some requirements on the directors of the company as appointing one woman director, appointing an independent director doesn't fully make the board diversified. So, this paper will give the importance and understanding of the diversity in the board of directors.

Keywords: Board Diversity, M&A Decision-Making, Different Perspectives.

INTRODUCTION

Journal of Legal Research and Juridical Sciences

The board of directors is the representative of the shareholder's interest and the board provides its assistance and advice to the CEO and executive team of the company. It is necessary for every incorporated company to have a board of directors to act as a decision-making body. The directors of the company make the best decisions in board meetings for the future growth and development of the company. The board of directors should be comprised of a minimum of 3 directors in a public company, 2 directors in a private company, and one director in a personal company which is mentioned in section 149(1)(a) of the Companies Act of 2013¹ and section 149(1)(b) of the Companies Act of 2013 states that the companies can have a maximum of 15 directors and may also appoint more than that by passing a special resolution².

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¹ Companies Act 2013, s 149(1)(a)

² Companies Act 2013, s 149(1)(b)

The diversity in the board opens up different perspectives on decision-making which leads to making the right decisions in the board meetings. Decision-making has a greater part in the improvement of the company in terms of business growth which also involves a lead role in mergers and acquisitions transactions and reviewing the merits and disadvantages of an M&A transaction constitutes an important area of board decision-making³. Especially in the Indian context, the board's engagement and function depend on the type of organization. While promoter-driven businesses are certainly more aggressive and quicker to make decisions on M&A transactions, professionally managed businesses with the proportion of shares might occasionally be more procedure- and governance. Board members possess an unpleasant task in both scenarios because, depending on whether they support the deal or impose checks and balances, they are either perceived as facilitators or as obstacles⁴.

RELATIONSHIP BETWEEN BOARD DIVERSITY AND DECISION-MAKING

Agency theory is frequently used by those who defend the benefits of board diversity. Diversity, according to Butler, can assist the board in stopping CEOs from "stacking the board." The CEO parity notion, which refers to choosing board members who are CEOs of other firms and are willing to support the CEO in his objectives through their voting preferences, may be curtailed by a diverse board, according to certain arguments⁵.

The resource dependency theory is based on the premise that director relationships with those outside of the board produce capital, which includes both social and human capital, such as the network of connections to other businesses and external groups, as well as human capital, such as reputation, experience, and expertise. The resource dependency hypothesis also looks at how this kind of corporate capital, depending on board connections, should supply resources to the firm⁶.

Through these theories, it is easy to understand that the diversity in the board makes an impact on decision-making as the different entries are unblocked. Regarding the diversity in the board,

³ Umakanth Varotti, 'Corporate Governance In M&A Transactions' (2013) 24(2) Manupatra <<http://docs.manupatra.in/newsline/articles/Upload/FB4E9034-8184-4712-8187-A52B7593B79D.pdf>> accessed 21 August 2023

⁴ Ibid

⁵ Darlene Booth-Bell et al., 'Governance Theory and Board Diversity, Where Do the Rationales for Board Diversity and Governance Theories Converge?' (2021) vol. 5 Global Journal of Accounting and Finance <https://www.igbr.org/wp-content/uploads/articles/GJAF_Vol_5_No_2_2021%20pp%2070-87.pdf> accessed 22 August 2023

⁶ ibid

the Companies Act of 2013 also stated in section 149(1) that every listed company must appoint at least one women director on the board⁷.

Through the board diversity in terms of race, caste, gender, experience, education, and other demographic groups the decisions are not taken in the groupthink as all the directors have their own opinion on decision making which results in increasing the shareholder's wealth. Also, the diversity in the board drives the directors to focus on managing risks and have a better understanding of the consumers of the company.

So, the relationship between diversity in the board and decision-making always takes place to get a better outcome not only in mergers and acquisitions but also in other decision-making processes. The board of directors plays a leading role in the M&A transactions and for which the diversity in the board drives the group to make better decisions on the transactions. Then the outcome of the same transaction would be resulted in the favoured way. This determines the interlink between diversity and decision-making.

DIMENSION OF BOARD DIVERSITY

The diversity of the board of directors can be in the dimensions of the different demographic conditions such as race, religion, gender, educational background, experience in the industry, cultural practices in the industry, professional qualification, etc. In this various diversity in board gender diversity, age diversity, expertise diversity, ethnic and cultural diversity has more requirement as in business perspective some diversity may not have much importance to establish.

Gender Diversity: By making a distinctive gender audit on the company board, the diversity of gender can be viewed and necessary steps can be taken in appointing the board of directors in a reasonable gender ratio, though if the company cannot appoint the directors in equal ratio, it is stated in the companies act of 2013 that at least 1 women director should be appointed. This board composition can unblock a new perspective and block groupthink. In an online report, one of the key findings mentioned that 'When examining the majority of internal metrics for acquiring company post-transaction performance, such as sales growth, profitability, and return on assets or equity, acquiring companies with female CEOs outperform those with male

⁷ Companies Act 2013, s 149(1)

CEOs, and acquiring companies with at least 30% female board members outperform those with all-male boards or boards with a low percentage of female board members⁸.

Age Diversity: Section 196(3) of the Companies Act, 2013 states that a director should be at least 21 years old at the time of being appointed as director, and the maximum age limit of the director is 70 years⁹ and also this is not applied to all the key members of the company. However, the Companies Act does not specify the age limit for other directors such as independent directors, additional directors, etc. Related to age and experience might also relate to this diversity. If the director is old then they might be a bit experienced director and even if the director is young then they might have a bit of understanding of the consumer's needs as they enter the industry being with the consumer and also with the knowledge of modern industry expectations. Thus, the director's age is also one of the categories for the diversity establishment on the board.

Expertise Diversity: This type of diversity involves many demographic conditions such as educational background, knowledge of the industry, professional qualification, and many others. This diversity in the board of directors creates a new entry into the opinion on decision-making. However, the expertise diversity in the board cannot be considered the best opinion in the meeting. The expertise directors may be the experts in the industry but they are only taken inside the board for the task-oriented expertise and it is not in the interest of leadership. The expertise diversity only adds value in the meeting for the opinion they cannot lead the other director's opinion.

Ethnic and Cultural Diversity: This diversity involves race, culture, practice, and many others. Adopting this kind of diversity opens a wide range of opinions in the board meetings. Apart from the expertise, gender, and age this also leads to different opinions. Cultural diversity is something new to the boardrooms as this type of diversity might not be seen in the other diversity categories. As this widens the range of opinions, it also focuses on the financial perspective of the company.

⁸ 'GENDER DIVERSITY AND M&A OUTCOMES' (*Interlinks*, February 2020)

<<https://www.intralinks.com/sites/default/files/2020-02/intralinks-gender-diversity-ma-outcomes-report-en.pdf>>
accessed 25 August 2023

⁹ Companies Act 2013, s 196(3)

INFLUENCE OF BOARD DIVERSITY ON M&A DECISION-MAKING

Mergers and acquisitions are considered one of the best ways to accomplish business plans and provide shareholders with better value. The board of directors plays an important role in this transaction in various ways such as framing strategic plans, perceiving the risks that can arise from the transactions, aligning with the other directors to assist and advise the key managerial persons of the company, and many more.

Benefiting from the M&A transactions is the key success of a company and to benefit from the deal, the company needs to make some changes and improvements before the transaction and also needs to assess the present status of both the acquirer and target. Through this transaction, the company may lose to retain some employees, changes may occur in the governance, the company might face loss on some resources, and also chances might come to make changes within the organization.

Due to the board diversity in the boardroom, different perspectives and opinions on the decisions will be suggested by the board members through which the board can discuss and choose the right decision and they can avoid risk management. This diversity widens the scope of analysing the risk factors in mergers and acquisitions transaction deals. Post-merger should also need to be assumed or predicted before the transaction, as that will avoid inconvenience in the future course of the deal. To predict the inconvenience of the post-merger the normal board can also make better assumptions but diversity in the board adds more value to the group and deeper analysis will be made to avoid the inconvenience.

The diversity in the board will drive the board meeting to the analysis of the mergers and acquisition transaction where the different opinions will be given by the directors as that could not able to take place in the board meeting when there is no diversity in the board of directors. Thus, the diversity in the board meeting will influence the transaction in the greater aspect and try to make favourable transactions. Apart from this risk risk-managing factor the diversity in the board of directors also helps in making innovative deals in the transaction which leads to the benefit of the company through the transaction. Also, diversity helps in evaluating the targeted mergers and acquisitions in the deal.

CHALLENGES AND BARRIERS

There are some challenges faced by the diversity in the board of directors though there is no chance of groupthink in the board meetings if the board is diversified, conflicts could arise in the decisions, and as the diversified board room would be with different perspectives which causes in the miscommunication or no alignment the path to achieve the goal. Also, hiring someone to avoid criticism is a barrier to the concept of diversity on the board of directors. The detailed view of the challenges faced is as follows:

Implicit Bias: To avoid biased decisions independent directors come into play and same as that in the diverse board members conflicts may arise in the decision-making part for the different opinions and in this circumstance the director makes the biased decision not the influence of the other person but on the fact of their own decision to make the different decision. This kind of difficulty is faced due to the varied opinions on the conflict. To avoid this implicit bias decision the other challenge should be covered up which also occurs due to the diversity in the board of directors that is communication and alignment between the boards of directors. By bringing coordination between the directors the company can overcome the implicit bias decision challenge.

Communication and Alignment: Due to the lack of communication between the directors they might face conflicts in the decision-making process. One might feel the other opinion is an incorrect decision. Effective communication between the diverse boards will solve the conflicts and at the same time, the directors also focus on the decision-making process for the well-being of the company. If the directors are not aligned with the company's aim and focus then it will create an impact in the company management. The lack of communication also affects the task of examining the potential difficulties that are to be faced by the company in future endeavors. So, communication between the diverse boards should be a necessary element of the company.

Tokenism: This challenge can also be simply said to hire someone to avoid the criticism of diverse board members. The member who added to the board in that cause might not decide for the benefit of the company and they might also be influenced by someone on the board. As they added to the board to avoid criticism they will also not work for the needs of the company and also, they might not represent the interest of the shareholders. This type of difficulty is also

one of the key challenges faced by the diverse board. To avoid this challenge the company should appoint the director in the good cause.

Apart from these challenges the diverse board also faces challenges such as discrimination of race, gender, and age which is witnessed by many people in the board meetings, different perspectives and opinions but very slow in the decision-making process and also slow towards achieving the company goal. Cultural misunderstanding is also a challenge faced by the board members in the boardroom.

BEST PRACTICES FOR ACHIEVING BOARD DIVERSITY

Corporate governance is the rules and practices that are adopted and followed by the company. Diversity in the board and its composition is also a major part of corporate governance. By implementing some of the policies or practices the company can adopt to achieve board diversity. They are:

Adopt Diversity Policy: Diversity is a source of competitive advantage and value creation in addition to being a matter of fairness and social responsibility. In addition to enhancing the board's legitimacy, credibility, and responsiveness to stakeholders, a diverse board may provide a variety of perspectives, experiences, and insight into the decision-making process. The board should create a clear and quantifiable diversity policy and targets that address issues like gender, color, age, background, and tenure to encourage diversity. The board should also hold itself accountable for accomplishing its goals and make public its diversity strategy and success.

Make Room for Diverse Viewpoints: New board members can find it difficult to speak up at meetings. Asking for their opinions on subjects where they know and making sure everyone is aware of their areas of contribution are two ways to assist in making space for individuals new to the boardroom. The purpose of having a diverse collection of people on a board is to obtain all points of view on everything from the balance sheet to long-term strategic objectives, thus board members must keep this in mind¹⁰.

¹⁰ Nasdaq Center for Board Excellence, 'BEST PRACTICES FOR WELCOMING DIVERSE BOARD MEMBERS' (*Nasdaq*, 4 November 2022) <<https://www.nasdaq.com/articles/best-practices-for-welcoming-diverse-board-members>> accessed 26 August 2023

Get the Board to Commit to Diversity: It's crucial to get support at the highest levels. The board and senior management set the tone for diversity by giving certain initiatives top priority and allocating the required funds. Create a board diversity policy, if one doesn't already exist. Diversity policy can be short and basic or long and detailed. You can modify your strategy as necessary as the organisation develops. Most importantly, utilise it to direct future efforts at diversification and to promote openness.¹¹

CONCLUSION

In conclusion, the board of directors is a crucial decision-making body for a company, representing the shareholder's interest and providing advice to the CEO and executive team. Diversity in the board allows for different perspectives on decision-making, leading to the right decisions in board meetings. This is particularly important in mergers and acquisitions transactions, where the board's engagement and function depend on the type of organization. Diversity in the board and decision-making is essential for achieving better outcomes in mergers and acquisitions, as well as other decision-making processes. Thus, the relationship between board diversity and M&A decision-making has an interconnection, not only in the M&A transaction but also for other decision-making diversity in the board leads to a separate role with different perspectives and insights.

¹¹ '7 WAYS TO INCREASE BOARD DIVERSITY' (*Forbes*, 14 November 2021) <<https://www.forbes.com/sites/carolinecastrillon/2021/11/14/7-ways-to-increase-board-diversity/?sh=25682c54196e>> accessed 27 August 2023