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THE ZEE-SONY MARRIAGE – CONCERNS IN CORPORATE GOVERNANCE

Authored By-Vidhya Sankar

Abstract

With the ZEEL-SONY merger all set to take off, the eyes are riveted on a stand-alone basis on merger and corporate governance. The most anticipated merger in Indian entertainment market could turn out to be a melancholic drama of a falling empire orotherwise, the rise of the greatest competitor to Star-Disney collaboration. The only thing thatstops the merger from achieving the latter is its weak corporate governance practices. The essay casts light on the intersection between the ZEEL-SONY merger and its impact on corporate governance, analyzing what lies at the cusp of these two prominent phenomena. At the time when SONY's gift of shares to the promoters through methods that remain opaque indicates a looming shareholder – board conflict and with the already disordered corporate governance leftover to resolve, how would the merger revamp the corporate governance structure?

Introduction

A merger just like a marriage is an integration of different ideologies, work ethics, culture, goals etc. The aim of both companies is nevertheless the same – to grow and succeed, however the road taken to achieve the same may differ and it's the alignment of their routes that would ultimately help them succeed. Thus, the success of this merger heavily depends on developing a socially responsible business practice and structured corporate governance.

The merger would have implications on the relationship between the company's board members, its management, its shareholders (both minority and majority) along with other stakeholders of both the companies, hence for a positive outcome it is necessary to plan a well-designed integration process along with intelligible discernment of the structure of the corporate governance. A coherent corporate governance oversees the sustainability issues that might arise post-merger.

The Tale Of Two Media Conglomerates

Zee Entertainment Enterprises Limited is one of India's leading media and entertainment companies. It is amongst the largest producers and aggregators of entertainment content in the world with an extensive library housing over 250000 hours of television content. As on March 31 2018 the Company had 29 Subsidiaries 2 associates and 1 joint venture Company. Sony Pictures Networks India Pvt Ltd., on the other hand is an Indian indirect wholly owned subsidiary of Sony Pictures Entertainment through its India division. [2]SPNI manages and operates 26 television channels, 1 OTT platform, 1 film production arm and 1 independent production venture for original content and IPs for TV and digital media.[3]

Through this deal Sony Pictures will pay a non-compete fee to some founders of ZEEL which will be used to infuse primary equity capital into SPNI for acquiring shares of Sony. This would be approximately 2.11% of the share of the combined company on a post-closing basis. Sony Pictures after the closing of the deal will indirectly hold a majority 50.86% of the combined company; the founder of Zee Entertainment Enterprises Limited will hold 3.99% and other ZEEL shareholders will hold a 45.15% stake.[4]

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Due Diligence & Corporate Governance

The ZEEL-SONY merger has the potential to make a quantum leap in its profit, market presence, enable the renegotiation of pricing, creating a better service portfolio and a transparent corporate governance. To witness a favorable outcome, however, the board's directors ought to oversee the merger process from its initial stage to the final integration stage which is possible only through the practice of the due diligence process. The Zee Entertainment Enterprises Limited company's management team derailed from the basic task of periodic discussion let atleast update the board, a member's point of view from his experience and knowledge of the industry, is a part of the fiduciary duty of due care. Due diligence creates an environment for sound corporate governance, symbolic of effective integration. Every M&A process should be designed to benefit from the experienced input of seasoned directors at the right times, and facilitate keeping the board appropriately informed throughout the process so it can fulfill its oversight responsibilities and duty of care to shareholders.[5] In the ZEEL-SONY merger, the perceptible absence of periodic discussions between the board of directors and the shareholders which has vehemently kept the shareholders bewildered. If the merger does not work as presumed then the liability of the outcome will lie with the management. ZEEL being a listed firm has to give paramount importance to the relationship between the management and shareholders. However, as with any other company, SONY will pursue self-interests rather than prioritizing shareholder value maximization, Afterall along with saving the sinking ship the company is infusing an additional $1.4 billion into the merger. The result being an inherent conflict of interest due to misalignment of interests between shareholders and board of directors of the new alliance. Only a mature and sophisticated corporate governance structure within these companieswould avert the likelihood of an inefficacious merger deal.

[1] Business Standard, Company Overview – Zee Entertainment Enterprises Ltd., https://www.business-standard.com/company/zee-entertainmen-3126/info
[2] Business Wire India, 'Sony Pictures India Enters Into a Licensing Agreement With The Indian Performing Right Society Ltd', https://www.businesswireindia.com/sony-pictures-networks-india-enters-into-a-licensing- agreement-with-the-indian-performing-right-society-ltd-66885.html , February 7th, 2020, 10:40AM IST
[3] Aveek Datta, Sourav Majumdar, Fortune India, 'Sony Pictures Networks: Life after IPL', https://www.fortuneindia.com/enterprise/sony-pictures-new-revenue-avenues-after-ipl/103691 , October 20,2019
[4] Bar and Bench, Shardul Amarchand Mangaldas, Trilegal act on Zee-Sony Merger, https://www.barandbench.com/dealstreet/shardul-amarchand-mangaldas-trilegal-act-on-zee-sony-merger 30th December, 12:41pm
[5] Deloitte Financial Advisory Services LLP, Corporate Development 2013: Pushing boundaries in M&A, pages 22 and 24

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ZEEL being a large company makes it more difficult for SONY to undertake due diligence and post-merger integration would likely be slow and rough. SONY-ZEEL merger is more likely driven by the urge to build a massive empire. There is no doubt about the existence of managerial egos and need to acquire more power in decision making. However, looking at the bright side of this merger a large entity is capable of bringing in more efficient lawyers, better negotiation and bargaining strategies thus putting the shareholders out of their current miseries.

I. The Future Of Share Holder Activism And Developing A Shareholder Model Of Corporate Governance

The company witnessed shareholder activism that saw an open call for the ouster of the erstwhile promoters (Essel Group) and appointment of six new independent directors by two of its majority shareholders OFI China Fund and Invesco Developing markets. The shareholder's concern over the lack of information of the process is a failure in fulfilling the oversight responsibilities and the primary duty of care, which in turn can foreshadow the benefits that would have been achieved from the merger. Further the disapproval of Mr. Punit Goenka as the director can evoke a class action suit against the company citing mismanagement or oppression. "There seems to have been a fall-out between Chandra and Invesco Oppenheimer and since the former is not a part of the board, the axe has fallen on Punit," says Arun Kejriwal, Founder, Kejriwal Research & Investment Services.[6] The involvement of Mr. Chandra and his micro-management over the company through Mr. Punit as a puppet has evoked distrust among the shareholders, as it led to the question of who is actually in power of decision making in the company. Invesco's open letter to ZEE mentions prolonged underperformance and leadership failures from the side of Mr. Punit Goenka, with SONY re-appointing him as the director would further agitate the shareholders who are already harboring fear over transaction terms which enrich Zee's promoters (owning 4% shares) keeping the shareholders holding 98% share at stake. Invesco foresees a bright future for ZEEL provided a board that has been strengthened with independent voices to guide ZEEL into a healthy future, deliberate and decide on its leadership structure, and create a framework for the equitable evaluation of any potential strategic alignments.[7] The shareholders en masse is convinced that handing over ZEEL to an independent team of experienced people from within the company or from the versatile Indian media market can pull them out of their current misery.

[6] Ajita Shashidhar, Fortune India, why investors want Punit Goenka out of Zee, https://www.fortuneindia.com/enterprise/what-caused-punit-goenkas-ouster-from-zee/105858 , September14th,2021

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The merged entity shall ensure that the shareholders are given an opportunity to be heard after giving sufficient notice prior to taking any action. The shareholders are responsible to adapt and support fair strategic alignments that can develop ZEEL into a stronger media platform, like the merger itself. A sound corporate governance system can help the entity raise its existing value. From a corporate governance viewpoint, with SONY controlling the vast majority of the board, the promoters including Punit Goenka himself would not be pulling the strings alone. Hence, it's a win-win situation for Invesco and the future ofshareholder activism in India.

II. PROMOTERS INVOLEMENT POST-MERGER -

The current CEO Mr. Punit Goenka is presumed to continue his role post-merger. Ironically, the trouble at ZEE is conjoined to him holding the office, owing to the fact that the promotersowned a mere 3.99 percent share but still fully controlled the firm. Rarely do Indian promoters pass on the company to professional management. But stake is very little incentive for somebody who is coming from a business family to continue to work on this.[8] A CEO undeniably has a role of that of a bridge between company management and board, proving how crucial they are to have a healthy corporate governance system both external andinternal.

According to Gaurav Dua, Head (Capital Market Strategy), "ZEEL, as listed stock, has suffered due to promoter-related issues rather than anything related to its operational and financial performance. The steps taken by the key shareholders is a positive movement for the stock.[9] The Indian industrial watchdogs have raised reasonable suspicion over untraceable money transaction between the web of companies that manage Subhash Chandra's businessesincluding ZEEL. This suspicion is a clear red flag for lack of corporate governance in the company. Added to this the lack of clarity in the pre-merger stage raises suspicion on how things might unfold. The skepticism surrounding the non-binding agreement that gifts the promoters with an equity stake of two percent under the veil of a "non-compete" is interpreted as a non-viable move. It is not the case that the promoters are deprived of any benefit from the merger as their very own Mr. Punit Goenka gets to retain his position, so is the largesse in the form of performance linked ESOPs which is acceptable as efficient leadership and work performance should be duly acknowledged. This gesture from SONY is quite unjust from the shareholders point of view and might be a reason for future disputes andlegal tussles.

[7] Justin M. Leverenz, Invesco Developing Markets Fund Releases Open Letter to Zee Entertainment Shareholders, October 11, 2021
[8] Business Standard, Invesco reiterates demand to oust Punit Goenka from Zee Entertainment, September 25,2021, 23:21 IST

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V. Transparent Corporate Governance – The Future?

The merged entity will be a publicly listed company in India.[10] The compromised standards corporate governance during the lifetime of Zee Entertainment Enterprise Ltd might see an upgrade.

THE BOARD INDEPENDECE

To have a stronger internal corporate governance mechanism the company needs a well-structured board of directors, the role of the CEO and placing incentive system for the employees work performance analysis and rewards. Since SONY holds greater share in the newly merged company one might expect a change in how they respond legally and socially. The boards members of the merged entity have to be diverse, neutral, experienced with a clear insight over the objectives of this merger.

Mr. Punit Goenka who will continue as the CEO and MD has directorship holdings in nine companies including Zee Entertainment Enterprises Limited, ETC Networks Limited, Prozone Intu Properties Ltd, Zee Digital Convergence Limited to name a few. So, the question arises whether Goenka controlling these many companies at the same time would deduce his efficiency and focus over his role and responsibilities as a CEO in the merger entity where the stakes are much higher especially in the initial years.

Each director owes fiduciary duties to the corporation and would be liable for any damages incurred by the corporation as the result of a transaction.[11] Numerous multinational companies that bought into Indian companies with governance lapses failed to effectively create value in a reasonable time because the 'clean-up' consumed a great deal of time.[12]

Alas, an independent board will have its own share of advantage as opposed to a leadership laden with ulterior motives.

[9] Krishan Gopalan, Business Today.in, Can beleaguered MD Punit Goenka stave off shareholders demanding his exit, September 14 2021, 10:09 PM IST.
[10] The Wall Street Journal, ZEE Entertainment board agrees to merger with Sony India, September 22, 2021, 07:36 PM IST

CORPORATE CONTROL

An efficient market for corporate control may diminish the managerial inefficiencies and weak governance in the ZEEL-SONY merger as it ensures a threat of kicking out the underperformers. The board members would have to face the wrath through mergers where they likely would be weeded out and the company by doing so will extract better profits and synergies. This threat of untimely oust would ensure a disciplined governance. Corporate control systems have to parallelly take forward the rewards and punishment systems. The merged entities' future goal should include to stay out of threat via aligning the shareholders' and mangers' interest and involve the shareholders in all potential alignments.

Addressing the internal governance issues that impacts the day-to-day activities such as the employment practices can be fixed through maintaining a strong relationship with the employees – providing them due incentives based on their performance both in ways such as promotion or salary hikes. Acknowledging their work will have them stick with the company for a longer period. Yet another issue of 'hire and fire' at will can boomerang against the company as it will increase the resistance within the company, to avoid such a scenario the firm can opt for a relationship-based contract with the company's employees.

It's a wait and watch situation for ZEEL who are anxiously looking for light at the end of the tunnel. For a company that's already plagued by the weak corporate governance it would be a challenge for SONY to plan the closing and post-closing corporate governance issues of ZEE. Prospective investors from both domestic and international markets would invest their money in the new merged entity only if they can have faith in the ability of the entity's management to act as trustees and act in their best interests by following quality corporate governance practices.

[11] Anderson Mori and Tomotsune, Lexology, Corporate Governance, https://www.lexology.com/library/detail.aspx?g=c4ec1f1d-b8af-456e-9a5c-4e1a975824cd , July 5 2019 [12] N Mahalakshmi, Moneycontrol, ZEEL-Sony deal: non-binding nature, new Sebi regulations reason for Invesco pressing for EGM, September 27, 2021, 06:31 PM IST