Account and Financial Management Journal e-ISSN: 2456-3374
Volume 5 Issue 07 July-2020, (Page No.-2187-2191)
DOI: 10.33826/afmj/v5i7.01, Impact Factor: 5.97

Effectiveness of Corporate Governance System

Ganesh Reddy Gali
University Of Bedfordshire

Abstract: This report aims at critically analysing 'EMIS group' company from the UK Software and computer services industry. In this process of critical analysis, the business need analysis of EMIS group is carried out followed by analysing the capital structure and dividend policy of this EMIS group. After identifying the impact of capital structure and the dividend policy on the company performance levels, the way in which investment appraisal tools can be used by EMIS group is analysed in this report. Finally the effectiveness of corporate governance system is analysed followed by concluding statements of this report.

Keywords: EMIS Group-Company Background, Key Drivers and Trends, Implications of Debt and Equity, Implications of Interest Paid, Implications of Dividends Paid

INTRODUCTION

High globalisation, technological developments and knowledgeable consumers have all together made the current business environments highly competitive and dynamic. The long-term sustainable growth of the contemporary organisations in the current competitive business environments depend on several factors of which financing is one of the most important ones (Atrill, 2014). Financing is important for companies right from the company setup, to avail new opportunities in the industry, to follow the key trends in the industry and thereby achieve long-term sustainable growth in the industry (Campbell, 2017).

EMIS Group-Company Background

EMIS group is one of the leading providers of information technology, software and the related services to the healthcare organisations in the UK. The main purpose of EMIS group is to offer a faster, better and the safer healthcare solutions by providing highly innovative and integrated technology services (Emisgroupplc, 2018a).

The four brands of EMIS group such as EMIS health, EMIS care, Patient and EGTON intends in providing healthcare solutions for four different healthcare settings such as primary care, community, acute care, community practice, specialist care and patient self-care (Emisgroupplc, 2018c). The corporate strategy of EMIS group is to support the longer and healthier lives of everyone through provision of the high quality based healthcare technology. In other words, there is an alignment between NHS strategy and EMIS group strategy 'to put IT at heart of the efficient NHS'.

Corporate objectives:

In order to achieve the above corporate strategy using its business model, EMIS group has set its six corporate objectives (Emisgroupplc, 2018b). These corporate objectives are

(1) Highest clinical standards and content.
(2) Achieving high level of customer satisfaction.
(3) Achievement of the medium-term growth of the business.
(4) Offering connected healthcare.
(5) Product innovation.
(6) Clear focus on the people development activities (Emisgroupplc, 2018a).

KEY DRIVERS AND TRENDS:

This EMIS group is affected by the key drivers and trends in UK software and computer services industry and also the digital health sector in UK. The key trends in the UK software and computer services industry like cloud computing, business intelligence, mobile technology and high technology consumerism (Offices for Life Sciences, 2015) can have an impact on the companies like EMIS group operating in this industry.

The key growth drivers of this UK digital health sector in which EMIS group exist are increasing ageing population, government incentives for technology based health care services, high technology penetration and internet usage in UK, increasing health consciousness of UK people (PWC, 2017; PWC, 2018). In the same way, the companies like EMIS group present in UK digital health sector are affected by the different trends or the market dynamics as indicated in Deloitte (2018). These trends are connected healthcare, accessible data, data analytics, data governance; evidence based clinical trials and healthcare commissioning, increase in the government programmes and funding.

In the process of achieving corporate objectives and getting aligned with the key trends and the growth drivers of this digital health care technology and UK software and computer services industry, EMIS group could face certain problems. These problems are related to development of trust worthy innovative solutions, cost-effective technology solution that reduces growing healthcare costs at NHS and connected health care solutions that incorporates connected patient care and connected healthcare care providers. In the process of resolving these problems, there is a need for EMIS group to involve in certain technological investments. As technological investments are huge and risky in nature (Bromiley et al, 2017), the capital structure, dividend policy of EMIS group and the applicability of the investment appraisal methods to this company are analysed in this report in helping the company to overcome the challenges faced by EMIS group in meeting its corporate objectives and following the industry trends.

Capital Structure and Dividend Policy of EMIS group:

The capital structure of EMIS group specifies its mix of the long term financing and the equity financing. Analysing the capital structure of EMIS group helps in analysing the way in which this group can finance its operations and growth using different sources of finance. Application of the capital structure theories to the case of EMIS group greatly helps in linking among equity financing, debt financing and the market value of the company (Atrill, 2014). For analysing the capital structure of EMIS, the following figures are calculated for the past three years (2017, 2016 and 2015) based on the group financial statements (Emisgroupplc, 2016; Emisgroupplc, 2017).

	Year 1 (2017)	**Year 2 (2016)**	**Year 3 (2015)**
EBIT	37,406,000	38,753,000	36,553,000
Net Profit	8,893,000	20,152,000	5,263,000
Equity	108,014,000	114,142,000	107,046,000
Debt	13, 991,000	4,30,000	91,09,000
Interest Paid	2,000,000	5,500,000	11,500,000
Dividends Paid	15,476,000	14,006,000	12,422,000

Initially, the net profit and EBIT values are calculated from the consolidated income statement of EMIS group for the past three years. EBIT (Earnings Before Interest and Taxes) is calculated by considering the adjusted operating profit in group’s income statement. The net profit of EMIS group is obtained from the net earnings obtained after all tax and interest deductions from EBIT in group’s income statement. Total equity of EMIS group is the earnings that are available to be provided by this group to its shareholders. In case of EMIS group, the calculation of total equity is done by reducing the value of total liabilities from the total assets available for the company as indicated in group’s balance sheet. In the same way, the calculation of debt is done by considering the financial liabilities of EMIS group that the group has to pay, when it has raised cash from its operations. The interest paid and the dividends paid by EMIS group are calculated by considering the ‘cash to be paid for operating activities’ section in the group’s statement of cash flow.

From the very small change in EBIT across the three years, it can be inferred that EMIS group has brought small variation in its earnings that is calculated before deducing the interests and taxes. From 2015 to 2016, this earning value increased by 6%, but then has been declined by 3% in 2017. Altogether, the group earnings value has increased by 3% from 2015 to 2017. However, this decline in the EBIT value by 3% is due to the new investment worth of £ 3.5 million made by EMIS group into patient health care software solutions. In the similar way, the net profit of EMIS group increased from 2015 to 2016, which then declined from £20 million to £8 million due to rise in the operating expenses between 2016-2017. Altogether, the net profit of EMIS group increased from £5.2 million to £8.9 million in the period 2015-2017.

This rise in EBIT value, recurring revenue and net profit of EMIS group from 2015 to 2017 is reflected on the rise in the group’s total equity value. Increase in the total equity value from £107,046,000 to £ 108,014,000 has key implications on the group.

IMPLICATIONS of EBIT and Net Profit:

(1) Increase in the earnings available to be paid as shareholder returns.
(2) Attracting more investors towards the company.
(3) Decreasing the financial risk of EMIS group.
(4) Positive impact of increased shareholder equity on the financial performance of EMIS group (Vatavu, 2015).

IMPLICATIONS of Debt and Equity:

Taking the values of debt, the debt to equity ratio of EMIS group has been calculated as 0.09 in 2017 and 0.06 in 2016. In both the years, the calculated debt-to-equity ratio is far less than 1. This value of debt-to-equity ratio implies that EMIS group is not liable to high debt in raising finance sources to carry out its operations. In other words, the fall in the debt value of EMIS group from 2015 to 2017 years and very low value of debt to equity ratio (0.09) implies the ability of this group in generating the required cash needed to finance its operations each year. As a result, the need of EMIS group to depend on external financing like loans that can increase the debt value has greatly minimised, thereby having a positive impact on improving financial strength and reducing the financial risk of EMIS group.

IMPLICATIONS of Interest Paid:

The interest by EMIS group, which come under the cash paid by this group in the cash flow statement, has declined from

2015 to 2017. This decline has key implications on the financial performance of EMIS group by

(1) Decreasing the short-term and long-term liabilities of the group.

(2) Increase in the net cash generated from financing activities to finance the operation activities.

(3) Increase in group's financial performance and financial strength.

IMPLICATIONS of Dividends Paid:

With respect to the dividend paid, the above table reveals a significant rise by 10% in 2016 and further rise by 10 % in 2017. Application of Gordon and Lintner theory of dividend policy argues the relevance of dividend, which suggested the preference given by investors to the dividends because of its certainty level (Jabbouri & Attar, 2018). According to this preference for dividends model, investors tend to prefer large investors. Based on these grounds, this increase in dividends paid implies that

(1) EMIS group is able to increase the share of group's earnings to be paid for its shareholders.

(2) Maintenance of progressive dividend policy.

(3) Decline in the financial risk and increase in the financial performance and strength of EMIS group to continue its future investments and operational activities.

Considering the supportive argument on dividend relevance that dividends are considered by investors as the signal of future profitability of a company, the increase in the dividends paid by 10% implies in increasing the financial performance and future profitability of EMIS group.

Altogether, the analysis of the capital structure and the dividend policy of EMIS group revealed that this group is currently experiencing high financial strength and low financial risk. This is mainly because of the ability of this group is improving its recurring revenue that is reflected on the total equity value of the group. Lowering debt, lowering interest paid and rise in the dividends paid reflect certainty in the financial growth and profitability of EBIT group in the future.

Review of Investment Appraisal Tools

EMIS group has laid six corporate objectives in order to achieve its vision of 'supporting healthier and longer lives of individuals through provision of quality based healthcare technology'. Each of these corporate objectives consists of several activities that have to be completed to order to achieve them. For instance, in order to achieve the fourth objective 'connected healthcare' , EBIS group is intended to undertake mobile developments, develop the next generation based community pharmacy system, develop ProScript Connect platform that can connect various EMIS products (Emisgroupplc, 2018a). Undertaking all these activities certainly require significant investments from EMIS group. The same is the situation in case of meeting other activities that are formulated to achieve the corporate objectives of EMIS group.

The managers of EMIS group, who are involved in making capital investment decisions, are required to make appropriate decisions by adopting the investment appraisal methods. Atrill (2014) indicated the existence of four investment appraisal tools such as Accounting Rate of Return (ARR), Payback Period (PP), Net Present Value (NPV) and Internal Rate of Return (IRR). Besides the applicability of all these four tools, profitability index is also applicable for EMIS group in order to perform capital budgeting (Konstantin and Konstantin, 2018).

ARR investment appraisal tool assess the value of an investment by taking average of operating profit generated by investments, which is later expressed as percentage as average investment that is made on the project. ARR tool is advantages to calculate the investment return easily, easiness in comparing the investments and easiness in obtaining the required information (Atrill, 2014). However, the application of this ARR method by EMIS group requires the managers to deal with the problems related to producing expected results because of using average investment value, not suitable for competing investments with different sizes and not being considering the timing of cash flow (Konstantin and Konstantin, 2018). The second investment appraisal tool that the managers of EMIS group can assess investment decisions is the payback period. In this PP method, the amount of time taken for an investment to be repaid from net cash inflows of the project will be identified. The investment project with lower PP must be accepted by EMIS investment managers as part of their capital budgeting decisions. The simplicity in calculation, use of Cash flows and the ability to minimise this by considering the investment decisions of the quick payback and quick returns are the advantages that could recommend use of this PP method by EMIS group. However, the managers could face problems because of this PP method ignoring time value of money, practical problems because of forecasting cash flows for a long time period and not able to consider other risk associated with an investment decision (Atrill, 2014).

The NPV, IRR and profitability index are the other three discounted cash flow (DCF) investment appraisal tools that can be applied by EMIS group managers to evaluate the investment projects and take proper investment decisions for achieving the groups' corporate objectives. NPV method calculates the future value of the investment today by incorporating time value of money (Baum and Crosby, 2014). When compared to previous investment appraisal tools, this NPV method is advantages for EMIS group as it considers time value of money, takes all the relevant cash flows into account, considers timing of cash flows and at the same time produce results which are aligned with the business objectives. But Baum and Crosby (2014) indicated that, this NPV could also pose different problems when used by EMI group managers and these problems include prediction problems, complexity in calculation, and risks of not considering later cash flows. IRR is another DCF based investment appraisal tool related to NPV. An investment decision has to be accepted when discount rate of the investment calculated using future cash flows can produce NPV that is close to zero. However IRR is also associated with some problems not addressing wealth generation question, ignoring scale of investment and difficulty in making decisions with the projects consisting of unconventional cash flows. Profitability index also be applied by managers of EMIS group as the investment appraisal tool which is calculated as variation in NPV. The simplicity in calculating profitability index and its suitability for comparing even mutual exclusive projects having different sizes makes it suitable for EMIS group (Baum and Crosby, 2014; Konstantin and Konstantin, 2018).

By reviewing the merits and demerits of all the five investment appraisal tools, the managers of EMIS group are required to adopt DCF tools such as NPV, IRR and profitability index. As all these three investment appraisal tools are related to each other by considering time value of money, it could benefit the managers of EMIS group in minimizing the extent of calculations. The other reason for considering these DCF investment appraisal tools to be suitable for EMIS group is their ability to minimise different risks related to interest rates, inflation rates and risk premium by taking time value of money. Also EMIS group involves in undertaking investments related to projects of different sizes, which need to be compared as part of capital budgeting. Use of profitability index method combined with NPV can help EMIS group managers in doing this comparison and making suitable and risk free investment decisions.

Corporate Governance

Corporate governance is mainly intended in providing effective, prudent and the entrepreneurial management to developer long term success for an organization (Financial Reporting Council (FRC), 2016). The UK corporate governance code also known as the code produced by Cadbury Company in the year 1992 is one of the widely adopted corporate governance code. Recently amendments have been made in the period 2016 (FRC, 2016). The effectiveness of corporate governance at EMIS group is analysed by applying the four principles of the code related to leadership, effectiveness, accountability, remuneration and relations with share holders.

Under the 'comply or explain' approach, EMIS group complies with the UK corporate governance code as explicitly specified in its annual reports (FRC, 2016). With respect to leadership, EMIS group has formed a board with seven members whose main role lies in providing effective leadership for the long-term success of the group. In line with the new amendments made to the code in 2016, EMIS group is adopting separate role for CEO and the chairman. This separation enables the group in dividing and providing clear responsibilities between board running and business learning (Emisgroupplc, 2017). In the same way, EMIS group organizes 12 board meetings as specified in the code. With respect to effectiveness EMIS board is formed with 7 members (all males), that include one chairman, 2 executive directors and four non executive directors (Emisgroupplc, 2018d). The diversified age profile, background and experience level helped in increasing board effectiveness. In line with the accountability principle, EMIS group consists of a dedicate audit group, remuneration committee, nomination committee that is responsible in having internal control and risk management (Emisgroupplc, 2018d). Under the principle of relations with share holders, EMIS group relay on consistent board meetings where CEO and COO are responsible to engage with investors and the share holders.

Number of meetings of the Board and its committees in 2015, 2016 and 2017 years:

	Board			Audit committee			Nomination committee			Remuneration committee		
	2017	2016	2015	2017	2016	2015	2017	2016	2015	2017	2016	2015
Total Number of meetings	12	12	12	4	4	4	3	5	3	10	6	4
Attendance of Executive Directors												
Chris Spencer	5	12	12	-	-	-	-	-	-	-	-	-
Andy Thorburn	7	-	-	-	-	-	-	-	-	-	-	-
Peter Southby	12	12	12	-	-	-	-	-	-	-	-	-
Attendance of Non-executive Directors												
Mike O'Leary	12	12	12	4	4	4	3	5	3	10	6	4
Robin Taylor	12	12	12	4	4	4	3	5	3	10	6	4
Kevin Boyd	12	12	12	4	4	4	3	5	3	10	6	4
Andy McKeon	12	12	4	4	4	1	3	5	1	10	6	1
David Sides	12	-	-	4	-	-	3	-	-	10	-	-

Conclusion

Identifying the importance of financing decisions on the long-term success of an organization, this report has critically analysed EMIS Group Company operating in software and computer services industry and digital health industry. Analysis of group's capital structure and dividend policy revealed that the group is having string financial strength because of positive impact on future profitability of a company. The suitability of discounted cash flow investment appraisal tools for EMIS group to meet its corporate objectives has been identified. Finally the analysis of the corporate governance practices adopted by EMIS group revealed its compliance with the UK corporate governance code and the recent amendments that were made in the year 2016. Altogether, it can be said that EMIS group has strong financial strength that can achieve future profitability, guaranteeing achievement of its corporate objectives and there by achieving long-term success.

References

1. Atrill, P. (2014). *Financial management for non-specialists*. Prentice Hall.
2. Deloitte (2018). How digital technology is transforming health and social care. Online available at: https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/life-sciences-health-care/deloitte-uk-connected-health.pdf , Viewed on: (30th August 2018).
3. Emisgroupplc (2016). EMIS Group plc Annual report and accounts 2016. Online available at: https://www.emisgroupplc.com/media/1360/emis-group-plc-annual-report-and-accounts-2016.pdf, Viewed on: (05th September 2018).
4. Jabbouri, I., & Attar, A. E. (2018). The dividend paradox: a literature review. *International Journal of Markets and Business Systems*, *3*(3), 197-221.
5. Emisgroupplc (2017). EMIS Group plc Annual report and accounts 2017. Online available at: https://www.emisgroupplc.com/media/1438/emis-group-plc-annual-report-and-accounts-2017.pdf , Viewed on: (29th August 2018).
6. Emisgroupplc (2018d). Corporate governance. Online available at: https://www.emisgroupplc.com/investors/corporate-governance/ , Viewed on: (01st September 2018).
7. Emisgroupplc (2018a). Our Group. Online available at: https://www.emisgroupplc.com/who-we-are/our-brands/ , Viewed on: (04th September 2018).
8. Baum, A. E., & Crosby, N. (2014). *Property investment appraisal*. John Wiley & Sons.
9. Emisgroupplc (2018b). Our Strategy. Online available at: https://www.emisgroupplc.com/who-we-are/our-strategy/ , Viewed on: (06th September 2018).
10. Emisgroupplc (2018c). What we do. Online available at: https://www.emisgroupplc.com/who-we-are/what-we-do/, Viewed on: (25th August 2018).
11. FRC (2016). The UK Corporate Governance Code. Online available at: https://www.frc.org.uk/getattachment/ca7e94c4-b9a9-49e2-a824-ad76a322873c/UK-Corporate-Governance-Code-April-2016.pdf, Viewed on: (15th August 2018).
12. Konstantin, P., & Konstantin, M. (2018). Investment Appraisal Methods. In *Power and Energy Systems Engineering Economics* (pp. 39-64). Springer, Cham.
13. Offices for Life Sciences (2015). Digital Health in the UK. Online available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/461479/BIS-15-544-digital-health-in-the-uk-an-industry-study-for-the-Office-of-Life-Sciences.pdf , Viewed on: (28th August 2018).
14. PWC (2017). Transforming healthcare through technology. Online available at: https://www.pwc.co.uk/healthcare/assets/transforming-healthcare-through-technology.pdf , Viewed on: (27th August 2018).
15. PWC (2018). Emerging trends pwc healthcare. Online available at: https://www.pwc.com/gx/en/industries/healthcare/emerging-trends-pwc-healthcare.html, Viewed on: (27th August 2018).
16. The Telegraph (2018). Performance by Sector. Online available at: https://shares.telegraph.co.uk/sectors/fundamentals/sector/9530 , Viewed on: (03rd September 2018).
17. Campbell, J. Y. (2017). *Financial decisions and markets: a course in asset pricing*. Princeton University Press.
18. Bromiley, P., Rau, D., & Zhang, Y. (2017). Is R & D risky?. *Strategic Management Journal*, *38*(4), 876-891.