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"Mergers And Acquisitions In Corporate Sector"

Management

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ABSTRACT

Mergers and acquisitions represent the ultimate in change for a business. No other event is more difficult, challenging as a merger and acquisition. It is imperative that everyone involved in the process has a clear understanding of how the process works. Hopefully this short course will provide you with a better appreciation of what is involved. You might be asking yourself, why do I need to learn the merger and acquisition (M & A) process? Well for starters, mergers and acquisitions are now a normal way of life within the business world. In today's global, competitive environment, mergers are sometimes the only means for long-term survival. In other cases, such as Cisco Systems, mergers are a strategic component for generating long-term growth. Additionally, many entrepreneurs no longer build companies for the long-term; they build companies for the short-term, hoping to sell the company for huge profits.

Definition of 'Merger'
The combining of two or more companies, generally by offering the stockholders of one company securities in the acquiring company in exchange for the surrender of their stock.

'Merger'
Basically, when two companies become one. This decision is usually mutual between both firms.

Mergers and acquisitions (M&A) and corporate restructuring are a big part of the corporate finance world. Every day, Wall Street investment bankers arrange M&A transactions, which bring separate companies together to form larger ones. When they're not creating big companies from smaller ones, corporate finance deals do the reverse and break up companies through spinoffs, carve-outs or tracking stocks.

Mergers and acquisitions are methods by which distinct businesses may combine. Joint ventures are another way for two businesses to work together to achieve growth as partners in progress, though a joint venture is more of a contractual arrangement between two or more businesses.

A:- MERGERS AND AMALGAMATIONS
The term 'merger' is not defined under the Companies Act, 1956 (the 'Companies Act'), the Income Tax Act, 1961 (the 'ITA') or any other Indian law. Simply put, a merger is a combination of two or more distinct entities into one; the desired effect being not just the accumulation of assets and liabilities of the distinct entities, but to achieve several other benefits such as, economies of scale, acquisition of cutting edge technologies, obtaining access into sectors / markets with established players etc. Generally, in a merger, the merging entities would cease to be in existence and would merge into a single surviving entity. Very often, the two expressions "merger" and "amalgamation" are used synonymously. But there is, in fact, a difference.

Merger generally refers to a circumstance in which the assets and liabilities of a company (merging company) are vested in another company (the merged company). The merging entity loses its identity and its shareholders become shareholders of the merged company. On the other hand, an amalgamation is an arrangement, whereby the assets and liabilities of two or more companies (amalgamating companies) become vested in another company (the amalgamated company).

B:- Types of Mergers:
Mergers may be of several types, depending on the requirements of the merging entities:

1. Horizontal Mergers. Also referred to as a 'horizontal integration', this kind of merger takes place between entities engaged in competing businesses which are at the same stage of the industrial process. .
2. Vertical Mergers. Vertical mergers refer to the combination of two entities at different stages of the industrial or production process. For example, the merger of a company engaged in the construction business with a company engaged in production of brick or steel would lead to vertical integration.
3. Congeneric Mergers. These are mergers between entities engaged in the same general industry and somewhat interrelated, but having no common customer-supplier relationship.
4. Conglomerate Mergers. A conglomerate merger is a merger between two entities in unrelated industries. The principal reason for a conglomerate merger is utilization of financial resources, enlargement of debt capacity, and increase in the value of outstanding shares by increased leverage and earnings per share, and by lowering the average cost of capital.
5. Cash Merger. In a typical merger, the merged entity combines the assets of the two companies and grants the shareholders of each original company shares in the new company based on the relative valuations of the two original companies. However, in the case of a 'cash merger', also known as a 'cash-out merger', the shareholders of one entity receive cash in place of shares in the merged entity.
6. Triangular Merger. A triangular merger is often resorted to for regulatory and tax reasons. As the name suggests, it is a tripartite arrangement in which the target merges with a subsidiary of the acquirer.

C:- ACQUISITIONS:
An acquisition or takeover is the purchase by one company of controlling interest in the share capital, or all or substantially all of the assets and/or liabilities, of another company. A takeover may be friendly or hostile, depending on the offeror company's approach, and may be affected through agreements between the offeror and the majority shareholders, purchase of shares from the open market, or by making an offer for acquisition of the offeree's shares to the entire body of shareholders.

- Friendly takeover. Also commonly referred to as 'negotiated takeover', a friendly takeover involves an acquisition of the target company through negotiations between the existing promoters and prospective investors.
- Hostile Takeover. A hostile takeover can happen by way of any of the following actions: if the board rejects the offer, but the bidder continues to pursue it or the bidder makes the offer without informing the board beforehand.

- ❖ Leveraged Buyouts. These are a form of takeovers where the acquisition is funded by borrowed money. Often the assets of the target company are used as collateral for the loan.
- ❖ Bailout Takeovers. Another form of takeover is a 'bail out takeover' in which a profit making company acquires a sick company. This kind of takeover is usually pursuant to a scheme of reconstruction/rehabilitation with the approval of lender banks/financial institutions.

D:- Synergy Value: The joining or merging of the two companies creates additional value which we call "synergy" value.

Synergy value can take three forms:
- ❖ Revenues: By combining the two companies, we will realize higher revenues then if the two companies operate separately.
- ❖ Expenses: By combining the two companies, we will realize lower expenses then if the two companies operate separately.
- ❖ Cost of Capital: By combining the two companies, we will experience a lower overall cost of capital.

E:- Strategic Reasons: Accounting, Information Technology, etc. However, the best mergers seem to have strategic reasons for the business combination.

These strategic reasons include
- ❖ Positioning: Taking advantage of future opportunities that can be exploited when the two companies are combined. For example, a telecommunications company might improve its position for the future if it were to own a broad band service company.
- ❖ Gap Filling: One company may have a major weakness (such as poor distribution) whereas the other company has some significant strength. By combining the two companies, each company fills-in strategic gaps that are essential for long-term survival.
- ❖ Organizational Competencies: Acquiring human resources and intellectual capital can help improve innovative thinking and development within the company.
- ❖ Broader Market Access: Acquiring a foreign company can give a company quick access to emerging global markets.

F:- Mergers can also be driven by basic business reasons, such as:
- ❖ Bargain Purchase: It may be cheaper to acquire another company then to invest internally. For example, suppose a company is considering expansion of fabrication facilities.
- ❖ Diversification: It may be necessary to smooth-out earnings and achieve more consistent long-term growth and profitability. This is particularly true for companies in very mature industries where future growth is unlikely.
- ❖ Short Term Growth: Management may be under pressure to turnaround sluggish growth and profitability. Consequently, a merger and acquisition is made to boost poor performance.
- ❖ Undervalued Target: The Target Company may be undervalued and thus, it represents a good investment. Some mergers are executed for "financial" reasons and not strategic reasons.

G:- The Merger & Acquisition Process can be broken down into five phases:
Phase 1: Pre Acquisition Review: The first step is to assess your own situation and determine if a merger and acquisition strategy should be implemented. If a company expects difficulty in the future when it comes to maintaining core competencies, market share, return on capital, or other key performance drivers, then a merger and acquisition (M & A) program may be necessary. It is also useful to ascertain if the company is undervalued. If a company fails to protect its valuation, it may find itself the target of a merger

Phase 2: Search & Screen Targets: The second phase within the M & A Process is to search for possible takeover candidates. Target companies must fulfill a set of criteria so that the Target Company is a good strategic fit with the acquiring company. For example, the target's drivers of performance should complement the acquiring company. Compatibility and fit should be assessed across a range of criteria - relative size, type of business, capital structure, organizational strengths, core competencies, market channels, etc.

Phase 3: Investigate & Value the Target: The third phase of M & A is to perform a more detail analysis of the target company. You want to confirm that the Target Company is truly a good fit with the acquiring company.

We now want to calculate a value for the target as well as all other costs associated with the M&A The calculation can be summarized as follows:

Value of Our Company

Value of Target Company

Value of Synergies per Phase I Due Diligence

Less M & A Costs (Legal, Investment Bank, etc.)

Total Value of Combined Company

Phase 4: Acquire through Negotiation: Now that we have selected our target company, it's time to start the process of negotiating a M & A. We need to develop a negotiation plan based on several key questions:

1. How much resistance will we encounter from the Target Company?
2. What are the benefits of the M & A for the Target Company?
3. What will be our bidding strategy?
4. How much do we offer in the first round of bidding?

This negotiated arrangement is sometimes called a "bear hug." The negotiated merger or bear hug is the preferred approach to a M & A since having both sides agree to the deal will go a long way to making the M & A work.

Tender offers are characterized by the following:
1. The price offered is above the target's prevailing market price.
2. The offer applies to a substantial, if not all, outstanding shares of stock.
3. The offer is open for a limited period of time.
4. The offer is made to the public shareholders of the target.

Phase 5: Post Merger Integration: If all goes well, the two companies will announce an agreement to merge the two companies. The deal is finalized in a formal merger and acquisition agreement. This leads us to the fifth and final phase within the M & A Process, the integration of the two companies.

H:- The integration process can take place at three levels:
1. Full: All functional areas (operations, marketing, finance, human resources, etc.) will be merged into one new company. The new company will use the "best practices" between the two companies.
2. Moderate: Certain key functions or processes (such as production) will be merged together. Strategic decisions will be centralized within one company, but day to day operating decisions will remain autonomous.
3. Minimal: Only selected personnel will be merged together in order to reduce redundancies. Both strategic and operating decisions will remain decentralized and autonomous. Check

I:- Some of the reasons behind failed mergers are:
- ❖ Poor strategic fit: The two companies have strategies and objectives that are too different and they conflict with one another.
- ❖ Cultural and Social Differences: It has been said that most problems can be traced to "people problems." If the two companies have wide differences in cultures, then synergy values can be very elusive.
- ❖ Incomplete and Inadequate Due Diligence: Due diligence is the "watchdog" within the M&A Process. If you fail to let the watchdog do his job, you are in for some serious problems within the M & A Process.
- ❖ Poorly Managed Integration: The integration of two compa-

nies requires a very high level of quality management.

- ❖ Paying too Much: In today's merger frenzy world, it is not unusual for the acquiring company to pay a premium for the Target Company. Premiums are paid based on expectations of synergies.
- ❖ Overly Optimistic: If the acquiring company is too optimistic in its projections about the Target Company, then bad decisions will be made within the M & A Process. An overly optimistic forecast or conclusion about a critical issue can lead to a failed merger.

CONCLUSION: The above list is by no means complete. As we learn more about the M & A Process, we will discover that the M & A Process can be riddled with all kinds of problems, ranging from organizational resistance to loss of customers and key personnel.

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