

Challenges of Corporate Growth through Mergers & Acquisitions

Abstract

This paper studies the effectiveness of Mergers and Acquisitions on businesses especially in rapidly evolving business like telecommunication, Information Technology, BPO as well as in traditional businesses to gain instantaneous opportunities to enter into a new market or product segment for responding to the challenges at the marketplace with expanding customer base and to get strength in the area of core competencies.

Keywords: Synergy, Inorganic Growth, Non-Compliance.

Introduction

Corporate restructuring is a natural & desirable phenomenon in the current economic environment. While in the pre-reform economic regime Companies could establish their presence by organic development through steady and incremental growth in their customers base, human and infrastructure resources and thus revenues and profits. However, in a competitive environment, an inorganic growth would provide instantaneous opportunities to expand through mergers and acquisitions to gain strengths in the area of core competencies expand customer base, cut competition or enter into a new market or product segment for responding to the challenges at the marketplace. Such inorganic growth minimizes the time lag in achieving the desired market share or the gestation period of setting up a new business line or expanding an existing one.

Aim of the Study

To study the effect of Inorganic growth of companies through Merger and Acquisition in a competitive Global environment.

Mergers Vs. Acquisitions

Although Mergers, acquisitions, takeover etc are termed often uttered in the same breathe and used as though they were synonymous but often differ in real sense. Merger happens when two equal players agree to go forward as a single entity. Both companies stocks are surrendered & new company stock is issued in its place. Acquisition refers to one player buying out another to combine the bought entity with itself. Target Company ceases to exist and buyer swallows the business & buyer's stock continues to be traded. A purchase will be also be called a merger when both CEO's agree to join together in best interest the company but when the deal is unfriendly e.g. when the target company does not want to be purchased. It is always regarded as an acquisition. So the deal is a merger or acquisition, really depends on whether a purchase intention is friendly or hostile & how the purchase is communicated to and received by the target Company. Board of Director, Employees, and Shareholders.

Synergy

Synergy is the magic force that increases cost efficiencies of the new business. It takes the form of revenue enhancements & cost saving in the following forms;

1. Economies of sale
2. Acquiring new technology
3. Improved market research & industry visibility
4. Expanded customer base.
5. Staff reduction

Pattern of Mergers & Acquisition

M&A generally have three typical patterns.

1. In the first model, the investor acquires a controlling stack in Target Company & retain it as a separate entity to avoid legal hurdles for merging the acquired company into a parent company. Hutchison followed this method & has retained most of the acquired companies as separate legal entities like Usha Martin, Escotel, Fascal.



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- In the second model, the target company is merged with parent company after acquiring a controlling stake with due approval of Judicial & respective appropriate authority Bharti followed this model.
- In the third pattern, the merger can take place by purchase of Assets of the target company on a stand-alone basis without purchasing the company as a whole e.g.in telecom industries, Companies used to sell telecom assets & customer database to that acquirer who would easily integrate the same into its existing license for strengthened network and customer base at a nominal cost.

Since business is based on expectations which are dynamic, not static. Naturally, both sides of an M&A deal will have different ideas about the worth of M & A deal. The common method is to look at comparable companies in an industry but deal maker employs a variety of other methods and tools when assessing a target company. Sometimes the same transaction would be valued by the same player at different values at two different times.

Important Regulatory Framework Regulating Mergers and Acquisitions

M&A are subject to various statutory guidelines and industry-specific provisions A few of these will be referred to as below;

- The Competition Act: Competition Commission of India (CCI) established in 2003 holds statutory responsibility for ensuring free & fair competition in all sectors of the economy. The CCI has provided for a liberal regime which is quite high for mergers whereby combinations exceeding the threshold limit fall within the jurisdiction of CCI. CCI can also suo moto take cognizance of a merger perceived as potentially anti-competitive & can also make an inquiry, even one year after the merger has taken place.
- SEBI Takeover Guidelines: SEBI takeover guidelines (Substantial Acquisition of Shares & Takeover Regulation 2011) are applicable to listed public companies. These guidelines have been amended from time to time by notifications. It may be mentioned that mergers & amalgamations are methods of restructuring business & different from the takeover.

Understanding Substantial Acquisition & Takeover – Role of Sebi

Substantial acquisition refers to the acquisition of that proportion of shares or voting right of a company which would entitle the Acquirer to exercise control over the affairs of the company taken over. A takeover is the wider term which implies of control over the Assets or business of a company directly through a substantial acquisition of shares or voting rights in the company by entering into an agreement with those who control voting rights in the company. Thus the true test of takeover is the test of control.

SEBI (Substantial Acquisition of Shares & Takeover) Regulation 2011 has listed following

principles for guiding the commercial behavior under the operational regulations:

- Equality of treatment & opportunity to all shareholders.
- Protection of minority shareholders
- Fair & truthful disclosure of all material information by the acquirer in all public announcements & offer documents.
- No information to be furnished by the acquirer exclusively to any group of shareholders.
- The acquirer & all other intermediaries professionally involved in the offer to exercise the highest standard of care and accuracy in preparing offer documents.
- All parties to an offer to refrain from creating a false market in securities of the target company.

Rational For M&A and Valuation – A Case Study (Example)

Tata Steel acquisition of Anglo-Dutch Corus steel plants

It is perhaps one of the biggest international victories for India after the Mitttel Arcelor Takeover. TATA's acquisition of Corus is a big deal & is a source of national pride for many people Tata Steel has won the bid to acquire Anglo-Dutch Corus steel plant, the World's fifth largest steel company. Tata paid almost \$12 Billion to win this deal The alliance between Corus group and Tata Steel could benefit both in two ways:-

Access to low-cost slab synergies from distributing Corus long products through Tata's distribution arm. Corus has benefited from a strong world steel price underpinned by demand from China.

Risk Management in Mergers & Acquisitions – A Challenging Issue before Corporation

It is no secret that plenty of mergers does not work. Historical trends show that roughly two-thirds of big mergers will disappoint on own term. They will lose the value of the stock market. The motivations that drive mergers can be flawed and efficiencies from economies of scale may prove elusive.

A merger may often have more to be with glory seeing man business strategy the executive ego, which is boosted by buying the competition is a major force in M&A especially when combined with the influence from the bankers, lawyers & other associated advisors.

On the other side of the coin, mergers can be driven by a generalized fear of globalization, the arrival of new technological developments or a fast-changing economic landscape that makes the outlook uncertain are all factors that can create a strong incentive for defensive mergers. Sometimes the management team feels that they have no choice and must acquire a rival before being acquired. The idea is that only big players will survive in a more competitive world. In fact, merging companies can focus on integration and cost-cutting so much that they neglect day to day business thereby prompting nervous customers to flee. The success of mergers depends on how realistic the deal markers are & how well they can integrate two companies while maintaining day to day operation.

Remarking An Analisation

Important Issues for Mergers & Acquisition Withdrawal of the Offer by the Acquirer

Offer once made cannot be withdrawn except in the following circumstances:

1. Statutory approval(s) required has been refused.
2. The sole acquirer being a natural person has died.
3. Such circumstances as in the opinion of the Board merit withdrawal.

Protection to Shareholders

Before making the Public Announcement, the acquirer has to open an escrow account in the form of cash deposited with a scheduled commercial bank or bank guarantee in favor of the Merchant Banker. The Merchant Banker is also required to confirm those firm financial arrangements are in place for fulfilling the offer obligations. In case, the acquirer fails to make the payment, MB has a right to forfeit the escrow account and distribute the proceeds in the following way.

1. 1/3 of the amount to target company
2. 1/3 to regional SEs, for credit to investor protection fund etc.
3. 1/3 to be distributed on Pro rata basis among the shareholders who have accepted the offer.

Acquisitions/Transactions Where Reporting to SEBI is Mandatory

Reporting is mandatory under Regulation 3(4) in respect of acquisitions arising out of firm allotment in public issues, rights issues, inter share transfer amongst group companies, relatives, promoters, acquirer and PACs, Indian promoters and foreign collaborators and transfer of shares from state-level Financial Institutions to co-promoters of company pursuant to the agreement. The report to be submitted on the prescribed form to SEBI within 21 days from the date of acquisition/allotment along with a fee of Rs. 1,000/- per report.

Penalties for Non-Compliance of The Regulations

The Regulations have laid down the general obligations of the Acquirer, Target Company and the Merchant Banker. Penalties have been prescribed for failure to carry out these obligations as well as for failure /non-compliance of other provisions of the Regulations.

Exemption from the applicability of the provisions

An acquirer who proposes to acquire shares through a mode which is not specifically covered under regulation 3 may seek exemption from the applicability of the provisions of the offer process by making an application which is called the Takeover Panel.

The Acquirer shall make an application to SEBI which is then forwarded to the Takeover Panel. The Takeover Panel would make a recommendation to SEBI. SEBI, after affording a reasonable opportunity to the concerned parties, whenever necessary, will pass a reasoned order and publish the same.

Though there may be many more issues relevant to mergers and takeovers/acquisitions which may be raised, the above are the issues which are

frequently raised. These are the issues and challenges before the corporate going for mergers or takeovers. Here a Company Secretary and a Chartered Accountant both play a principal role in resolving the issues listed above.

Conclusion

To sum up, M&A comes in all shapes and sizes and investors need to consider the complex issues involved in M&A. Critics claim that mergers & acquisitions reduce competition and promote monopoly. In reality, these mergers are part of a healthy competitive process and would foster innovation and bring benefits to consumers.

In nutshell, the challenge to valuing for M&A is to obtain a thorough understanding of the business dynamics of both the parties, the rationale for the merger, the industry. Dynamics the resulting synergies, as well as likely risk of the transaction, are required in order to ensure that the valuation is the win-win for both the parties & is financially viable. It is also important to understand that there are no hard & fast rules since one is projecting the future which is unknown based on current understanding. Therefore, experience, good judgment, and diligence are important in working out values.

Finally, the success of a merger hinges on how well the post-merged entity positions itself to achieve cost and profit efficiencies. In fact, the whole idea behind the above exercise of mergers and acquisitions is to strengthen the company's dominant position, which in turn be fruitful for the overall growth of the company benefiting both the companies and the shareholders in terms of their net worth

At last, "A cautious approach in choosing a partner or entering into an alliance, careful valuation and disciplined negotiations are vital to successful Mergers/Acquisitions, but in business, as in life it is sometimes more important to be lucky than smart" A slight deviation from the above may lead to disastrous consequences.

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