**MBA** **2018 - 2019**

**Semester - IV**

**18MBAPF402B** **MERGERS, ACQUISITIONS AND CORPORATE RESTRUCTURING** **4H - 4C**

**Instruction Hours / week: L: 4 T: 0 P: 0** **Marks: Internal: 40 External: 60 Total: 100**

**End Semester Exam: 3 Hours**

**COURSE OBJECTIVES:**

**To make the students**

1. To Understand the Concept mergers, Demergers, LBO, MBO, JV its valuation and accounting.
2. To compute, analyse and evaluate the corporate restructuring decisions and its impact on company..
3. To communicate orally and in written form the understanding of mergers, Demergers, LBO, MBO, JV its valuation and accounting.

**COURSE OUTCOMES:**

**Learners should be able to**

1. Understand the Concept mergers, Demergers, LBO, MBO, JV its valuation and accounting.
2. Compute, analyse and evaluate the corporate restructuring decisions and its impact on company..
3. Communicate orally and in written form the understanding of mergers, Demergers, LBO, MBO, JV its valuation and accounting.

**UNIT I Introduction to Merger and Acquisition:**

Meaning of mergers and acquisitions (M & A), motives behind the M & A, advantages and disadvantages of M & A, types of mergers and steps for a successful merger.

Strategic Evaluation of M & A Opportunities- selection approaches and criteria, modalities of fixing the acquisition price, key steps in the strategic planning of a merger, feasibility analysis in respect of cash and stock deals, describes fair value: institutional criteria and special features of acquisition of sick companies.

**UNIT II M & A Activity and Demerger Activity :**

Merger process right from planning the merger till implementation, five-stage model, methods of financial mergers and capital budgeting decision

Synergy and Value Creation in Mergers - synergy and its different types, role of industry life cycle, value creation in synergy, theoretical factors that would affect M & A activity

Corporate Restructuring- meaning of corporate restructuring, need for corporate restructuring, methods of corporate restructuring.

International M & A –Introduction of international M & A activity, the opportunities and threats, role of M & A in international trade growth, the external advantages in differential products, impact of government policies and political and economic stability on international M&A decisions, recommendation for effective cross-border M & A.

Demergers- Meaning of demerger, characteristics of demerger, structure of demerger, and tax implication of demergers

**UNIT III LBO, MBO, JV and Take overs.**
LBOs, MBOs, MLPs and ESOPs - meaning of LBO, MBO, MLP , ESOP, governance and mode of purchase in LBO, key motives behind an MBO, structure of MBO, types of MLP and ESOP, regulations that govern ESOPs.

Joint Ventures - Meaning of joint ventures, characteristics of a joint venture, states the rationale for joint ventures, role of joint ventures in business strategy, defines joint venture and complex learning, tax aspects of joint ventures, international joint ventures, reasons for failure of joint ventures, and joint venture vis-à-vis anti-trust policy

Takeover Defences - types of takeovers, techniques of bidding for a takeover, defences against takeover bids, regulations and amendments, and guidelines for takeovers

**UNIT IV Valuation and accounting**
Valuation - valuation approaches, basis of valuation, different methods of valuation, valuation of synergy, corporate control and LBO

Accounting for Amalgamation –Meaning of amalgamation, types of amalgamation, methods of accounting for amalgamation, meaning of consideration, treatment of goodwill, reserves and other profits

**UNIT VLegal and Regulatory Framework of M & A and Post Merger Integration :**
Provisions of the Companies Act, 1956 relating to M & A, buyback of shares, provisions of SEBI act, 1992 and 1997, provisions relevant to M & A activity in the Income Tax Act, and Foreign Exchange Management Act.

Post-Merger Integration - integration planning, factors in post-merger integration model, post-merger integration model, strategic interdependence and autonomy, political and cultural aspects in integration, cultural profiling and assessment of cultural compatibility, HRM issues, and problems in integration and five rules of integration process

**SUGGESTED READINGS:**

1. Rabi Narayan Kar/Minakshi (2017), Mergers Acquisitions & Corporate Restructuring - Strategies & Practices, 3rd edition, Taxmann, New Delhi.
2. Prasad G. Godbole(2013), Mergers Acquisitions and Corporate Restructuring, 2nd edition, Vikas Publishing House, New Delhi.
3. Chandrashekar Krishnamurti (Editor), Vishwanath S R(2018), Mergers

Acquisitions and Corporate Restructuring – Texts and Cases, 2nd edition, SAGE Publications Pvt. Ltd, New Delhi.
4. Patrick A. Gaughan(2019), Mergers Acquisitions and Corporate Restructuring, 7th edition, Wiley New Delhi.
5. Sheeba Kapil, Kanwal N. Kapil (2018), Mergers and Acquisitions: Strategy, Valuation, Leveraged Buyouts and Financing, 2nd edition, Wiley, New Delhi.

# UNIT- I

**Introduction to Merger and Acquisition:** Meaning of mergers and acquisitions (M & A), motives behind the M & A, advantages and disadvantages of M & A, types of mergers and steps for a successful merger. Strategic Evaluation of M & A Opportunities- selection approaches and criteria, modalities of fixing the acquisition price, key steps in the strategic planning of a merger, feasibility analysis in respect of cash and stock deals, describes fair value: institutional criteria and special features of acquisition of sick companies.

## Mergers

1. In the pure sense of the term, a merger happens when two firms agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a "merger of equals".
2. A merger refers to the process whereby at least two companies combine to form one single company. Business firms make use of mergers and acquisitions for consolidation of markets as well as for gaining a competitive edge in the industry.

The phrase **mergers and acquisitions** refers to the aspect of corporate strategy, corporate finance and management dealing with the buying, selling and combining of different companies that can aid, finance, or help a growing company in a given industry grow rapidly without having to create another business entity.

- ***Merger*** – Combination and pooling of equals, with newly created firm often taking on a new name
- ***Acquisition*** – One firm, the acquirer, purchases and absorbs operations of another, the acquired
- ***Merger-acquisition strategy***
    - Much-used strategic option
    - Especially suited for situations where alliances do not provide a firm with needed capabilities or cost-reducing opportunities
    - Ownership allows for tightly integrated operations, creating more control and autonomy than alliances

**Objectives of Mergers and Acquisitions**

- To create a more cost-efficient operation
- To expand a firm's geographic coverage
- To extend a firm's business into new product categories or international markets
- To gain quick access to new technologies or competitive capabilities
- To invent a new industry and lead the convergence of industries whose boundaries are blurred by changing technologies and new market opportunities

**Mergers - Definition**

- Any transaction that forms one economic unit from two / more previous ones.
- It's a combination of two or more companies into a single company where one survive and other lose their corporate existence.
- A/c to Halsubury's Laws of England, *Merger is blending of two or more existing undertakings into one undertaking, the shareholders of each blending company becoming substantially the shareholders in the company which is to carry on the blended undertaking.*
- The shareholders of two companies deciding to pool the resources of the companies under a common entity to do the business activity is called merger.
- Two companies agree to go forward as a single company rather than separately owned and operated.
- Both companies' stocks are surrendered and new stock is issued in its place.
- Examples of Mergers

➢ TATA-CORUS-$13 Billion

➢ Daimler- Benz & Chrysler -> Daimler Chrysler.

➢ JP Morgan /Chase Manhattan becomes JP Morgan Chase

➢ Exxon and Mobil becomes Exxon-Mobil

- Sometimes target firms name disappears and combined firms are known by acquired name or sometimes, by a completely new name.

  Ex: Burroughs/ Sperry Rand became Unisys.

- It is also called as Amalgamation.

**Types of merger**

- Horizontal Mergers
- Vertical Mergers
- Conglomerate Mergers
- Concentric Mergers
- Circular Combination

**1. Horizontal Merger**

- This involves two firms operating in the same kind of business activity. Both acquiring and the target company belong to same industry.
- Main purpose is to obtain economies of scale in production by eliminating duplication of facilities and operations.
- This is a combination of two or more firms in similar type of production, distribution or area of business.

Motives:

- Elimination or reduction in competition
- Putting an end to price cutting
- Economies of scale in production
- Research and development
- Better control over Marketing and management.
- Increase market power
- Ex: combining of book publishers or two mufgco's to gain dominant mkt share. (Mittal's Strategy)
- The acquisition of American Motors by Chrysler in 1987 represents a horizontal combination or merger.
- Bank of Madura was merged with ICICI Bank.
- Horizontal merger increase monopoly power of the combined firm.

**2. Vertical Merger**

- This occurs between firms in different stages of production and operation.
- Expands the espousing backward integration to assimilate sources of supply and forward integration towards market outlets.
- Vertical merger occurs when a firm acquires firms 'Upstream' from it or firms 'downstream' from it.

- In case of an 'Upstream' merger it extends to the firms supplying raw materials and to those firms that sell eventually to the consumer in the event of a 'down-stream' merger.
- When co combines with the supplier of materials it is called backward merger and when it combines with the customer it is known forward merger.
- EX: **Vertical Forward Integration** – Buying a customer
- Indian Rayon's acquisition of Madura Garments along with brand rights

**Vertical Backward Integration** – Buying a supplier

- IBM's acquisition of Daksh

  Merits:

- Low buying cost of materials
- Lower distribution costs
- Assured supplies and market
- Increasing or creating barriers to entry for potential competitors
- Placing them at a cost disadvantage. Control over product specification
- Technological Economies

**Carnegie Steel**

- One of the earliest, largest and most famous examples of vertical integration was the Carnegie Steel company. The company controlled not only the mills where the steel was manufactured but also the mines where the iron ore was extracted, the coal mines that supplied the coal, the ships that transported the iron ore and the railroads that transported the coal to the factory, the coke ovens where the coal was coked, etc. The company also focused heavily on developing talent internally from the bottom up, rather than importing it from other companies.

**American Apparel**

- American Apparel is a fashion retailer and manufacturer that actually advertises itself as vertically integrated industrial company. The brand is based in downtown Los Angeles, where from a single building they control the dyeing, finishing, designing, sewing, cutting, marketing and distribution of the company's product. The company shoots and distributes its own advertisements, often using its own employees as subjects. It also owns and operates each of its retail locations as opposed to franchising. According to the

  management, the vertically integrated model allows the company to design, cut, distribute and sell an item globally in the span of a week. [9] Since the company controls both the production and distribution of its product, it is an example of a **balanced vertically integrated** corporation.

**Oil industry**

- Oil companies, both multinational (such as ExxonMobil, Royal Dutch Shell, or BP) and national (e.g. Petronas) often adopt a vertically integrated structure. This means that they are active all the way along the supply chain from locating crude oil deposits, drilling and extracting crude, transporting it around the world, refining it into petroleum products such as petrol/gasoline, to distributing the fuel to company-owned retail stations, where it is sold to consumers.

**3. Conglomerate Merger**

- This occurs between companies engaged into two unrelated industries.
- Conglomerate merger represents a merger of firms engaged in unrelated lines of business.
- Rationale for such merger:Diversification of risk
- 3 types of Conglomerate merger:
  a) **Product-extension mergers** broaden the product lines of firms. These are mergers between firms in related business activities and may also be called **concentric mergers**. These mergers broden the product lines.
- **Product Extension**: New product in Present territory
- P&G acquires Gillette to expand its product offering in the household sector and smooth out fluctuations in earning.
  b) **geographic market-extension merger** involves two firms whose operations have been conducted in non overlapping geographic areas.
- Ex: Pizza Hut a fast food chain restaurant centered in USA, sought to wow Indian customers by opening their restaurant in all most all major urban centers of India.
- c) **Pure conglomerate mergers**involves unrelated business activities. These would not qualify as either product-extension or market extension.
- New product&New territories
- Indian Rayon's acquisition of PSI Data Systems.
- Mohta Steels with Vardhaman Spinning Mills Ltd.

**4. Concentric Mergers:**A merger in which there is carry –over in specific mgt functions (ex: mktg) or complementarily in relative strengths among specific mgt functions rather than carry-over/complementarities in only generic mgt functions (eg: planning).

Therefore, if the activities of the segments brought together are so related that there is carryover of specific mgt functions (mufg, finance, mktg, personnel, & so on) or

complementarily in relative strengths among these specific mgt functions, the merger should be termed concentric rather than conglomerate.

Ex: if one co., has competence in research, mufg., or mktg that can be applied to the pdt problems of another co., that lacks that particular competence, a merger will provide the opportunity to lower cost function.

Firms seeking to diversify from advanced technology industries my be strong on research but weaker on pdtn., and mktg., capabilities firms in industries with less advanced technology.

**5.Circular Combination/circular merger**

- This happens among companies producing distinct products to share common research and distribution facilities to obtain economies by elimination of cost on duplication and promoting market enlargement.

- Acquiring company has the benefit in form of economies of resource sharing and diversification
- When the firms belonging to the different industries and producing altogether different products combine together under the banner of central agency, it is referred as mixed or circular mergers.
- Ex: Merger of Sony (camera provider for mobiles)Erricson(cell phone producer)
- **Circular Merger** involves bringing together of products or services that are unrelated but marketed through the same channels, allowing shared dealerships. Ex: McLeod Russell (a tea company) with Eveready Industries (batteries).

**Categories of Merger**

A merger is said to occur when two or more companies combine into one company. Mergers may take any one of the following forms.

- Amalgamation
- Absorption
- Combinations
- Acquisitions
- Takeover
- Demergers

1. **Amalgamation**

- Ordinarily amalgamation means merger.
- Amalgamation: is used when two or more companies' carries on similar business go into liquidation and a new company is formed to take over their business.
- Ex: the merger of Brooke Bond India Ltd., with Lipton India Ltd., resulted in the formation of a new company Brooke Bond Lipton India Ltd.

2. **Absorption**

- Absorption is a combination of 2 or more companies into an existing co. All co's except one lose their identity in a merger through absorption.
- Ex: Absorption of Tata Fertilizer Ltd (TFL) by Tata Chemicals LTd (TCL)
- TCL an acquiring co (buyer); survived after merger while TFL an acquired co ( a seller) ceased to exist.
- TFL transferred its assets, liabilities and shares to TCL under the scheme of merger.

3. **Combinations/ Consolidation**

- Consolidation: two or more companies combine to form a new company. In this form of merger all companies are legally dissolved and a new entity is created.
- In a consolidation, the acquired company transfers its assets, liabilities and shares to the new company for cash or exchange of share.
- Ex : Merger or amalgamation of Hindustan Computers Ltd, Hindustan Instruments Ltd, Indian software co Ltd and Indian Reprographics ltd in 1986 to an entirely new co, called HCL ltd.

4. **Acquisitions**

    - Acquisition means acquiring the ownership in the company. When 2 companies become one , but with the name and control of the acquirer, and the control goes automatically into the hands of the acquirer.
    - A classic example in this context is the acquisition of TOMCO by HLL.

5. **Takeover**

    - A takeover generally involves the acquisition of a certain stake in the equity capital of a company which enables the acquirer to exercise control over the affairs of the company.
    - keover implies acquisition of controlling interest in a company by another company. It doesn't lead to the dissolution of the company whose shares are being / have been acquired. It simply means a change of controlling interest in a company through the acquisition of its shares by another group.
    - Ex: HINDALCO took over INDAL by acquiring a 54% stake in INDAL from its

overseas parent, Alcan. However, INDAL was merged into HINDALCO.

6. **Demergers**
   - Demerger or split or division of a company is opposite of mergers and amalgamations
   - Ex: Hero Honda demerged from Honda and became Hero.

RECENT M&A TRENDS

The pace of mergers and acquisitions (M&As) picked up in the early 2000s after a short hiatus in 2001. The economic slowdown and recession in the United States and elsewhere in 2001 brought an end to the record-setting fifth merger wave. This period featured an unprecedented volume of M&As. It followed on the heels of a prior record-setting merger wave—the fourth. This one in the 1990s, however, was very different from its counterpart in the previous decade. The fifth wave was truly an international one and it featured a heightened volume of deals in Europe and, to some extent, Asia, in addition to the United States. The prior merger waves had been mainly a U.S. phenomenon. When the fourth merger wave ended with the 1990–1991 recession, many felt that it would be a long time before another merger wave like it would occur. However, after a relatively short recession and an initially slow recovery, the economy picked up speed in 1993, and by 1994 the world was on a path to another record-setting merger period. This wave would feature deals that would make the ones of the 1980s seem modest. There would be many megamergers and many cross-border deals involving U.S. buyers and sellers, but also many large deals not involving U.S. firms.

Figure 1.1 shows that both European and U.S. M&A volume began to rise in 2003 and by 2006 had reached levels comparable to their peaks of the fifth wave. Deal volume began to decline in the United States in 2007 while it continued to rise in Europe. However, by 2008 the effects of the global recession and the subprime crisis began to take hold. The recession, which began in January 2008, caused potential acquirers to reign in their acquisition-oriented expansion plans. Those bidders who were still inclined to go ahead with proposed deals found that their access to financing was sharply curtailed. Many bidders who had reached agreements with targets sought to renegotiate the deals or even back out altogether. Deals were canceled with increased frequency. While the number and dollar value of M&As in 2009 were well below 2008 levels, which, in turn, were well below 2007 levels, there were some signs of a rebound in the latter half of the year of 2009. As is often the case in economic downturns, bidders with strong balance sheets and abundant cash reserves found some opportunities in the weak M&A market.

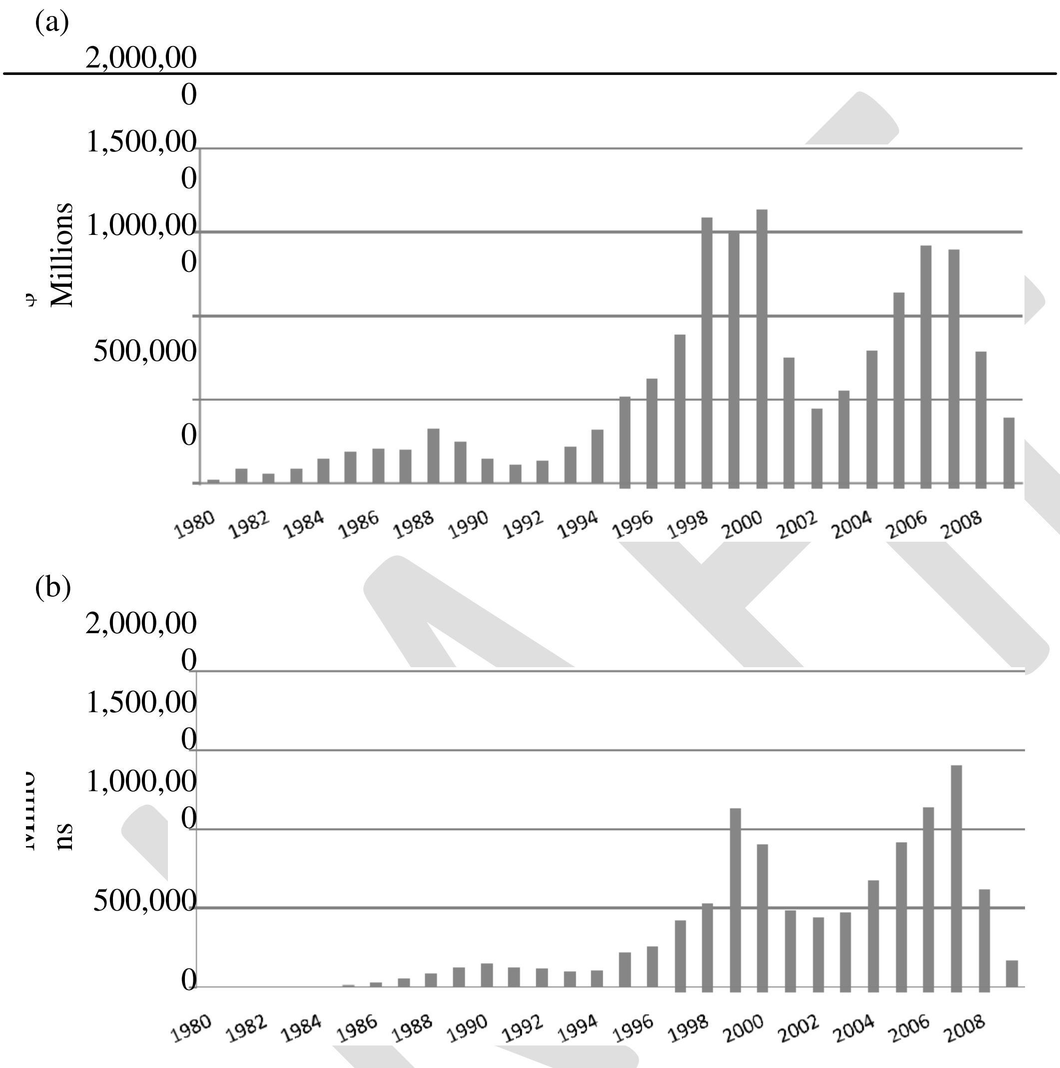



FIGURE 1.1 VALUE OF M&AS 1980–2009: (A) UNITED STATES AND (B) EUROPE
Source: Thomson Financial, January 7, 2010.

Deal volume in most regions of the world generally tended to follow the patterns in the United States and Europe. Huge mega-mergers took place in both the United States and Europe (see Tables 1.1 and 1.2). Australia, for example, exhibited such a pattern with deal volume growing starting in 2003 but falling off in 2008 and 2009 for the same reason it fell off in the United States and Europe. The situation was somewhat different in China and Hong Kong. The value of deals in these economies has traditionally been well below the United States and Europe but had been steadily growing even in 2008, only to fall off sharply in 2009. China's economy has realized double-digit growth for a number of years but is still about one-quarter the size of the U.S. economy. However, there are many regulatory restrictions imposed on M&As in China that inhibit deal volume from rising to levels that would naturally occur in a less controlled environment. The Chinese

regulatory authorities have taken measures to ensure that Chinese control of certain industries and companies is maintained even as the economy moves to a more free market status.

In the rest of Asia, deal volume generally expanded starting in 2003 and declined with the global recession in 2008 and 2009. This was the case in India and South Korea (see Figure 1.2). In Japan, other factors help explain the trend in deal volume. Although Japan is the world's second largest national economy, it suffered a painful decade-long recession in the 1990s that has had lasting effects, some of which remain even today. The government has sought to deregulate the economy and take apart the myriad restrictive corporate interrelationships that had kept alive many businesses that otherwise would have failed. This helped create some M&A opportunities over the period 1999–2007. Deal volume fell after 2007 as it did elsewhere in the world.

| Date Announced | Date Effective | Value of Transaction ($ Millions) | Target Name | Target Nation | Acquirer Name | Acquirer Nation |
|---|---|---|---|---|---|---|
| 11/14/1999 | 6/19/2000 | 202,785.13 | Mannesmann AG | Germany | Vodafone AirTouch PLC | United Kingdom |
| 1/10/2000 | 1/12/2001 | 164,746.86 | Time Warner | United States | America Online Inc | United States |
| 8/29/2007 | 3/28/2008 | 107,649.95 | Philip Morris Intl Inc | Switzerland | Shareholders | Switzerland |
| 4/25/2007 | 11/2/2007 | 98,189.19 | ABN-AMRO Holding NV | Netherlands | RFS Holdings BV | Netherlands |
| 11/4/1999 | 6/19/2000 | 89,167.72 | Warner-Lambert Co | United States | Pfizer Inc | United States |
| 12/1/1998 | 11/30/1999 | 78,945.79 | Mobil Corp | United States | Exxon Corp | United States |
| 1/17/2000 | 12/27/2000 | 75,960.85 | SmithKline Beecham PLC | United Kingdom | Glaxo Wellcome PLC | United Kingdom |
| 10/28/2004 | 8/9/2005 | 74,558.58 | Shell Transport & Trading Co | United Kingdom | Royal Dutch Petroleum Co | Netherlands |
| 3/5/2006 | 12/29/2006 | 72,671.00 | BellSouth Corp | United States | AT&T Inc | United States |
| 4/6/1998 | 10/8/1998 | 72,558.18 | Citicorp | United States | Travelers Group Inc | United States |

TABLE 1.1 TOP TEN WORLDWIDE M&AS BY VALUE OF TRANSACTION

Source: Thompson Financial, January 7, 2010.

| Date Announced | Date Effective | Value of Transaction ($ Millions) | Target Name | Target Nation | Acquirer Name | Acquirer Nation |
|---|---|---|---|---|---|---|

| | | | | | | |
|---|---|---|---|---|---|---|
| 11/14/99 | 06/19/00 | 202,785.134 | Mannesmann AG | Germany | Vodafone AirTouch PLC | United Kingdom |
| 08/29/07 | 03/28/08 | 107,649.948 | Philip Morris Intl Inc | Switzerland | Shareholders | Switzerland |
| 04/25/07 | 11/02/07 | 98,189.193 | ABN-AMRO Holding NV | Netherlands | RFS Holdings BV | Netherlands |
| 01/17/00 | 12/27/00 | 75,960.847 | SmithKline Beecham PLC | United Kingdom | Glaxo Wellcome PLC | United Kingdom |
| 10/28/04 | 08/09/05 | 74,558.583 | Shell Transport & Trading Co | United Kingdom | Royal Dutch Petroleum Co | Netherlands |
| 02/25/06 | 07/22/08 | 60,856.454 | Suez SA | France | Gaz de France SA | France |
| 01/26/04 | 08/20/04 | 60,243.38 | Aventis SA | France | Sanofi-Synthelabo SA | France |
| 07/05/99 | 03/27/00 | 50,070.051 | Elf Aquitaine | France | Total Fina SA | France |
| 05/30/00 | 08/22/00 | 45,967.068 | Orange PLC | United Kingdom | France Telecom SA | France |
| 11/29/99 | 03/13/00 | 38,412.856 | National Westminster Bank PLC | United Kingdom | Royal Bank of Scotland Group | United Kingdom |

TABLE 1.2 TOP TEN EUROPEAN M&AS BY VALUE OF TRANSACTION
Source: Thompson Financial, January 7, 2010.

The 2000 $34 billion takeover of Cable & Wireless HKT Ltd. by Pacific Century CyberWorks Ltd., both Hong Kong companies, was a signal to the Asian market that U.S.-type takeovers had come to that continent (see Table 1.2). Pacific Century Cyber-Works was an Internet and technology company founded by Richard Li, the young scion of Hong Kong tycoon Li Ka-Shing. The deal was clearly the largest Asian takeover.

The takeover allowed Cable & Wireless to stay in Hong Kong hands as Pacific Century outbid Singapore Telecommunications Ltd., which was the government-owned telephone company of Singapore. The deal also underscored the buying power of Internet companies during that time period.

Given the rapid growth of the Chinese economy, we would expect there to be many more M&As—especially takeovers of Chinese companies by non-Chinese. The fact that we do not see this in Table 1.3 is attributable to the reluctance of the Chinese government to allow unrestricted takeovers of Chinese companies. Nonetheless, the M&A market between Chinese companies has been quite robust. Chinese industries have been consolidating under the watchful eye of the Beijing government, which favors the building of large, internationally powerful enterprises, and if M&A is the best way to achieve this, most deals will receive government support.

Three of the top ten Asian deals involve Australian companies. The largest Australian deal, a merger between two of that nation's largest banks, resulted in the formation of the largest Australian bank by market capitalization.

The total volume of deals in South and Central America (see Figure 1.3) is compara-tively small compared to the United States and Europe. However, in South America, M&A volume has grown steadily from 2003 even into 2008 when most of the rest of the world were scaling back on deals. While countries such as Argentina have continued to deal with stagnant economies, others such as Brazil have shown impressive growth. In 2009, however, we begin to see more retrenchment in the South American M&A activity. In Central America, a much smaller combination of national economies relative to South America, deal volume spiked in 2006 but fell off dramatically in 2008 and 2009.

## UNIT- 2

**M & A Activity and Demerger Activity :** Merger process right from planning the merger till implementation, five-stage model, methods of financial mergers and capital budgeting decision. Synergy and Value Creation in Mergers - synergy and its different types, role of industry life cycle, value creation in synergy, theoretical factors that would affect M & A activity. Corporate Restructuring- meaning of corporate restructuring, need for corporate restructuring, methods of corporate restructuring. International M & A –Introduction of international M & A activity, the opportunities and threats, role of M & A in international trade growth, the external advantages in differential products, impact of government policies and political and economic stability on international M&A decisions, recommendation for effective cross-border M & A.Demergers- Meaning of demerger, characteristics of demerger, structure of demerger, and tax implication of demergers

### M & A – A strategic perspective

Mergers and Acquisition activities should take place within the framework of long range planning by business firms. M&A are the most popular means of corporate restructuring or business combinations. It is believed that mergers and acquisitions are strategic decisions leading to the maximization of the company's growth by enhancing its production and marketing operations. The reasons why M&A activities are considered to strategic in decision are:

- It includes huge amount of investment and the benefits are long term in nature.
- Maintaining or accelerating a company's growth, particularly when the internal growth is considered due to scarcity of resources.
- Enhancing profitability, through cost reduction resulting from economies of scale, operating efficiency and synergy.
- Diversifying the risk of the company, particularly when it acquires those businesses whose income streams are not correlated.
- Limiting the severity of competition by increasing the company's market power.
- Reducing tax liability because of the provision of setting off accumulated losses and unabsorbed depreciation of one company against the profits of another.

Strategy formulation is a sequential process which consists of strategic situation analysis by which is meant a company's analysis of the present scenario, its strengths and weaknesses and how they match with the opportunities and threats that the market analysis throws up. Strategic choice analysis involves a forward looking scenario building analysis by the company as to where does it see itself in the future, what kind of capability it must build to reach that position it sees for itself and most importantly how should it go about building these capabilities.

After the company has identified segments of the market to invest in, the next part of the strategy is market entry. The different entry level strategies available are:

- Organic growth
- Acquisitions or strategic alliances

The choice of entry strategy depends upon the market scenario and the industry life cycle which are governed by:

- Level of competition and growth
- Start-up and maturity risks
- Availability of organizational resource for organic growth and
- Advantage of speed of entry and exit

**Merger As a Capital Budgeting Decision**

Like capital budgeting decision, merger deci-sion requires comparison between the expected benefits [measured in terms of the present value of expected benefits/cash inflows (CFAT) from the merger] with the cost of the acquisition of the target firm. The acquisition costs include the payment made to the target firm's shareholders, payment to discharge the external liabilities of the acquired firm less cash proceeds expected to be realised by the acquiring firm from the sale of certain asset(s) of the target firm. The decision criterion is 'to go for the merger' if net present value (NPV) is positive; the decision would be 'against the merger' in the event of the NPV being negative.

- Determination of Incremental Projected free cash flow to the firm(FCFF)
- Determination of Terminal value
- Determination of appropriate discount rate or cost of capital
- Determination of Present value of FCFF
- Determination of cost of acquisition

**Share exchange ratio**

The relative number of new shares that will be given to existing shareholders of a company that has been acquired or merged with another. After their old company shares have been delivered, the exchange ratio is used to give shareholders the same relative value in new shares of the merged entity.

An exchange ratio is designed to give shareholders an asset with the same relative value of the asset they delivered upon the acquisition of the acquired company. Relative value does not mean, however, that the shareholder receives the same number of shares or same dollar value based on current prices. Instead, the intrinsic value of the shares and the underlying value of the company will also be considered when coming up with an exchange ratio.

**Synergies from M&A: Operating and Financial synergy**

**Synergies and merger value**

In order for mergers and acquisitions to create value, cash flow of the combined entities must exceed the sum of cash flows of the individual entities before the combination. In other words, there must be synergistic cash (value) gains through the combination. From the perspective of the acquiring entity, the synergistic value gain must exceed the acquisition (takeover) premium in order that the M&A makes economic sense.

Two main types of synergy are operating synergy and financial synergy. Operating synergy comes in two forms: revenue enhancements and cost reductions. They may be derived in horizontal or vertical mergers. Financial synergy refers to the possibility that the cost of capital may be lowered by combining one or more companies.

**Operating Synergy**

Operating synergy is when the value and performance of two firms combined is greater than the sum of the separate firms apart and, as such, allows for the firms to increase their operating income and achieve higher growth.

Operating synergies can arise from the following:

- Economies of scale;
- Greater pricing power and higher margins resulting from greater market share and lower competition;
- Combination of different functional strengths such as marketing skills and good product line; or
- Higher levels of growth from new and expanded markets.

Operating synergies are achieved through horizontal, vertical or conglomerate mergers. Mergers of firms which have competencies in different areas such as production, research and development or marketing and finance, can also help achieve operating efficiencies.

Operating synergy is an important reason why significant premiums are sometimes paid by strategic buyers. Mid-market business owners that are approached by strategic buyers should try to quantify the operating synergies that buyers might be able to realize post-acquisition. This can go a long way to obtaining a premium valuation upon exit.

**Financial Synergy**

Financial synergy is when the combination of two firms together results in greater value than if they were to operate separately. Financial synergies are most often evaluated in the context of mergers and acquisitions. These type of synergies relate to improvement in the financial metric of a combined business such as revenue, debt capacity, cost of capital, profitability, etc.

Synergies related to operational metrics are referred to as operating synergies.

Examples of positive financial synergies include:

- Increased revenues through a larger customer base
- Lower costs through streamlined operations
- Talent and technology harmonies

In addition, financial synergies can result in the following benefits post acquisition:

- Increased debt capacity
- Greater cash flows
- Lower Cost of Capital
- Tax Benefits

When evaluating a merger or acquisition, the positive synergies usually produce a successful result. While financial synergies are often used with a positive connotation, these synergies can also be negative in some situations. For instance, an acquiring company may have to incur additional costs in the target company to bolster the management team or implement systems to meet the standards of the acquirer.

Although financial synergies are usually experienced by strategic buyers, a financial buyer may be willing to pay a premium for the acquisition of a mid-market business due to the benefits associated with a more efficient capital structure and lower cost of financing.

**Industry life cycle and product life cycle analysis in M&A decision**

- **INDUSTRY LIFE CYCLE**

FOUR DISTINCT STAGES

- INTRODUCTION OR PIONEERING STAGE
- GROWTH STAGE
- MATURITY STAGE
- DECLINE STAGE

1. PIONEERING STAGE

CHARACTERISTICS

1) No Ready Market

2) Sales Are Low

3) Important Pricing Strategy

2. GROWTH STAGE

CHARACTERISTICS

1) Increased Demand for Product

2) Increased Sales of Products

3) Entry of Competitors

4) Competition Oriented Pricing

3. MATURITY STAGE

CHARACTERISTICS

1) Demand Reaches Saturation Point

2) Tough Competition

3) Product Differentiation

4. DECLINE STAGE

CHARACTERISTICS

1) Sales begin to fall

2) Availability of new advanced products

3) Price margin get depressed

**Role of Industry Life Cycle**

Various Stages of Industry Life Cycle are –

- Fragmentation Stage
- Shake Out Stage
- Maturity Stage &
- Decline Stage

**1.Fragmentation Stage:**

- At this stage, the new industry normally arises when an entrepreneur overcomes the twin Problems of innovation and invention, and works out how to being the new product and services into the market.
- Example: Air travel services of major airlines in Europe were sold to a target market at a high price, concentrating on people with high income group. Ryan air was the first airline to engage low cost airlines in Europe. Its services were perceived as the innovation of the European Airline industry.

  Eliminated unnecessary services offered by traditional airlines. No free meals, uses paper-free air tickets, using secondary airports and offers frequent flights

**2. Shake out Stage:**

- During this stage, competitors start to realize business opportunities in the emerging industry. The value of the industry also rises.
- Example: UK govt. decided to launch a campaign to encourage people to quit smoking. Nicorette, a manufacturer of various nicotine products encouraged people quit smoking by giving them Nicolette patches and Nicorette gums. Nic Lite realized the opportunity and entered this industry and extended beyond UK border when the govt introduced non- smoking policy in public places. This business threat created a new business opportunity to launch Nic Time (an eight ounce bottle containing a lemon-flavored drink laced with nicotine, the same amount of nicotine as two cigarettes.

**3. Maturity:**

- A stage at which the efficiencies of the dominant business model give these organizations Competitive advantage over competition. Some companies may shift some of the production to overseas for gaining competitive advantage.
- Example – Toyota – export and import taxes mean that its cars lose competitiveness to the local competitors (in European market). Thus Toyota decided to open a factory at UK. Nike has factories in China and Thailand as both countries have cheap labor and materials. However, their overseas partners are not allowed to sell shoes produced. These have to be shipped back to US, and then will be exported to other countries.

**4.Decline:**

- A stage during which a war of slow destruction between businesses may develop and those with heavy bureaucracies may fail. In this stage, many companies may leave the industry or they may develop new products / services. This will create a new industry.
- Example : communication industry - the communication process of pagers couldn’t be accomplished without telephones. To send messages to another pager, the user had to phone the call-center staff that would type and send message to another pager. On the other hand, people who use mobile phones can make a phone-call and send messages to other mobiles without going thru call-center staff.

**PRODUCT LIFE CYCLE AND MERGERS**

- INTRODUCTION STAGE

- NEWLY CREATED FIRMS SELL TO OUTSIDE LARGER FIRMS IN MATURE OR DECLINING INDUSTRY
- HORIZONTAL MERGERS TAKES PLACE TO HAVE BETTER MANAGEMENT AND UTILISATION OF RESOURCES

- GROWTH STAGE

MERGERS TAKES PLACE BECAUSE OF

- Prospective Growth
- Profit And Larger Capital Requirement

- MATURITY STAGE

MERGERS TAKES PLACE TO

- Achieve Economies Of Scale
- Rounding Out Management Skills
- Broader Financial Base

- DECLINE STAGE

MERGERS TAKE PLACE FOR

- The Survival Of The Firms
- Increase Efficiency And Profit Margin

**Porter's five forces model**

**Introduction**

The model of the Five Competitive Forces was developed by Michael E. Porter in his book „Competitive Strategy: Techniques for Analyzing Industries and Competitors"in 1980. Since that time it has become an important tool for analyzing an organizations industry structure in strategic processes.

Porter's model is based on the insight that a corporate strategy should meet the opportunities and threats in the organizations external environment. Especially, competitive strategy should base on and understanding of industry structures and the way they change.

Porter has identified five competitive forces that shape every industry and every market. These forces determine the intensity of competition and hence the profitability and attractiveness of an industry. The objective of corporate strategy should be to modify these competitive forces in a way that improves the position of the organization. Porter's model supports analysis of the driving forces in an industry. Based on the information derived from the Five Forces Analysis, management can decide how to influence or to exploit particular characteristics of their industry.

**The Porter's Five Competitive Forces**

The Five Competitive Forces are typically described as follows:

- **Bargaining Power of Suppliers**

The term 'suppliers' comprises all sources for inputs that are needed in order to provide goods or services.

Supplier bargaining power is likely to be high when:

- The market is dominated by a few large suppliers rather than a fragmented source of supply,
- There are no substitutes for the particular input,
- The suppliers customers are fragmented, so their bargaining power is low,
- The switching costs from one supplier to another are high,
- There is the possibility of the supplier integrating forwards in order to obtain higher prices and margins. This threat is especially high when
- The buying industry has a higher profitability than the supplying industry,
- Forward integration provides economies of scale for the supplier,
- The buying industry hinders the supplying industry in their development (e.g. reluctance to accept new releases of products),
- The buying industry has low barriers to entry.

In such situations, the buying industry often faces a high pressure on margins from their suppliers. The relationship to powerful suppliers can potentially reduce strategic options for the organization.

- **Bargaining Power of Customers**

Similarly, the bargaining power of customers determines how much customers can impose pressure on margins and volumes.

Customers bargaining power is likely to be high when

· They buy large volumes, there is a concentration of buyers,

· The supplying industry comprises a large number of small operators

· The supplying industry operates with high fixed costs,

· The product is undifferentiated and can be replaces by substitutes,

· Switching to an alternative product is relatively simple and is not related to high costs,

· Customers have low margins and are price-sensitive,

· Customers could produce the product themselves,

· The product is not of strategical importance for the customer,

· The customer knows about the production costs of the product

· There is the possibility for the customer integrating backwards.

- **Threat of New Entrants**

The competition in an industry will be the higher; the easier it is for other companies to enter this industry. In such a situation, new entrants could change major determinants of the market environment (e.g. market shares, prices, customer loyalty) at any time. There is always a latent pressure for reaction and adjustment for existing players in this industry.

The threat of new entries will depend on the extent to which there are barriers to entry. These are typically

· Economies of scale (minimum size requirements for profitable operations),

· High initial investments and fixed costs,

· Cost advantages of existing players due to experience curve effects of operation with fully depreciated assets,

· Brand loyalty of customers

· Protected intellectual property like patents, licenses etc,

· Scarcity of important resources, e.g. qualified expert staff

· Access to raw materials is controlled by existing players,

· Distribution channels are controlled by existing players,

· Existing players have close customer relations, e.g. from long-term service contracts,

· High switching costs for customers

· Legislation and government action

- **Threat of Substitutes**

A threat from substitutes exists if there are alternative products with lower prices of better performance parameters for the same purpose. They could potentially attract a significant proportion of market volume and hence reduce the potential sales volume for existing players. This category also relates to complementary products.

Similarly to the threat of new entrants, the threat of substitutes is determined by factors like

· Brand loyalty of customers,

· Close customer relationships,

· Switching costs for customers,

· The relative price for performance of substitutes,

· Current trends.

**Competitive Rivalry between Existing Players**

This force describes the intensity of competition between existing players (companies) in an industry. High competitive pressure results in pressure on prices, margins, and hence, on profitability for every single company in the industry.

Competition between existing players is likely to be high when

· There are many players of about the same size,

· Players have similar strategies

· There is not much differentiation between players and their products, hence, there is much price competition

· Low market growth rates (growth of a particular company is possible only at the expense of a competitor),

· Barriers for exit are high (e.g. expensive and highly specialized equipment).

Michael Porter has elaborated his views in number of writings. His approach can be summarized as –

- **Select an attractive Industry**.

Porter defines an attractive industry or strategic group as *"one in which, entry barriers are high, suppliers & buyers have only modest bargaining power, substitute products or services are few & the rivalry among competitors is stable."*

- **Develop Competitive advantage through Cost Leadership and Product Differentiation**.

Competitive advantage may be based on cost leadership or on product differentiation. Cost advantage is achieved by consideration of wide range of checklist factors including BCG's learning curve theory. The focus of cost advantage or of product differentiation can be narrow market segments or niche (BMW, Mercedes) or broader market groups or across the board (GM)

- **Develop attractive value chains.**

A matrix that relates the support activities of infrastructure, HRM, Technological development and procurement to the primary activities of inbound logistics, marketing, sales and service. The aim is to minimize outlay in adding characteristics valued by customers.

**Synergy**

Synergy refers to the type of reaction that occur when two substances or factors combine to produce a greater effect together than that with the sum of the two operating independently could account for. It refers to the phenomenon 2+2=5.

- **FINANCIAL SYNERGY**

The impact of a corporate merger or acquisition on the costs of capital to the acquiring or the combined firm refers to financial synergy. Financial synergy occurs as a result of the lower costs of internal financing versus external financing. A combination of firms with different cash flow positions and investment opportunities may produce a financial synergy and achieve lower cost of capital.A firm in a declining industry will provide large cash flows since there are few attractive investment opportunities. A growth industry has more investment opportunities than cash with which to finance them

- **Operating Synergy**
  - This theory assumes that economies of scale do exist in the industry and that prior to the merger; the firms are operating at levels of activity that fall short of achieving the potentials for economies of scale.

- Ex: one firm might be strong in cash but weak in marketing while another has strong marketing department without the R&D capability. Merging the two firms would result in operating synergy.
- One problem in merging is- how to combine and coordinate the good parts of the organization and eliminate what is not required?
- Vertical integration is one area in which operating economies may be achieved.
- Combining firms at difft stages of an industry may achieve more efficient coordination of the difft levels.

**2. Pure Diversification**

- First, in contrast to the position of shareholders who can diversify across firms in the capital market, employees of the firm have only a limited opportunity to diversify their labor sources. Diversification of the firm can provide managers and other employees with job security and opportunities for promotion and, other things being equal, results in lower labor costs.
- Second, in the modern theory of the firm, information on employees is accumulated within the firm over time. If the firm is diversified, teams can be transferred from unprofitable business activities to growing and profitable activities. Diversification may ensure smooth and efficient transition of the firm's activities and the continuity of the teams and the organization.
- Third, firms have reputational capital which customers, suppliers and employees utilize in establishing their relationships with the firm. Diversification can help preserve the firm's reputational capital which will cease to exist if the firm is liquidated.
- Fourth, diversification can increase corporate debt capacity and decrease the present value of future tax liability. These effects are a result of the decrease in cash flow variability due to the merger.

**3. Strategic Realignment to Changing Environments**

- Strategic planning is concerned with the firm's environments and constituencies, not just operating decisions. The strategic planning approach to mergers implies either the possibilities of economies of scale or tapping an underused capacity in the firm's present managerial capabilities.
- The speed of adjustment through merger would be quicker than internal development. There may be opportunities to realize synergies in managerial capabilities. On the other hand, a competitive market for acquisitions implies that the net present value from merger and acquisition investments is likely to be small.

However, if these investments exploit synergy opportunities and can be used as a base for still additional investments with positive net present values, the strategy may succeed.

**4. Undervaluation**

- Some studies attribute merger motives to the undervaluation of target companies. One cause of undervaluation may be that management is not operating the company up to its potential.
- Second possibility is that the acquirers have inside information. How they acquired this special information may vary with circumstances, but if the bidders possess information which the general market does not have, they may place a higher value on the shares than currently prevails in the market.
- Another aspect of the under valuation theory is the difference between the market value of assets and their replacement costs.

**Operating, financial and managerial synergy of mergers**

**SYNERGY**

- Synergy represents the two plus two equals to five effect(2+2=5) phenomenon. What is critical is how the extra gains are to be achieved. Synergy refers to the type of reactions that occur when two substances or factors combine to produce a greater effect together than that which the sum of the two operating independently could account for.
- One example of synergy is found in the history of pharmaceutical industry when after World War II the major firms shifted from producing bulk chemicals for others. To process to an emphasis on basic research and packaging products that were ready for final sale. A sales organization also was required. After a no. of years, synergistic mergers took place involving companies strong in research or marketing with companies that had complementary strengths and weaknesses.

**TYPES OF SYNERGY**

1. Operating synergy

2. Financial synergy

3. Managerial synergy

1**. Operating synergy**

- Operating synergy or operating economies may be involved in horizontal and vertical mergers. For horizontal mergers the source of operating economies must represent a form of economies of scale. The economies, in turn, may reflect indivisibilities and better utilization of capacity after the merger.

Another area in which operating economies may be achieved is vertical integration. Combining firms at different stages of an industry may achieve more efficient coordination of the differentlevels. Costs of communication, and various forms of bargaining and opportunistic behaviour can be avoided by vertical integration.

2**. Financial synergy**

- The motive of the merger is to capture investment opportunities available in the acquired firm's industry by lowering the costs of capital of the combined firm through the merger and also utilizing lower-cost internal funds of the acquiring firm. The opportunity for utilizing the cash flows of the acquiring firm will be enhanced if the cash flow of the acquired firm is low.
- The decrease in bankruptcy probability may decrease the expected value of bankruptcy costs and increase the expected value of tax savings from interest payments for premerger debts, and thus increase the value of the combined firm by lowering its cost of capital.
- Internal funds do not involve transaction costs of the flotation process and may have differential tax advantages over external funds.
- The acquiring firms may supply lower-cost internal funds to the combined firm. Further, the acquired firms will typically have low free cash flows because high expected demand growth in their industries requires greater investments. The low free cash flows of the acquired firms provide synergistic opportunities in financing.
- Economies of scale in floatation and transaction costs of securities are another potential source of financial synergy.
- 3. **Managerial synergy**
- Now imagine a production process employing four factor inputs ---- generic managerial capabilities, industry-specific managerial capabilities, firm-specific nonmanagerial human capital and capital investment.
- The firm-specific non-managerial human capital can only be supplied by a long-term learning effort or by merging with existing firms in the same industry. The industry-specific managerial resources can be obtained by internal learning or by merging with a firm in the same or related industries.
- Suppose that a firm, call It B has 'excess capacity' in industry specific resources and that another firm in a related industry, call it T experiences 'shortages' in these resources.
- The acquisition of T by B will make the firms realize more balanced factor proportions between industry-specific and firm-specific resources by transferring the excess capacity of B in the

industry-specific capabilities to T's operation.

- An example of the T-type firm will be an R&D oriented firm lacking marketing organizations and being acquired by a B-type firm with strong marketing capabilities in related fields of business.

Value creation in Horizontal, Vertical and Conglomerate mergers

**a) Horizontal merger**

- A horizontal merger is one that takes place between two companies that are essentially operating in the same market. Their products may or may not be identical. The horizontal merger takes place between business competition who are manufacturing, selling and distributing the similar type of service for profit.
- Horizontal merger results in reduction of competitors in the same industry. This, type of merger enables to derive the benefit of economies of scale & elimination of competition. But it leads to increase in monopolistic tendency in the market.
- For example, merger of Tata Oil Mills Company Ltd. with Hindustan Lever Ltd. is a horizontal merger. Both the companies have similar products.

**b) Vertical Merger**

- A vertical merger is one in which the company expands backwards by merging with a company supplying raw material or expands forward in the direction of the ultimate consumer. Thus in a vertical merger, there is a merging of companies engaged at different stages of the production cycle within the same industry.
- The vertical merger will bring the firms together who are involved in different stages of production, process or operation. A vertical merger allows for smooth flow of production, reduced inventory, and reduction in operating cost, increase in economies of scale, elimination of bottlenecks etc.

For example, the merger of Reliance Petrochemicals Limited with reliance industry limited is an example of vertical merger with backward linkage as far as RIL is concerned.

**c) Conglomerate Merger**

- In a conglomerate merger, the concerned companies are in totally unrelated lines of business. This type of merger involves the integration of companies entirely involve in a different set of activities, products or services. The merging companies are neither competitors nor complementary to each other.

- This form of merger is resorted to increase economic power, profitability , diversification of activities.
- For example, Mohta Steel Industries Limited merged with Vardhaman spinning mills Ltd.
- Conglomerate mergers are expected to bring about stability of income & profits, since the two units belong to different industries.

**Internal and external change forces contributing to M & A activities**

**Or**

**Changing Factors contributing to Mergers & Acquisitions**

1. Technological changes (technological requirements of firm has increased)
2. Economies of scale and complimentary benefits (growth opportunities among product areas are unequal)
3. Opening up of economy or liberalization of economy
4. Global economy (increase in competition)
5. Deregulation
6. New industries were created.
7. Negative trends in some economies.
8. Favorable economic & financial conditions (real time financial planning and control information requirements have increases).
9. Widening inequalities in income & wealth
10. High valuation on equities.
11. Requirement of human capital has grown relative to physical assets.
12. Increase in new product line.
13. Distribution and marketing methods have changed.

**Internal Factors**

- High Cost
- Less Profit
- Shortage of Inputs
- Excess Resources
- Low Growth
- Low Price
- Changing Factors contributing to Mergers & Acquisitions

**External Factors**

- Globalization- widened challenges and opportunities
- Technology- complexity and criticality of processes and methods
- Awakened customer- customer rules the business
- Stringent government norms- environment, labour, taxation, quality etc.
- Innovation-creative destruction- reduced product life cycle.
- More Competition

**Pitfalls of Mergers and Acquisitions**

- Combining operations may result in
    - Resistance from rank-and-file employees
    - Hard-to-resolve conflicts in management styles and corporate cultures
    - Tough problems of integration
    - Greater-than-anticipated difficulties in
        - Achieving expected cost-savings
        - Sharing of expertise
        - Achieving enhanced competitive capabilities

**Impact of M & A on stakeholders.**

Acquisitions are generally assumed to be objective, or focused on the numbers. Consistent with this perspective, synergy is the most common justification for acquisition activity. Achieving synergy involves integrating firms to produce a combined performance greater than what they achieved independently. An implicit challenge then is to coordinate the efforts of groups with different interests to realize expected gains. This means that acquisitions quickly go from numbers to considering the impacts on people, as achieving synergy requires clear communication of the implications of an acquisition to impacted groups. As a result, considering and enlisting stakeholders becomes important to achieve success for any acquisition. Accomplishing a stakeholder analysis during acquisition planning can identify and address issues by helping to communicate information to influential groups. Still, gaps between different stakeholder groups are often not addressed in acquisitions, or they are considered too late. The starting point for any stakeholder analysis is identifying different groups and their interests. The perspective of seven stakeholder groups is briefly reviewed as a guide to improving acquisition outcomes.

1. **Employees**. The first group to consider relates to the impacted employees, as even the best strategy will fail if it does not consider the people needed to execute it. When employees learn of a merger, they expect and are prepared for dramatic changes. Employees will be hungry for information to cope with the uncertainty created by an acquisition. Employees will look to see that a plan for creating a better organization exists and for signals that people matter, as well as answers to what the acquisition means for them. This means employees will have little tolerance for delays that fail to set a clear direction that communicates their place in a merged firm. An example of something that can help reduce employee anxiety in large companies is an e-mail from the CEO to employees about a merger, so they learn about it from work and not the press. In smaller firms, a face to face meeting would be a better option to share news and implications of an acquisition. Without these steps, a lack of information to employees will only lead to speculation and resulting anxiety that will complicate integration efforts. Employee commitment to a merged firm is lowest following an acquisition announcement and increased employee turnover is a primary suspect in poor acquisition performance. An obvious reason for this is that the first employees to leave are generally the best and brightest. In other words, if an acquirer does not take steps to address the concerns of their employees they will likely find what they bought walked out the door when they were not looking. For example, many employees will get job offers from competitors within five days of an acquisition announcement. Successful acquirers focus on retaining employees, if for no other reason than to avoid the need to recruit old employees back at a higher salary. However, if the employees are not "on board" with the business and communication plan, competitors have a greater ability to frame the discussion with the market.

**Competitors**. While obvious in hindsight, it is easy to overlook this group. Failing to consider the actions of groups that want to see you fail can hurt your success, and competitive pressures driving the use of an acquisition to meet firm goals do not end once an acquisition is announced. Acquisition announcements are public and clarify what competitors can expect. Often competitors treat the inevitable distraction of combining firms as an opportunity. Not bound by restrictions of regulatory review competitors can immediately plant doubts with customers andemployees. For example, quality disruptions frequently occur during acquisitions from downsizing manufacturing capacity and transferring work to facilities with people unfamiliar with the products and processes used to produce them. Meanwhile, employees will also have lower commitment to a new organization. As a result, competitors also actively recruit from the employees and customers of firms involved in a merger when those firms are most vulnerable.

2. **Customers**. Merging firms often focus on internal issues during integration at the expense of external market issues, and customers of both acquirer and target firms are sometimes overlooked. For example, service disruptions during an acquisition results in two-thirds of merged businesses losing market share. Again, failing to address customer impacts in a communication plan will provide competitors an opportunity to frame customer perceptions on the impact of a merger. A strong emphasis on communicating with customers can reduce uncertainty and lower customer defection, as retaining customers may be more important to acquisition performance than reducing costs. In one example, while a combination of two hightechnology companies was meant to better serve IBM, uncertainty about implications of the merger led IBM to cut its orders for the firms in half because no one communicated what the acquisition meant to this important customer. Firms that communicate a continued commitment to their customers by considering their perspective during a merger can expect improved success.

3. **Advisors**. Completing an acquisition depends on advisors and incorporating an external perspective can enable better acquisition decisions. Additionally, more prestigious advisors can provide important reputation advantages. However, increasing the number of advisors increases the amount of time and money to complete a deal. This becomes an important consideration as the primary advantage of acquisitions involves speed or faster access to needed resources than internal development. Another consideration for public firms and sellers is that advisors may be required to help ensure managers fulfill their fiduciary obligations to shareholders. For example, as part of due diligence following an announcement to purchase Titan Corp for $2.4 billion, Lockheed Martin uncovered improper overseas payments that led to a Justice Department investigation and cancellation of the deal. It is unlikely irregularities, such as this one, could be found without the help of external auditors. Having a team of seasoned advisors can help find and account for negative information that can effect a deal’s value.

4. **Lenders**. Most acquirers include debt as part of their payment for a target, making lenders an important advisor. While lenders are interested in available collateral and the use of provided funds, they will also be interested in the projections of the merged firm and its ability to pay off the increased debt load. Selection of lenders is an important consideration, as more prestigious underwriters are associated with positive outcomes, such as completing deals faster. Banks may also be interested in marketing other services—a circumstance that can complicate their interests. For example, Barclays Capital recently agreed to pay Del Monte shareholders almost $90 million following conflict of interest surrounding allegations it steered the sale of Del Monte to bidders using it for financing. The desire for advisory fees may bias bank lending decisions, so prudence may drive keeping deal advisors and lenders separate.

**Vendors**. Acquisitions can also be disruptive to businesses a merged firm depends on. Suppliers of goods and services of merging companies will have a vested interest in their ability to continue to supply a business and in being paid on a timely basis. It is not uncommon for vendors to require updated credit data for merging firms. Still, an acquisition offers the opportunity to consolidate vendors and increase bargaining power. As a result, vendors will want information about continued business. Communication with vendors, especially the key ones, is another critical piece of the overall acquisition communication plan. The last thing an acquiring company wants to learn is that a key vendor is skittish about the transaction and that they may not deliver scheduled product or service! In other words, without vendor support a merged firm can find it difficult to maintain normal operations.

5. **Government Regulators**. Firms planning an acquisition generally make filings with government agencies for regulatory approval that is followed by a waiting period that allows regulators to review information to consider labor or anticompetitive implications, and any conditions for completing a deal. For example, plant closings often require advance notice under state and federal law before it can be accomplished. Requirements for regulatory review go beyond the state and nation where firms are headquartered. For example, the European Union required concessions from Intel prior to providing regulatory approval of its McAfee acquisition. Only focusing on U.S. requirements likely hurt approval of the NYSE Euronext and Deutsche Borse merger, as Duncan Niederauer (CEO of NYSE Euronext) commented that he “misjudged the process” and that it was unlikely the merger would happen. While the focus for regulators is satisfying requirements, a more proactive approach goes from anticipating regulatory review to influencing it. However, going beyond providing information to regulators is a higher risk strategy. For example, AT&T employed a team of 93 lobbyists in Washington D.C. and spent
$46 million in campaign contributions to both parties in a failed effort to get its bid for T-Mobile approved. This suggests that an obvious way to strengthen regulatory resistance is to announce a deal as a fait accompli before or during regulatory review. The risk of a deal failing regulatory approval has to be considered and dealt with along with at the start of in the negotiation process.

**Corporate restructuring**

- Corporate restructuring refers to the changes in ownership, business mix, asset mix & alliance with a view to enhance the shareholders value. Hence, corporate restructuring may involve ownership restructuring, business restructuring, asset restructuring for the purpose of making it more efficient and more profitable.
- A company can affect ownership restructuring through mergers & acquisitions, leveraged buy outs, buy back of shares, spin-offs, joint venture & strategic alliance.
- Business restructuring involves the reorganization of business units or divisions. It includes diversification into new businesses, out sourcing, divestment, brand acquisitions etc.
- Asset restructuring involves the acquisition or sale of asset & their ownership structure. E.g. Sale & lease back of assets, securitization of debts, receivable factoring, etc.

**Purpose of Corporate Restructuring**

- The basic purpose is to enhance the share holder value.
- The company should continuously evaluate its portfolio of businesses, capital mix & ownership & assets arrangements to find opportunities to increase the share holders’ value.
- It should focus on asset utilization & profitable investment opportunities, & reorganize or divest less

profitable or loss making businesses/products.
 The company can also enhance value through capital restructuring; it can innovate securities that help to reduce cost of capital.

**Significance**

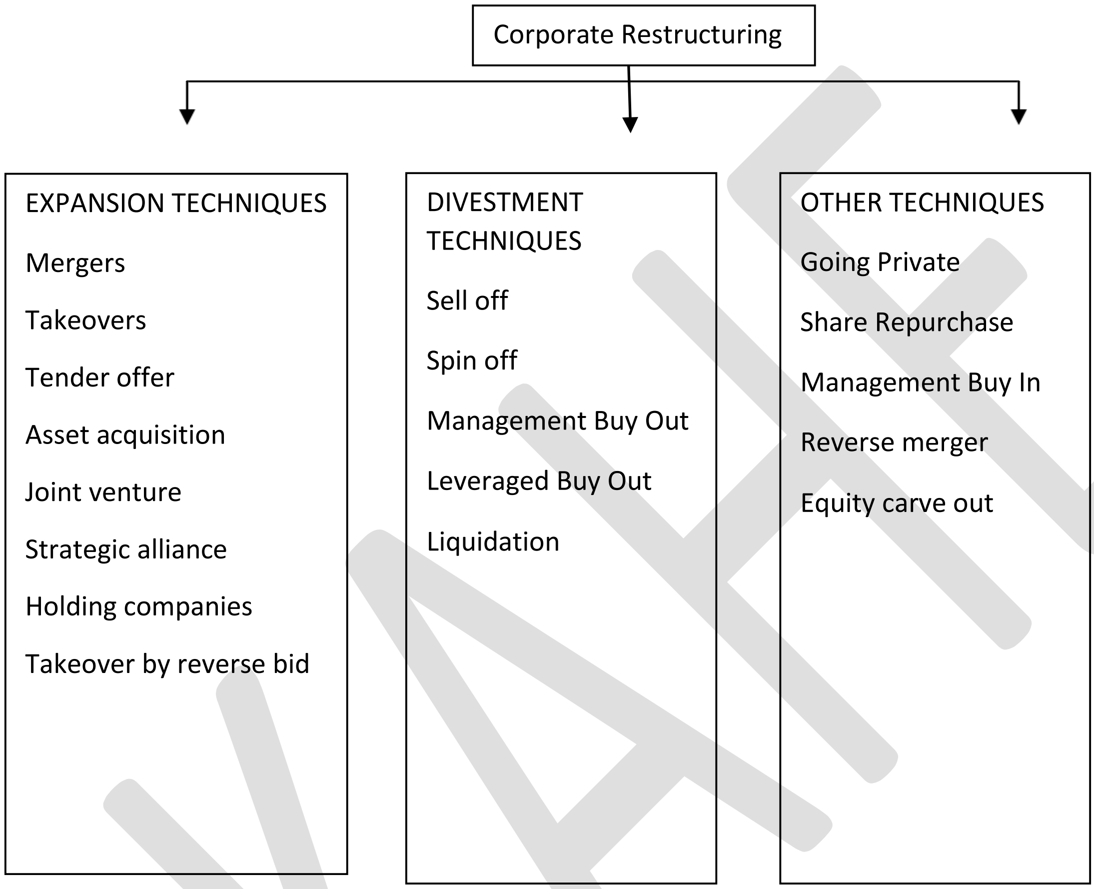
- Limit competition
- Utilize under-utilised market power
- Overcome the problem of slow growth and profitability in one's own industry
- Achieve diversification
- Gain economies of scale and increase income with proportionately less investment
- Establish a transnational bridgehead without excessive start-up costs to gain access to a foreign market
- Utilize under-utilised resources- human and physical and managerial skills
- Displace existing management

Circumvent government regulations

- Reap speculative gains attendant upon new security issue or change in P/E ratio.
- Create an image of aggressiveness and strategic opportunism, empire building and to amass vast economic powers of the company.

**Forms of restructuring**

**Forms of Corporate Restructuring**




**Different Methods of Corporate Restructuring**

- Joint Venture
- Divestitures
- Corporate sell-off
- Corporate spin-off
- Equity Carve Out
- Leveraged Buyout
- Management buyouts
- Master Limited partnerships
- Employee Stock ownership plans

**DIVESTITURE / DEMERGER**

- Divestiture: Sale of segment of a company (assets, a product line, a subsidiary) to a third party for cash and/or securities.

- Although divestitures causes contraction from the perspective of selling firm, it doesn't however, entail decrease in its profits.
- It is believed that, the value will be enhanced by parting / divesting / demerging some of its assets as they are either causing losses or yielding very low returns.

**Motives of Divestitures**

- **Raising Capital**

It is a common motive. Cash strapped firms seem to resort to divestiture to shore up their liquidity.

E.g. CEAT sold its nylon tyre cord plant at Gwalior to SRF for Rs. 3250 million so that it could settle its out standings and raise funds to concentrate on tyre manufacturing.

- **Curtailment of losses**

Prominent reason is to cut losses. It may imply that the unit that is proposed to be divested is earning a sub normal rate of return.

- **Strategic Realignment**

The sellers may divest a unit which no longer fits with its strategic plan. Often such a unit tends to be in an unrelated line and may demand a lot of managerial time & attention.

- **Efficiency Gain**

A divestiture results in an efficiency gain when the unit divested is worth more as part of some other firm or as a standalone business.

- **Inability to adopt new technology.**
- **Underperformance of Labor including managers.**
- **Subsidiaries not able to exploit advantages of new policies.**

**Financial Evaluation of Divestiture Procedures:**

***Step 1: Estimate the divisional post tax cash flow Step 2:***

***Establish the discount rate for the division Step 3:***

***Calculate the division's present value***

**Step 4:** ***Find the market value of the division-specific liabilities-*** The MV is the PV of the obligations arising from the liabilities of the division.

**Step 5: A*ssume the value of the parent firm's ownership position in the division*** – the value of the ownership position enjoyed by the parent firm is PV of the division's cash flow (Step 3)-MV of the division's specific liabilities. (Step 4)

**Step 6:** ***Compare the value of the ownership firm with the divestiture proceeds-***When a parent firm transfers the assets of a division along with its liabilities, it receives divestiture proceeds as compensation for giving up its ownership position in the division.

***Forms of Corporate Divestitures***

- Inter-corporate sell-off: that is sale to another company
- Spin-off or de-merger
- Equity Carve out, in which a subsidiary is floated on a stock exchange, but parent, retains a majority control.
- Issue of tracking stock
- Management buyout