Management

AN OVERVIEW OF MERGERS AND ACQUISITION

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ABSTRACT

Mergers and acquisitions (M&A) and corporate restructuring are a big part of the corporate finance world. M&A which bring separate companies together to form larger ones. This paper highlight on the various ways of the M&A and regulatory implications on the M&A entities.

Keywords: Competition Commission ,Mergers and Acquisitions (M&A), Ownership-location-internalization (OLI), SEBI, Transaction cost economics (TCE)

Introduction

The Global Consulting firm, Grant Thornton declared a couple of years back, "*2012 will be the year of mergers and acquisitions*." What are Mergers & Acquisitions? Mergers and acquisitions are strategic decisions taken for maximization of a company's growth by enhancing its production and marketing operations. These are being used in a wide array of fields such as information technology, telecommunications, and business process outsourcing as well as in traditional businesses in order to gain strength, expand the customer base, cut competition or enter into a new market or product segment.[1]

Mergers & Acquisitions

A merger is a combination of two or more businesses into one business. Laws in India use the term 'amalgamation' for merger. The Income Tax Act,1961 [Section 2(1A)] defines amalgamation as the merger of one or more companies with another or the merger of two or more companies to form a new company, in such a way that all assets and liabilities of the amalgamating companies become assets and liabilities of the amalgamated company and shareholders not less than nine-tenths in value of the shares in the amalgamating company or companies become shareholders of the amalgamated company. [2]

Regulations for Mergers & Acquisitions

Mergers and acquisitions are regulated under various laws in India. The objective of the laws is to make these deals transparent and protect the interest of all shareholders. These are regulated through the provisions of:-

a) Competition Act, 2002

The main provisions related to the four components of Competition Act, 2002 are anti-competitive agreement, abuse of dominance, combination regulation and competition advocacy. The companies always use merger, a type of combination, as a business strategy to grow and consolidate and to eliminate competition.

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b) Companies Act, 1956

Merger/Demerger is a compliance of provisions under sections 391-394 of the Companies Act, 1956. The Companies Act , 1956 (Section 372) stipulates that a company's investment in the shares of another company in excess of 10 percent of the subscribed capital can result in takeovers.

c) Income Tax Act, 1961

Under the provisions of the IT Act, 1961;unabsorbed losses of the amalgamating companies are deemed to be the losses for the previous year in which the amalgamation was effected, the amalgamated company (subject to fulfillment of certain conditions) will have the right to carry forward the loss for a period of eight assessment years immediately succeeding the assessment year relevant to the previous year in which the amalgamation was effected.

d) Foreign Corrupt Practices Act, 1977 of the US

Foreign Corrupt Practices Act, 1977 (FCPA) extends even to a US investor's investee company in India and could expose the investor's management in the US to penal sanctions if an Indian investee company has been involved in bribing or unduly influencing a public official. During a market downturn, the likelihood of fraud increases and financial integrity concerns are more frequently uncovered. In a merger or acquisition, due diligence that includes the use of forensic accountants to assess bribery and corruption risk can help the acquiring company to better understand the risks associated with a target, including its relationships with customers, suppliers, government agencies and officials, and other business partners.

e) SEBI

Under SEBI's Amendment to Clause 24 of the Disclosure & Investor Protection Guidelines, each of the companies involved in a merger has to obtain the opinion of an independent merchant banker on the valuation of the deal. Modifying the Clause 41 of the listing agreement to bring more efficiency in the disclosure of financial results, SEBI has allowed a listed entity two months' time from the end of a quarter if it is submitting consolidated financial results in addition to submitting quarterly and year-to-date stand alone financial results.

Scope of M&A

Mergers & Acquisition have gained popularity throughout the world in the recent times. These have become popular due to globalization, liberalization, technological developments & intensely competitive business environment. Mergers and acquisition are a big part of the corporate finance world. This process is extensively used for restructuring the business organization. In India, the concept of mergers and acquisition was initiated by the government bodies. The Indian economic reform since 1991 has opened up a lot of challenges both in the domestic and international spheres. The increased competition in the global market has prompted the Indian companies to go for mergers and acquisitions as an important strategic choice. [3]

The trends of mergers and acquisitions in India have changed over the years. The immediate effects of the mergers and acquisitions have also been diverse across the various sectors of the Indian economy. Mergers and Acquisitions have been around for a long time and has experienced waves of popularity during these times and they are very much an important part of today's business world. They have also become increasingly international which can be due to the rising global competition.[4] The popularity of cross-border M&As makes it important to look at them from an international perspective.

An Overview

Mergers and acquisitions (M&As) have long been a popular strategy for firms . The companies indulge for strategic expansion without undertaking tedious work of establishing a new entity in a new place. Technological development in financial sector and globalization of finance have vastly contributed to the popularity of M&As and cross-border M&As since it becomes easier for the capital to seek best profit from anywhere in the world. In the decade of the 1990s (the so-called fifth merger wave), the popularity of this strategy increased tremendously. Acquisitions completed in 1997 alone were valued at more than all acquisitions during the 1980s (*Hitt et al.,* 2001a,b). In 1998, worldwide M&A activity totaled more than US$2 trillion in terms of the stock value of the transactions announced (*Child et al*., 2001). And, while the overall M&A market follows a cyclical nature—and has cooled since the heyday of the late 1990s—the total number of worldwide M&As has been increasing recently at a rapid rate. This can be attributed to the dynamic nature of international trade. The consolidations of industries and regions have also contributed to the overall number and value of M&As worldwide to continuously increase. While the majority of M&As involve two firms within the same country, over 40% of the M&As that were completed between 1999 and 2000 involved firms headquartered in two different countries (*Hitt et al.,* 2001a,b). The increasing globalization of business has heightened the opportunities and pressures to engage in cross-border M&As (*Hitt,* 2000; *Hitt et al.,* 1998a,b). Cross-border M&As pose tremendous challenges, in particular, at the post acquisition stage (*Child et al.,* 2001).

Recent evidence suggests that they are not highly successful. For instance, a study by KPMG found approximately that only 17% of cross border acquisitions created shareholder value, while 53% destroyed it *(Economist*, 1999). Given the increasing number of cross-border M&As and their growing importance in the global market, a better understanding of the opportunities and challenges for firms following this strategy is required. While the occurrence of cross-border M&As has grown dramatically in the last few years, academic research on this type of strategic action has not kept pace with the changes. A review of the academic literature suggests that the results are fragmented across various disciplines, including strategic management, international business, human resource management, and finance. In fact, this subtopic has not been universally recognized as warranting distinctive examination separate from (domestic) M&As, in general. Presumably, this is the reason why *Werner* (2002) did not include cross-border M&As when identifying 12 distinct topics in the review of international management research between 1996 and 2000. Nevertheless, research on cross-border M&As has focused on a number of important issues, such as mode of foreign direct investment (FDI) or entry (*Andersen*, 1997; *Barkema* and *Vermeulen*, 1998; *Brouthers and Brouthers*, 2000; *Hennart* and *Reddy*, 1997; *Kogut* and *Singh,* 1988;), performance outcomes from acquisitive entry (*Brouthers*, 2002; *Li and Guisinger*, 1991; *Nitsch* et al., 1996), and shareholders' wealth creation by the cross border M&As (*Datta and Puia*, 1995; *Harris and Ravenscraft*, 1991*; Kang*, 1993; *Markides* and *Ittner*, 1994; *Morck* and *Yeung*, 1992). Recently, more attention has been paid to post acquisition issues such as integration processes (*Child et al*., 2001; Inkpen et al., 2000; *Lubatkin et al*., 1998; *Olie,* 1994; *Weber et al*., 1996), integration processes from an employee viewpoint (*Risberg,* 2001), post-acquisition turnover of acquired firm executives (*Krug and Hegarty,* 2001; *Krug and Nigh*, 2001), post-acquisition performance of acquired (*Very et al*., 1997) and acquiring firms (*Larsson and Finkelstein*, 1999; *Morosini* et al., 1998), and the resulting knowledge transfer and organizational learning (*Bhagat* et al., 2002; *Bresman et al*., 1999; *Vermeulen and Barkema*, 2001). Because of the growing importance and popularity of cross-border M&As, this study provides a review of the extant literature across different areas, with an explication of the theoretical bases used. Furthermore, we identify potential areas for future research. First, we compare important issues regarding domestic and international M&As to identify the differences, if any. Next, we examine the current research from the perspectives of cross border M&As as a mode of entry, as a dynamic learning process, and as a value-creating (or destroying) strategy.

Herein, we define cross-border M&As as those involving an acquirer firm and a target firm whose headquarters are located in different home countries. However, it is important to note that ''M&As of companies with their headquarters in the same country, although normally classified as domestic, often have cross-border issues of concern when they integrate operations located in different countries'' (*Child et al.,* 2001). Cross border M&As are an implementation instrument for the firm's international diversification strategy (internationalization). Cross-border M&As have been motivated by the necessary search for new opportunities across different geographic locations and markets in a turbulent and continuously changing environment.

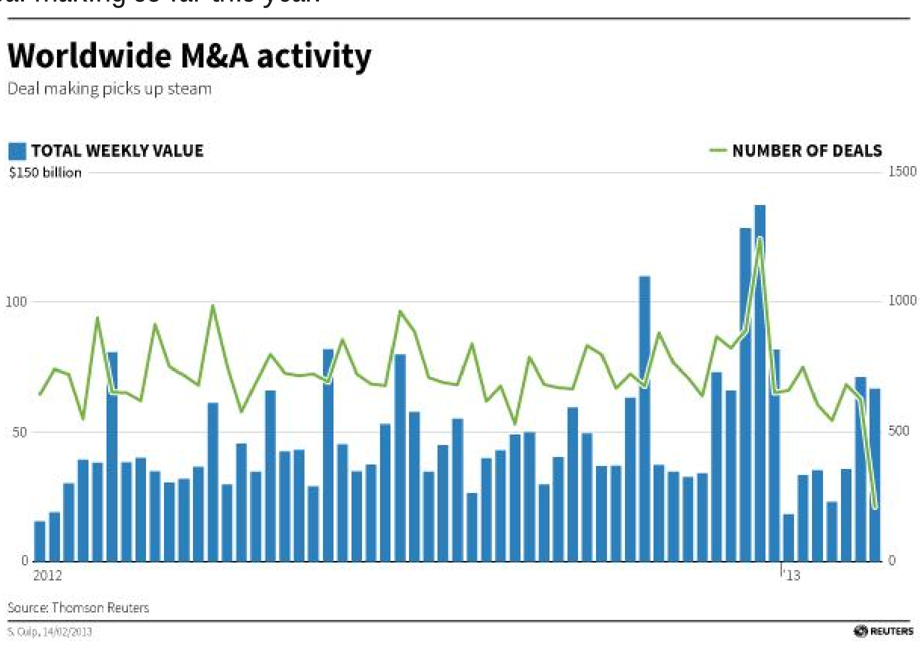
2. **Cross-border mergers and acquisitions**

There is evidence suggesting that the rate of cross-border M&As is growing rapidly. In 1999, cross-border M&As were valued at approximately US$1.4 trillion (nearly 40% of the overall acquisitions for that year), doubling the value of the preceding year (*Hitt et al.,* 2001). Thomson Reuters full year review of world-wide M& A activity reveal the staggering growth in this strategic activity of the companies.

The value of worldwide M&A totaled US$2.6 trillion during 2012, a 2% increase from comparable 2011 levels. Worldwide spinoffs and divestitures, which totalled US$1.2 trillion for full year 2012, accounted for 47% of overall M&A activity. The companies based in the emerging markets accounted for one quarter of worldwide announced merger activity, and the amount totaled US$723.0 billion during 2012, a 9% increase from 2011. Cross Border M&A activity totaled US$944.1 billion during same period 2012, accounting for 36% of overall M&A volume and up 6% compared to the previous year 2011.

The Report points out that most of the cross border M&A was driven by the energy & power, industrials, and consumer staples sectors, which comprised 42% of cross-border deal volume during 2012. Regionally, the deal activity was maximum in the Americas that accounted for 58%of the worldwide fee pool, while Europe, Middle East and Africa accounted for 28%. Asia Pacific and Japan contributed 10% and 5%, respectively. The energy & power sector was most active during full year 2012, commanding 18% of announced M&A, while the financials and real estate sectors accounted for 13% and 11% of M&A activity, respectively. [5]

The year 2013 has seen greater increase in the M& A activity, particularly in the US. United States pushed February M&A levels to $147.9 billion with nearly two weeks remaining, a 15% increase over the entire month of January 2013. Year-to-date, M&A activity totals $278.9 billion, an increase of 18% compared to the same time last year. US M&A, which has more than doubled compared to the year ago period, accounted for 57% of global deal making so far this year. [6]



Several factors are responsible for fueling the growth of cross-border M&As. Among these factors are the worldwide phenomenon of industry consolidation and privatization, and the liberalization of economies. The dynamics of cross-border M&As are largely similar to those of domestic M&As. However, due to their international nature, they also involve unique challenges, as countries have different economic, institutional (i.e., regulatory), and cultural structures (*Hofstede,* 1980; House et al., 2002). Cross-border M&As can be used to access new and lucrative markets, as well as expand the market for a firm's current goods. *Martin et al.(*1998) found that suppliers often follow the international expansion of the related buyers. This is a strategic move to ensure that the transplanted buyer does not start a relationship with an alternate foreign supplier, which could later threaten the current supplier in its own domestic market. Thus, international M&As may be motivated to take advantage of a new opportunity or to avoid a possible future threat. Moreover, acquisitions of firms headquartered in other countries present an especially good opportunity for the acquiring firm to learn new knowledge and acquire new capabilities. The pursuit of cross-border M&As is not without challenges. Firms engaging in cross border M&As are faced with unique risks such as ''liability of foreignness'' (*Zaheer,* 1995) and ''double-layered acculturation'' (*Barkema et al*., 1996). Differences in national culture, customer preferences, business practices, and institutional forces, such as government regulations, can hinder firms from fully realizing their strategic objectives. Uncertainty and information asymmetry in foreign markets make it difficult for firms to adjust and learn from both the local market and target firm (*Kogut and Singh*, 1988; *Zaheer*, 1995). Thus, liability of foreignness and double-layered acculturation serve as barriers to learning new knowledge and capabilities in a cross-border M&A.

In pursuing cross-border M&As, firms consider various conditions, including country-, industry-, and firm-level factors, which relate both to the acquiring and to the target firm. At national and industry levels, factors such as capital, labor, and natural resource endowments, in addition to institutional variables such as the legal, political, and cultural environment, are highly significant. At the firm level, organizations pursuing an internationalization strategy need to identify and evaluate potential targets to acquire in the host countries. After completing an acquisition, firms generally must integrate the target firm into their operations to realize the potential value of their investment. Accordingly, in the following sections, we review the current literature on cross-border M&As in terms of cross-border M&As (1) as a mode of entry/diversification in a foreign market, (2) as a dynamic learning process, and (3) as a value-creating strategy. Historically, economic perspectives such as transaction cost economics (TCE) and ownership-location-internalization (OLI) framework have provided the dominant theoretical foundations on which cross-border M&A research was based (*Dunning*, 1993; *Williamson,* 1975). This is not surprising, given that cross-border M&As were often examined in the context of FDI, with emphasis on entry mode decisions and resulting wealth creation. A major focus in this research has been the uncertainty and risk associated with different national cultures and institutional settings. This stream of work emphasized minimization of the risks and inefficiencies in entering the foreign markets in which transaction costs played a key role. Recent research has examined the value of international expansion and cross-border M&As from the resource-based (RBV) and organizational learning perspectives (*Barkema and Vermeulen*, 1998; *Madhok*, 1997; *Vermeulen and Barkema*, 2001). Moreover, attention has gradually changed from the antecedents of M&As to the processes and outcomes of post-M&A implementation. These aspects are crucial to the comprehension of M&As (*Haspeslagh and Jemison*, 1991) but have not been carefully examined, particularly in international contexts (*Child et al*., 2001). TCE and OLI framework provide limited insights for M&A implementation processes. Given the increasing strategic importance of cross-border M&As, both from research and practitioner perspectives, we suggest that additional theoretical insights and broader foci of research are required.

Conclusion

M&A create synergies and economies of scale, expanding operations and cutting costs. Investors can take comfort in the idea that a merger will deliver enhanced market power. However M&A has to be augmented with the regulatory compliance in the country where M&A takes place.

Notes

1. Merger And Acquisitions

http://business.gov.in/growing_business/mergers_acq.php

2. Ibid.

3. Bedi, Harpreet Singh(2010). *Merger & Acquisition in India: An Analytical Study.* Paper presented during the *National* Conference on Business Innovation conducted by Apeejay Institute of Management, Jalandhar-144001, Punjab, February 27, 2010 , http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1618272

4. *What is the scope of Merger & Acquisitions?*

http://wiki.answers.com/Q/What_is_the_scope_of_mergers_and_acquisitions

5. Thomson Reuters(2012). *Merger & Acquisition Review Full Year* 2012,p.1 http://dmi.thomsonreuters.com/Content/Files/4Q2012_MA_Financial_Advisory_Review.pdf)

6. Thomson Reuters(2013). *Global Mergers and Acquisitions* http://blog.thomsonreuters.com/index.php/tag/global-mergers-and-acquisitions/

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