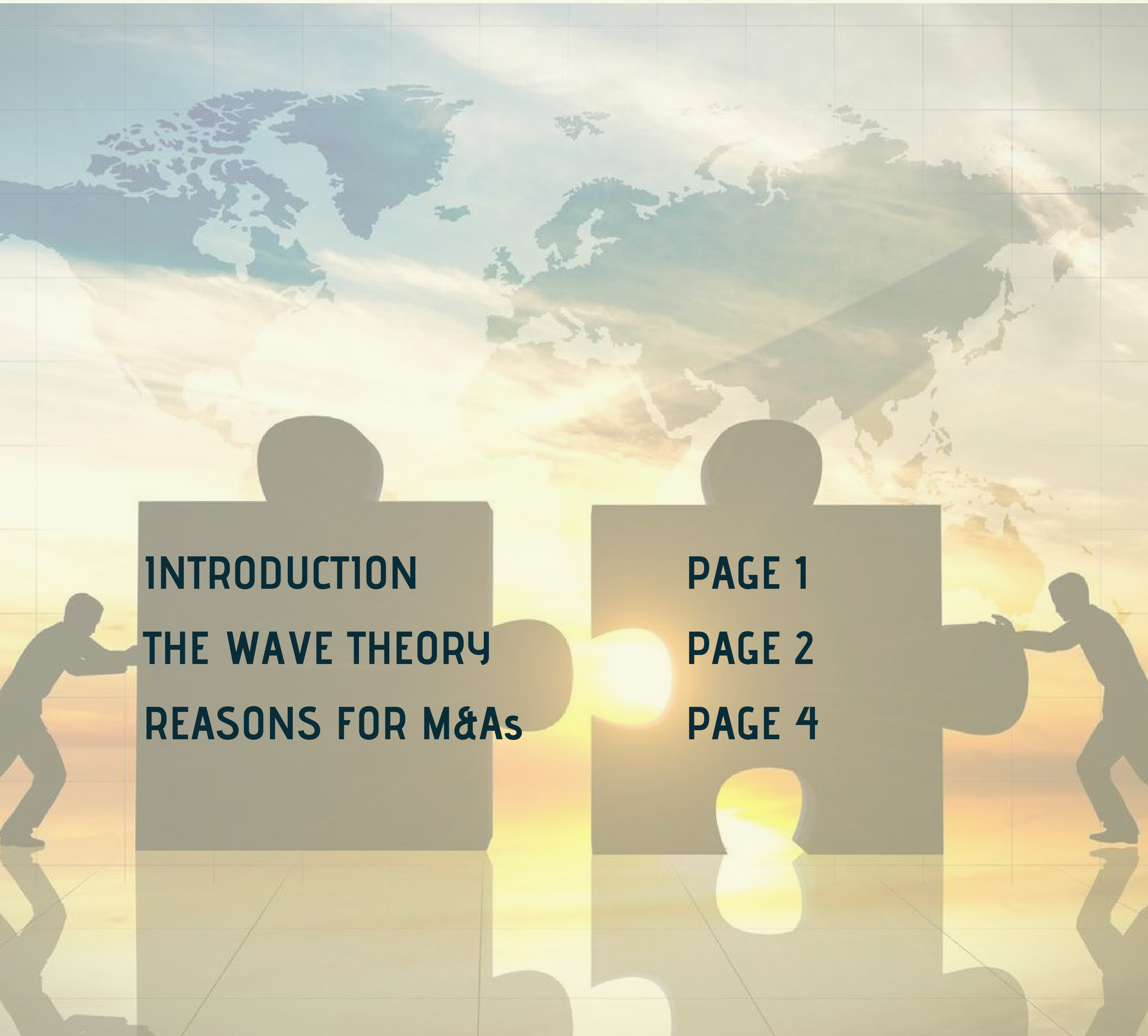
FINANCE AND INVESTMENT CELL
SHRI RAM COLLEGE OF COMMERCE

THE DYNAMICS OF MERGERS AND ACQUISITIONS

VOLUME 1



INTRODUCTION

Cell fusion refers to the biological process of amalgamation of several uninuclear cells which give birth to a single multinuclear cell, known as syncytium. Our 8th grade biology taught us something extremely important regarding the build-up of the biological processes across organisms. But, little did we know that these biological processes have their counterparts in the financial world as well which give rise to consolidation of companies and firms. These are what we call in modern financial markets mergers, acquisitions and joint ventures, which are financial consolidation processes which allow financial entities to combine in order to incentivise their interests.

Mergers, as the term suggests, is the process of consolidation when the two companies combining, seek the shareholders' approval that result in one of the companies ceasing to exist, becoming a part of the other company. A simple example for this can be contemplated back to the Vodafone-Hutch merger in 2007 that marked the entry of Vodafone in the Indian telecommunications market. Vodafone acquired a 52 percent stake in Hutchison Essar for $10.9 Billion, giving birth to then biggest financial merger in the sector.

The term 'Acquisition' has been derived from the word 'acquire', which is essentially what an acquisition is. However, opposed to popular opinion, it isn't exactly the same as a merger. In an acquisition, a company acquiring the majority stake in another company doesn't lead to a name change or an alteration to either's legal structure. For instance, take Facebook's acquisition of WhatsApp in 2014. The deal was concluded with a price tag of $19 Billion and allowed Facebook the access of the messaging app's 450 million user base, which currently stands north of 700 million.

Movies form an integral part of the Indian society. When one talks "bollywood" in India, one name resonates its presence in the movie business - PVR, which stands for its lesser known full form Priya Village Roadshow. However, something that a majority is oblivious to is the fact that PVR started with a joint venture agreement between Priya Exhibitors Private Limited and Village Roadshow limited in 1995. A joint venture usually comes into play when two or more financial entities strategize on entering into a new business, expertise or even an investment. The distinction that draws a line between mergers or acquisitions and joint ventures is the fact that a joint venture may or may not be limited to a particular duration.

DIFFERENCES

However basic and fundamental the story about mergers and acquisitions might seem, it transcends to far more intricacies than those given and the differences among the same are much more intricate.Mergers are generally taken up and progressed along the lines of mutual beneficial agreements, whereas acquisitions might be hostile as well cordial. In a merger, the firms lose their original identity and become a part of the new identity, which is the amalgamated firm. In a Joint Venture, although a new firm is formed, it is only an extension to the company/companies and the firms keep their individual identity. To keep things simpler, let's say that if in a merger two companies become one, but in a joint venture two companies become three. Generally, when two companies are merging, the name of new firm is taken from the name of the existing firms and joining them together. On the other hand, in case of an acquisition, the acquired company comes under the acquiring company, restricting itself from any name change. For example, Tata Motors acquisition of Jaguar Land Rover.

The motive behind the formation of the three varies greatly. In case of a merger, the main aim is to obtain a larger market share. As a combined force, the companies merging would be able to cater to the market of the companies together and gain a competitive edge over other firms in market. Other reasons behind a merger taking place can be credited to increased revenue and decreased costs. In a joint venture, the main goal remains to increase their productivity or availability of resources. The firms benefit individually.

THE WAVE THEORY

The cut-throat competition in the global financial markets and industry is largely instrumental in widespread application of mergers and acquisitions, categorized by a wave nature. This wave theory is minutely broken down into 7 stages and we will look into them in greater depth in the succeeding discussion.

First Wave (1893 – 1904)
The first wave came to be known as "The Great Merger Movement" in the Western financial markets, especially in the manufacturing sector, which majorly focused on horizontal consolidations – where the companies that run within the same industry or field combine together. Incentivized by market dominance, companies realized that having an amalgamated yet sizeable market share is better than independent shares, giving rise to manufacturing and transportation monsters in the United States, particularly in the primary industries of oil, steel, mining and railroads. The "Great War" became a major factor that marked the end of the first wave of the M&A's.

Second Wave (1910 – 1929)
Vertical mergers characterized this wave – instead of increasing revenue, the motive was to reduce costs and improve the company's overall efficiency. The two companies concerned with merging, would not be rivals but allies. This would eliminate the cost of finding suppliers and purchasing raw materials and outsourcing would give rise to an easy supply and logistics chain between the two. The effects of changes in the features in this wave stage could be seen as oligopolies replacing monopolies. The conclusion of this wave was marked by the "Great Depression" and the crash in 1929.

Third Wave (1955-1975)
Owing to a surge of horizontal and vertical fusions in the first 2 waves, a spark was needed to specialize in this stage. This spark was diversification. Unrelated companies came into play, which did not belong to the same industry or space, or their products and services were entirely different. Diversification enhanced the risk-taking capacity of the firms and the negative profits in one industry being offset by the positive profits in the other range. The significant oil crisis became the reason for economic recession thus ending the third wave slowly in the 1970's.

Fourth Wave (1984-1989)
This wave saw the advent of corporate raiders, aggressive takeovers, and congeneric mergers. The term “corporate raider” is more suited to an investor or a financier who takes over a giant business or a company by acquiring large shareholdings or a controlling interest, often in a less than congenial manner. “Aggressive takeovers” are hostile in nature and can be easily understood by the fact that mergers create a conflicting behaviour and disharmony among everyone.
On the other hand, congeneric mergers take place between 2 companies or firms that belong to the same or a similar industry, allowing them to have synergy, but are not involved in making the same products or providing same services. “Junk bond markets” emerged which marked selling off the bonds of the companies that had a low credibility, resulting in a predictable demise of this wave – when the banks ended up lending too much and stock markets crashing in 1987.

Fifth Wave (1993 - 2000)
Due to the fall of the Soviet Union and the advent of globalization and liberalisation, the rationale with which the companies entered the foreign markets was that the larger they are, the more dominant they will become in the market. This wave was characterized by technological innovations like information technology, satellites, media and telecommunications, creating mega deals beyond the thinkable horizon.
Eventually, the bubble of the advent of new cyberspace, applied science and computers burst and there was a dramatic slowdown in all the sectors as well as in the atmosphere of M&A’s. Since the source of financing was mostly equity, the NASDAQ fell more than 50% from its high, the junk bond market got replenished, banks tightened their credit facilities, and the announcements in the M&A’s was not well received in the equity markets, thereby marking a melancholic end to the fifth wave.

Sixth Wave (2003 – 2008)
The governments of some countries had become conscious after the markets crashed and realized their roles for interventions. Even the” larger than large” and already established companies expressed their desire to expand further through mergers and acquisitions. Owing to the flood of dollars in the market due to lower interest rates by the Federal Reserve, the environment was conducive and the governments were motivating. However, good things don’t last long. The U.S. subprime mortgage crisis, coincided with the recession, marking the end of the sixth wave, eventually.

Seventh Wave (2011 onwards)
After the 2008 crisis, still all hope was not lost. Things did take turns, rather making the firms more rough and tough to bear with the environment. Optimism is prevalent and the evident proof of this in the increased value of mergers and acquisitions. We are living in a volatile era but corporates realize that this is the new standard. There will be wars, there will be unrest, but the firms should be able to tackle and handle all kinds of situations through strategies and tactics.

REASONS FOR MERGERS AND ACQUISITIONS

Mergers and Acquisitions are two extremely intriguing phenomena. The reasons and the dynamics that lead to it are a step further. The factors that lead cases of Mergers and Acquisitions do share a common ground and it becomes even clearer when the following points are taken into consideration.

1. Succumbing to financial pressure – The foremost reason of any acquisition or a merger is the financial pressure upon either of the companies. The nature of business is such that the companies are lead into dangerous territories of financial insecurities which most often than not are solved through mergers and acquisitions. The dynamics behind it lies in the fact that when two companies combine to become one, its equity and debts are greatly affected providing quite a good amount of recluse to the suffering entity.

2. Increasing market share- Quite contrary to the aforesaid point, M&A's also take place when the companies take to expanding their market share. Raising capital is one of the biggest issues when an entity tries to expand its market share via increased production. However, M&A's provide an easy solution to this problem because by acquiring or merging with a company, one gets the right kind and amount of funds in a relatively easy and cheaper manner.

3. Increasing efficiency- A relatively indirect yet an important reason for the companies to get involved in this act of consolidation is increasing their efficiency by either reducing its cost or increasing income. The costs can be curbed by acquiring companies which have high equity capital alongside low debt capital which would ensure more funds at disposal, backed by lower costs which ultimately increase efficiency. On the other hand, merging with a company that would help the parent company increase its reach and performance standards is obviously going to increase its efficiency. For instance, let's say that an e-commerce company acquires/merges with a delivery company. This would help the e-commerce in reducing any added expenses that it would have had to incur in outsourcing the delivery alongside increasing efficiency in delivery of goods, as things related to it would be in direct control of the acquiring firm.

4.Operating Synergy - Synergy is basically the difference between the value of the resulting entity formed by the merger of the firms and the sum of the individual worth of the 2 merged firms. For example, suppose there are 2 companies – company A & company B. Now V(AB) > V(A) + V(B) will always be true, where V(AB) is the value of the merged company and V(A), V(B) is the individual values of the companies A and B respectively. The combined value will be more than the individual values of the company. Well, one can always take the reference of the proverb, "if you can't beat them, join them" to understand the main concept behind M&A's.