MERGER AND ACQUISITIONS: THE FUTURE OF CORPORATE-FINANCE WORLD

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ABSTRACT

Mergers and Acquisitions are one of the most important factors of Corporate-Finance world. It has become a conventional approach for reasons like expanding the business or attaining a larger consumer base or diversification of base, etc. In order to ensure the growth and stability of any company a successful merger or acquisition can transform a company's position in the market. This article provides a brief insight into Mergers and Acquisitions, the reasons for their failure, and the decoding of one of the biggest mergers in India- The merger of PVR and Inox.

Keywords: Mergers, Acquisitions, PVR-Inox, Corporate Restructuring.

INTRODUCTION

Mergers and Acquisitions (M&A)[1] are one of the most important factors in the Corporate Finance world. M&A in today's cutthroat competition world is more of a strategy to erase your competitor's name rather than coming together for friendly deals.

Due to the last few economically volatile years, India has witnessed over 3,600 M&A deals from year 2015 to 2019. In today's Corporate Finance world, M&A has become a conventional approach for several reasons like expanding the business on a larger scale or attaining a larger consumer base or diversification of business, etc.

What is M&A?

The term "mergers" and "acquisitions" are used interchangeably but they have different meanings in legal sense. M&A is the legal integration or consolidation of two or more companies by way of one company purchasing the other company entirely, merging with another entity to create a new identity, or acquiring the assets of the company wholly or partially or by way of a hostile takeover.

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[1] https://corporatefinanceinstitute.com/resources/valuation/mergers-acquisitions-ma/

The decision of merger is usually taken mutually by entities to merge into a single unit. In a merger, the ownership of a company is combined with another company. A merger can be called an "equal merger" when the owners of both companies mutually decide that it is in the best interest for both entities to join hands to move forward as a single entity rather than a separate one.

One example of such a successful corporate transaction is the merger of Walt Disney and Pixar[2] in the year 2006. This merger resulted beneficial for both the companies as well as consumers as the merged company generated huge profits.

The acquisition is one company purchases all or most of the shares of another company to gain control of that company and institute itself as the new owner. Acquiring more than 50% shares of the target company allows the acquiring entity to make its own decisions without the approval of the acquired company's shareholders. The acquisition can be a friendly takeover also or a hostile takeover also.

Google acquired Android in the year 2005. At that time android was just a small startup and today it is the most popular mobile OS in the world.

TYPES OF M&A

Horizontal Merger: A horizontal merger is a merger between two companies functioning in the same or similar industry. Companies operating in the same or similar business come together to utilize the resources efficiently, expand the consumer base, increase the market share and cut down the competition to decrease rivalry. Hewlett Packard (HP) and Compaq merged in 2011 due to a rise in competition by IBM and Dell.

Vertical Merger: A vertical merger is a merger between two companies at different stages of production within a similar industry. The reason for this merger is to lower the operating costs, gain better control of the supply chain, reasonable quality control, and increase revenue and operational efficiency. eBay and PayPal merged in the year 2002. Online marketplace eBay joined hands with the online payments app PayPal to further their purchases and make online transactions for users easy.

[2] https://www.nytimes.com/2006/01/25/business/disney-agrees-to-acquire-pixar-in-a-74-billion-deal.html

Conglomerate Merger: A conglomerate merger is a merger where two entities unrelated in business activities come together. These mergers usually take place between entities in different geographical bases. Generally, such companies come together to diversify their business, access a larger consumer base, cross-sell their products, and increase their market share.

Amazon and Whole Foods merger in the year 2017 has been also termed as a conglomerate merger since Amazon diversified in the grocery industry by acquiring Whole Foods.

Market extension merger: A market extension merger occurs solely with the purpose to acquire a larger consumer base. Companies in this merger aim to increase their business to a wider geographical location.

In the year 2022, two shipbuilding companies Wight Shipyard from the UK and OCEA from France came together to a larger access to both markets.

Friendly acquisition: Friendly takeovers/acquisitions are takeovers in which one company is willingly acquired by another company. This takeover is subject to the target company's shareholder's approval. Such acquisitions are approved only if the shareholders believe that per share price offered is fair and reasonable. In 2014, Facebook acquired WhatsApp in a friendly takeover deal.

Hostile Acquisition: Hostile acquisition/ takeover is a takeover in which the acquirer company takes over the target company despite objection from the target company's Board of Directors. In September 2009, Kraft Foods Inc. took over Cadbury PLC with an undervalued and unattractive offer.

WHY DO COMPANIES OPT FOR M&A?

Mergers and Acquisitions happen across every industry for a variety of reasons. Companies enter into M&A deals to wipe off their competitor's position from the market or increase the market share or dominate a larger consumer base etc.

Even though there is a significant amount of risk involved in M&A deals, a successful merger or acquisition can overnight transform a company's position in the market.

REASONS FOR M&A

Growth: One of the main ambitions of M&A deals is the prospect of growth increase after a merger or an acquisition. It can take years for a company to grow double in size and increase its growth and stability prospects organically. Growth being every company's priority today is one of the main strategic reasons for M&A.

Competition: The corporate sector today is a world of fierce competition. To survive, a company must thrive in the competition and corporate restructuring is one of the ways to do so. A merger can enable a company to stand strong in a complex market. M&A strategies are used by companies mostly to join hands with a company with a strong and stable portfolio of assets before a rival company does.

Synergies: For a company to function in the long run, it is necessary to maintain its value and net worth in the market. For the creation of synergies i.e. combined worth, growth, and performance achieved by the companies merged is much higher than the companies would have achieved individually. M&A is a strategy for unlocking cost-based synergies, revenue-based synergies, and operating-based synergies.

Cost-based synergies are achieved through cost savings, supply chain efficiencies, resource management, effective use of the production chain, etc. Revenue-based synergies are achieved through an increase in market share due to cross-selling of products, an increase in consumer base, a larger market share, etc. Operational synergies are achieved through the performance of a company. The workforce of a company can function more effectively and efficiently than a merged company rather than the workforce functioning individually.

Diversification: M&A paves an easy way for companies to diversify their operations and enter into a new market. Diversification is a way for companies to avoid losses in their revenues if there is a slowdown in the industry in which they are functioning. Entering into a relatively new market without significant resources and a base can be a risk to the company hoping to expand its business. M&A serves as a proven strategy for diversification since it is easy to establish the business in a completely new market and lower the risk of losses rather than starting organically.

Market Share: The ability to dominate a market with its product and prices is every company's dream. To gain this power, companies opt for M&A to get a higher market share and the ability to influence and control the prices in the market. Also, companies merge intending to gain control of the supply chain and unlock cost synergies.

REGULATORY FRAMEWORK OF M&A IN INDIA

Mergers and Acquisitions are governed under different statutes and have to fulfill various compliances in India. No separate Act or regulation has been formed yet to administer these transactions. Following are the statutes under which these M&A transactions are regulated:

The Companies Act 2013: Sections 230 to Sections 240 of The Companies Act 2013 covers the provisions relating to Mergers and Acquisitions. These provisions include companies, their members, structures, eligibility, and creditors. Apart from these provisions, mergers, and acquisitions are also governed under the Compromise, Arrangements and Amalgamation Rules, 2016.

The Companies Act does not specifically define the term "merger" but gives the insight of merger to be:

- The transfer of the whole or any part of an undertaking, properties, or liabilities of one or more companies to another existing or new company or;
- The division of the whole of any part of an undertaking, properties, or liabilities of one or more companies to two or more existing or new companies.

Several authorities like the Registrar of Companies (ROC), Regional Director (RD), Official Liquidator (OL), and the National Company Law Tribunal (NCLT) also have a significant role to play in any M&A transaction. The final approval for any merger or acquisition is given by NCLT.

Competition Act 2002: The Competition Act came into force by replacing the Monopolistic and Restrictive Trade Practices Act, of 1970 (MRTP). The act was introduced to prohibit unfair trade practices and ensure healthy and fair competition in the market. The Act governs Mergers and Acquisitions and seeks to ensure that the combinations do not result in any anti-competitive practices. Prior approval of the Competition Commission of India (CCI) is mandatory for completion of any M&A transaction. Any combination which causes or is likely to cause an appreciable adverse effect on competition (AAEC) in the relevant market in India is void under the Act.

Mergers and acquisitions are done to achieve a dominant position and higher share in the market which might result in an unhealthy trade or abuse of power. M&A deals to achieve a monopoly in the market are prohibited by the Competition Commission of India. Sections 3 to section 6 are the governing rules under the Act. Chapter VI talks about appeals and penalties for the same. Therefore, it is vital for Companies entering into any merger or acquisition transactions to comply with the provisions of this Act.

Securities and Exchange Board of India (SEBI): Additional compliances of SEBI are to be fulfilled by listed companies opting for M&A under the Securities and Exchange Board of India Act 1992. The compliances to be fulfilled under the Act are:

- SEBI (substantial acquisition of shares and takeovers) Regulations 2011 (The takeover regulations).
- SEBI (issue of capital and disclosure requirements) Regulations 2018 (The ICDR regulations).
- SEBI (listing obligations and disclosure requirements) Regulations 2015 (The LODR regulations).

Regulations for cross-border M&A transactions: M&A transactions in India involving foreign companies have to strictly adhere to the provisions of the Foreign Exchange Management Act 1999 (FEMA) regulated by the Reserve Bank of India. In addition to this, the policy guidelines related to foreign investment in India issued by the Department for Promotion of Industry and Internal Trade of the Ministry of Commerce and Industry are also to be fulfilled.

WHY DO M&A DEALS FAIL?

Corporate Restructuring is a complex and lengthy process. Even though negotiations for an M&A deal kickstart on a smooth basis, conquering the milestone of closing the deal is still a challenging task. Many things can go wrong in an M&A deal.

The reasons why major deals fail are:

Difference in valuation: Negotiating a company's value at the right price can be quite a demanding process. A seller company may try to overvalue themselves based on their past performances or present status or their future predictions. A buyer may try to bargain with them for a lower price to acquire a company by undervaluing them. The cash flow and assets might make the financial records of the company look desirable but the reality is many times different. This is one of the major reasons, many major M&A deals fall through.

Overdoing or lack of Due Diligence: Overdoing or insufficient due diligence also might lead to a failure of the deal in the long run. Due Diligence is a vital part of any transaction. Overdoing the process leads to the deal eventually being sidelined since due diligence on irrelevant things gives rise to minute issues that might lead to failure. The acquirer company relies on the target company to provide them with all the information for analysis and research. But sometimes the target company withholds or refrains from explaining the information unfavorable to the deal. In extreme cases, both factors fail the transaction.

Poor Integration: For a transaction to close successfully, not only successful negotiations and planning is essential but the actual execution is also necessary. A successful negotiation or due diligence does not guarantee that a deal will prove to be a success. Many times deals fall through because the integration is not handled properly. The actual execution of such deals is a major step to close the deal.

Cultural Differences: Many companies fail to recognize that cultural difference is not a major issue but the unwillingness to reduce those cultural differences is a big challenge. Since M&A in itself is a big change for any company, the inability to cope with another change may lead to huge losses in deals.

Lack of motive: The reason behind any M&A deal is of utmost importance. If a company does not have a good motive for the purpose, the deal will eventually result in a complete and absolute failure. A simply unexplainable why will more likely result in a failure.

Some of the major M&A deals that failed:

The M&A transaction between America Online (AOL) and Time Warner[3] resulted in a big failure after a year when the company reported the largest annual net loss of US $99 Billion.

The Microsoft- Nokia[4] deal fell through in the year 2013, since Nokia failed to keep up with the technological developments and the annual net loss reported was US $7.6 Billion with 15,000 Nokia employees being laid off.

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[3] AOL- Time Warner Merger

Google and Motorola[5] merged in the year 2012 but this transaction proved to be a failure. Motorola was divested for US $2.9 Billion and an annual net loss was reported of US $12.5 Billion.

DECODING THE PVR-INOX MERGER[6]

India's two multiplex giants Inox Leisure Ltd and PVR Ltd announced their merger in the year 2022. The biggest players in the entertainment industry are all set to come together to form the largest multiplex chain in the country. The PVR-Inox merger is a horizontal merger where two companies in the same industry are joining forces. Currently, PVR owns 871 screens in 73 cities and Inox owns 675 screens in 72 cities. This merger will altogether lead to 1,546 screens in 109 cities and they aim to increase their screen count to 3000 or 4000. Existing cinemas will be called PVR and Inox only but new cinemas opened after the merger will be named as PVR-Inox. The announcement of the PVR-INOX merger came as a shocker to all since both companies were performing well individually and were never expected to merge.

Before the Pandemic, PVR held a 33% market share whilst Inox was in second position at a 20% market share. Both companies were engaged in a cutthroat competition with the motive to outset their rivals. PVR and Inox both were the first to enter the market with multiplex chains and replace single-screen domination. They established their respective stronghold in the market.

PVR's revenue increased from Rs.274 crores in 2010 to Rs.3,284 crores in 2016 with a Compound Annual Growth Rate (CAGR) of 42%. Inox also generated revenue from Rs.230 crores in 2010 to Rs.1,872 crores in the year 2016 achieving a CAGR of 30%.

The business of these multiplexes was hit by the introduction of Over-The-Top (OTT) platforms. The increased affordability, flexibility, and accessibility of OTT devices, high-speed internet, and smartphones resulted in the disruption of theatres. The OTT platforms offered the viewers a relatively different experience to the audience than these traditional theatres, thus increasing their challenges.

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[4] Microsoft- Nokia Merger
[5] Google- Motorola Merger
[6] https://www.businessworld.in/article/Power-Play-Analysing-The-Implications-And-Opportunities-Of-The-PVR-Inox-Merger-/10-05-2023-476071/

After the disruption caused due to OTT, the Covid-19 pandemic hit the world and theatres were shut down and were inaccessible to people for a long time. Due to people staying in their homes usage of OTT increased and the revenues, profitability, and liquidity of these multiplexes suffered a huge hit. The revenues of PVR and Inox in the year 2020 were barely meeting the revenue generated in the year 2016. After Covid-19 CAGR has barely reached 21%.

One of the main motives behind the merger of the companies is to regain their market share and reestablish their stability, strength, and operational flows. The merger will result in the new company achieving a dominant position in the market with a strong and desirable market stake of above 40% with the ability to bargain the prices. This deal will outset other players namely Cinepolis, Carnival, and Miraj cinemas and give a competitive advantage to the new entity in terms of synergies, resources, technologies, and real estate.

The Boards of both companies approved the merger with PVR promoters having a stake of 10.62% and Inox promoters having a stake of 16.66% in the newly formed company, while the shareholders of Inox will get 3 shares of PVR for every 10 shares held by them.

On 27th July 2022, after the merger was announced Consumer Unity and Trust Society (CUTS) filed a complaint in CCI against the proposed merger. They alleged that the deal will have an appreciable adverse effect on competition in the film exhibition industry and also that the agreement between them is anti-competitive. The NGO appealed to the competition watchdog to investigate the PVR-Inox merger agreement stating that if it had not been covid lockdowns the transaction would not have been exempted from the mandatory examination and approval of merger by CCI.

CCI rejected the plea stating that apprehension of the likelihood of appreciable adverse effect on competition of an entity that is yet to be formed cannot be a subject matter of investigation or inquiry under Section 3 or 4 of the Competition Act 2002, which prohibits Anti-Competitive practices.

The merger has been approved by their respective shareholders, creditors, and SEBI and now on 12th January 2023 received a green signal for their merger from the Mumbai Bench of NCLT. With everyone looking forward to this merger, the multiplex industry is expected to be a two-player market in India.

CONCLUSION

Corporate Restructuring is the future of growth of the corporate finance world. Mergers and Acquisitions play a vital role in ensuring the growth and stability of any company. For companies to achieve a higher market share or dominant position in the market M&A is a way to grow inorganically rather than growing organically. Since competition in the corporate sector is fierce, these transactions are also a way to reduce the competition and rat race in the market. Despite M&A being more of a friendly deal of working together effectively, it is used as a strategy today with a motive to wipe out or weaken a competitor's position in the market. Corporate history has seen many big M&A deals fall through due to poor execution of the deals. From negotiation to closing the deal, it is pertinent to note that a successful merger or acquisition requires the management to find a uniting path.