MERGERS AND ACQUISITIONS: INITIATIVES TO PREVENT FAILURES

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ABSTRACT:

Mergers and Acquisitions (M&As) are not new to India. However, they acquired prominence since liberalisation. The Indian companies are treating M&As as their strategic choice. Mergers and acquisitions are undertaken to fulfil various corporate objectives. They may be intended to reduce the likelihood of hostile takeovers, to diversify risk, or to achieve competitive advantage through synergistic efficiencies. M&As bring a number of changes within the organization. The size of the organizations change, its stocks, shares and assets change, even the ownership may also change. Thus, M&As show impact on employees, shareholders, management and on competition. The trend of Mergers and Acquisitions has been continuing in India with a rapid speed. During 2011, top 10 deals prove this. Government of India is also encouraging this trend liberalising rules of M&As through Competition Commission of India (CCI). No doubt this is the recent business world trend. However, there are many cases of failures in this arena. Therefore, it is high time to take certain initiatives to prevent failures of M&As to continue this trend going.

Keywords: Mergers and Acquisitions – Strategic choice – Synergy – Failures – Prevention – Initiatives

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Introduction:

The process of M&As has gained substantial importance in today's corporate world. This process is extensively used for restructuring the business organizations. In India, the concept of M&As was initiated by the government bodies. Some well known financial organizations also took the necessary initiatives to restructure the corporate sector of India by adopting the mergers and acquisitions policies. The Indian economic reform since 1991 has opened up a whole 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 M&As as an important strategic choice.

A company may grow its business either by internal expansion or by external expansion. In the case of internal expansion, the company grows gradually over time in the normal course of the business, through acquisition of new assets, replacement of the technologically obsolete equipments and the establishment of new lines of products. But in external expansion, the company acquires a running business and grows overnight through corporate combinations. These combinations are in the form of mergers, acquisitions, amalgamations and takeovers and have now become important features of corporate restructuring. They have been playing an important role in the external growth of a number of leading companies the world over. They have become popular because of the enhanced competition, breaking of trade barriers, free flow of capital across countries and globalisation of businesses

M&As are strategic decisions taken for maximisation of a company's growth by enhancing its production and marketing operations. They 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. In recent years, India has been a very active player in the Mergers and Acquisitions transactions, both locally and globally. The news of Indian companies acquiring foreign businesses is quite common now. The percentage of cross-border transactions has risen significantly. Cross border deals in India have taken the form of both inbound and outbound transactions. The growth in inbound transactions can mainly be attributed to the fact that foreign companies have been increasingly interested in acquiring Indian companies in the IT and telecom sectors. As far as the outbound transactions are concerned, they too have increased significantly, with manufacturing companies acquiring the overseas companies. Two of the major acquisitions made by Indian companies worldwide are those of Tata Steel acquiring Corus Group plc (UK) for $12,000 million and that of Hindalco acquiring Novelis (Canada) for $6,000 million, both in the steel industries.

Whether it's Indian companies wanting to expand by capturing foreign markets or foreign companies wishing to acquire market share in India, Mergers and Acquisitions have been used as means to achieve crucial growth and are becoming more and more accepted than ever as a tool for implementing business strategy. Major factors like favorable government policies, buoyancy in the economy, additional liquidity in the corporate sector, and dynamic attitudes of Indian entrepreneurs have helped in facilitating the Mergers and Acquisitions transactions in India.

Objectives of M&As:

M&As are undertaken to fulfil various corporate objectives. They may be intended to reduce the likelihood of hostile takeovers, to diversify risk, or to achieve competitive advantage through synergistic efficiencies. They may involve merely integrating accounting functions and creating a new legal entity, or, at the other extreme, they may involve integration of capital assets, functional departments, and human resources.[1]

The most common objectives of M&As are as follows:

1. A company can acquire production facilities as well as other resources from outside through M&As as a **growth strategy**. Specially, for entering in new products/markets, the company may lack technical skills and may require special marketing skills and a wide distribution network to access different segments of markets. The company can acquire existing company or companies with requisite infrastructure and skills and grow quickly.
2. A combination of two or more companies may result in **enhancing profitability** due to cost reduction and efficient utilization of resources. This may happen because of economies of scale, operating economies and synergy.
3. Companies go for **Diversification of risks** through the combination of companies in unrelated businesses. It results in reduction of total risks through substantial reduction of cyclicality of operations. The combination of management and other systems strengthen

[1] Shrivastava, P. Postmerger integration. *Journal of Business Strategy* 7: 65–76, 1986.

the capacity of the combined firm to withstand the severity of the unforeseen economic factors which could otherwise endanger the survival of the individual companies.

4. A merger can increase the market share of the merged company and **limits the severity of the competition**. The bargaining power of the company vis-à-vis labour, suppliers and buyers is enhanced. The merged company can exploit technological breakthroughs against obsolescence and price wars.

Further, Indian Government's dynamic policies, economic stability and "ready to experiment" attitude of industrialists are also identified as reasons for mergers and acquisitions. Sectors like pharmaceuticals, IT, ITES, telecommunications, steel, construction, etc, have proved their worth in the international scenario and the rising participation of Indian companies in signing M&A deals has further triggered the acquisition activities in India.

M&A Strategies:

M&As are the corporate strategies that deal with buying, selling or combining different companies with a goal to achieve rapid growth. However, the decisions on M&As are taken after considering a few facts like the current business status of the companies, the present market scenario, and the threats and opportunities etc. In fact, the success of M&As largely depend upon the M&A strategies adopted by the organizations.

Many big companies continuously look out for potential companies, preferably smaller ones, for mergers and acquisitions. Some companies may have their core cells, which concentrate on M&As. M&A strategies, are devised in accordance with the policy of the organization. Some may prefer to diversify or to expand in a specific field of business, while some others may wish to strengthen their research facilities etc.

Impact of M&As:

M&As bring a number of changes within the organization. The size of the organizations change, its stocks, shares and assets also change, even the ownership may also change due to the mergers and acquisitions. The M&As play a major role on the activities of the organizations. The impact of M&As also depend on the structure of the deal.

Impacts of M&As:

The following are the impacts of M&As.

1. M&As may have great economic **impact on the employees** of the organization. In fact, M&As could be pretty difficult for the employees as there could always be the possibility of layoffs after any merger or acquisition. If the merged company is pretty sufficient in terms of business capabilities, it doesn't need the same amount of employees that it previously had to do the same amount of business. As a result, layoffs are quite inevitable. Besides, those who are working would also see some changes in the corporate culture. Due to the changes in the operating environment and business procedures, employees may also suffer from emotional and physical problems.
2. The percentage of **job loss may be higher in the management level** than the general employees. The reason behind this is the corporate culture clash. Due to change in corporate culture of the organization, many managerial level professionals, on behalf of their superiors, need to implement the corporate policies that they might not agree with. It involves high level of stress.
3. Impact of M&As also include some economic **impact on the shareholders.** If it is a purchase, the shareholders of the acquired company get highly benefited from the acquisition as the acquiring company pays a hefty amount for the acquisition. On the other hand, the shareholders of the acquiring company suffer some losses after the acquisition due to the acquisition premium and augmented debt load.
4. Mergers and acquisitions have different **impact on market competitions**. Different industry has different level of competitions after the M&As. For example, the competition in the financial services industry is relatively constant. On the other hand, change of powers can also be observed among the market players.

M&As - Success and Failures:

For any business activity the chances of success and failure are same. M&As do not have any exemption. Though there are many cases of success, there are many cases of failures too.

Failures of Mergers and Acquisitions:

Mergers and acquisitions may seem to be beneficial, resulting in the amalgamation of two conglomerates. They have been found to lead to cost cuts and increased revenues. However, merger and acquisition failures are not uncommon. These failures may harm the companies, tarnish their credibility in the market, and ruin the confidence of their shareholders.

Reasons for Failures:

There could be several reasons behind the failure of mergers and acquisitions. Many companies look mergers and acquisitions as the solution to their problems. But before going for merger and acquisition, they do not introspect themselves. Before an organization can go for mergers and acquisitions, it needs to consider a lot. The parties, viz. buyer and seller need to do proper research and analysis before going for mergers and acquisitions.

The example of merger between two leading players in the global computer industry- Hewlett – Packard Company (HP) and Compaq Corporation (Compaq) shows how a merger fails. It is identified that the reasons of HP's **failure is to realize the synergies identified prior to the merger.**

Growth through mergers and acquisitions is desirable, but they must be manageable, implementable, and scalable. They must be strategy driven, with a focus on creating significant and sustainable value, especially for customers and investors. While the timeline for merger-related changes is being compressed by investor impatience for returns, the complexity is increasing. The risks and challenges are greater particularly when the integration is global and talent focused.[2]

Although Mergers and Acquisitions are undertaken for good reasons, many high-cost mergers and acquisitions fail to meet their objectives, in part because human resource (HR) issues are generally poorly understood, undermanaged, and often discarded at the outset as irrelevant to the strategic planning process.[3]

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[2] Strategy implementation insights, Merger and Acquisition s uccess, MCC Reight & Company, INC. Research & Operations Center, July, 2006.

[3] Carolyn Kristianson Love, Mergers and Acquisitions: The Role of H R M in Success, Queen's University, Industrial Relations Centre, Kingston.

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Following could be the reasons behind the failure of Mergers and Acquisitions.

1. Cultural Difference

One of the major reasons behind the failure of mergers and acquisitions is the cultural difference between the organizations. It often becomes very tough to integrate the cultures of two different companies, who often have been the competitors. The mismatch of culture leads to deterring working environment, which in turn ensure the downturn of the organization.

2. Flawed Intention

Flawed intentions often become the main reason behind the failure of mergers and acquisitions. Companies often go for mergers and acquisitions getting influenced by the booming stock market. Sometimes, organizations also go for mergers just to imitate others.

In such cases, the outcome can be discouraging.

3. Over estimating the value of the target company

Though the basic aim of a company in merger and acquisition is to provide benefit to the shareholders and maximize its profits but in reality most of the companies are not able to achieve this. Many parent companies often over estimate the value of their target company due to lack of due diligence. Also, sometimes, two or more companies are interested in acquiring the same company and this greatly shoots up the amount they eventually have meat out for the target company.

4. High cost debt

The acquirer many a time's gets submerged in large and extra ordinary debts during merger and acquisition. Most of the mergers and acquisitions are financed through unsecured

[4] Strategy implementation insights, Merger and Acquisition success, MCC Reight & Company, INC. Research & Operations Center, July, 2006.

debts which carry a huge rate of interest with them. These high cost debts eventually lead to a fall in the stock prices of the parent company. Also when two or more companies bid for the same company they may end up paying more for the target company. This over estimated price is usually raised by the company through high cost debts. As a result the company will try to cover these high cost debts which lead to a fall in the stock prices of the parent company which eventually hampers the company.

5. Job Loss

One of the major reason as to why Mergers and Acquisitions is feared amongst the employees is because of job loss. This job loss is mainly the result of the company going into cost cutting schemes to give some breathing space to its highly skewed balance sheet as a result of the merger or acquisition. Job loss may also happen some times to save pay bills and to reduce surplus staff.

3. Other Reasons

The following reasons sometimes may hamper the success of Mergers and Acquisitions.

- Often the ego of the executive can become the cause of unsuccessful merger. Top executives often tend to go for mergers under the influence of bankers, lawyers and other advisers who earn hefty fees from the clients.
- Mergers can also happen due to generalized fear. The incidents like technological advancement or change in economic scenario can make an organization to go for a change. The organization may end up in going for a merger.
- Due to mergers, managers often need to concentrate and invest time to the deal. As a result, they often get diverted from their work and start neglecting their core business. The employees may also get emotionally confused in the new environment after the merger. Hence, the work gets hampered.
- In addition to the above, failure may also occur if a merger takes place as a defensive measure to neutralize the adverse effects of globalization and a dynamic corporate environment.

It would not be correct to say that all mergers and acquisitions fail. There are many examples of mergers that have boosted the performance of a company and addressed the well-being of its shareholders. The primary issue to focus on is how realistic the goals of the prospective merger are.

Prevention of Failures:

Although Mergers and Acquisitions are undertaken for good reasons, many high-cost mergers and acquisitions fail to meet their objectives, in part because human resource (HR) issues are generally poorly understood, undermanaged, and often discarded at the outset as irrelevant to the strategic planning process.[5]

An excellent HR function has much to offer for successful integration, so there's no need to hide behind the door of the HR department. We don't say that looking at HR policies, processes, and systems has no place in the early stages of an integration project. However, they should be seen as a means rather than an end, and the aim should be to achieve the objectives of the integration project as a whole rather than only efficiency gains within HR.[6]

Initiatives:

The following initiatives can be undertaken in order to prevent the failure of mergers and acquisitions.

1. Continuous communication is of utmost necessary across all levels – employees, stakeholders, customers, suppliers and government leaders.
2. Managers have to be transparent and should always tell the truth. By this way, they can win the trust of the employees and others and maintain a healthy environment.
3. During the merger process, higher management professionals must be ready to greet a new or modified culture. They need to be very patient in hearing the concerns of other people and employees.
4. Management need to identify the talents in both the organizations who may play major roles in the restructuring of the organization. Management must retain those talents.
5. The new organisation need to take all possible steps to run orientation and refresher sessions for all the employees about the changed situation and clear all their doubts and make them satisfied.

[5] Carolyn Kristianson Love, Mergers and Acquisitions: The Role of H R M in Success, Queen's University, Industrial Relations Centre, Kingston.
[6] Danny A Davis and Sven Ringling, The role of HR in successful M&A integration.

Conclusion:

Most of the big companies these days are indulging in merger and acquisition and in the coming years this process is only going to get bigger. However there are many failures in this arena. Therefore, it is of utmost need that the success rate of mergers and acquisition be improved. This can only be done if all the aspects involved in merger and acquisition are given proper attention. It is to be borne in mind that a merger or an acquisition done in haste cannot be successful. The initiatives like continuous communication, transparency, patience, keeping talented personnel and training the employees help the Mergers and Acquisitions successful.

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