Research Paper Commerce

Impact of Mergers and Acquisitions: A Theoretical Framework

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ABSTRACT

Mergers & Acquisitions (M&As) are the most popular means of business restructuring. Merger is said to occur when two or more firms combine into one firm. Mergers can be either through absorption or through consolidation. Acquisition is defined as an act of acquiring effective control over assets or management of a company by another company without any combination of business or companies. For a firm entering into M&A, the various principles of valuation have to be taken into consideration. For that the acquiring firms has to decide which type of valuation is needed in order to have financial and economic gain out of M&A process. The present study showed that the impact of M&A on shareholders, workers or employees, Top management Customers, culture that are affected has been briefed. International and Cross-border merger plays an important role in this era of globalization. Most of the firms resort to cross-border mergers in order to explore new market area and to fortify their financial position. But in this globally competitive era the firm has to be absolutely vigilant about the global economic condition and must decide the perfect time for merger and other forms of corporate restructuring.

KEYWORDS Mergers and Acquisition, Process, Impact, Differential Efficiency & Financial Synergy

Introduction

Mergers and acquisitions are aimed at improving profits and productivity of a company. Simultaneously, the objective is also to reduce expenses of the firm. However, mergers and acquisitions are not always successful. At times, the main goal for which the process has taken place loses focus. The success of mergers, acquisitions or takeovers is determined by a number of factors. Those mergers and acquisitions, which are resisted not only affects the entire work force in that organization but also harm the credibility of the company. In the process, in addition to deviating from the actual aim, psychological impacts are also many. Studies have suggested that mergers and acquisitions affect the senior executives, labor force and the shareholders.

Indian industries were exposed to surplus of challenges both nationally and internationally, since the introduction of Indian economic reform in 1991. The cut-throat competition in international market compelled the Indian firms to opt for mergers and acquisitions strategies, making it a vital premeditated option Sector wise, large volume of mergers and mergers and acquisitions in India have occurred in finance, telecom, FMCG, construction materials, automotives and metals. Presently as mergers and acquisitions may be productive in some cases, the impact of mergers and acquisitions on various sects of the company may differ.

Merger and Acquisition Process

1. First Round Assessment or Business Valuation

In this first step of Merger and Acquisition Process, the market value of the target company is assessed. In this process of assessment not only the current financial performance of the company is examined but also the estimated future market value is considered. The company which intends to acquire the target firm engages itself in an thorough analysis of the target firm's business history. The products of the firm, its' capital requirement, organizational structure, brand value everything are reviewed strictly.

2. Phase of Proposal

After complete analysis and review of the target firm's market performance, in the second step, the proposal for merger or acquisition is given. Generally, this proposal is given through issuing a non-binding offer document.

3. Exit Plan

When a company decides to buy out the target firm and the target firm agrees, then the latter involves in Exit Planning. The target firm plans the right time for exit. It considers all the alternatives like Full Sale, Partial Sale and others. The firm also does the tax planning and evaluates the options of reinvestment.

4. Ordered Marketing

After finalizing the Exit Plan, the target firm involves in the marketing process and tries to achieve highest selling price. In this step, the target firm concentrates on structuring the business deal.

5. Origination of Purchase Agreement or Merger Agreement

In this step, the purchase agreement is made in case of an acquisition deal. In case of Merger also, the final agreement papers are generated in this stage.

6. Stage of Integration

In this final stage, the two firms are integrated through Merger or Acquisition. In this stage, it is ensured that the new joint company carries same rules and regulations throughout the organization.

Impact of Mergers and Acquisitions

Impact of Mergers and Acquisitions on workers or Employees:

Aftermath of mergers and acquisitions impact the employees or the workers the most. It is a well known fact that whenever there is a merger or an acquisition, there are Bound to be layoffs.

In the event when a new resulting company is efficient business wise, it would require less number of people to perform the same task. Under such circumstances, the company would attempt to downsize the labor force. If the employees who

have been laid off possess sufficient skills, they may in fact benefit from the lay off and move on for greener pastures. But it is usually seen that the employees those who are laid off would not have played a significant role under the new organizational set up. This accounts for their removal from the new organization set up. These workers in turn would look for re employment and may have to be satisfied with a much lesser pay package than the previous one. Even though this may not lead to drastic unemployment levels, nevertheless, the workers will have to compromise for the same. If not drastically, the mild undulations created in the local economy cannot be ignored fully.

Organizations need to develop a system before integration, which must encourage proper communication among employees from top to downwards. This approach will lead to decrease the severity of ambiguities found among the employees during the integration process

Impact of Mergers and Acquisitions on top level Management:
Impact of mergers and acquisitions on top level management may actually involve a "clash of the egos". There might be variations in the cultures of the two organizations. Under the new set up the manager may be asked to implement such policies or strategies, which may not be quite approved by him. When such a situation arises, the main focus of the organization gets diverted and executives become busy either settling matters among themselves or moving on. If however, the manager is well equipped with a degree or has sufficient qualification, the migration to another company may not be troublesome at all.

Impact of Mergers and Acquisitions on Shareholders:
We can further categorize the shareholders into two parts:

- The Shareholders of the acquiring firm
- The shareholders of the target firm.

Shareholders of the Acquired Firm:
The shareholders of the acquired company benefit the most. The reason being, it is seen in majority of the cases that the acquiring company usually pays a little excess than it what should. Unless a man lives in a house he has recently bought, he will not be able to know its drawbacks. So that the shareholders forgo their shares, the company has to offer an amount more than the actual price, which is prevailing in the market. Buying a company at a higher price can actually prove to be beneficial for the local economy.

Shareholders of the Acquiring Firm:
They are most affected. If we measure the benefits enjoyed by the shareholders of the acquired company in degrees, the degree to which they were benefited, by the same degree, these shareholders are harmed. This can be attributed to debt load, which accompanies an acquisition.

Impact of Mergers and Acquisitions on Customers:
The impact of M&A has brought a win situation for the customers this is because the customers are left with a high range of products with a low range of price. This has become possible because the cost of production which has been reduced due to the cost of reduction process adopted by the banks. Thus, offering a wide range of services at a lower rate. All this has become possible due to the advent of information and technology, which allows them to save cost by operating with fewer branches or without a traditional branches network. Impact of Mergers and Acquisitions On Culture According to a KPMG study, "83% of all mergers and acquisitions (M&As) failed to produce any benefit for the shareholders and over half actually destroyed value". Interviews of over 100 senior executives involved in these 700 deals over a two-year period revealed that the overwhelming cause for failure "is the people and the cultural differences". Difficulties encountered in M&As are amplified in cross-cultural situations, when the companies involved are from two or more different countries.

Seven Pitfalls on the Path to M&A Success
Merger success is possible; however, being part of the 17% that succeeds, rather than the 83% that does not deliver, requires more than insight. Merger success is based on acceleration; concentration and creating a critical mass for operational change (adaptation).

Up to the point in the transaction where the papers are signed, the merger and acquisition business is predominantly financial - valuing the assets, determining the price and due diligence. Before the ink is dry, however, this financially-driven deal becomes a human transaction filled with emotion, trauma, and survival behavior - the non-linear, often irrational world of human beings in the midst of change.

The seven pitfalls represent the critical and vulnerable areas of the M&A transaction. These areas must not only be valued for their negative impact on the critical success factors that drove the "deal", they are the very agenda for the organization's action in the critical first 90 days of the new entity.

In the case of international mergers and acquisitions, the complexity of these processes is often compounded by the difference in national cultures. People living and working in different countries react to the same situations or events in very different manners.

Therefore, a company involved in an international merger or acquisition needs to consider these differences right from the design stage if it is to succeed.

1. Preoccupation
2. List making
3. Organisation proliferation
4. Infrequent and irrelevant Communication
5. Triangulation
6. The relatives
7. The Guiding light

These pitfalls of mergers and acquisitions challenge today's leaders to a new standard of managing change. The strategy is clear - accelerate, concentrate, adapt, and in the case of international M&As, consider cultural differences. The human and cultural issues that separate the 17% from the 83% are not about some abstract values or the "soft stuff", but the concrete reality of productivity, economic value and sustained growth.

Differential Efficiency & Financial Synergy: Theory of Mergers
Differential Efficiency
According to the differential efficiency theory of mergers, if the management of firm A is more efficient than the management of firm B and if after firm A acquires firm B, the efficiency of firm B is brought up to the level of firm A, then this increase in efficiency is attributed to the merger.

According to this theory, some firms operate below their potential and consequently have low efficiency. Such firms are likely to be acquired by other, more efficient firms in the same industry. This is because; firms with greater efficiency would be able to identify firms with good potential operating at lower efficiency. They would also have the managerial ability to improve the latter's performance.

However, a difficulty would arise when the acquiring firm overestimates its impact on improving the performance of the acquired firm. This may result in the acquirer paying too much for the acquired firm. Alternatively, the acquirer may not be able to improve the acquired firm's performance up to the level of the acquisition value given to it.

The managerial synergy hypothesis is an extension of the dif-

ferential efficiency theory. It states that a firm, whose management team has greater competency than is required by the current tasks in the firm, may seek to employ the surplus resources by acquiring and improving the efficiency of a firm, which is less efficient due to lack of adequate managerial resources. Thus, the merger will create a synergy, since the surplus managerial resources of the acquirer combine with the non-managerial organizational capital of the firm.

When these surplus resources are indivisible and cannot be released, a merger enables them to be optimally utilized. Even if the firm has no opportunity to expand within its industry, it can diversify and enter into new areas. However, since it does not possess the relevant skills related to that business, it will attempt to gain a 'toehold entry' by acquiring a firm in that industry, which has organizational capital along with inadequate managerial capabilities.

Financial Synergy

The managerial synergy hypothesis is not relevant to the conglomerate type of mergers. This is because, a conglomerate merger implies several, often successive acquisitions in diversified areas. In such a case, the managerial capacity of the firm will not develop rapidly enough to be able to transfer its efficiency to several newly acquired firms in a short time. Further, managerial synergy is applicable only in cases where the firm acquires other firms in the same industry.

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 effect and achieve lower cost of capital. Tax saving is another considerations. When the two firms merge, their combined debt capacity may be greater than the sum of their individual capacities before the merger.

The financial synergy theory also states that when the cash flow rate of the acquirer is greater than that of the acquired firm, capital is relocated to the acquired firm and its investment opportunities improve.

Mergers and acquisition plays a very important role in today's competitive global world. Many a times various business organization are resorting to mergers and acquisition for several reasons such as enhancement of business, capturing the market, fortifying the financial strength of the organization, tax benefit etc. But while seeking the policy of merger and acquisition the firm must keep in mind the various theories of merger and acquisition like differential efficiency, financial synergy , operating synergy and pure diversification by adopting the right policies at the right time. Therefore timing of merger is very essential factor for the firms while framing the policy of merger and acquisition. In developed economies, corporate mergers and amalgamations are regular feature where hundreds of mergers take place every day. In India too mergers have become very important corporate game today. But one thing the firms must keep in mind especially in India, that while going for merger or amalgamation, the firm must follow the accounting standard i.e. AS 14 and should frame the policy within the set rules and regulation, so that a sustainable & healthy business environment can be created for betterment of economy as a whole.

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